

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

Philadelphia Water Department's Proposed Change in Water, Wastewater and Stormwater Rates and Charges	Fiscal Years 2022-2023
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**EXCEPTIONS TO THE HEARING OFFICER'S REPORT  
SUBMITTED ON BEHALF OF THE  
PHILADELPHIA WATER DEPARTMENT**

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## I. INTRODUCTION

The Philadelphia Water Department (“PWD” or “Department”) files these Exceptions to the Hearing Officer’s Report, dated May 18, 2021 (the “Report”), rendered by Hearing Officer Marlane R. Chestnut (the “Hearing Officer”) in the above-captioned proceeding before the Philadelphia Water, Sewer, and Storm Water Rate Board (“Rate Board”).

The Department supports the Report’s recommendation to approve the Partial Settlement.<sup>1</sup> In the Report, the Hearing Officer properly recommends that the Rate Board approve the Partial Settlement.<sup>2</sup> The Department fully endorses this aspect of the Report.

The Department, however, disagrees with the Report’s recommendation to reject PWD’s arrearage forgiveness (AF) cost recovery proposal.<sup>3</sup> As explained below, the Department proposes to update the Tiered Assistance Program Rate Rider (“TAP-R”) formula to include an arrearage forgiveness factor (“AF Factor”) in this proceeding. The proposed AF Factor is intended to allow the Department to recover a portion of the costs of providing arrearage forgiveness to eligible Tiered Assistance Program (“TAP”) customers through the TAP-R surcharge rate. For purposes of cost recovery, the Department proposes that arrearage forgiveness be calculated at the time of the annual TAP-R reconciliation.<sup>4</sup> The amount of arrearage forgiveness to be recovered via the TAP-R surcharge rate would be only a portion of the actual

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<sup>1</sup> Amendments were made to the Department’s proposals to acknowledge the terms agreed-upon in the Joint Petition for Partial Settlement (“Joint Petition” or “Partial Settlement”) between the Department and the Public Advocate (“Advocate” or “PA”). See <https://www.phila.gov/media/20210505154832/Joint-Petition-for-Partial-Settlement.pdf>.

<sup>2</sup> Report at 5, 53.

<sup>3</sup> Report at 44, 52.

<sup>4</sup> PWD Statement 7B at 10-11.

amount of arrears forgiven during the prior rate period in accordance with City policy and Section 206.7 of the Department's regulations.<sup>5</sup>

The framework for AF cost recovery is addressed in PWD Statement 7B and detailed support for the proposal is provided in Schedule BV-S1 (appended to the aforesaid Statement). As described in Schedule BV-S1, the Department's proposed approach to recover pre-program arrears for TAP customers specifically takes into account the implications of revenue projections and cost of service analysis used in developing PWD base rates.<sup>6</sup> Stated differently, following-up on the issues identified in the 2018 Rate Determination, the Department gathered collection and payment pattern data to determine the appropriate level of cost recovery for TAP pre-program arrears. This data and the associated analysis are detailed in PWD Statement 7B (Schedule BV-S1). Please note that because the subject of cost recovery relates to accumulated arrears (TAP pre-program arrears), the analysis differs from that used in setting base rates for a prospective period (using collection factors).

Instead, in determining the level of arrears to be recovered through the TAP-R surcharge, (i) a balance factor ("Balance Factor")<sup>7</sup> is used to estimate the amount of total arrears that might have been recovered following the collection period; and (ii) a TAP lost revenue adjustment factor ("Lost Revenue Factor")<sup>8</sup> is applied to the amount of AF credits earned during the prior

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<sup>5</sup> As of the end of FY 2020, customers enrolled in TAP had pre-program arrears eligible for principal forgiveness totaling roughly \$39 million, which reflects water debt up to 15 years old. See Schedule BV-S1 at 1, 3, 8. Of that amount, the Department could have reasonably anticipated collecting between \$3.6 million and \$10.5 million; which represents between 9% and 27% of the pre-program arrears as of the end of FY 2020. The 9% is based upon the payment pattern of TAP Customers Outside of Enrollment, while the 27% represents the payment pattern of Overall Customers system wide. The Department is proposing to utilize the lower end of this estimate as the basis for establishing the amount of forgiven arrears to be recovered. See discussion *infra* (Section A.2).

<sup>6</sup> Schedule BV-S1 at 1-6.

<sup>7</sup> Schedule BV-S1 at 3.

<sup>8</sup> Schedule BV-S1 at 7-9.

rate period to calculate the amount of AF credits to recover via TAP-R. In the instant context, total pre-program arrears for TAP participants are estimated at \$39 million.<sup>9</sup> Only a portion of this amount is assumed to be recoverable (in the range of \$3.6 million to \$10.5 million).<sup>10</sup>

As discussed in Schedule BV-S1, the balance factor represents the total estimated amount of receipts anticipated from outstanding billings (on a percentage basis). The balance factor utilizes the same data set as the collection factors, but compares the total cumulative payments received following the collection period to the remaining balance for that same period. Given the fact that pre-program arrears for TAP customers are frozen, applying a balance factor provides an estimate of what the Department might have otherwise received, if such arrears were subject to collection activities (like non-TAP customers or TAP customers prior to enrollment).

Also as discussed in Schedule BV-S1, the Lost Revenue Factor is intended to represent the percentage of pre-program arrears that a TAP customer would have likely paid had (i) such customer not been enrolled in the TAP program; (ii) their arrears not been frozen; and (iii) the Department continued to collect on those arrears.<sup>11</sup> The Department proposes only to recover the amount of arrears forgiven (as adjusted above) in the calculation of the TAP-R surcharge rate. Recovery of AF will also be tracked so that, on an annual basis, any amount of over or under recovery will be included in the subsequent annual reconciliation filing. The AF Factor would also not be subject to interest earnings.<sup>12</sup>

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<sup>9</sup> See footnote 5, citing Schedule BV-S1 at 1, 3, 8.

<sup>10</sup> Schedule BV-S1 at 3. The above estimated range reflects the amount that could potentially be collected from non-TAP customers via the TAP-R surcharges to account for a portion of the revenues the Department will forgo with the adoption of the updated arrearage forgiveness policy for TAP customers. The Department is proposing to utilize the lower end of this estimate as the basis for establishing the amount of forgiven arrears to be recovered. See discussion *supra* (footnote 5).

<sup>11</sup> PWD Statement 7B at 11.

<sup>12</sup> PWD Statement 7B at 11.

Stated simply, the amount of forgiven arrears proposed to be recovered by including AF in the development of TAP-R surcharge rates, is determined by multiplying the lost revenue factor by the actual arrears forgiven for the prior rate period. The resulting dollar amount is the amount of arrearage forgiveness to be included in TAP-R surcharge rates.<sup>13</sup>

The Report substantially ignores the Department's development of a cost recovery approach that is specifically designed to avoid over-recovery of AF credits. The development of the AF Factor (to be included in TAP Rate Rider formula to recover arrearages forgiven) is fully documented in Schedule BV-S1. This Schedule also describes the data collected from the Department's customers (payment pattern data) and its application in the proposal to update the TAP Rider formula to include an AF Factor. Because it appears that Schedule BV-S1 was overlooked in the Report, erroneous findings/conclusions were reached regarding:

- (i) the analysis supporting the Department's AF cost recovery proposal;<sup>14</sup>
- (ii) the Department's rebuttal to the Advocate's contentions that base rates already take into account the payments (or lack of payments) for TAP and non-TAP customers;<sup>15</sup> and
- (iii) the fact that TAP pre-program arrears are "frozen" and not subject to collection activity.<sup>16</sup>

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<sup>13</sup> PWD Statement 7B at 11.

<sup>14</sup> *See*, Report at 52.

<sup>15</sup> *See*, Report at 52.

<sup>16</sup> *See*, Report at 52. It is critical to recognize that TAP arrears (unlike other customer arrears) are "frozen" or "roped off" so there is no collection activity with regard to same. Collections for non-TAP customers are not restricted like TAP customers. As a result, collections continue for their arrears. In absence of similar collection activity for TAP customers, some mechanism is needed to recover the revenue shortfall (TAP pre-program arrears). The proposed AF Factor is designed to fairly recover a portion of such arrears. *See*, PWD Statement 7B at 10; Schedule BV-1 at 1, 2.

Taken together, PWD believes that the foregoing findings are at variance with the evidence presented (unsupported by the record) and offer a disincentive for AF program enhancement, as there is a clear penalty to the Department over time as arrears are forgiven.

## **II. EXCEPTIONS**

The Department submits these Exceptions to urge the Rate Board to reconcile the recommendations in the Hearing Officer's Report<sup>17</sup> with the record, the Department's Main Brief<sup>18</sup> and this submission.

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### **A. Exception No. 1: The Report Errs in Recommending the Rejection of the Department's Arrearage Forgiveness Cost Recovery Proposal.**

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The Department disagrees with the Report's recommendations on one of the two issues that were not resolved by the Partial Settlement.<sup>19</sup> Specifically, PWD disagrees with the Report's recommendation to reject the Department's arrearage forgiveness cost recovery proposal, since errors or omissions have been made in not recognizing the detailed analysis supporting the proposed AF Factor and the false impression that the Department did nothing to rebut the Advocate's positions.<sup>20</sup>

Contrary to the Report's recommendation, the Department submits – as stated in PWD Statement 7B, PWD Rebuttal Statement 1, Section IV.D of the Department's Main Brief, and herein – that the Department's proposal to update the TAP Rate Rider formula to include the AF

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<sup>17</sup> The Report can be adopted, modified or rejected by the Rate Board.

<sup>18</sup> <https://www.phila.gov/media/20210513093206/Brief-May-11-2021.pdf>.

<sup>19</sup> The two issues not resolved by the Partial Settlement relate to the Department's proposals for (i) implementation of the City policy on arrearage forgiveness; and (ii) recovery of a portion of the arrears forgiven in connection with the TAP program. See, Report at 44-45. PWD files these Exceptions in connection with the second issue only.

<sup>20</sup> Report at 50-52.

Factor should be adopted as it is (i) reasonable; (ii) calculated based on the amount of arrearage forgiven during the prior rate period; and (iii) consistent with current City policy.

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**1. The Report Does Not Recognize the Detailed Analysis Supporting the Development of the Proposed AF Factor.**

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The Report rejects the Department's arrearage forgiveness cost recovery proposal indicating, among other things, that the Department did not take into account the implications of revenue projections and cost of service analysis used in developing its base rates.<sup>21</sup> As explained in these Exceptions, this is a false premise. The Report appears to overlook Schedule BV-S1 and the detailed analysis undertaken by Black & Veatch. PWD Statement 7B (Schedule BV-S1) fully details the AF cost recovery proposal and describes how it differs from projecting future revenues for the purpose of setting base rates. Please note that tracking arrears for purposes of cost recovery is plainly different from prospective ratemaking. That is, AF cost recovery must look backwards in time and analyze payment patterns to estimate the levels of arrears that might have been recovered during an historic period. Setting base rates, however, is about projecting future revenues.

The Board should be aware that Schedule BV-S1 provides a substantive and comprehensive explanation of the reasonableness of the Department's AF cost recovery proposal. It specifically (i) addresses the Department's use of collection factors to project future revenues, (ii) proposes the use of a Balance Factor to estimate the recovery of arrears (such as pre-program arrears for TAP customers) and (iii) proposes the use of a Lost Revenue Factor to specifically

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<sup>21</sup> Report at 52.



avoid the over-recovery of TAP arrears.<sup>22</sup> These key elements of the Department's rebuttal to the Advocate's contentions are documented in the aforesaid Schedule.

Schedule BV-S1 is central in (i) describing the total amount of pre-program arrears of TAP customers to be recovered through the TAP Rider and (ii) explaining how the Department examined the implications of its proposal with revenue projections and cost of service analysis used in developing its base rates. Simply put, this Schedule documents how the Department followed-up on the issues identified in the 2018 Rate Determination (e.g., potential over-recovery of arrears through surcharge rates) and explains how an appropriate level of cost recovery for TAP arrears is determined.<sup>23</sup>

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**2. The Report Mistakenly Concludes that the Department Did Not Rebut the Advocate's Contentions that Base Rates Already Take Into Account the Recovery of TAP Arrears.**

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The Report also mistakenly finds that the Department did not rebut the Advocate's contentions with regard to over-recovery should the AF Factor be added to the TAP Rider formula.<sup>24</sup> This finding is addressed, in part, in the preceding section. Please note, however, that the Advocate's contentions are tied to the Department's use of collection factors in establishing

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<sup>22</sup> See Schedule BV-S1 at 1-9.

<sup>23</sup> See Schedule BV-S1 at 1-9.

<sup>24</sup> Report at 52.

its base rates.<sup>25</sup> This is a red herring (misnomer) in the context of a discussion of the appropriate recovery of arrears. That is, by their nature, collection factors are forward looking and are used to project receipts as a percentage of billings to develop rates. Collection factors are an inappropriate tool to estimate the recovery of TAP pre-program arrears.<sup>26</sup>

As noted in Schedule BV-S1, the Department's collection factors project receipts as a percentage of billings received over multiple years and do not use just a single billing year's receipts as the basis for calculation. During the rate proceeding for FY 2019 – FY 2020, Black & Veatch developed rates utilizing collection factors based on billings and receipts reporting from FY 2012 to FY 2016. For the current proceeding, Black & Veatch used data reflecting billings and receipts from FY 2012 to FY 2020.

The current collection factor reports generated by Raftelis and incorporated in the rate filing include billings associated with current pre-program TAP arrears. Consistent with City policy and Section 206.7 of Department regulations, however, PWD is no longer pursuing

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<sup>25</sup> This issue was raised in the 2018 general base rate proceeding. At that time, the current arrearage forgiveness policy was not implemented. The decision to update the TAP arrearage forgiveness policy (to include principal forgiveness) occurred following the aforesaid proceeding. Pursuant to Section 206.7(a) of the Department's regulations, as amended in September 2020, arrearage forgiveness is allowed after the payment of twenty-four (24) TAP bills. Based on the current policy, no arrears had been forgiven at the time of the instant base rate filing, except for a *de minimus* level of arrears forgiven pursuant to Department regulations at Section 206.7(a), (b) and (d).

Please note that collection factors used in setting rates prospectively are based upon system wide payment patterns so that future revenues are sufficient. The Advocate appears to suggest that PWD should adjust its collection factors to reflect forgiveness that has not occurred yet.

To be clear, customer arrears that are forgiven as a matter of policy do not reflect a payment against a bill issued to said customer for service. In setting cost of service rates, it's reasonable to apply historical collection patterns to estimate future revenues and establish correspondingly sufficient rates. In other words, the projected revenues should reflect actual payment history. Forgiven arrears do not meet this criteria. It bears reiteration that no arrears had been forgiven when the cost of service study was prepared for this rate case, as the current policy only went into effect in September 2020 (24 months needed to estimate arrears actually earned under the new policy). The proposed AF cost recovery proposal is the best approach to track actual arrears forgiven and recover a reasonable portion of such arrears over time.

<sup>26</sup> Schedule BV-S1 at 3. Please note that although the current collection factor reports generated by Raftelis include billings associated with the current Pre-Program TAP Arrears. Per TAP policies, the Water Department is no longer pursuing collections on these outstanding bills (i.e., these arrears are "frozen" or "roped-off"). See, PWD Statement 7B at 10.

collections on these outstanding bills (i.e., these arrears are “frozen” or “roped-off”). Therefore, it is reasonable to assume that the Department will not collect on any of these outstanding amounts. Moreover, it is also reasonable to assume that the Department will not recognize any further revenues from TAP customers to satisfy these outstanding arrears.<sup>27</sup>

Given that the pre-program arrears for TAP enrolled customers are “frozen,” applying a Balance Factor provides an estimate of what the Department could have otherwise reasonably expected to collect. In aggregate, a comparison of the anticipated collected arrears to the total outstanding arrears provides the basis for establishing an overall Arrearage Forgiveness Factor.

Using the collection reports developed by Raftelis, Black & Veatch developed Balance Factors based upon billings and payments from the following customer billing groups:

1. Verified Low-Income Customers - Includes TAP Customer and Senior Citizen billings.
2. TAP Customer Billings Outside of TAP Enrollment - Includes customers that are in or have participated in TAP. The billings and payments represented by this group are not TAP bills or payments but rather bills and payments for these customers while not enrolled in TAP (i.e. outside of TAP enrollment).
3. Overall Customers - Total customer billings based upon FY 2020 collection analysis reports (this includes customers in billing groups 1 and 2).<sup>28</sup>

Estimated forgone collections for the above customer billing groups were developed by applying the applicable Balance Factor to the total pre-program TAP arrears. Based upon the above analysis, the Department can reasonably anticipate collecting between \$3.6 million to \$10.5 million of the roughly \$39.0 million in total pre-program TAP arrears.<sup>29</sup> This estimated range

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<sup>27</sup> Schedule BV-S1 at 2.

<sup>28</sup> Schedule BV-S1 at 3.

<sup>29</sup> See footnote 5, citing, Schedule BV-S1 at 1, 3, 8.

reflects the amount that can be reasonably collected from non-TAP customers via the TAP-R surcharges — to account for revenues the Department would forgo with the adoption of the updated arrearage forgiveness policy for TAP customers. This amount needs to be recovered to make the Department whole over time.

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**3. The Report Does Not Recognize that TAP Pre-Program Arrears Are Not Subject to Collection Activities.**

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The Report does not fully recognize that a critical issue in connection with AF cost recovery is the fact that TAP pre-program arrears are frozen and not subject to collection activity.<sup>30</sup> This is unlike non-TAP customers whose arrears are subject to ongoing collections through civil actions and sheriff sales. When this key fact is recognized, it should be clear that the use of an AF Factor to recover a portion of TAP arrears is necessary.

Absent updating the TAP Rider formula to include an AF Factor, there is no vehicle to recover a reasonable portion of pre-program TAP arrears.<sup>31</sup> The Department's proposal for arrearage forgiveness cost recovery is a straightforward way to arrive at a reasonable result. Please recall that there are \$39 million in estimated total pre-program TAP arrears as of the end of FY 2020.<sup>32</sup> The Department's AF cost recovery approach is proposed to provide a way to sustainably manage this revenue shortfall. Based upon payment pattern data gathered in developing the instant cost recovery proposal, the Department could reasonably anticipate having collected anywhere from \$3.6 million to \$10.5 million of the pre-program TAP arrears.<sup>33</sup>

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<sup>30</sup> Report at 52.

<sup>31</sup> PWD Main Brief at 54-57.

<sup>32</sup> See footnote 5, citing Schedule BV-S1 at 1, 3, 8.

<sup>33</sup> Schedule BV-S1 at 3.

Comparing the “total estimated forgone collections”<sup>34</sup> to the total pre-program TAP arrears provides a sense of how much of the arrears are anticipated to be received, expressed as a percentage.<sup>35</sup> This ratio provides a basis for establishing the Lost Revenue Factor, which can be applied to forgiven arrears irrespective of age. This Factor is proposed to be included in the TAP-R formula as a simple percentage. It will be applied to the actual pre-program arrears forgiven during the prior rate period for TAP customers who meet the requirements of the arrearage forgiveness policy. A Lost Revenue Factor of 9 percent is recommended. Use of this approach will allow the Department to recover a reasonable portion of pre-program TAP arrears (based upon the adjusted amount of arrears forgiven during the prior rate period).

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**B. Exception No. 2: The Report Errs in Rejecting the Proposed AF Factor and Barring Reasonable Cost Recovery — Creating a Disincentive for AF Program Enhancement.**

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The Report indicates that there is a collective interest in improving TAP and making arrearage forgiveness available to all eligible households.<sup>36</sup> It also recommends the approval of the Partial Settlement (including Section 2.D.1 thereof) which tasks the parties to work together to address certain customer service and policy agreements related to TAP outreach and recertification, among other things.<sup>37</sup> Please note that these agreements are to strengthen TAP implementation and the associated policy of arrearage forgiveness. The Department submits, however, that the upshot of the Report’s recommendations, related to AF cost recovery, will be to slow progress made to enhance TAP implementation by rejecting a reasonable basis for AF cost

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<sup>34</sup> Estimate of what the Department would have received had (i) the subject arrears not been frozen and (ii) collections continued to be pursued. *See*, Schedule BV-S1 at 3.

<sup>35</sup> Schedule BV-S1 at 8.

<sup>36</sup> Report at 49.

<sup>37</sup> Report at 49 (footnote 107).

recovery. PWD believes this is true because, as more TAP households earn arrearage forgiveness, the revenue shortfall that would have been recovered through the TAP Rate Rider will continually accumulate over time. Also, as additional households are identified through enhanced outreach efforts, this amount will potentially increase even more. The Report places us on an unsustainable path. And the Department submits that there will be a reckoning in our future (pressure to raise rates tied to ignoring the issue of AF cost recovery with a potential push-back from non-TAP customers).

As a point of comparison, the Department requests that the Rate Board take administrative notice of the Philadelphia Gas Works (“PGW”) arrearage forgiveness policy (associated with its Customer Responsibility Program or “CRP”<sup>38</sup>) which requires the recovery of a portion of forgiven past due arrearages through the Universal Service Surcharge<sup>39</sup> (analogous to the TAP Rate Rider). Such recovery (approved by the Pennsylvania Public Utility Commission or “PUC”) is in recognition that PGW is not made whole when arrears are frozen and not pursued through the collection process. This is also true with respect to PWD arrearage forgiveness, as TAP pre-program arrears are roped-off and collection activity suspended.

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<sup>38</sup> CRP is an assistance program, administered by PGW, that helps low-income customers better afford their bills and maintain their gas service. CRP customers pay less each month (than non-CRP customers) and a portion of pre-CRP debt is forgiven. The CRP discount is based on factors like household size, gross household income and the home’s average gas bill.

By way of background, CRP was originally adopted by the Philadelphia Gas Commission in November 1993 and was subsequently approved by the PUC. Under CRP, PGW forgives 1/36 of the customers pre-CRP debt each month for each CRP bill paid in full. In addition to meeting program eligibility criteria, participants in CRP, who are eligible, are required to apply for the Low-Income Home Energy Assistance Program (“LIHEAP”) and designate PGW as the grant recipient. The minimum payment under a CRP agreement is \$25 monthly. The main costs for PGW related to CRP are associated with the discounts that CRP participants receive and their arrearage forgiveness. *See*, City Official Statement, Gas Works Revenue Bonds (Sixteenth Series) at 85-86.

<sup>39</sup> *See*, PGW Tariff (Supplement No. 139 to Gas Service Tariff - Pa. PUC No. 2) at page 81. This requirement applies to customers enrolling in CRP after September 1, 2003.

At the very least, a portion of this AF shortfall should be recovered (analogous to PGW's CRP program). The proposed AF Factor allows a modest level of cost recovery to take place. Such AF Factor is needed no matter what the current City policy is with regard to the basis of earned arrearage forgiveness (24 completed payments or the 1/24 formula suggested by the Advocate). The Department believes that there is substantial evidence to support the PWD arrearage forgiveness cost recovery proposal in this proceeding and that it is analogous to AF cost recovery used for similar customer assistance programs (like PGW's CRP Program). In short, the Department's proposal should be approved.

However, in the alternative, should the Rate Board authorize the Partial Settlement, but be hesitant to approve the PWD arrearage forgiveness cost recovery proposal under the current circumstances, it could defer its decision on the AF Factor until the Special Reconciliation Proceeding in March 2022. At that time, should the City policy evolve, PWD suggests that its proposal to recover a portion of arrearages forgiven, as detailed in PWD Statement 7B (Schedule BV-S1), be reconsidered, approved and made effective by September 1, 2022.

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### III. CONCLUSION

For the reasons set forth in the record, its Main Brief, and these Exceptions, the Department respectfully requests that the Rate Board grant the Department's Exceptions and reject the recommendations in the Report on cost recovery for Arrearage Forgiveness so as to adopt the Department's cost recovery proposal for Arrearage Forgiveness.

Respectfully submitted,

*/s/ Andre C. Dasent*

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