PHILADELPHIA WATER DEPARTMENT
REBUTTAL STATEMENT NO. 2

BEFORE THE
PHILADELPHIA WATER, SEWER AND STORM WATER RATE BOARD

In the Matter of the Philadelphia Water Department's 2022 Special Rate Proceeding	Fiscal Year 2023

Rebuttal Testimony

of

Black & Veatch Management Consulting, LLC

on behalf of

The Philadelphia Water Department

Dated: April 19, 2022

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I. INTRODUCTION AND PURPOSE OF TESTIMONY

Q1. PLEASE STATE YOUR NAMES AND POSITIONS.

A1. My name is Ann Bui, and I am a Managing Director with Black & Veatch Management Consulting, LLC ("Black & Veatch"). Joining me from Black & Veatch are Brian Merritt, Manager, and Dave Jagt, Senior Manager. Together, we are the Black & Veatch panel.

Q2. HAVE ANY WITNESSES ON THE BLACK & VEATCH PANEL PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

A2. Yes. The Black & Veatch panel provided testimony and schedules marked as Philadelphia Water Department ("PWD" or "Department") PWD Statement No. 3 in the 2022 Special Rate Proceeding ("Special Rate Proceeding" or "SRP") before the Philadelphia Water, Sewer and Storm Water Rate Board ("Rate Board"). Our resumes were provided with our direct testimony. Before the Rate Board, we also provided testimony and developed the Cost of Service Study utilized in the 2021 General Rate Proceeding ("2021 Rate Proceeding").

Q3. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A3. This rebuttal provides Black & Veatch's response, on behalf of the Department, to recommendations and criticisms raised by Mr. Lafayette Morgan in his direct testimony (PA Statement 1) on behalf of the Public Advocate.[1]

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[1] This proceeding is focused on two potential adjustments to the FY 2023 Base Rate Incremental Increase. The two potential adjustments include: (i) the Federal Stimulus Adjustment and (ii) the FY 2021 Financial Performance Adjustment. Mr. Morgan concurs with the Department that no Federal Stimulus Adjustment is warranted in this proceeding. He disagrees with the Department about the FY 2021 Financial Performance Adjustment.

This rebuttal specifically addresses areas of disagreement concerning Mr. Morgan's proposed FY 2021 Financial Performance Adjustment, including:

- Overall Recommendation
- Methodology for Calculating FY 2021 Financial Performance Adjustment
- FY 2021 Financial Performance
- Meeting Financial Metrics

PWD Rebuttal Statement 1 addressed other areas raised in Mr. Morgan's testimony.

II. OVERALL RECOMMENDATIONS

Q4. WHAT ARE THE POSITIONS OF THE OTHER PARTICIPANTS WITH RESPECT TO A POTENTIAL ADJUSTMENT RELATED TO FEDERAL STIMULUS FUNDING?

A4. The Public Advocate indicates that they agree with the Department that no reduction in FY 2023 rates and charges is warranted with respect to the receipt of Stimulus Funds as established in the Settlement. PA Statement 1 at 19. No other participant submitted direct testimony on this potential adjustment.

Q5. WHAT ARE THE OTHER PARTICIPANTS' POSITIONS CONCERNING POTENTIAL ADJUSTMENTS RELATED TO THE DEPARTMENT'S FY 2021 FINANCIAL PERFORMANCE?

A5. The Public Advocate made recommendations on this potential adjustment. PA Statement 1 at 19. No other participant submitted direct testimony on this potential adjustment.

Q6. MR. MORGAN RECOMMENDS A $6.6 MILLION REDUCTION IN THE FY 2023 BASE RATE INCREMENTAL INCREASE BASED ON HIS CALCULATION OF THE FY 2021 FINANCIAL PERFORMANCE ADJUSTMENT. PA STATEMENT 1 AT 18-19. DO YOU AGREE WITH HIS RECOMMENDATION?

A6. No, we do not agree with this recommendation. Mr. Morgan's recommendation fails to recognize that PWD cannot afford a rate reduction in FY 2023's approved rates, which means a reduction to its limited reserves in the Rate Stabilization Fund ("RSF"). See PWD Rebuttal Statement 1 for a more detailed response.

Q7. MR. MORGAN'S RECOMMENDED ADJUSTMENT CONSISTS OF TWO COMPONENTS. CAN YOU COMMENT ON EACH?

A7. Mr. Morgan's recommendation consists of two components based on the source of the funds associated with the adjustment: (1) Rate Stabilization Fund balance and (2) Residual Fund balance.

<u>Rate Stabilization Fund Balance</u>

$5.35 million of Mr. Morgan's total $6.6 million recommended adjustment is based on funds in the RSF balance We agree with Mr. Morgan's approach of sharing the potentially available RSF Balance above a Minimum Threshold is consistent with the Settlement terms. However, we disagree with his recommendation regarding the Minimum Threshold balance, the amount he identifies to share, and the resulting adjustment to the FY 2023 incremental increase.

Residual Fund Balance

The remainder of Mr. Morgan's $6.6 million recommended adjustment, $1.24 million, is based on the Residual Fund balance. Mr. Morgan recommends reducing the FY 2023 base rate incremental increase based on funds in the Residual Fund. We disagree with this recommendation. Mr. Morgan's approach here is not consistent with the Settlement terms or the 2021 Rate Determination.

Q8. PLEASE COMPARE MR. MORGAN'S RECOMMENDATION WITH THE DEPARTMENT'S POSITION RECOMMENDING A "ZERO ADJUSTMENT" BASED ON FY 2021 FINANCIAL PERFORMANCE.

A8. The Department recommends "zero adjustment" based on its FY 2021 financial performance because such adjustment (i) is consistent with the terms of the Settlement and the 2021 Rate Determination, (ii) provides sufficient revenue to meet the financial metrics, and (iii) avoids a negative credit rating action. The rationale for the Department's position is fully explained in PWD Statement 1.

III. METHODOLOGY FOR CALCULATING THE FY 2021 FINANCIAL PERFORMANCE ADJUSTMENT

Q9. IS THE DEPARTMENT'S POSITION CONSISTENT WITH THE TERMS OF THE STIPULATION ENTERED INTO BETWEEN PWD AND THE PUBLIC ADVOCATE?

A9. Yes. The Department's position regarding the methodology for calculating the FY 2021 Financial Performance Adjustment is consistent with the Stipulation entered into between the Department and the Public Advocate (dated April 5, 2022).

Q10. PLEASE REVIEW THE OVERALL TERMS OF THE STIPULATION.

A10. The Stipulation is an agreement between the Department and the Public Advocate establishing terms to resolve their differences regarding the use of portions of PWD Statement 3 and Schedule BV-4. The terms of the Stipulation are presented in two components: (1) Calculation of 2021 Financial Performance Adjustment and (2) Use of the Updated Financial Model.

<u>Calculation of 2021 Financial Performance</u>

1. PWD and the Public Advocate expressly acknowledge and agree that rates and charges determined in the SRP will be calculated based on the FY 2023 Base Rate Incremental Increase ("FY 2023 incremental revenues") agreed to in the Joint Petition for Partial Settlement ("Joint Settlement Petition") and approved by the Rate Board in its June 16, 2021, Rate Determination ("2021 Rate Determination"), subject to adjustment solely on the basis of the two reconciliation frameworks set forth on pages 41-43 of the aforesaid Rate Determination.
2. **The "starting point" for determining the 2021 Financial Performance Adjustment will be the actual RSF balance for the beginning of FY 2022 (which is the same as the ending balance for FY 2021). The starting point is hereafter referred to as the "actual RSF starting balance."**
3. **The actual RSF starting balance will be compared with the "minimum threshold" for the RSF as determined by each Stipulating Party.**
4. The "minimum threshold" is undefined in the Joint Settlement Petition and the 2021 Rate Determination approving same and must be litigated as a part of the Special Rate Proceeding.

5. **Based upon the comparison of the actual RSF starting balance and the "minimum threshold" (proposed by each party), an initial determination will be made as to whether there is any amount to be shared. If not, no further calculation is needed.**
6. **Assuming there is an amount to be shared, the parties can submit their respective positions as to how such amount should be "shared" to reduce the FY 2023 incremental revenues ($34.110 million) approved in the 2021 Rate Determination.**
7. Any amount designated for sharing cannot exceed the Maximum Adjustment ($34.110 million).
8. Any amount to be shared will be reflected as an adjustment to incremental revenues approved for FY 2023 in the 2021 Rate Determination.
9. If any adjustment will reduce FY 2023 approved incremental revenues ($34.110 million) from the 2021 Rate Determination, the resulting (net) incremental revenues must be sufficient to fulfill PWD's required covenants with bondholders, as prescribed in the City's Restated Water and Wastewater Revenue Bond Ordinance of 1989, as supplemented and amended from time to time, and legislatively mandated financial obligations as prescribed in the Rate Ordinance, Philadelphia Code, Section 13-101. Such covenants and obligations are hereinafter referred to as the "required financial metrics."

<u>**Use of Updated Financial Model**</u>

10. Schedule BV-4 can be used for the limited purpose of (i) supporting or corroborating the parties' positions regarding adjustments (or absence of adjustments) proposed for FY 2023 incremental revenues and, assuming an adjustment is made to FY 2023 incremental revenues, (ii) establishing whether such resulting revenues (net of the adjustment) will be sufficient to meet the required financial metrics and maintain the utility's financial stability (to avoid negative rating action).

11. PWD testimony describing the Updated Financial Outlook can likewise be used for the limited purpose of supporting or corroborating the parties' positions regarding adjustments (or absence of adjustments) proposed for FY 2023 incremental revenues.
12. The Stipulating Parties have not agreed to any limitations on the presentation of their respective cases via rebuttal and/or rejoinder testimony — which has not been presented as of this date.

Q11. IS THE PUBLIC ADVOCATE'S POSITION CONSISTENT WITH THE STIPULATION?

A11. No. The Public Advocate's position regarding the 2021 Financial Performance Adjustment, as presented in Mr. Morgan's testimony, is based on ending fund balances in the Residual Fund and the RSF. The Stipulation does not include the Residual Fund in its terms. Similarly, the terms and conditions of the Joint Settlement Petition also do not contemplate this adjustment.

Q12. WHAT IS THE APPROPRIATE BASIS FOR CALCULATING THE FY 2021 FINANCIAL PERFORMANCE ADJUSTMENT?

A12. Per the Stipulation terms (specifically items 2, 3, 5, and 6), using the actual FY 2021 year-end RSF fund balance is the appropriate basis for calculating the 2021 Financial Performance adjustment and comparing the same with the Minimum Threshold established in this Special Rate Proceeding. As alluded to above, this is also consistent with the Joint Settlement Petition, the Philadelphia Water Department Statement of Support for Joint Settlement Petition, and the Statement of the Public Advocate in Support for Joint Settlement Petition.

Q13. DOES MR. MORGAN'S RECOMMENDATION DEPART FROM THE AGREED-UPON FRAMEWORK FOR THE FY 2021 FINANCIAL PERFORMANCE ADJUSTMENT IN USING THE RESIDUAL FUND?

A13. Yes. Mr. Morgan's testimony initially recognizes the appropriate basis for the 2021 Financial Performance adjustment (using the RSF balance). However, he includes additional funds that he believes are available in the Residual Fund in his recommendation. His utilization of the Residual Fund balance is a departure from the stipulated terms.

Q14. HOW WAS THE MINIMUM THRESHOLD TO BE USED IN THIS PROCEEDING?

A14. Per the terms of the Stipulation (specifically items 3, 4, and 5), the Minimum Threshold is the basis of comparison relative to the actual end-of-year FY 2021 RSF balance to establish the potential 2021 Financial Performance Adjustment. This use of the Minimum Threshold is also consistent with the terms of the Joint Settlement Petition.

Q15. DOES MR. MORGAN'S ANALYSIS, AS PRESENTED IN HIS TESTIMONY, INCLUDE A REASONED BASIS FOR THE PROPOSED MINIMUM THRESHOLD?

A15. No, Mr. Morgan's testimony offers no rationale for his proposed minimum threshold. The proposed Minimum Threshold presented in his testimony is based on "the projected RSF balance at the time the Settlement was entered." The Settlement is a "Black Box" settlement, and it clearly states that "parties do not specifically identify adjustments to projected revenues and expenses." As the projected FY 2021 year-end RSF balance at the Settlement results from projected revenues and expenses that were not agreed to, we believe that it is questionable to use the same as a reasonable basis for a Minimum Threshold. The Minimum Threshold should be a more objective metric.

Q16. WHY WASN'T A MINIMUM THRESHOLD AGREED TO AS PART OF THE 2021 SETTLEMENT?

A16. Although the Settlement helped resolve many issues identified during the 2021 Rate Proceeding, the Department and the Public Advocate could not agree on the basis for the Minimum Threshold. As stated in the Stipulation (item 4), the Minimum Threshold is undefined in the Joint Settlement Petition, and the 2021 Rate Determination approving same and must be litigated as a part of this Special Rate Proceeding.

Q17. WHAT MINIMUM THRESHOLD DOES MR. MORGAN PROPOSE IN HIS TESTIMONY?

A17. Mr. Morgan recommends using the ending RSF balance projected in the 2021 Rate Proceeding for his minimum threshold. He provides no detailed explanation as to why this is appropriate.

Q18. IF THE ENDING RSF BALANCE, AS PROJECTED IN THE LAST GENERAL RATE PROCEEDING, WAS TO BE USED FOR THIS PURPOSE, WHY WAS THE JOINT SETTLEMENT PETITION SILENT ON THIS POINT?

A18. The parties could not resolve this issue as a part of the Joint Settlement Petition. Please also note that as a rate consultant to the Department, Black & Veatch could not recommend that the Department agree to settlement terms that would establish a Minimum Threshold less than the RSF target balance of $135 Million. As documented throughout the established record for this Special Rate Proceeding, the RSF target balance was established after substantial discussion and deliberation during the 2018 Rate Proceeding. That metric has been accepted by the Rate Board and shared with the rating agencies with every financial disclosure and as part of all the Department's credit and debt market activities since the aforesaid proceeding.

Q19. WHY IS USING THE ENDING RSF BALANCE AS PROJECTED WHEN THE SETTLEMENT WAS ENTERED INAPPROPRIATE AS A MINIMUM THRESHOLD?

A19. To understand why using the ending RSF balance as projected is inappropriate, we first need to provide some background regarding the development of the Settlement tables under a "Black Box" agreement.

The projected FY 2021 year-end RSF balance at the time of Settlement results from projected revenues and expenses not agreed to by the parties. The Settlement clearly states that the "parties do not specifically identify adjustments to projected revenues and expenses." In other words, the parties agreed to the level of revenue increases, not to the details on how such revenue increases would be attained.

As we are all aware, there are many ways to achieve a level of increase. It may be through increases in revenues, decreases in expenses, use of reserves, and any combination of these options. As such, the projected FY 2021 RSF balance of $113.988 million in the Settlement tables reflects one possible outcome. Black & Veatch could not recommend a minimum threshold figure less than the $135 million agreed upon in the 2018 Rate Determination. Since the Settlement established that the Minimum Threshold was to be determined as part of the Special Rate Proceeding, to keep things simple, adjustments to the RSF were made to reflect the agreed-upon revenue increases. For these reasons we believe that using the projected RSF ending balance presented in the Settlement tables is inappropriate. It implies agreement by the parties on revenue and expense projections that is not the case. Further, it implies that the financial metrics, including the resulting RSF balances presented in the Settlement tables were sufficient, reasonable, and represents an acceptable financial position.

IV. FY 2021 FINANCIAL PERFORMANCE

Q20. MR MORGAN INDICATES THAT PWD'S FY 2021 FINANCIAL PERFORMANCE WAS "GOOD." PA STATEMENT 1 AT 8. DO YOU AGREE?

A20. No. We would not describe PWD's FY 2021 financial performance as "good" based on the following observations:

- The FY 2021 financial performance reflects deficit spending and reliance on RSF funds to meet its annual revenue requirements.
- The peer analysis presented in Schedule ML-2 includes comparing PWD's financial metrics with its peers and the average for similarly rated utilities. PWD's performance in several metrics is below a number of its peers and the average for similarly rated utilities.
- PWD's FY 2021 year-end RSF balance of $124.66 million is below the $135 million target balance and barely above the RSF balance that Standard & Poors ("S&P") indicated would trigger a rating downgrade.

Q21. MR MORGAN ALSO INDICATES THAT WITH $10.4 MILLION IN INCREASED RATE REVENUES IN FY 2022, THE DEPARTMENT "OUTPERFORMED THE METRICS THAT ARE USED TO DETERMINE THE ADEQUACIES OF RATES" IN FY 2021. PA STATEMENT 1 AT 8. DO YOU AGREE?

A21. No. The $10.4 million increased rate revenues granted for FY 2022 have no impact on the Department's FY 2021 financial performance. The aforesaid revenue increase became effective on September 1, 2021, during FY 2022, and does not impact the actual revenues received during FY 2021 (July 1, 2020 to June 30, 2021). There was no adjustment to the base rates in FY 2021 as the Department withdrew the rate request for FY 2021.

Q22. HOW IS OUTPERFORMANCE OR OVERPERFORMANCE APPROPRIATELY MEASURED IN THIS PROCEEDING?

A22. In this Special Rate Proceeding, outperformance is measured based on a comparison of the <u>actual</u> year-end FY 2021 RSF balance with the Minimum Threshold to be established during the proceeding as per the terms of the Settlement, the 2021 Rate Determination, and the Stipulation. It is imperative that the Minimum Threshold be established at an amount which reflects reasonable financial position, provides PWD with sufficient reserves and does not violate minimum reserve levels identified by S&P.

Q23. MR. MORGAN REFERS TO FY 2022 FINANCIAL EVENTS TO SUPPORT HIS FY 2021 FINANCIAL PERFORMANCE. PA STATEMENT 1 ON PAGES 8-10. PLEASE COMMENT ON THIS.

A23. In addition to Mr. Morgan's reference to the FY 2022 additional revenues granted by the 2021 Rate Determination (as addressed in Question 21), he also refers to the cost impact associated with remnants of Hurricane Ida, which occurred in September 2021 (FY 2022) to support his position. The approved FY 2022 revenue increase and cost impacts due to Hurricane Ida are events that occurred in FY 2022 and do not impact the FY 2021 Financial Performance.

As noted in PWD Rebuttal Statement No. 1, the Rate Ordinance provides that the Department's rates and charges shall include "a reasonable sum to cover unforeseeable or unusual expenses." Philadelphia Code, Section 13-100(4)(b). Currently, the Department's rates and charges do not include an explicit amount to "cover unforeseeable or unusual expenses." Instead, the Department has used the RSF to handle such situations. Despite its name, the RSF is more than just a fund for managing revenue impacts; it is the Department's primary source of liquidity. Consequently, the adequacy of those reserves is of paramount importance. In fact, Mr. Morgan's statements in this regard actually point directly to the need to maintain adequate reserves (i.e., above a minimum threshold).

The Department has maintained its position regarding the $135 million target throughout this and prior proceedings since the Rate Board's 2018 determination. Further, S&P has indicated a clear red-line that a negative rating action may be triggered should RSF balances indicate a downward trend and a possible downgrade for a breach of the $120 million mark. Please see PWD Rebuttal Statement 1 for further details.

Q24. MR MORGAN INCLUDES A TABLE SHOWING A COMPARISON OF FY 2021 ACTUAL AND PROJECTED OPERATING REVENUES, OPERATING EXPENSES, DEBT SERVICE, TOGETHER WITH RESIDUAL FUND AND RSF BALANCES. PA STATEMENT 1 ON 9. PLEASE COMMENT ON THE SUBJECT

MATTER OF THIS TABLE, GIVEN THE SETTLEMENT OF THE 2021 GENERAL RATE CASE AND THE SCOPE OF THIS PROCEEDING.

A24. As previously discussed in response to Question 22, the outperformance is to be measured based on a comparison of the actual year-end FY 2021 RSF balance with the Minimum Threshold to be established during this proceeding. Mr. Morgan's recommended Minimum Threshold is based on the projected FY 2021 RSF balance as of the Settlement. His comparisons of the projected FY 2021 Financial Performance reflected in the Formal Notice for the 2021 Rate Proceeding are outside the scope of this proceeding and are not relevant to establishing whether the Department outperformed in FY 2021.

Q25. MR MORGAN INCLUDES TWO TABLES SHOWING COMPARISONS OF "FY 2021 ACTUAL" AND PROJECTED OPERATING REVENUES, OPERATING EXPENSES, DEBT SERVICE, TOGETHER WITH RESIDUAL FUND AND RSF BALANCES. AND TAP-R SURCHARGES. PA STATEMENT 1 ON PAGES 9 AND 12. PLEASE COMMENT ON THE ACTUAL FY 2021 DATA PRESENTED IN THESE TABLES.

A25. Mr. Morgan's statement regarding the nature of the FY 2021 data is incorrect. He indicates in his testimony (PA Statement 1 at 8 and 11) that the "FY 2021 Actual" data source was the Black & Veatch model supporting Schedule BV-4 (provided in response to interrogatory PA-I-16). Mr. Morgan later contradicts himself and acknowledges that "The model used to produce Schedule BV-4 does not use PWD's FY 2021 financial results as supplied in response to PA-I-13" PA Statement 1 at 17. Please note that no FY 2021 data is presented in Schedule BV-4. Rather, an estimate of FY 2021 revenue data is calculated in the model supporting BV-4 based on billing data[2]. Furthermore, actual FY 2021 results were provided to all parties via interrogatory response PA-I-13 and the Simple Model for the 2022 Rate Reconciliation Proceeding (as reflected in Schedule LKM-1).

Despite the foregoing, Mr. Morgan ignores the provided FY 2021 actual data. Instead, he presents the aforesaid estimated revenue data in his tables (PA Statement 1 at 9 and 12) as the basis of comparison with prior projections during the 2021 Rate Proceeding. Mr. Morgan presents this information as if it were actual FY 2021 financial results, and uses it as the basis of his analysis and findings. Moreover, Mr. Morgan suggests that by comparing the same with projections used in the 2021 Rate Proceeding that PWD financial "over-performance" is demonstrated. This conclusion is untrue and based on incorrect data. Mr. Morgan's tables offer a comparison of calculated data rather than actual results[3].

Q26. ARE ANY OF THE STATEMENTS IN MR MORGAN'S TESTIMONY REGARDING THE ACTUAL FY 2021 FINANCIAL PERFORMANCE BASED ON HIS INAPPROPRIATE USE OF THE CALCULATED FY 2021 REVENUE DATA INCLUDED IN THE MODEL SUPPORTING SCHEDULE BV-4?

A26. Yes, the following presents a summary of some of the misstatements regarding PWD's actual FY 2021 financial performance in Mr. Morgan's testimony:

[2] FY 2021 was not presented in Schedule BV-4. Rather, an estimate of the FY 2021 revenue data is calculated in the model supporting BV-4 based on the actual billing data (number of accounts, billed volumes, and billed impervious and gross areas), the FY 2021 rate schedule (effective September 1, 2019), distribution of accounts by meter size and customer type, billed volume distribution by rate block and customer type, and actual collection factors. The FY 2021 calculated revenues are included in the model to provide a measure of the accuracy of the model revenue projections relative to actual revenues from the Department's accounting system.

[3] In his response to PWD's interrogatory request I-10, Mr. Morgan recognizes that the FY 2021 revenue data reflects calculated revenues based on actual billing data.

PA Statement 1 at 16, Lines 13-16

Mr. Morgan claims that "Comparing …as it existed at the time of the Settlement versus the updated projections utilized for Schedule BV-4 reveals that PWD generated 3.60% ($25.497 Million) …" Based on the actual FY 2021 data provided in PA-I-13 and the Simple Model for the 2022 Rate Reconciliation Proceeding (Schedule LKM-1), the variance is 3.16% ($22.364 million).

PA Statement 1 at 16, Lines 17-18

Mr. Morgan states that "…however, this comparison shows that PWD generated 7.10% more ($47.379 Million) …" This is an incorrect statement. Based on the actual FY 2021 data provided in PA-I-13 and the Simple Model for the 2022 Rate Reconciliation Proceeding (Schedule LKM-1), the variance is 5.7% ($38.103 million).

PA Statement 1 at 16, Lines 21-22

Mr. Morgan states that …"FY 2022 revenues to be lower than FY 2021's actual result." Again, this is another misstatement. The data provided in PA-I-13 and Simple Model for the 2022 Rate Reconciliation Proceeding (Schedule LKM-1) show the FY 2021 revenues of $705.612. Projected FY 2022 revenues of $714.178 presented in Schedule BV-4 (Table ES-7) are actually greater than the actual FY 2021 revenues.

Q27. MR. MORGAN INDICATES THAT THE $124.661 MILLION RSF BALANCE DOES NOT INDICATE A WEAK FINANCIAL PERFORMANCE. PA STATEMENT 1 AT 13. RATHER, HE CHARACTERIZES THIS FY 2021 ENDING BALANCE AS OVER-PERFORMANCE. DO YOU AGREE?

A27. We do not agree with the characterization of the $124.661 million RSF balance as over-performance. Mr. Morgan's basis for this characterization is the projected RSF balance presented in the Settlement tables. As we previously stated, the projected RSF balance presented in the Settlement tables is based on revenues and revenue requirements that were a part of a "black box" settlement. See discussion in response to Question 19.

Importantly, as noted in PWD Statement 1, PWD's FY 2021 year-end RSF balance of $124.66 million is well below the $135 million RSF metric accepted by the Rate Board and is barely above the RSF balance that S&P indicated would trigger a rating downgrade is a clear indication that the current balance in the RSF indicates poor financial performance.

Q28. MR MORGAN INDICATES THAT THE FACT THAT THE FY 2021 RSF ENDING BALANCE IS LESS THAN $135 MILLION DOES NOT SHOW THAT OPERATING EARNINGS ARE INADEQUATE. PA STATEMENT 1 AT 13. DO YOU AGREE?

A28. No. The continued reliance on RSF balance to meet annual operating costs clearly indicates that operating earnings are inadequate. The Financial Panel addresses this question in more detail in PWD Rebuttal Statement 1.

Q29. MR MORGAN INDICATES THAT COST PRESSURES (NEW FINANCIAL ASSUMPTIONS) ARE BEYOND THE SCOPE OF THIS PROCEEDING. DO YOU AGREE?

A29. No. The Department has managed recent economic challenges due to the COVID-19 pandemic by making significant budget cuts, deferring capital and maintenance activities, and using the RSF. However, the Department cannot continue to operate in such a manner. It would not be prudent to ignore the Department's current financial challenges when considering reducing additional revenues from the previously approved FY 2023 rates. Cost pressures associated with new or changing assumptions impacting the Department's projected operating costs are an important factor that should be considered when evaluating the amount of any potential adjustment to the FY 2023 incremental additional revenues associated with the FY 2021 Financial Performance, specifically in context of the amounts available above the minimum threshold and what portion of which (if any) that can be reasonably shared. Consisetnt with the Stipulation, the Department is not proposing a revised cost of service but simply supporting and corroborating their position for a "zero adjustment." The Department has a fiduciary responsibility to point out that it faces financial challenges due to unusual cost pressures. Any reduction in the previously approved FY 2023 additional revenues would only add to the challenges and potentially impact service levels.

Q30. MR MORGAN INDICATES THAT PWD SIGNIFICANTLY OUTPERFORMED ITS FY 2021 PROJECTIONS COLLECTING $47 MILLION IN ADDITIONAL REVENUES IN THAT FISCAL YEAR. DO YOU AGREE?

A30. No. As identified in response to Question 26, Mr. Morgan overstates the variance between the projected Customer Rates and Charges Revenues presented in the Settlement tables relative to the actual FY 2021 financial performance because he uses <u>projected</u> results, not <u>actual</u> FY 2021 results.

Similar to the other statements regarding the comparison of the projected revenues and revenue requirements from the Settlement with actual FY 2021 data, this comparison is not appropriate for the following reasons: (1) the positions of the parties were not fully litigated, and (2) a "black box" Settlement was negotiated where the parties did not agree to specific adjustments to revenues or revenue requirements.

Q31. MR MORGAN CRITICIZES THE PWD PRESENTATION OF CURRENT COST PRESSURES AS "ONE-SIDED" AND SPECIFICALLY SUGGESTS THAT COST SAVINGS SUCH AS THE LOWER PENSION FUND CONTRIBUTION WERE NOT INCLUDED IN THE UPDATED ANALYSIS. PA STATEMENT 1 AT 18. DO YOU AGREE?

A31. No. Mr. Morgan's criticism is incorrect. The tables included in the Settlement Agreement already reflect updated pension costs for FY 2021, FY 2022, and FY 2023. Further, PWD's presentation of the updated projected costs included in Schedule BV-4 and reflected in ML-2 includes the updated costs associated with the pension fund contributions. As noted in PA-I-2, "pension contribution costs have increased from those reflected in the settlement agreement tables by $1.90 Million in FY 2022 and $1.81 million in FY 2023."

Mr. Morgan indicates that additional cost savings are not accounted for in the updated analysis while ignoring the significant cost pressures related to additional personnel needs and in the face of inflation not seen in decades. The updated projections do consider cost savings as reflected in PWD's adopted budget for FY 2022. As noted in PWD Statement No. 2 from the 2021 Rate Proceeding (Page 9 at Line 24 and Page 10 at Lines 1-5), FY 2021 already reflected a $25 million budget reduction in reaction to the COVID-19 pandemic. FY 2023 expenditures represent a continued move back toward normal (i.e., outside of the COVID-19 Pandemic) operating conditions. Mr. Morgan implies that these potential cost savings would be greater than actual cost increases resulting from the City's approved labor agreements (2.5% in FY 2022 and 3.25% in FY 2023) and additional staffing needs.

In addition, Mr. Morgan is completely silent on inflationary pressures. As discussed in Schedule BV-5, the Consumer Price Index (CPI) is at levels not seen since the 1970s, and the various CPI and Producer Price Indices (PPI) demonstrate significant pricing increases in both the short (i.e., 12 months) and near term (i.e., 36 months). It is unreasonable to assume that PWD will not be impacted by the same inflationary pressures that the broader economy faces.

Mr. Morgan also does not reference the response to PA-II-1, which demonstrated that PWD is seeing increased unit cost pricing for chemicals increases up to 3160% in calendar year 2022 compared to 2021, which is more than the 20% utilized in updated financial projections, as well as the October increase in PPI for Industrial Chemicals of 47.3%,

Mr. Morgan is dismissive of these cost pressures and suggests that they are not relevant in this proceeding nor compelling. However, these cost pressures speak directly to the issue of how much of the available fund balances (above a minimum threshold) can potentially be shared in this proceeding. In FY 2021, chemical costs, personnel salaries, pensions, and benefits costs represent almost 58% of PWD's total operating expenses. The adequacy of reserves is further eroded by ongoing cost increases and inflationary pressures, which reduce the extent to which those funds can cover costs (both anticipated and not). As such, these cost pressures, ignored by Mr. Morgan, are relevant in this Special Rate Proceeding.

Given the significant cost pressures, the amount available to share based upon the current RSF balance of $124.66 million and the minimal level indicated by S&P ($120 million), there are no monies available to share, as any reduction in revenues will require further use of RSF funds[4].

V. MEETING FINANCIAL METRICS

Q32. MR. MORGAN INDICATES HIS CONCERN ABOUT THE USE OF SCHEDULE BV-4. PA STATEMENT 1 ON 17. PLEASE COMMENT.

A32. Mr. Morgan indicates his concern regarding the use of Schedule BV-4 and the associated model as it "does not use PWD's financial results as supplied in response to PA-I-13."[5] The projections presented in Schedule BV-4 are based on the actual FY 2021 operating and financial data, including the financial data presented in PA-I-13. Mr. Morgan has provided no substantive evidence to support his concerns.

Projected revenues in the Financial Plan Model, referenced by Mr. Morgan as the basis for his analysis, are based upon actual billing determinants and the application of the associated rate schedules (among other things) as documented in Schedule BV-4. The model projects through FY 2021 to estimate revenues and establishes the basis for FY 2022 and FY 2027 projections. The beginning RSF and Residual Fund balances for FY 2022 (i.e., end of FY 2021 balances) are directly reflected, and serve as the basis for projected future balances.

[4] Table C-1 in both Schedule BV-4 and the Settlement tables reflect projected draws from the RSF in FY 2023 based on the base rate incremental increase in FY 2023 (prior to any reduction).

[5] Although Mr. Morgan makes this statement, he in turn utilizes the calculated revenues for FY 2021 included in the model as the basis for his arguments. As previously discussed, the model supporting Schedule BV-4 presented calculated revenues for FY 2021 based on actual supporting data.

His dismissal of Schedule BV-4 is misplaced and based upon a misinterpretation of the data in the model.

Q33. DOES SCHEDULE BV-4 INDICATE THAT WITH A "ZERO" ADJUSTMENT TO THE FY 2023 INCREMENTAL ADDITIONAL REVENUES, PWD CAN BARELY MEET ITS FINANCIAL METRICS?

A33. Yes. Schedule BV-4 indicates that PWD can barely meet its financial metrics with a "zero" adjustment to the FY 2023 incremental additional revenues. Note that the projected FY 2023 year-end balance of $120.661 million is just barely above the RSF balance that S&P indicated would trigger a rating downgrade. It also demonstrates that a reduction in FY 2023 Base Incremental Revenues, as proposed by Mr. Morgan, will place PWD on a trajectory for a rating downgrade, as the RSF balance will fall below the S&P metric ($120 million).

VI. CONCLUSION

Q34. DOES THIS COMPLETE YOUR REBUTTAL TESTIMONY?

A34. Yes, it does.