

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

In the Matter of the Philadelphia : **Fiscal Years 2024 – 2025**
Water Department’s Proposed : **Rates and Charges to Become**
Change in Water, Wastewater, : **Effective September 1, 2023**
and Stormwater Rates and : **and September 1, 2024**
Related Charges :

EXCEPTIONS OF THE PUBLIC ADVOCATE
TO THE HEARING OFFICER REPORT

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I. INTRODUCTION

On May 30, 2023, Hearing Officer Marlane R. Chestnut submitted the Hearing Officer Report (Report) recommending PWD rates and charges be increased to attain incremental net revenues of \$56,752,000 in FY 2024 and \$56,774,000 in FY 2025. Compared to PWD's proposed increases, the Hearing Officer's recommendations would save PWD customers just over \$59 million over the two-year rate period, authorizing PWD to receive approximately 75% of the incremental revenues it sought.

Although the Public Advocate concurs with many of the Hearing Officer's recommendations, and accepts the reasoning behind others, the Public Advocate submits the following exceptions, discussed more fully in the sections that follow:

- An adjustment to PWD's Capital Improvement Program (CIP) budget for FY 2025 (eliminate inflation escalation), as submitted by the Public Advocate, is appropriate and warranted.
- The carry forward adjustments to PWD's CIP budget for FY 2024 and FY 2025, as submitted by the Public Advocate, are appropriate and warranted.
- Extra capacity factors and cost allocation recommendations supported by the Public Advocate should be approved in this proceeding, with PWD required to do a formal demand study prior to its next general rate proceeding.
- The Board should disallow operations and maintenance (O&M) expenses associated with filing liens to secure balances subject to forgiveness through the Tiered Assistance Program (TAP).

Except as set forth herein, the Public Advocate submits that the Hearing Officer's recommendations, reflected in the Report, are reasonable and appropriate to resolve the issues raised in this proceeding and within the Board's jurisdiction in establishing PWD rates and charges for FY 2024-2025. Exceptions filed by any other participants should be denied.

II. FY 2025 CIP BUDGET

The Hearing Officer recommended that the Board not accept the Public Advocate's proposal to eliminate \$30,188,000 inflation adjustment for PGW's FY 2025 CIP budget. As set forth in the Report:

I recommend that the Rate Board not accept the Public Advocate's proposal to remove the inflation adjustment. PWD's FY 2025 CIP budget is based on FY 2024 dollars, and therefore should be adjusted to reflect additional inflation which is likely to occur

between now and when the final version of the FY 2025 CIP is adopted. The development of a budget for annual Council review is not quite the same as developing a normalized level of revenues and expenses for determining the appropriate revenue to be recovered through rates and charges.¹

The Hearing Officer, in the Report, disregards the primary argument for excluding the inflation escalation, namely: the amount presented as the CIP budget for FY 2025 does not reflect the approved budget amount, but instead represents the best estimate of PWD's 2025 budgeted expenditure. PWD acknowledges this fact.² Indeed, regardless of whether PWD, for ratemaking purposes, now desires to artificially increase what it plans to spend in FY 2025, it remains true that PWD has already determined the best estimate of 2025 CIP spending and it is now equating the estimate to an approved budget amount. The fact is that PWD will be legally obligated to produce its FY 2025 capital budget, just as it was its FY 2024 capital budget. In both instances, PWD must include therewith its ***planned spending*** ("capital expenditures which are planned") over the ensuing six years.³ It is simply incorrect to approve an escalation of the FY 2025 CIP budget, for ratemaking purposes, when those projections are contrary to what PWD actually plans to spend.

Furthermore, while there certainly are differences between budgeting and ratemaking, that does not justify inclusion of a \$30,188,000 inflation escalation for FY 2025's CIP budget. As the Public Advocate noted, PWD's FY 2024 CIP budget, currently pending in City Council, is already escalated to account for what PWD anticipates will be the impact of inflationary forces on its capital spending.⁴ Projecting an **additional 4%** across-the-board increase in expenses, on top of the projection already embedded in the FY 2024 capital budget, is purely speculative. Contrary to the Hearing Officer's conclusion, the Public Advocate submits that such increase is extraordinarily unlikely to occur and constitutes an unreliable basis upon which to project revenue requirements in this proceeding.

For the foregoing reasons, the Public Advocate's adjustment, removing the \$30,188,000 FY 2025 CIP inflation escalation, should be approved by the Board, resulting in the reduction of future bond sizing and debt service expense.

¹ Report at 31.

² May 3, 2023 Tech. Hrg. Tr. at 34.

³ PA Main Brief at 17 (citing Phila. Home Rule Charter §2-303(2)).

⁴ PA Main Brief at 16.

III. CIP BUDGET CARRY FORWARD ADJUSTMENTS

PWD FY 2024 capital spending is subject to City Council appropriations via the capital budget ordinance, Bill No. 230145, which is pending in City Council. PWD’s CIP budget is project-based, “provid[ing] funding for the design and construction of projects with durations of 2 to 5 years.”⁵ As a result, it is clear that total appropriations in one year will not be fully expended in any one budget year. For this reason, the Board should approve the Public Advocate’s carry forward adjustment to PWD’s CIP budgets for FY 2024 and 2025. Notably, the Hearing Officer acknowledges that “some adjustment may have been appropriate,” but finds the Public Advocate’s proposal inadequately supported on the record. The Public Advocate excepts to the Hearing Officer’s recommendation, because the proposed adjustment is appropriate and is adequately supported.

As explained by the Public Advocate, an average derived from prior years was utilized as the basis for proposing the adjustment to the FY 2024 and 2025 CIP budgets.⁶ However, in entering the adjustment, and based on the average size of prior year carry forwards, the Public Advocate’s witnesses utilized the rollforward adjustments already identified by PWD as reasonable proxies for their adjustment. This is a reasonable estimate of the amounts to be carried *forward* because it reflects PWD’s own projections of amounts carried *into* each fiscal year. The necessity of the adjustment is obvious: because PWD will not expend the entire budget amount in the budget year, some amount will necessarily carry forward to subsequent years. However, as shown in PWD Statement No. 7, PWD has not projected ***any amount*** of its FY 2024 and 2025 CIP budgets rolling forward to future years. Instead, PWD shows its CIP budget for those two fiscal years increased by rollforward adjustments from prior years, and assumes, for ratemaking purposes, that FY 2024 and 2025’s CIP budget will be fully spent. This is contrary to PWD’s own statement, namely, that appropriations fund projects with durations of 2 to 5 years.

As submitted by the Public Advocate, failure to recognize that amounts from FY 2024 and 2025 CIP budgets will, in fact, carry forward for expenditure in future years, overstates the necessary revenue requirements, establishing rates as if all appropriations will be spent in each budget year. This assumption is unsupported and contrary to PWD’s historical experience.

⁵ PWD Main Brief at 54.

⁶ PA Main Brief at 18.

Furthermore, although the Hearing Officer recognizes the need to normalize revenues and expenses for ratemaking purposes (quoted above), the omission of the Public Advocate's recommended adjustment fails to implement what is properly considered a normalization adjustment.

The Public Advocate's carry forward adjustments, supported by past PWD actual CIP experience, constitute reasonable proxies for the amount of appropriations left unspent during each of the fiscal years in the rate period. They should be approved so that rates and charges do not reflect borrowing costs and debt service expense which will not be incurred.

IV. EXTRA CAPACITY FACTORS AND COST ALLOCATION

Because PWD has not conducted a formal study of class usage characteristics, the basis for its class cost of service (CCOS) study has been, for many years, a prior capacity factor analysis. According to PWD, this analysis was conducted pursuant to Appendix A of the AWWA M-1 Manual, and based on data from some unidentified period prior to 2012.⁷ As the Public Advocate submitted:

Nowhere in the record does PWD indicate which year of system maximum day demand to system average demand was relied upon to develop the extra capacity factors utilized in PWD's CCOS Study. Therefore, it is impossible to determine if the extra capacity factors utilized in PWD's CCOS Study are reasonable.⁸

As a result, the Public Advocate submits that the Hearing Officer errs in permitting PWD to continue to design rates based on unknown assumptions which fail to correspond to current usage demands.

Implicit in the Hearing Officer's recommendation is that PWD's existing CCOS is based on data that, when assembled, was more reliable *at that time* than the Public Advocate's CCOS study is *today*. As stated in the Report, the Hearing Officer is "hesitant to make a recommendation based on estimated extra capacity factors rather than those developed from actual or current data."⁹ But failing to adopt the Public Advocate's recommendation continues to permit PWD to utilize extra capacity factors without any examination of the data underlying them – which may or may not be "actual" but certainly is not "current." Furthermore, the fact that the Public Advocate's CCOS study, and use of extra capacity factors for which there is

⁷ PA Main Brief at 30.

⁸ PA Main Brief at 34.

⁹ Report at 43.

actual record support, would create some shifting in class cost responsibility is not a justification for maintaining PWD's unsupported rate design.

As set forth in Public Advocate testimony and Main Brief, the Public Advocate's CCOS study, and the extra capacity factors it utilizes, employ the same methodology supposedly used by PWD – Appendix A to the AWWA M-1 Manual.¹⁰ Neither PWD nor PLUG contest the methodology the Public Advocate employed, which uses actual PWD data from FY 2019 (capturing unique characteristics of PWD's service territory). Nonetheless, PWD and PLUG oppose the changes, preferring to maintain the unsupported status quo that disadvantages residential and small user customers to the benefit of large industrial users.

The Public Advocate submits that it is erroneous to maintain in place capacity factors that are untested and unsupported. The fact that they have been in place for many years does not support their continuation. Furthermore, it should be noted that, as the proponent for rate relief in this proceeding, it is PWD's burden to prove each element of its request, including its proposed rate design, is just and reasonable. It has not done so, and the Public Advocate has instead performed a CCOS study to produce rates that are just and reasonable, supported by substantial evidence, methodologically consistent with the AWWA M-1 Manual, and fully defensible in this proceeding.

For these reasons, the Board should approve the extra capacity factors recommended by the Public Advocate and likewise implement its revenue allocation methodology which is consistent with principles of gradualism and establishes an appropriate rate design for all customer classes. PWD should nonetheless be required to conduct a formal study of its class usage characteristics prior to filing its next rate proceeding. Should adjustments to the rate design be necessary based on the data PWD attains in that formal study, they can be considered in such future rate proceeding.

V. LIEN FEES ASSOCIATED WITH PRE-TAP DEBT

The Public Advocate excepts to the Hearing Officer's recommendation to reject its proposed O&M adjustment associated with the City's practice of filing liens to secure pre-TAP indebtedness subject to forgiveness. Although the Public Advocate does not challenge the

¹⁰ Notably, the Hearing Officer rejects the Public Advocate's proposal to assign average day usage volumes to Public Fire as *inconsistent* with the AWWA M-1 Manual, yet fails to require extra capacity factors that are *consistent* with the AWWA M-1 Manual.

Hearing Officer's conclusion that the Board cannot require PWD to implement "lien blockers" or to alter lien policies, that is beside the point.¹¹

The authority to determine the legitimacy or appropriateness of O&M expenses included in PWD's cost of service is inherent in the Board's ratemaking power.¹² Accordingly, although the Hearing Officer acknowledges that PWD incurs expenses in filing the liens, the mere fact that the expense may occur does not justify its inclusion in rates and charges. Moreover, it is important to recognize that the adjustments proposed by the Public Advocate are for rates and charges to take effect in September 2023 and September 2024. PWD has not incurred any expenses associated with the potential filing of liens to secure pre-TAP indebtedness in the future and can easily avoid such expenses going forward.

It should be noted that the City's filing of liens to secure pre-TAP indebtedness is entirely voluntary activity and is not dictated by either the Municipal Claims and Tax Liens Act (MCTLA) or the First Judicial District of Pennsylvania. Additionally, the timing for the City to file liens for unpaid water bills and charges, if it chooses to do so, is very generous. Such liens may be timely filed "on or before the last day of the third calendar year after the date they first become payable."¹³ Furthermore, even if the City does not file within the statutory period provided by the MCTLA, and "loses" the lien, MCTLA broadly permits the City to revive a lost lien at any time, provided that such lien cannot reattach to property transferred to a purchaser or take priority over a subsequent mortgage or other lien.¹⁴

Based on the foregoing, it is unnecessary and unreasonable for PWD customers to pay the cost of filing liens to secure debt subject to forgiveness under TAP. Because TAP provides for a 2-year forgiveness period, the City's ability to file its liens would extend beyond the forgiveness period, enabling PWD to file in the event the customer ceased to participate in TAP. As a result, PWD faces no significant risk to the ultimate recovery of unpaid water bills, if they are not forgiven through the TAP program. However, by authorizing PWD's rates to include future lien fees for pre-TAP debts, the Board will unnecessarily pass on to PWD's non-TAP

¹¹ The Hearing Officer notes that "PWD presented no reason why it could not do so, and thus avoid the placing of liens on TAP arrearages that are subject to earned forgiveness." Report at 64-65.

¹² Dauphin Consol. Water Supply Co. v. Pa. PUC, 55 Pa. Cmwlt. 624, 635, 423 A.2d 1357, 1362 (1980) ("Inherent in the Commission's power to establish just and reasonable rates is the authority to determine the legitimacy of operating expenses reported by the utility.").

¹³ See, e.g., Pennsylvania Real Estate Tax Sales and Municipal Claims (4th Ed, 2020), at §7.42.

¹⁴ See Id., at §7.62.

customers \$1,130,000 in higher rates and charges that provide no value to customers or the enterprise.

The Board should approve the Public Advocate's adjustment, finding that it is inappropriate to include lien fees associated with pre-TAP arrears in PWD's cost of service. PWD can make the decision whether, in operation, to cease filing such liens, but it should be properly incentivized to do so.

VI. CONCLUSION

The Public Advocate respectfully submits that the Board should grant the exceptions identified herein, reject any exceptions submitted by other participants, and thereby ensure just and reasonable rates for the Small User Customers.