BEFORE THE

PHILADELPHIA WATER, SEWER AND STORM WATER RATE BOARD

In Re: Philadelphia Water Department	:	Special Rate Filing:
Proposed Change in Water, Sewer and	:	Reconciliation Proceeding
Stormwater Rates and Related Charges	:	for Fiscal Year 2023

EXCEPTIONS OF THE PUBLIC ADVOCATE

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I. Introduction

On May 23, 2022, Hearing Officer Marlane R. Chestnut issued the Hearing Officer Report (Report) in the matter of the Philadelphia Water Department's (PWD) 2022 Special Rate Proceeding. As described therein, this proceeding was commenced in compliance with the May 5, 2021, Joint Petition for Partial Settlement (Settlement) that was approved by the Philadelphia Water, Sewer and Storm Water Rate Board (Board) in its June 16, 2021 Rate Determination. Namely, pursuant to the Settlement, this proceeding requires the Board to determine whether certain conditions have been satisfied "so as to warrant downward adjustment of the incremental rates and charges approved to take effect in FY 2023."[1]

The Report suggests several important findings, discussed herein, based on the evidence submitted on the record. However, the Report falls short of recommending a specific outcome, failing to tackle the central question of whether an adjustment is warranted. Rather, the Report recommends a reduction of *no more than* $3 million, stating:

> This recommended adjustment of no more than $3 million is far less than the maximum adjustment of $34.11 million referenced in the Joint Settlement Petition, but it cannot be denied that a risk of a credit downgrade is of particular importance. Therefore, at its discretion, the Rate Board could decrease this recommended sharing of no more than $3 million or even eliminate it entirely, to help mitigate the risk of a downgrade or negative action by the rating agencies.[2]

The Public Advocate takes exception to this recommendation and submits that the Board's final determination must be based upon substantial evidence on the record of the proceeding. A downward adjustment to the incremental increase of at least $5.35 million is certainly warranted

[1] Report at 1-2.
[2] Report at 13.

based upon that evidence, as discussed herein. Finally, the Public Advocate submits that the Report implicitly places undue weight on Rate Stabilization Fund (RSF) balances forecasted in PWD's newly projected Updated Financial Outlook, the outputs of its confidential and proprietary rate model.

II. **The Board's Rate Determination Must be Based on Substantial Evidence.**

The Commonwealth Court's Memorandum Opinion in Public Advocate v. Philadelphia Water, Sewer and Storm Water Rate Board, 1070 C.D. 2019 (Sept. 24, 2021) (hereinafter, Public Advocate Appeal), articulates the standard to be applied on review of the Board's rate determinations. As set forth therein:

> [W]here the statute is silent on appeal rights and procedures, as is the case *sub judice* where the applicable standard of review on appeal is not specified, the Local Agency Law applies. 2 Pa. C.S. §§ 752 & 754. Therefore, we apply the provisions of the Local Agency Law to establish the applicable standard of review here, because the ordinance does not provide for such a standard.[3]

Accordingly, applying the Local Agency Law's standard of review, set forth in 2 Pa. C.S. §754(b), the Board's determination is subject to remand (and potential reversal) if it violates the rights of the parties or the applicable procedural rules, constitutes an error of law, or lacks substantial evidence in support of a necessary finding of fact.[4] Likewise, complimenting the substantial evidence standard, the Philadelphia Code requires the Board's rate determination to "incorporat[e] the information used by the Board in reaching a decision to approve, modify or reject the proposed rates and charges."[5]

[3] Public Advocate Appeal at 10.
[4] Public Advocate Appeal at 10-11.
[5] Phila. Code §13-101(4)(b)(.3).

Contrary to the applicable legal standard, however, the Report submits that the Board may simply reach a determination that the incremental rate increase should not be reduced at all, based purely on its discretion. The converse is true: the Board's failure to base its decision on substantial evidence constitutes an *abuse* of discretion.[6] Furthermore, in order for the Board's determination to result in just and reasonable rates, its determination must articulate the bases, on the record, for the Board's ultimate conclusion.[7] For these reasons, the Public Advocate submits that the Board's final rate determination must articulate the findings made, and the substantial evidence supporting them; it must not be the product of the Board's discretion.

III. The Report Indicates Important Findings are Supported by Substantial Evidence.

As articulated in the Report, the Hearing Officer reached a conclusion that there was, in fact, a basis for an adjustment based on FY 2021 financial performance pursuant to the Settlement (Financial Performance Adjustment).[8] The Report first identifies $124.661 million, the FY 2021 ending balance in the RSF, as the starting point for calculation of the Financial Performance Adjustment.[9] This is the amount disclosed in PWD testimony and discovery responses and has not been called into question.[10] Indeed, the Public Advocate's witness testimony and Main Brief support use of this amount.[11]

Second, the Report analyzes the parties' positions regarding what the $124.661 should be measured against (referred to as the "minimum threshold"). The Hearing Officer rejects PWD's

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[6] See, e.g., Zoning Hearing Bd. of Sadsbury Twp. v. Bd. of Sup'rs of Sadsbury Twp., 804 A.2d 1274 (Pa. Commw. Ct. 2002).

[7] See, e.g., Action Alliance of Senior Citizens of Greater Philadelphia, Inc. v. Phila. Gas Comm'n, 406 A.2d 1155 (Pa. Commw. Ct. 1979) (reversed on other grounds); Madeja v. Whitehall Tp., 457 A.2d 603 (Pa. Commw. Ct. 1980) (identifying remand to agency as proper remedy for inadequate findings).

[8] Settlement at ¶11.A(2)(a)(ii).

[9] Report at 9.

[10] See PWD St. 1 at 16, Sch. ML-4; PA-I-13 (attachment)

[11] PA St. 1 at 12 (table, line 38); PA M.B. at 7-8.

proposal to utilize $135 million as the minimum threshold, concluding that "[t]his level is considerably higher than even the projected RSF balance for fiscal year-end ($109.188 million) contained in PWD's 2021 general rate filing."[12] Instead, the Hearing Officer recommends that the minimum threshold be set at $113.988 million, which is "the FY 2021 ending RSF balance projected as of the date of the Rate Board's adoption of the Joint Settlement Petition."[13] This was also the minimum threshold supported by the Public Advocate and its witness.[14] As a result, consistent with the Public Advocate's testimony and Main Brief,[15] the Report identifies a "total amount available for sharing of approximately $10.7 million ($124.7 - $114 million)."[16]

The Public Advocate submits that the Board should make the following findings of fact, which are supported by substantial evidence, and identified by the Hearing Officer:

1. PWD's FY 2021 RSF balance was $124.661 million, which is in excess of PWD's projections in the 2021 general rate proceeding.

2. The minimum threshold against which the FY 2021 RSF balance should be measured is $113.988 million, the amount anticipated at the time the Settlement was approved by the Board.

3. There is a total of $10.7 million (rounded) available for sharing pursuant to the Financial Performance Adjustment set forth in the Board-approved Settlement.

Each of these findings is supported by substantial evidence on the record of this Special Rate Proceeding and should be adopted by the Board in its final rate determination.

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[12] Report at 10-11.
[13] Id. at 11.
[14] PA St. 1 at 12 (table, line 38); PA M.B. at 7-8.
[15] PA St. 1 at 12 (table, line 38); PA M.B. at 7-8.
[16] Report at 10.

IV. **The Public Advocate's Proposed Adjustment is Supported by Substantial Evidence.**

As explained by the Hearing Officer, the Public Advocate set forth its position that the minimum warranted adjustment is $5.35 million, half of the $10.7 million available for sharing.[17] That the Public Advocate's minimum adjustment amount, $5.35 million, is supported by substantial evidence cannot reasonably be questioned. This amount is precisely half of the amount available for the Financial Performance Adjustment mechanism, reflecting a simple understanding of how PWD and its customers may fairly "share" that $10.7 million. Indeed, PWD's own witnesses, Black & Veatch, specifically contemplated in testimony that the amount available for any Financial Performance Adjustment would be divided equally. As set forth in Schedule BV-1 to their testimony, Black & Veatch specifically "assumed equal sharing" of the amount above the minimum threshold, incorporating a calculation that simply divides the excess by two.[18] For these reasons, a minimum adjustment of $5.35 million is supported by substantial evidence on the record of this Special Rate Proceeding.

Nonetheless, the Public Advocate recommended that more than half of the $10.7 million be shared with PWD customers because the RSF balance is not the only measure of financial outperformance. As explained in the Public Advocate's Main Brief, PWD was also able to outperform its senior debt service coverage target of 1.20x, reaching a coverage level of 1.28x, and enabling an additional $13.217 million transfer to the Construction Fund[19] that would otherwise have been available to contribute to higher levels of reserves.[20] Since those transferred dollars are not available, the Public Advocate recommended the Board increase the Financial

[17] Report at 10.
[18] PWD St. 3, Sch. BV-1 at 4.
[19] PA St. 1 at 12 (table, line 32).
[20] PA M.B. at 9.

Performance Adjustment by the amount in excess of projections contained in the Residual Fund, $1.24 million.[21] This produces an overall recommended $6.6 million downward adjustment to the FY 2023 incremental rate increase. Like the minimum warranted adjustment, this higher recommended adjustment is supported by substantial evidence on the record of this special rate proceeding.[22] Indeed, as discussed in the Public Advocate's Main Brief, the degree of PWD outperformance in FY 2021 warrants a greater than 50/50 sharing of the $10.7 million available for the Financial Performance Adjustment.[23]

For the foregoing reasons, the Board should find that a minimum $5.35 million, preferably $6.6 million, reduction to the FY 2023 incremental rate increase is warranted and supported by substantial evidence on the record in this proceeding.

V. <u>The Report Implicitly Places Undue Weight on PWD's Updated Financial Outlook.</u>

The Hearing Officer's recommendation to approve a downward adjustment of up to $3 million appears premised upon the potential for PWD's future RSF balance to fall below $120 million.[24] PWD has identified this RSF balance as a level of concern due to S&P's September 17, 2021 analysis, stating that depleting the RSF below this level may result in a rating downgrade.[25] This level of reserves was not identified in the 2021 general rate proceeding, nor did the Settlement or the Board's 2021 Rate Determination anticipate that PWD would actually maintain this level of reserves. Indeed, that Rate Determination indicates that the balance in the

[21] PA St. 1 at 20; PA M.B. at 8, 13 n. 45.
[22] <u>See</u> PA St. 1 at 19-20.
[23] PA M.B. at 8-10.
[24] Report at 12-13
[25] Report at 11-12.

RSF was anticipated to decline to $103.857 million in FY 2022 and $92.303 million in FY 2023.[26]

In presenting its Updated Financial Outlook, Schedule BV-4, PWD has revised its estimated revenues, expenses, fund transfers, and myriad other inputs into the proprietary and confidential rate model to demonstrate that, *miraculously*, maintaining the entire $34.411 million FY 2023 rate increase will result in almost exactly $120 million in the RSF for FY 2023.[27] Regarding these projections, the Hearing Officer correctly held, "[i]t is neither necessary nor appropriate for the Department to present new financial assumptions or revenue requirements, or a Financial Stability Plan beyond year-end FY 2021, beyond those already included in the record of the FY 2022-2023 general rate proceeding."[28] Yet, the Hearing Officer's concern with PWD potentially suffering negative rating agency action implicitly relies upon the newly forecasted financial assumptions – maintaining an RSF balance of $120 million – that the Hearing Officer has held to be inappropriate. Furthermore, under no circumstance will the Board's determination in this Special Rate Proceeding, potentially reducing the FY 2023 incremental rate increase based on FY 2021 actual financial performance, indicate that RSF balances are anticipated to reach that level. That is because the adjustment must be applied to the otherwise applicable projections utilized in the Board's 2021 Rate Determination.[29]

As the Public Advocate explained, the limited significance of PWD's revised forecast simply confirms PWD's expectation that it will continue its long-standing history of financial outperformance.[30] Indeed, just as PWD attained Net Revenues after Operations that were

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[26] PA St. 1 at 15.
[27] PWD St. 3 at Sch. BV-4 (Table 2-11, line 40).
[28] March 9, 2022 Order Granting in Part and Denying in Part the Public Advocate's Motion to Strike, at 5.
[29] See April 5, 2022 Stipulation at ¶1.
[30] PA M.B. at 14-15.

between $12,697,000 and $14,540,000 higher than anticipated in FY 2021, a year in which it *did not receive* a rate increase,[31] PWD's financial position will be much stronger in FY 2022 and FY 2023 than it projected a handful of months ago.[32] PWD's new projections remain inappropriate for the Board's consideration, implicitly or explicitly, and its depiction of a $120 million RSF balance in FY 2023 simply demonstrates that PWD's consultants have manipulated the financial model to mathematically produce that outcome. PWD's actual fund balances will likely be even better, in keeping with its historical outperformance.

Finally, while the Hearing Officer states PWD has "taken substantial steps to reduce the revenue burden on its customers,"[33] the Report fails to acknowledge that PWD has made decisions, in operation, that have diverted funds that would otherwise contribute to even higher RSF balances. As the Public Advocate explained:

> In total, as Mr. Morgan shows, PWD retained approximately $12 million more in combined reserves at 2021 fiscal year-end than is reflected in the Rate Determination. As demonstrated in his testimony and at hearing, PWD also made a discretionary transfer of more than $13 million to the Construction Fund which was not anticipated in its 2021 projections. This transfer resulted in higher levels of senior debt service coverage (rounding to 1.28x) and constituted funds that could have contributed to a higher year-end RSF balance. Although this transfer may result in debt service savings in future years, it nonetheless was not anticipated by the parties and the Board at the time of the Settlement and the Rate Determination. The funds available for this transfer were achieved due to PWD's outperformance.[34]

During the context of a global pandemic, affecting the public health and financial stability of millions of Americans, PWD decided to transfer funds that could otherwise reduce pressure on rates and charges *now*. The Board need not question the propriety of that transfer to reach the

[31] PA M.B. at 16.
[32] See PA St. 1 at 16-17 ("PWD's rate consultants anticipate PWD's outperformance will continue and that PWD will conclude FY 2023 with more than $28 million in combined reserves than projected in settlement of the 2021 Rate Proceeding.").
[33] Report at 12.
[34] PA M.B. at 9 (internal footnotes and citations omitted)

obvious conclusion that PWD has a high degree of confidence that it will continue to outperform its projections. Failing to provide to customers a significant reduction to the incremental increase, $5.35 million at minimum, would reward PWD for depicting a future financial condition more fragile than it is.

VI. Conclusion

The Board's final rate determination must be based upon, and identify, the substantial evidence in support of its decision to approve, modify or reject a downward adjustment to the FY 2023 incremental increase in rates and charges. For the reasons set forth herein, the Public Advocate submits that the Board should approve at least a $5.35 million, but preferably a $6.6 million, downward adjustment to FY 2023's incremental rate increase, finding that such adjustment is warranted under the terms and conditions of the Settlement and supported by the weight of substantial evidence submitted in this proceeding.

Respectfully submitted,

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