

**BEFORE THE  
PHILADELPHIA WATER, SEWER AND STORM WATER RATE BOARD**

In the Matter of a Proposed Rate Increase in :  
Water, Sewer and Storm Water Rates : FY 2017-2018 Rates

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**MAIN BRIEF OF THE  
PHILADELPHIA LARGE USERS GROUP**

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## I. INTRODUCTION

On January 8, 2016, the Philadelphia Water Department ("PWD" or "Department") submitted a preliminary rate increase proposal to the Philadelphia Water Rate Board ("Board"). On February 8, 2016, the Board submitted a final proposed rate increase preserving the same rate proposal initially presented on January 8, 2016. PWD proposes to establish rates for water, sanitary sewer, and stormwater services projected to increase its annual revenues by \$34.7 million in Fiscal Year ("FY") 2017 and \$70.9 million in FY 2018.

Pursuant to its Regulations, the Board appointed Nancy Brockway as the Hearing Officer to preside over formal proceedings concerning the rate filing. Also in accordance with the Regulations, the Hearing Officer established a schedule for litigated proceedings, including intervention, testimony, technical hearings, and briefs. Consistent with the approved schedule, the Philadelphia Large Users Group ("PLUG")<sup>1</sup> intervened in the proceeding on February 9, 2016. Additional intervenors include Community Legal Services ("Public Advocate"), Citizens' for Pennsylvania's Future ("PennFuture"), PECO Energy Company and Exelon Generation Co., LLC ("PECO"), Tenant Union Representative Network ("TURN"), Community Lawyering Clinic ("CLC"), and Neighborhood Gardens Trust ("Gardens Trust").

In compliance with the procedural schedule, PLUG submitted the Direct Testimony of Randolph Haines ("PLUG Statement No. 1") on March 24, 2016. The Public Advocate, PennFuture, and PECO also submitted direct testimony. The Hearing Officer presided over technical hearings from April 5, 2016, through April 13, 2016, at which PWD presented oral

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<sup>1</sup> PLUG is an *ad hoc* group of Large Commercial & Industrial ("C&I") customers comprised, for the purposes of this proceeding, of Thomas Jefferson University, Temple University, St. Joseph's University, Drexel University, and Newman & Company, Inc.

rebuttal testimony before parties offered witnesses for cross-examination.<sup>2</sup> Pursuant to the approved procedural schedule, PLUG hereby submits its Brief addressing select issues from PWD's filing, other parties' testimony, and the technical hearings.

## II. SUMMARY OF ARGUMENT

PLUG's interests in this proceeding are as follows:

1. The Board must reject PWD's proposal to target debt service coverage above the 1.20 bond coverage covenant as a step towards reducing its debt issuances.
2. The Board must deny the Public Advocate's recommendation to reduce PWD's budget for the Storm Management Incentive Program ("SMIP") and Greened Acres Retrofit Program ("GARP").
3. The Public Advocate's remaining expense adjustments, including the recommendation to adjust the growth rate for 5/8 meters, should be approved, subject to a proportional scale-back of any revenue reduction.
4. The Board must deny PennFuture's proposal to eliminate the Enhanced CAP Program in 2019.
5. The Board must affirm its jurisdiction to address customer service issues as necessary to meet its obligation to set "just, reasonable, and nondiscriminatory" rates.

Each of these matters is addressed in detail below.

## III. ARGUMENT

### **A. The Board must reject PWD's proposal to target debt service coverage above the 1.20 bond coverage covenant as a step towards reducing its debt issuances.**

PWD proposes to implement annual increases to its debt service coverage target in excess of its legal obligation. PWD alleges that increasing its senior debt coverage is necessary to show financial strength to credit rating agencies and allow the Department to reduce its dependence of debt issuances for capital projects. This proposal should be rejected as unnecessary and

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<sup>2</sup> All parties to the proceeding waived cross-examination of Mr. Haines.

unsupported. The Department failed to establish that its legally required debt service coverage target falls outside the range of reasonableness. While a higher debt service target could result in funding for capital projects, the Department should apply any available funding towards reducing the proposed rate increases. Accordingly, the Board must deny PWD's misplaced allegation that higher coverage levels are necessary for credit rating purposes or to reduce its debt ratio.

1. *PWD's legally required debt service target of 1.20 is reasonable.*

PWD's General Ordinance requires a minimum debt coverage ratio of 1.20. PWD St. No. 7, p. 8. PWD proposes to target a minimum senior debt coverage of 1.24% for FY 2016, 1.25% for FY 2017, 1.26% for FY 2018, and 1.35% for FY 2019 and beyond. *Id.* at 8. PWD attempts to support its proposal by asserting "[h]igher levels of coverage are indicators of a system's ability to mitigate unforeseen emergencies, increased debt burden and operating expenses as well as economic downturns that can impact revenue." PWD St. No. 7, pp. 8-9. The Department adds that the increased debt service coverage results in additional cash to replace debt issuances for capital projects. *See id.* at 8-9. The Department's arguments are neither compelling nor persuasive.

Although, PWD focuses heavily on the consideration of coverage ratios, the Board must consider other indicators identified by credit rating agencies. Numerous other indicators identified by credit rating agencies show PWD's bonds to be a strong investment, including the combined system operating revenues, the Department's cash-on-hand, the Department's consistency in meeting its Minimum Annual Debt Service ("MADS"), and the Department's debt-to-operating revenues. *See id.* at 5. Moreover, even with regard to the debt service coverage ratio, Moody's Investors Service concluded that "[t]he City's ability to maintain

adequate coverage levels will be a key factor in its rating going forward." *See id.* p. 5. PWD itself also admitted that the investor community historically "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." Apr. 6 Hearing Tr. at 112. Taken as a whole, PWD has not demonstrated that its present coverage levels are unreasonable; as such, its proposal is unnecessary.

2. *PWD's has not provided credible evidence supporting its proposal to increase its debt service target as a step towards reducing its debt issuances.*

PWD's argument that increasing its debt service coverage ratio is a critical step towards transitioning towards a lower debt ratio also lacks credible support. The Department attempts to support its proposal to reduce its debt ratio through its observation that "[l]arge systems rated by Fitch have a 58% of capital financed by debt and Fitch "A" rated credits have a 64% debt financed CIP versus the projected 80% debt funding of the Departments CIP." PWD St. No. 7, p. 7. However, the referenced credit ratings report from Fitch Ratings, Inc. ("Fitch") measures median data across broad water and sewer sectors. *See* Public Advocate St. No. 1, p. 47. Therefore, PLUG concurs with the Public Advocate's conclusion that the general median debt ratios set forth in the Fitch report cannot establish that PWD's capital structure is unreasonable. *See* Public Advocate St. No. 1, p. 47. Accordingly, the Board should reject PWD's proposal to raise its debt service coverage target.

3. *A 1.20 debt service coverage target would allow PWD to use RSF withdrawals to further limit the proposed rate increases, to the benefit of customers.*

As additionally observed by the Public Advocate, maintaining the 1.20 coverage ratio would substantially reduce the necessity to withdraw RSF funds for debt service coverage and

make RSF funds available to offset rate increases. As demonstrated on the record, PWD ended FY 2015 with RSF funds totaling \$206 million, more than \$125 million in excess of the projections submitted with its 2013 rate case. *See* PWD Response to PLUG-7, *see also* Apr. 5 Hearing Tr. at 161. Therefore, equity supports using the RSF to minimize rate increases to customers. The Public Advocate calculated that using the 1.20 debt service coverage target would reduce PWD's reliance on the RSF for debt service coverage by \$3.7 million, \$3.5 million, and \$4.8 million respectively. *See* Public Advocate St. No. 1, p. 45. These numbers reflect various additional revenue reductions proposed by the Public Advocate, and therefore understate the impact of eliminating the need to use RSF withdrawals for debt service. *See* Apr. 6 Hearing Tr. at 65. The impact of applying the 1.20 debt service coverage target to the as-filed rate proposal can be observed from PWD's Response to PLUG-7.

PWD's Response to PLUG-7 shows that customers benefit tremendously from a 1.20 debt service coverage target. For FY 2016 PWD budgeted total revenues at \$644 million; which, minus expenses of \$431 million, produced net revenues of \$236 million. *See id.* However, with the Department's total Debt Service Coverage for FY 2016 projected at \$(220 million), net revenues of \$236 million would produce a debt service coverage ratio of just 1.07 ( $\$236M/\$220M = 1.07$ ). *See id.* To meet a 1.24 target coverage ratio, PWD increase its net annual revenues by withdrawing \$36.9 million from the RSF, as evidenced by the calculation on line 9. *See id.* However, just using a 1.20 target coverage ratio consistent with its bond covenant, would reduce the FY 2016 RSF withdrawal to \$28 million, leaving an additional \$9 million in the year-end RSF balance for FY 2016 and therefore increasing the RSF revenues available to offset the rate increases proposed for FY 2017 and 2018. This impact would be

further compounded by applying the 1.20 debt service coverage target in each subsequent fiscal year instead of the higher targets proposed by PWD.

4. *Conclusion.*

In summary, PWD has not provided sufficient evidence showing its current debt service coverage target or debt ratio to be unreasonable or inconsistent with best practices. Additionally, applying the 1.20 debt service coverage target would reduce PWD's necessity to draw down the RSF for debt service and provide flexibility to utilize the RSF to further mitigate a rate increase. Particularly in light of the beneficial rate impact of maintaining a lower debt service coverage target, the Board should deny PWD's proposal to increase its debt service coverage target above the legally required 1.20 level.

**B. The Board must deny the Public Advocate's recommendation to reduce PWD's budget for the Storm Management Incentive Program ("SMIP") and Greened Acres Retrofit Program ("GARP").**

As part of its rate filing, PWD proposed to increase its annual budget for SMIP and GARP to \$15 million. SMIP and GARP development and implementation have, in no uncertain terms, proven to be an enormous benefit to Large C&I customers. Yet, the Public Advocate alleges that PWD failed to support this adjustment and asks the Board to deny the request. As the record shows significant past participation in both programs, PWD has furnished compelling evidence supporting a reasonable budget increase for SMIP and GARP. Accordingly, the Public Advocate's proposal should be denied.

The Department utilizes both SMIP and GARP to offer grants towards stormwater mitigation measures, with the primary difference being that customers across the City can participate in SMIP, while GARP is available only to customers in the combined<sup>3</sup> sewer sections

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<sup>3</sup> "Combined sewer system" refers the parts of PWD's sewer system where both sanitary sewer and stormwater are conveyed through a single pipe to the sewage treatment plant. *See* PWD St. No. 4, p. 3. During peak rain events,



of the City. *See* Apr. 7 Hearing Tr. at 45. Although the programs have different qualifying standards, the Department allocates a combined budget for both. *See id.* at 38. For FY 2017 and 2015, the Department proposed to increase the FY 2016 budget of \$11.4 million for SMIP and GARP to a combined \$15 million annual budget. *See id.* at 48.

The Public Advocate opposed PWD's proposed \$15 million budget for SMIP and GARP on grounds the Department failed to provide supporting evidence for the adjustment. *See* Public Advocate St. No. 1. pp. 34, 36. To the contrary, PWD confirmed that SMIP and GARP have historically been fully subscribed, with \$30.5 million in grants awarded since 2011. *See* Apr. 7 Hearing Tr. at 46, *see also* PWD St. No. 4, p. 7. Additionally, the Department also supported increasing the budget for SMIP and GARP by demonstrating cost savings in excess of 300% for stormwater mitigation projects completed under SMIP and GARP compared to stormwater mitigation projects constructed directly by PWD. *See* PWD Response to PF 1-8. Finally, PWD showed that in FY 2016, when additional revenue for SMIP and GARP became available due to a one-time grant under Act 13 of 2012, the Department was able to award SMIP and GARP grants up to approximately \$14 million, thereby confirming strong demand for the programs in excess of the budgeted \$11.45 million. *See* PWD Response to PA-EXE-158. As such, no legitimate dispute exists as to the continued success of these vital programs.

The Board should also consider that the system-wide importance of the SMIP and GARP extends beyond the individual customers participating in the program. While individual customers receive direct savings through the grants, the more critical benefits extend to the entire system. As emphasized by PWD, the mitigation projects achieved through SMIP and GARP

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the level of stormwater in the combined system may exceed the system's capacity, resulting in untreated overflows discharged directly into the local waterways. *See id.*

contribute substantially towards ensuring the Department remains in compliance with the Consent Order and Agreement signed by PWD and the Pennsylvania Department of Environmental Protection on June 1, 2011 ("COA").<sup>4</sup> See PWD St. No. 4, pp. 3, 7. Without these programs, the Department would have to implement mitigation projects independently, which, as previously referenced, would exceed the cost of funding stormwater mitigation projects through SMIP and GARP by more than 300%. See PWD Response to PF I-8.

PWD has provided substantial and persuasive empirical evidence justifying the proposed \$15 million budget for its stormwater incentive programs. Accordingly, the Board must deny the Public Advocate's recommendation to preserve the current \$11.45 million budget for SMIP and GARP.

**C. The Public Advocate's remaining expense adjustments, including the recommendation to adjust the growth rate for 5/8 meters, should be approved subject to a proportional scale-back of any revenue reduction.**

In its Direct Testimony, the Public Advocate proposed to modify the projected growth rate for PWD's 5/8" meter customers. PWD's filing projects a negative growth rate for 5/8 inch customers. The Public Advocate's proposed adjustment would result in a lower rate of declining usage for the 5/8" meter customers. PLUG does not oppose the Public Advocate's proposal. Rather, PLUG seeks to clarify that such revenue adjustments must be applied proportionally to all customers, subject only to the Public Advocate's proposal to exclude City-Leased and City-Owned properties from any scale-back adjustments.

Although framed in terms of an adjustment to the growth rate for solely 5/8" meter customers, the Public Advocate's adjusted growth rate should reduce PWD's total revenue

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<sup>4</sup> As PWD depends substantially on SMIP and GARP to cost-effectively meet the compliance benchmarks set forth in the COA, the benefits of these programs extend to all customers and Philadelphia citizens. See Response to PF I-8.; see also PWD St. No. 4, p. 7.

requirement by approximately \$15 million over FYs 2017 and 2018. *See* Public Advocate Hearing Exhibit No. 1. The adjustment derives from the Public Advocate's recommendation to calculate the decline in sales for 5/8" meter customers based on a 3-year compound growth average rather than the 5-year compound growth average used to support the Department's as-filed annual reduction rate of 1.5%. *See* Public Advocate St. No. 1, p. 17. Notably, this adjustment is consistent with the methodology applied to determine growth rates for accounts with meter sizes larger than 5/8". *See* PWD Response to Transcript Request No. 2. The modified calculation adjusts the growth rate for 5/8" meter accounts from an annual reduction of 1.5% to an annual reduction of 0.5%, which results in a revenue reduction of \$5.9 million for FY 2017 and \$9.4 million for FY 2018. *See id.* at 18.

As stated above, PLUG does not oppose the Public Advocate's adjusted growth rate for 5/8" meter customers. However, as noted at the evidentiary hearing, PWD suggested that such revenue adjustments would have an impact on the allocations to different customer types. *See* April 5 Hearing Tr. at 77. Importantly, no party to this proceeding proposed modifications to the Cost-of-Service Study developed by PWD, except the Public Advocate's proposal to exclude City-Owned and City-Leased properties from any revenue scale-back. *See* Public Advocate St. No. 2, p. 16. Accordingly, consistent with the Public Advocate's testimony, PLUG recommends that all revenue adjustments approved by the Board be proportionally scaled-back for all customers except the two City classes. *See id.*

**D. The Board must deny PennFuture's proposal to eliminate the Enhanced CAP Program in 2019.**

During the preceding 2013 rate case, PWD adopted an Enhanced CAP designed to moderate rate increases for customers most severely impacted by the Department's transition from a meter-based stormwater rate structure to a parcel-based stormwater rate structure. In this

proceeding PennFuture remarkably alleges that the current program is unreasonable, fails to incentivize implementation of stormwater mitigation measures, and therefore should be eliminated at the end of 2019. PennFuture's claims rely on unsupported assumptions and unreasonably conflate the objectives of the Enhanced CAP program with PWD's stormwater incentive programs. Accordingly, PennFuture's recommendation should be summarily rejected.

By way of background, PWD developed the Enhanced CAP program as a means to avoid unjust and unreasonable rate increases for customers severely impacted by the transition from meter-based stormwater rates to parcel-based stormwater rates. PWD Witness David Katz outlined the relevant background as follows:

A lot of our businesses have tremendous percentage increases as we transferred from meter-based to land-based and multiple thousands of percentage increases. So we had to find some rational way in which businesses could absorb this increased cost and yet still manage and support our [parcel-based] program.

Apr. 7 Hearing Tr. at 50. As a solution, PWD offered customers an opportunity to register for the Enhanced CAP, under which annual increases to customers' stormwater charges are limited to 10% of the amount incurred in the prior year, provided that the total annual increase also exceeds \$100. *See* PWD St. No. 4, p. 6.

Importantly, customers enrolled in the Enhanced CAP receive rate mitigation, but still pay substantial and annually increasing stormwater fees. As set forth in PWD's Regulations, the Enhanced CAP allowed customers to enroll between January 1, 2013, and September 30, 2013. PWD Regulations, Chapter 2 § 204.0(F). For customers enrolling between January 1 and June 30, 2013 (end of FY 2013), the Enhanced CAP rate would be capped at a 10% increase to the customer's monthly stormwater bill for FY 2012. *Id.* For customers enrolling between July 1, 2013, and September 30, 2013 (start of FY 2014), the Enhanced CAP rate would be capped at a 10% increase to the customer's monthly stormwater bill for FY 2013. *Id.* Further, in

each successive year, the customer's stormwater charges will increase by 10% annually until the annual increase falls below 10% and the customer is thus terminated from the program. *See* PWD Response to PF 1-12.

PennFuture opposes continuation of the Enhanced CAP in its current form. Specifically, PennFuture claims that "[a]s it is currently designed, the program does not provide a reasonable limit to the amount of time that a customer may receive rate mitigation, and it does not provide adequate incentives for customers to implement stormwater management practices on private property." *See* PF St. No. 1, p. 10. Such claims disregard the record evidence and, with regard to the Enhanced CAP's impact on stormwater management practices, are irrelevant.

PennFuture misrepresents the duration of the Enhanced CAP by suggesting that the program provides rate mitigation for 30 years without clarifying that only a small segment of the most highly impacted customers will remain on the program for an extended period. *See* PF St. No. 1, p. 11. PennFuture arrives at the 30-year threshold only through a flawed extrapolation of PWD's projected decrease in annual Enhanced CAP costs. As stated by PWD, "[u]nder the current CAP program, it should be noted that with each succeeding year the number of enrollees will continue to decrease as parcels cease to meet the CAP eligibility requirements and are transitioned to their full parcel area based GA and IA charge." *See* PWD St. No. 9B, p. 9. PWD calculated the rate of drop-off will reduce annually the cost of the Enhanced CAP (projected at \$3.5 million for FY 2016) by \$100,000 per year from FY 2017 through FY 2021. *See id.* PennFuture, based solely on PWD's projection that Enhanced CAP costs will decline only by \$100,000 per year, recommends that the Board terminate the program at the end of 2019.

In making its recommendation, PennFuture seems to intentionally avoid PWD's clarification that the \$100,000 projected annual reduction is a "conservative annual revenue

reduction." *See* Response to PF I-23; *see also* Apr. 7 Hearing Tr. at 71. Consistent with the conservative qualifier applied to PWD's projection, the actual data available since implementation of the Enhanced CAP on January 1, 2013, shows a significantly more accelerated annual cost reduction of approximately \$550,000 per year between FY 2014 and FY 2016.<sup>5</sup> *See* PWD St. No. 9B, p. 8. Similarly, actual data also confirms that the total number of parcels on the Enhanced CAP decreased from 636 in FY 2014 to 520 in FY 2016, a reduction of 18.2% in just 2 years. *See* PWD Response to PA-EXE-157. Accordingly, while PWD's conservative projections for FY 2016-2021 indicate that many customers will remain on the Enhanced CAP for extended periods of time, the available actual data shows that most customers will be terminated under the existing 10% rule within the first 10 years of the program. PWD St. No. 9B, p. 8. Therefore, PennFuture's suggestion that the Enhanced CAP will provide rate mitigation for an "unnecessarily long time" is unsupported by actual data and therefore wholly misplaced.

PennFuture appears unconcerned with the rate impact of its recommendation, but the Board must consider that customers remaining on the Enhanced CAP program for extended periods of time are exactly those which the program was designed to assist. As stated above, the transition from meter-based stormwater rates to parcel-based rates would have subjected the most severely impacted customers to rate increases in excess of 1000%. *See* Apr. 7 Hearing Tr. at 50. The Board should consider that PennFuture proposes to end the Enhanced CAP in 2019, but has made no inquiry or provided any empirical evidence of the associated rate impact on any customers, much less the most severely affected customers. *See id.* at 71, 73. Considering that

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<sup>5</sup> The \$3.5 million Enhanced CAP costs for FY 2016 are based on an annualization of the \$880,082 in actual costs incurred through the first quarter of FY 2016. *See* PWD Response to PA-EXE-157.

PWD's transition to parcel-based stormwater rates would have generated rate increases in excess of 1000% for some customers, the Board must avoid prematurely dismantling a carefully constructed rate mitigation program without a detailed analysis of the customer impacts.

Aside from allegations regarding the duration of the Enhanced CAP, PennFuture also wrongfully criticizes the Enhanced CAP for failure to incentivize implementation of stormwater mitigation measures. *See* PF St. No. 1, p. 10. This criticism should be denied as factually unfounded and substantively irrelevant. PennFuture's allegation rests on a theory as opposed to demonstrated facts, as PennFuture made no inquiry into the rate at which Enhanced CAP customers actually install stormwater mitigation measures. *See* Apr. 7 Hearing Tr. at 66-67. To the contrary, PWD confirmed that Enhanced CAP customers remain strongly incentivized to implement stormwater mitigation measures, as evidenced by the following excerpt from PWD's Direct Testimony:

Many PWD customers appreciate CAP but realize that it only "lessens the blow" and does nothing to abate the fully realized stormwater charges. Many of our most impacted customers have used CAP as a transitional tool while they engaged engineers and contractors to complete a stormwater retrofit and be approved for credits.

PWD St. No. 4, p. 4. Moreover, while PWD demonstrated that Enhanced CAP customers actively install stormwater mitigation measures, participation in Enhanced CAP should not be premised on such actions. PWD developed a credit system to incentivize stormwater mitigation and further awards annual grants for implementation of such mitigation measures through SMIP and GARP. *See id.* at 3-4, 11. The Department implemented the Enhanced CAP as a customer assistance program and should continue making the program available to any customer that meets the rate qualifications.

For each of the above reasons, PennFuture's proposal to sunset the Enhanced CAP in 2019 must be rejected outright.

**E. The Board must affirm its jurisdiction to address customer service issues as necessary to meet its obligation to set "just, reasonable, and nondiscriminatory" rates.**

As noted above, PLUG presented testimony addressing PWD's practice of bifurcating customer service between the Water Revenue Bureau and PWD staff. *See* PLUG Statement No. 1, pp. 5-6. PLUG also propounded discovery upon PWD regarding its customer service policies for Large C&I customers, to which PWD responded by affirming "the Department is interested in identifying a staff person for such purpose." *See* PWD Response to PLUG-1. PLUG is satisfied with PWD's discovery response and considers the issue resolved for purposes of this proceeding. However, PLUG remains concerned with PWD's representation that the Board would be prohibited from ruling on customer service issues. *See* Feb. 22 Hearing Tr. at 168. This argument should be denied as regulation of customer service issues is necessary and appropriate to the Board's duty to set just and reasonable rates for the Department.

The Board's enabling legislation obligates the Board to set rates for PWD that are "just, reasonable nondiscriminatory as to the same class of customers." Philadelphia Code § 13-101(4)(c). The Board cannot assess the reasonableness of rates charged by PWD without some consideration of the Department's underlying services. If the Board is categorically prohibited from reviewing service-related issues, then the Board cannot properly discharge its duty to protect customers from unjust, unreasonable, or discriminatory rates. Particularly with regards to the potential for discriminatory rates, the Board must be authorized to review relevant customer service matters to ensure the Department does not offer undue preferential treatment to individual customers.



Therefore, in order to discharge its duties under its enabling legislation, the Board must affirm its authority to review and address customer service issues as necessary to ensure PWD's rates are just, reasonable, and nondiscriminatory.


#### IV. CONCLUSION

**WHEREFORE**, the Philadelphia Large Users Group respectfully requests that the Philadelphia Water Rate Board:

- (1) Deny the rate increase request proposed by the Philadelphia Water Department; or
- (2) Grant alternative relief consistent with this Main Brief.

Respectfully submitted,

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