

**Before the  
Philadelphia Water Commissioner**

In the Matter of the Philadelphia Water       :  
Department's Proposed Increase in       :  
Rates for Water and Wastewater       :               FY 2009-2012  
Utility Services, Phase I               :

Recommended Decision  
(Phase I)  
Hearing Officer Harris T. Bock, Esq.

Date: October 7, 2008

## TABLE OF CONTENTS

<u>Section</u>	<u>Page</u>
INTRODUCTORY STATEMENT	1
I. HISTORY OF THE PROCEEDINGS	3
II. LEGAL, STATUTORY, AND BOND COVENANT REQUIREMENTS FOR WATER DEPARTMENT RATES AND CHARGES	7
III. FINDINGS OF FACT	9
A. Statement of the Proceedings	9
B. Description of the Rate Increase	14
C. Purpose of Proposed Rate Relief	15
D. Rate Covenants	15
E. Rate Relief Needed to Fulfill Rate Covenants and Maintain Credit Rating	16
F. Rate Relief Needed to Continue Quality Utility Service	17
G. Length of Rate Period	19
H. Rate Relief for FY2009	27
I. Rate Relief for FY2010	30
J. Excess Interest Earnings (a.k.a. “scoop payment”)	33
K. Water Revenue Bureau	34
L. Philadelphia Housing Authority Discount	36
M. Philadelphia Large Users Group (“PLUG”) Settlement	37
N. Cost Allocation and Rate Design	38
O. Other Relief Requested by CCC	40

IV.	DISCUSSION	42
A.	Description of Utilities	42
B.	Philadelphia Water Department Management	44
C.	Water Revenue Bureau	44
D.	Present State of the Economy	46
	1. Unemployment	46
	2. Housing Crisis	46
	3. Poverty	47
	4. Bankruptcy Proceedings	47
	5. Price of Gasoline	47
	6. Inflation	48
	7. Consumer Price Index	48
	8. Cost of Living Adjustments	48
	9. City of Philadelphia Economic Woes	48
	10. Ability to Pay	49
E.	Basis for Establishment of Rates	51
F.	Rates Must be Reasonable	52
G.	Hearing Officer's Proposal to Recommend Rates for FY2009 and FY2010 and Presently Suspend the Determination of Rates for FY2011 and FY2012	54
H.	Rate Stabilization Fund	57
V.	CONCLUSIONS OF LAW	58
	ORDER	60

## **INTRODUCTORY STATEMENT:**

While there is a keen allure for a Hearing Officer to travel on the reliable trail that others have proceeded heretofore, this Hearing Officer opines that blind adherence to “what was done before” fails to discharge the weighty responsibility that has been bestowed upon him by the Mayor of the City of Philadelphia, the President of City Council, and the City Controller, as well as the Philadelphia Water Department’s own regulations.

As the Hearing Officer observed during the course of the technical hearings (N.T. 509:10-21), he does not view his role to be a mere umpire vested solely with the job of ruling on “vanilla-type” procedural and evidentiary issues. Rather, he construes his obligation to the citizenry of Philadelphia to scour the record before him and utilize his expertise to recommend rate relief that ensures that the Department is given the revenue needed, and no more, to continue its past excellence in the delivery of water of the highest quality, and to comply with legal, statutory, and bond covenant requirements. The entire rate plan of the Department, including all of its components that it has proposed to meet its formidable responsibilities, is before the Hearing Officer for his consideration. His recommended decision follows a balancing test of Quixotic magnitude between the needs of the utility and constitutionally permissible rates to be borne by the ratepayer.

The factual justification for the Hearing Officer’s aggressive intervention in questioning of witnesses and *sua sponte* formulating a rate plan proposal is that unlike the economic climate existing when Commissioner Kichinchand made his rate determination in 2001, and unlike the economic climate existing when Commissioner Brunwasser made his rate determination in 2005, the economic crisis that currently exists is truly of historic magnitude. While the Department has made numerous references to the uncertainty of the financial markets, such uncertainty is only

one outgrowth of the severe financial stranglehold that currently grips the country, and more particularly the citizens of the City of Philadelphia, at the time of the authoring of this Report. The severe economic malaise<sup>1</sup> that is currently being visited upon the majority of ratepayers in the City of Philadelphia is unparalleled in recent history with dire financial records being broken daily.<sup>2</sup> Notwithstanding the Philadelphia Water Department's position that the ability to pay is not an issue before the Hearing Officer (N.T. 189:20, J. Clare), it is. While whether a specific individual ratepayer has the ability to satisfy a current bill may not be relevant, the Philadelphia Water Department must conduct its operations consistent with the current economic climate and not in a vacuum. When economic conditions are "flush," the Department may operate consistent with such conditions. However, in times of economic crisis, which unequivocally currently exist, the Department must recognize the realities and impact of such crisis on its ratepayers and proceed "accordingly," just as the City of Philadelphia is proceeding "accordingly" as demonstrated by its recent announcement of budget cuts and layoffs.<sup>3</sup>

Automatic allowance of the past practice of a four year rate period with rates set at the beginning of the rate period assumes that the projections which are the foundations of such requested increases over such period are always accurate, and does not give credence to the current economic crisis and its concomitant uncertainty. The "smoking gun" on this record is proof of a variance of over 140 million dollars with respect to the FY2008 balance of the Rate

---

<sup>1</sup> Philadelphia remains the ninth poorest big city in the United States, with nearly one in four people living in poverty. (*Philadelphia Inquirer*, 8/27/08).

<sup>2</sup> On September 29, 2008, the Dow Jones Industrial Average lost 778 points. This was the highest one day point loss for the Dow in history. On October 3, 2008, an historic bank bailout of \$700 billion was adopted by Congress and signed into law by the President.

<sup>3</sup> On September 11, 2008, Mayor Nutter announced at a news conference that there is a \$450 million gap between the City's five-year spending plan and economic reality. Consequently, future tax cuts are in jeopardy, and as city departments are asked to trim their budgets, layoffs are not out of the question. (*Philadelphia Inquirer*, 9/12/08).

Stabilization Fund.<sup>4</sup> This “variance” along with other factors that were unknown at the time of the last filing and transpired late in the four year rate period (i.e. the decision to delay the issuance of bonds from FY2008 to FY2009) resulted in the ratepayers being “on the hook” for tens of millions of dollars more than was necessary to responsibly operate the utility during the last rate period. When this “track record” is considered *in pari materia* with the dire economic times that the citizens of the City of Philadelphia are experiencing, the Hearing Officer is obligated to begin his journey anew for just and reasonable constitutionally permissible rates without accepting in Pavlovian fashion rate plans approved in the past under markedly different facts and dramatically different circumstances.

## **I. HISTORY OF THE PROCEEDING**

On April 4, 2008, the Philadelphia Water Department (“PWD” or “Department”) initiated this rate proceeding pursuant to Sections 8-407 and 5-801 of the Philadelphia Home Rule Charter and Sections 13-101 and 13-201 of the Philadelphia Code. On May 5, 2008, the Department filed its rate request with the Department of Records of the City of Philadelphia. The filing requested the implementation of new rates, to become effective July 1, 2008, in the following service categories:

- 300.0 Rates and Charges Definitions
- 301.0 Process for Setting Water, Sewer and Stormwater Management Service Rates
- 302.0 Water Charges
- 303.0 Sewer Charges
- 304.0 Stormwater Management Service Charges
- 305.0 Billing for Water, Sewer and Stormwater

---

<sup>4</sup> Projections submitted in the FY2005-2008 rate case estimated the FY2008 year end balance to be \$13.5 million. In fact, the actual balance is estimated to approximate \$160.3 million.

## Management Service

- 306.0 Miscellaneous Water Charges
- 307.0 Miscellaneous Sewer Charges
- 308.0 Miscellaneous Stormwater Management Charges
- 309.0 Fire Service Connections.

In May 2008, pursuant to Philadelphia Water Department Regulations 300.3(a), the City of Philadelphia's Mayor, President of City Council, and City Controller appointed the Hearing Officer, Harris T. Bock, Esq. The same troika appointed Community Legal Services as the Public Advocate for the general rate proceeding, pursuant to Philadelphia Water Department Regulations 300.5(a).

Hearing Officer Order No. 1, dated May 27, 2008, set a Pre-Hearing Conference, which was held on June 6, 2008. At the duly advertised conference, the following parties entered their appearances: Andre C. Dasent, Esquire on behalf of the Philadelphia Water Department; Philip A. Bertocci, Esquire and Thu Tran, Esquire from Community Legal Services as the Public Advocate; and Charis Mincavage, Esquire and Shelby A. Linton-Keddie, Esquire on behalf of Philadelphia Large Users Group ("PLUG"). Subsequently, Daniel P. Delaney, Esquire entered his appearance on behalf of the Commercial Customer Consortium ("CCC" or "Consortium"), and later in the proceedings, Philip L. Hinerman, Esquire and Jill A. Guldin, Esquire entered their appearances on behalf of Philadelphia Housing Authority ("PHA"). Brian Glass, Esquire entered his appearance on behalf of Next Great City Stormwater Subcommittee<sup>5</sup>.

At the Pre-Hearing Conference, the parties agreed that the first phase of these proceedings would be limited to the Department's proposed rate changes for water and wastewater services. The second phase of these proceedings, which will commence promptly

---

<sup>5</sup> Next Great City Stormwater Subcommittee did not participate in this phase of the proceedings.

upon completion of Phase I, will address the rate design for stormwater collection/disposal services. At such Pre-Hearing Conference, the parties agreed to a tentative schedule for the Public Input and Technical Hearings, as well as a briefing schedule, all of which was memorialized in Hearing Officer Order No. 2 dated June 9, 2008.

The times and locations for the Public Input Hearings were finalized pursuant to Hearing Officer Order No. 3 dated June 12, 2008, and were duly advertised and held as follows:

1. North Philadelphia: July 21, 2008 (6:00 p.m. to 8:00 p.m.) YMCA – 1400 N. Broad Street, Philadelphia, PA 19121
2. NW Philadelphia: July 22, 2008 (6:00 p.m. to 8:00 p.m.) Roxborough Memorial Hospital – 5800 Ridge Avenue, Philadelphia, PA 19128
3. West Philadelphia: July 24, 2008 (6:30 p.m. to 8:30 p.m.) YMCA – 5120 Chestnut Street, Philadelphia, PA 19139
4. South Philadelphia: July 25, 2008 (10:00 a.m. to 12:00 p.m.) JNA Institute of Culinary Arts – 1212 South Broad Street, Philadelphia, PA 19146
5. NE Philadelphia: July 31, 2008 (6:00 p.m. to 8:00 p.m.) Holy Family College, Campus Center Conference Room 115, 9801 Frankford Avenue, Philadelphia, PA 19114

At the hearings, numerous Philadelphia residents, many of whom were dependent solely on social security, testified regarding the draconian impact of the proposed increased rates upon their already overstretched and fixed budgets. In addition, several Water Department customers recounted serious and troubling problems involving their interaction with the Philadelphia Water

Revenue Bureau.<sup>6</sup> The five Public Input Hearings generated combined transcripts totaling 370 pages.

Pursuant to Hearing Officer Order No. 9 dated August 1, 2008, a Technical Pre-Hearing Conference was conducted on August 11, 2008 to assure the orderly receipt of testimony at the technical hearings. The Technical Hearings, which were duly advertised pursuant to Philadelphia Water Department Regulations 300.6(b)(4), were conducted at the Philadelphia Gas Commission's hearing room located at 1515 Arch Street, 18<sup>th</sup> Floor, on August 12, 13, and 14. The Technical Hearings generated a 906 page Transcript. Such transcript, in addition to the Statements and Exhibits admitted into evidence, comprise the voluminous record of this proceeding, which is estimated at over 12,000 pages. In order to better understand the workings of the Department, the Hearing Officer requested and was provided a tour, together with the Public Advocate, on September 12, 2008, of portions of the Department's operations. The Hearing Officer found the tour extremely informative respecting his understanding of the complexity of the utility and the talent of its senior management, Deputy Commissioner Clare and Deputy Commissioner McCarty, who have stellar reputations in their respective financial and operating fields.

In accordance with Hearing Officer Order No. 14, the Parties submitted Initial Briefs on September 9, 2008, and Reply Briefs on September 19, 2008, and on September 24, 2008, Oral Argument was conducted at City of Philadelphia City Hall, Courtroom 696. This Recommended Decision follows.

---

<sup>6</sup> This testimony resulted in the Public Advocate's and Hearing Officer's focus on the quality of service provided by the Water Revenue Bureau. Although a part of the Revenue Department, the PWD regulations require that the Water Revenue Bureau be *de facto* part of the Water Department (300.2(m)) for purposes of the rate proceeding. Consequently, the Hearing Officer, at the behest of the Public Advocate, required the Water Department to provide an update on the status of these customers' complaints and focus on the service provided by the Water Revenue Bureau as an integral part of the Department's case. This resulted in testimony at the technical hearings by Revenue Commissioner Keith Richardson in direct response to the concerns voiced by the ratepayers, the Public Advocate, and the Hearing Officer.

## **II. LEGAL, STATUTORY, AND BOND COVENANT REQUIREMENTS FOR WATER DEPARTMENT RATES AND CHARGES**

Section 5-800 of the Charter conveys authority to the Department to operate the water and wastewater utilities. In addition, the Charter authorizes the Department to fix and regulate rates and charges for utility services. Specifically, Section 5-801 requires the Department to set rates that will yield annually amounts sufficient to cover its operating expenses and debt service, in accordance with standards City Council ordains. The Charter provides as follows:

**Rates and Charges.** In accordance with the standards as the Council may from time to time ordain, the Water Department shall fix and regulate rates and charges for supplying water, including charges to be made in connection with water meters, and for supplying sewage disposal services. The standards pursuant to which rates and charges shall be fixed by the Department shall be such as to yield to the City at least an amount equal to operating expenses and interest and sinking fund charges on any debt incurred or about to be incurred for water supply, sewage, and sewage disposal purposes. In computing operating expenses, there shall be included proportionate charges for all services performed for the Department by all officers, departments, boards or commissions of the City.

Section 5-801. The City Council standards referenced above are set forth in the Philadelphia Code, Sections 13-101 and 13-201. Section 13-101(2) of the Code specifically states the following as to the determination of water rates:

**Standards for Rates and Charges.** Pursuant to Section 5-801 of the Charter, the Water Department shall fix and regulate rates and charges for supplying water, without further authorization of Council, in accordance with the following standards:

(a) The rates and charges shall be such as yield to the City at least an amount equal to operating expenses, including interest and sinking fund charges on all obligations of the City in respect of the water system and, in respect of water and sewer revenue obligations of the City, such additional amounts as, together with additional amounts charged in respect of the City's sewer system, shall be required to comply with any rate covenant and sinking fund reserve requirements approved by ordinance of Council in

connection with the authorization or issuance of water and sewer revenue bonds, and proportionate charges for all services performed for the Water Department by all officers, departments, boards or commissions of the City.

(b) The rates and charges shall yield not more than the total appropriation from the Water Fund to the Water Department and to all other departments, boards or commissions, plus a reasonable sum to cover unforeseeable or unusual expenses, reasonable anticipated cost increases or diminutions in expected revenue, less the cost of supplying water to City facilities and fire systems and, in addition, such amounts as, together with additional amounts charged in respect to the City's sewer system, shall be required to comply with any rate covenant and sinking fund reserve requirements approved by ordinance of council in connection with the authorization or issuance of water and sewer revenue bonds. Such rates and charges may provide for sufficient revenue to stabilize them over a reasonable number of years.

(c) The rates and charges shall be equitably apportioned among the various classes of consumers.

(d) The rates and charges shall be just, reasonable and nondiscriminatory as to the same class of consumers.

(e) Special rates and charges, to be designated as "charity water rates and charges," shall be established for public and private schools, institutions of purely public charity, and places used for actual religious worship.

(f) Special rates and charges to be designated as "public housing water rates and charges" shall be established for property of the Philadelphia Housing Authority and shall be set so that Philadelphia Housing Authority receives a five percent (5%) reduction off of the Water Department's service and quantity charges.

The City Council standards applicable to wastewater rates (Section 13-201) parallel those set forth above and require that the Department fix and regulate rates so as to yield sufficient revenues over a reasonable period of years to pay its operating expenses, including interest and sinking fund charges approved by Ordinance in connection with the issuance of bonds, meet its obligations to investors and pay proportionate charges for all services performed for the

Department by all officers, departments, boards or commissions of the City.

The Department must collect sufficient revenues to meet its rate covenants, including that prescribed by the General Ordinance<sup>7</sup> which requires, *inter alia*, that the Department's annual net revenues be at least 120 percent of its senior debt service. The Department must also comply with additional rate covenant requirements with respect to the payment of deposits in various accounts and debt service, as prescribed by the General Ordinance, as well as rate covenants that are not set by City Council. The Department must establish rates and charges sufficient to yield net revenues (excluding amounts transferred from the Rate Stabilization Fund to the Revenue Account) at least equal to 90 percent of the Department's senior debt service requirements ("FGIC/FSA Covenant"). The Department must meet certain other requirements outside its discretion, including, *inter alia*, the amounts required to be deposited in the Debt Reserve Account during such fiscal year, and the deposits into the Capital Fund Deposit Account.

The foregoing governing legal, statutory, and bond covenant requirements, along with the constitutional mandate that rates must be just and reasonable, form the framework for consideration of the proposed rate relief requested by the Department.

### **III. FINDINGS OF FACT**

#### **A. Statement of the Proceedings**

1. On April 4, 2008, the Philadelphia Water Department ("Department") notified Philadelphia City Council of its intent to file proposed changes in rates for water and wastewater service to become effective July 1, 2008, or as soon thereafter as procedural requirements permit the enactment of new rates by regulation.

---

<sup>7</sup> General Water and Wastewater Revenue Bond Ordinance of 1989 (Ordinance of City Council, approved June 24, 1993 – Bill No. 544).

2. On May 5, 2008, pursuant to Sections 8-407 and 5-801 of the Philadelphia Home Rule Charter (“Charter”), the Department filed with the Department of Records the following proposed regulations promulgated in connection with the above proceeding to implement new rates:

- 300.0 Rates and Charges Definitions
- 301.0 Process for Setting Water, Sewer and Stormwater Management Service Rates
- 302.0 Water Charges
- 303.0 Sewer Charges
- 304.0 Stormwater Management Service Charges
- 305.0 Billing for Water, Sewer and Stormwater Management Service
- 306.0 Miscellaneous Water Charges
- 307.0 Miscellaneous Sewer Charges
- 308.0 Miscellaneous Stormwater Management Charges
- 309.0 Fire Service Connections

3. In support of this filing, the Department also submitted (A) pertinent engineering, financial and rate data, as developed in conjunction with the consulting firm of Black & Veatch Corporation (“Black & Veatch”); and (B) the prepared testimony, exhibits and supporting documentation of both the Department and Black & Veatch in connection with the rate filing.

4. In May 2008, in accordance with Philadelphia Water Department Regulations 300.3(a), Mayor Michael A. Nutter, City Council President Anna C. Verna and City Controller Alan L. Butkovitz appointed Harris T. Bock, Esquire to preside over the rate hearings and prepare a report to the Commissioner summarizing the record and his recommendations.

Concurrently, Community Legal Services was also appointed to serve as Public Advocate in the rate hearings in compliance with Philadelphia Water Department Regulations 300.5(a).

5. The Philadelphia Water Department duly advertised the filing of the proposed regulations and the administrative process, pursuant to Philadelphia Water Department Regulations 300.6(b)(3).

6. Pursuant to Hearing Officer Order No. 1 dated May 27, 2008, a Pre-Hearing Conference was held on June 6, 2008. At the conference, the following parties entered their appearances: Andre C. Dasent, Esquire on behalf of the Philadelphia Water Department; Philip A. Bertocci, Esquire and Thu Tran, Esquire from Community Legal Services as the Public Advocate; and Charis Mincavage, Esquire and Shelby A. Linton-Keddie, Esquire on behalf of Philadelphia Large Users Group (“PLUG”).

7. Subsequently, Daniel P. Delaney, Esquire entered his appearance on behalf of the Commercial Customer Consortium (“CCC” or “Consortium”), and Philip L. Hinerman, Esquire and Jill A. Guldin, Esquire entered their appearances on behalf of Philadelphia Housing Authority (“PHA”).

8. Brian Glass, Esquire entered his appearance on behalf of Next Great City Stormwater Subcommittee, but did not participate in this phase of the proceeding.

9. The Water Department, in compliance with Philadelphia Water Department Regulations 300.6(b)(4), advertised the public input hearings, which were held at the locations and on the dates specified below:

- a. North Philadelphia: July 21, 2008 YMCA – 1400 N. Broad Street,  
Philadelphia, PA 19121

- b. NW Philadelphia: July 22, 2008 Roxborough Memorial Hospital – 5800 Ridge Avenue, Philadelphia, PA 19128
- c. West Philadelphia: July 24, 2008 YMCA – 5120 Chestnut Street, Philadelphia, PA 19139
- d. South Philadelphia: July 25, 2008 JNA Institute of Culinary Arts – 1212 South Broad Street, Philadelphia, PA 19146
- e. NE Philadelphia: July 31, 2008 Holy Family College, Campus Center Conference Room 115, 9801 Frankford Avenue, Philadelphia, PA 19114

10. A transcript of some 370 pages was accumulated at the public input hearings, wherein testimony was received from approximately forty public witnesses.

11. The Department exceeded the applicable regulations and is to be complimented for utilizing its best efforts and going “beyond the call of duty” in attempting to attract ratepayers to the public hearings. Notwithstanding such good faith attempt by the Department to bring out the citizenry, the total turnout of the public at all five Public Input Hearings was disappointing. (N.T. 372:8-375:10)

12. The Hearing Officer finds that public participation is an extremely important part of the rate hearing process and that such importance also finds support in the Philadelphia Water Department regulations.

13. The Hearing Officer therefore recommends that the Department engage an outside vendor to produce more public participation in future rate filings. “Saddling” the Department with this responsibility places an unfair burden on them in an area outside their financial and operating expertise.

14. The Hearing Officer conducted a Pre-Hearing (Technical) Conference at The

Dispute Resolution Institute, 660 Two Logan Square, Philadelphia, Pennsylvania 19103, on August 11, 2008 to set a witness schedule and guarantee that all expert witnesses were given the opportunity to be heard and be subject to cross-examination.

15. In accordance with Philadelphia Water Department Regulations 300.6(b)(4), the Water Department advertised the technical hearings, which were held at the Philadelphia Gas Commission Hearing Room, 1515 Arch Street, 18<sup>th</sup> Floor, Philadelphia, PA 19107: August 12, 2008; August 13, 2008, and August 14, 2008.

16. At the technical hearings, testimony was offered from the following witnesses:

- a. *Philadelphia Water Department witnesses:* Deputy Commissioner Joseph S. Clare, III, J. Rowe McKinley, Deputy Commissioner Debra S. McCarty, Anthony M. Griffith, James Palladino, and Philadelphia Revenue Department Commissioner Keith Richardson
- b. *Public Advocate witnesses:* Jerome D. Mierzwa, Michael A. Bleiweis, and Roger D. Colton
- c. *CCC witnesses:* Robert Rossi, Floyd Ruppel, Jr., Larry G. Spielvogel, and Dennis M. Kalbarczyk

17. Following the technical hearings and in order to ensure a complete record and confirm or modify the briefing schedule, the Hearing Officer conducted a Post-Hearing (Technical) Conference at The Dispute Resolution Institute, 660 Two Logan Square, Philadelphia, Pennsylvania 19103 on August 25, 2008. (Hearing Officer Order No. 12).

18. In accordance with Hearing Officer Order No. 14, the Parties submitted Initial Briefs on September 9, 2008, and Reply Briefs on September 19, 2008.

19. On September 24, 2008, Oral Argument was conducted at City Hall, Courtroom

696.

20. A transcript of some 906 pages was accumulated for the pre-hearing (technical) conference, the three technical hearings, the post-hearing (technical conference), and oral argument.

**B. Description of Rate Increase**

21. The initial filing of the Department requested a rate increase designed to meet its projected revenue shortfall of some \$316.9 Million over the period FY 2009-2012 (“Rate Period”).

22. In order to raise this level of revenue, the Department proposed average annual increases of 6.4% in each year of the Rate Period. (PWD Statement 5 (Exhibit JRM-1 – Table 11)).

23. In its Initial Brief at page 29, the Department unilaterally submitted the following adjustments to the rate filing:

- a. *Rate Compression* – A \$15 million reduction to proposed revenues due to the delay in implementing the new rates.
- b. *Personnel Costs* – A \$1 million downward adjustment to revenue requirements due to the implementation of a \$1,100 bonus, rather than a \$1,500 bonus as budgeted.
- c. *Indemnities* – A \$2 million reduction from the amount of the expense initially requested to be spread over the four-year rate period.

24. In its Reply Brief, the Department unilaterally submitted a further reduction of its rate request in the nature of a \$3.2 million downward adjustment related to final FY2009 budgeted expenditures that was to be spread over the four-year rate period. (PWD Reply Brief, 5).

25. Accordingly, the net requested rate relief submitted to the Hearing Officer for his consideration for FY2009-FY2012 is \$295.7 million.

**C. Purpose of Proposal for Rate Relief**

26. The purpose of the rate increase is to fully fund operating and maintenance costs for the water, wastewater and stormwater portions of the utility and to ensure compliance with the Department's bond covenants.

27. The Department contends, and the Hearing Officer agrees, that existing rates are inadequate to comply with the aforesaid Charter, Philadelphia Code and bond covenant requirements (prescribing that the Department impose, charge and collect sufficient revenues to pay annual operating expenses, debt service and fulfill bond covenants).

28. The Hearing Officer finds that the Department needs rate relief to cover: (a) personal services (salaries and benefits); (b) purchase of services (contractual services for such needs as natural gas, electricity, telephone, biosolids hauling, maintenance contracts, enhanced security and professional consultants); (c) materials, supplies and equipment (costs for chemicals, heating oil and sophisticated laboratory equipment). Additional expenses include the payments for indemnities for legal claims against the Department and payments to the City's General Fund for such services rendered as procurement, auditing, fleet management, personnel, treasury, and central finance. (PWD Statement 1 at 2).

**D. Rate Covenants**

29. The Department must generate and the Hearing Officer must allow sufficient revenues to allow the Department to comply with its bond and bond insurance covenants.

30. The Department's principal covenants are set forth in and required by the 1989 General Ordinance and the FGIC/FSA Covenant entered into in connection with the issuance of

Series 1993 Bonds.

31. The rate covenant contained in the 1989 General Ordinance requires the Department to establish rates sufficient to yield Net Revenues in each fiscal year (after payment of operating expenses) at least equal to 1.20 times the Debt Service Requirements for such fiscal year (both as defined in the General Ordinance). In addition, net revenues in each fiscal year must be at least equal to 1.00 times (i) Debt Service Requirements for such fiscal year; (ii) amounts required to be deposited in the Debt Reserve Account during such fiscal year; (iii) principal or redemption price of and interest on General Obligation Bonds issued by the Department and payable in such fiscal year; (iv) debt service requirements on interim debt payable in such fiscal year; and (v) the Capital Fund Deposit Amount for such fiscal year, less amounts transferred from the Residual Fund to the Capital Account during such fiscal year. PWD Statement 5 at 8; PWD Exhibit 7 (SI-8 – PWD Official Statement, 2007A and 2007B Bonds at 14).

32. The Department is required by the Fiscal Agent, for the benefit of Financial Guaranty Insurance Company (“FGIC”), to establish rates and charges for the use of the water and wastewater systems sufficient to yield Net Revenue (excluding amounts transferred from the Rate Stabilization Fund into the Revenue Fund during, or as of the end of such fiscal year) at least equal to 90 percent of the Debt Service Requirements (excluding Debt Service due on any Subordinated Bonds) in such fiscal year for so long as the Series 1993 Bonds insured by FGIC and Series 2003 Bonds insured by FSA are outstanding. (PWD Statement 5 at 9).

**E. Rate Relief Needed to Fulfill Rate Covenants and Maintain Credit Rating**

33. Rates must be sufficient for the Department to meet its rate covenants with investors, and is a condition precedent to maintaining its favorable credit rating and funding its

capital program. Technical compliance with rate covenants is essential to maintain the Department's current favorable bond ratings. Current ratings are "A-" by Fitch IBCA; "A" by Standard & Poor's; and "A3" by Moody's. (PWD Statement 1 at 6; PWD Exhibit 35).

34. The Department and its Deputy Commissioner of Finance and Administration must be complimented for the excellent financial standing it enjoys in the investment community. Its credit rating is superior to the City of Philadelphia, and subsequent to the filing of this rate case, the Department was upgraded in August 2008 by Standard & Poor's Rating Services from "A-" to "A" rating. (PWD Exhibit 35).

35. The Department contends, and the Hearing Officer agrees, that these ratings are important because the Department plans to access the capital markets during the Rate Period to fund necessary capital improvements to the water and wastewater systems.

36. However, the importance of these ratings is tempered by the fact that, as disclosed at the technical hearings (N.T. 348:20-349:11, Griffith), in 2007 the Department actually presold one-half of the bonds it intends to now issue in FY2009 by doing a forward swap for a transaction set to occur in February 2009, and locked in the rate at 4.81% for approximately \$175 million of the bonds or one-half of the total proposed issuance.<sup>8</sup>

#### **F. Rate Relief Needed to Continue Quality Utility Service**

37. The Hearing Officer agrees that the Department must employ a program of renewal and replacement of existing infrastructure, and employ capital funds to pay many of the costs associated with escalating environmental regulations. (PWD Statement 2 at 7).

---

<sup>8</sup> It is pertinent to note that in the last rate case these bonds were projected to be issued in FY2008 and revenues were allowed in the rate plan to service such debt. Since these bonds were not issued, it resulted in the Department collecting \$22 million in rates to service debt that was not incurred. While the bond issuance projection was undoubtedly made in good faith, nevertheless it proved faulty and resulted in the Department collecting rates which do not meet constitutional muster. While such excess revenue that was collected to service debt that was never issued will inure to the benefit of ratepayers by decreasing the amount of rate relief required in this proceeding, it demonstrates the frailty of four year predictions and the danger of basing rates on costs which are neither known nor measurable, or, as was the case with the bonds, not incurred.

38. The Department is committed to producing and delivering drinking water of the highest quality to Philadelphia, as it has in the past (*Id.* at 3-5). The Department is to be commended for continuously satisfying such lofty goal that is too often taken for granted by its customers.

39. The Hearing Officer finds that the Department, and more particularly its senior management, deserves praise for the top notch operation of this extremely complex utility, as demonstrated by the many awards it has received and high ranking it has achieved for the quality of the water produced, as well as their adroit handling of fiscal affairs, which ultimately benefits the ratepayers.

40. The key objectives and strategies for accomplishing the Department's water quality and supply goals include: (a) compliance with all drinking water standards in the reauthorized Safe Drinking Water Act and achieve the Department's more rigorous performance standards; (b) strengthen the Department's role in protecting the region's source water; (c) optimize quality and reliability of treatment procedures; (d) implement best management practices in the distribution system to assure water quality and reliability of supply; and (e) employ advanced monitoring and analysis capabilities to support the Department's water quality objectives. (*Id.* at 3).

41. The Hearing Officer finds that the Department cannot continue the above efforts and meet the high standards it has set for itself without additional revenues to fund the increasing costs of operations.

42. The Hearing Officer finds that rate relief must be approved to permit the Department to fully pursue and fulfill its responsibilities to the City of Philadelphia, its citizenry, and the suburban municipalities which rely on the Department to provide what all parties agree is

a human essential: water.

**G. Length of Rate Period**

43. The proposed rate plan of the Department is a rate increase over a four year rate period with equal percentage increases each year of 6.4%. (PWD St. – 5 (Ex. JRM-1, Table 11)).

44. The Public Advocate has recommended a one year, or at most, a two year rate period. (PA Initial Brief, 67).

45. In considering the length of the rate period urged by the parties, the Hearing Officer must and does take administrative notice<sup>9</sup> of the distressed economic climate that currently exists and concludes that such climate must be taken into consideration in this rate proceeding, especially with regard to the timing of the setting of rates.

46. In recommending a rate period, the Hearing Officer is mindful of the unequivocal axiom that the longer the rate period for a multi test year case as the Department has proposed, the more the rates are set on projection and the less they are set on known and measurable costs.

47. The Hearing Officer cannot be blind to the distressed economic conditions which were not present and could not have been considered at the time the Department prepared its current filing, and which have the propensity to play havoc with good faith projections, including, *inter alia*:

- a. The housing crisis and resulting market “collapse”
- b. Foreclosures at record rates
- c. Record unemployment
- d. Bankruptcies at levels not seen in decades
- e. A widespread credit crisis

---

<sup>9</sup> The Hearing Officer is functioning in a quasi-judicial role pursuant to Philadelphia Water Department Regulations 300.3(c), and avails himself of Pennsylvania Rules of Evidence Rule 201 to take judicial/administrative notice of facts not subject to reasonable dispute.

- f. Stock market gyrations of extraordinary magnitude
- g. Recession-like state of the economy in general

48. Our current economic condition constitutes uncharted waters, and the fiscal storms and swells they may produce during the last two years of the proposed rate period mandate and compel the Hearing Officer to unequivocally conclude that setting rates for FY2011 and FY2012 at this juncture would not be prudent.

49. The Hearing Officer is justifiably fearful, based on the entire record before him, that setting rates now for FY2011 and FY2012 has the distinct probability of producing:  
(a) rates that in hindsight are constitutionally impermissible and an unfair burden on ratepayers, as happened in the last case<sup>10</sup>, or (b) rates that deny the Department the revenues they need to operate the utility consistent with their legislative mandate, bond covenants, and consistent high level of performance in servicing the water needs of the City and its citizenry.

50. The Hearing Officer therefore recommends that rate relief at this time, as will be explained and recommended, be limited to FY2009 and FY2010.

51. The Hearing Officer emphasizes that delaying his recommendation should not be considered a suggestion or implication by the Hearing Officer that no rate relief is warranted for FY2011 and FY2012. On the contrary, the Hearing Officer unequivocally concludes that based on this record rate relief will have to be afforded the Department for FY2011 and FY2012.

52. The Hearing Officer, although recognizing that increased rates will be required for FY2011 and FY2012, finds that the competing needs of the public and the Department will be better served if rates for FY2011 and FY2012 are set based more upon historical data and less

---

<sup>10</sup> The frailty of projections is demonstrated vividly by the projected FY2008 balance versus actual balance of the Rate Stabilization Fund ("RSF") projected in the prior rate proceeding. The balance of the RSF at the end of FY2008 was approximately \$160.3 million, which is \$146.8 million higher than the balance of \$13.5 million projected in the prior rate proceeding. This "eye popping" variance, unparalleled in the history of this utility, along with the current economic crisis, are major persuasive factors in delaying, but not denying, the decision regarding the requested rate relief for FY2011 and FY2012.

upon projections, some of which he considers speculative.<sup>11</sup>

53. Accordingly, the Hearing Officer proposes that his recommendation regarding the rate request for FY2011 and FY2012 be temporarily delayed pending receipt and the benefit of actual results from FY2009 and a portion of FY2010.

54. The procedure that the Hearing Officer originates and recommends is similar to the “true-up” procedure following the emergency phase of FY2005, prior to the granting of the rate increase for FY2006-2008.

55. The Hearing Officer rejects the request of the Public Advocate that the rate period be limited to two years.

56. The Hearing Officer further rejects the request of the Public Advocate that the Department be required to make a completely new filing to obtain rate relief for FY2011 and FY2012, since the Hearing Officer finds the Department has already satisfied such burden by the filing in April of this year.

57. The Hearing Officer recommends that the Commissioner adopt the Hearing Officer’s proposal and that he order that the following procedure be followed with respect to the pending rate increase requested for FY2011 and FY2012:

- a. Temporary delay of the Hearing Officer’s recommendation and the Commissioner’s determination of rates for FY2011 and FY2012;
- b. That the Department serve on the Hearing Officer and all parties to this proceeding a simplified updated statement (“true-up”) outlining its

---

<sup>11</sup> The Hearing Officer is not suggesting that a four year rate plan is *per se* speculative. His concern regarding the speculative nature of these projections is based on the special economic circumstances discussed throughout this Report. Undoubtedly, four year periods in future rate requests will probably be deemed appropriate, as they have in the past.

- revenue needs for FY2011 and FY2012 on or before February 28, 2010<sup>12</sup>;
- c. Such statement shall specify the amount requested, which shall be no more than the original rate request contained in the filing of \$316.9 million less whatever amount is authorized by the Commissioner for FY2009 and FY2010.
  - d. Included in such statement shall be the basis for such request in the general categories which have been the subject of these proceedings, along with an updated Table 11;
  - e. The Hearing Officer shall convene a Pre-Hearing Conference no later than March 15, 2010 to discuss and set limited discovery and hearing for this “true-up” process;
  - f. The Hearing Officer shall require that all discovery, hearings, and submissions to the Hearing Officer be completed no later than April 30, 2010;
  - g. The Hearing Officer shall make his recommendation to the Water Commissioner for rate relief to the Department no later than May 17, 2010; and
  - h. This procedure will give the Water Commissioner sufficient time to make his determination so as to allow any change in rates to be effective July 1, 2010.

58. This suggested procedure will allow new rates to be implemented for FY2011 and FY2012 at the same time contemplated by the Department when it made the rate filing *sub*

---

<sup>12</sup> At the technical hearings, Department management explained that 18-month figures for FY2009 and the first two quarters of FY2010 would be available by late January. (N.T. 149:21-150:12).

*judice.*

59. Central to the procedure that the Hearing Officer is recommending is that it be expedient and that the dollar cost and time commitment required to effectuate such procedure be a small fraction of that expended for the current rate case.

60. The Hearing Officer is cognizant of the fact that this procedure has not been utilized in the past, but cautions on the danger of rejecting something simply because “it was not done that way before.”

61. The Hearing Officer emphasizes his finding that this record discloses special and unique circumstances which require special and unique procedures to respond to such circumstances, and his “out of the box” proposal is a reasonable and responsible response to such circumstances.

62. In view of the current economic crisis, the motivation of the Hearing Officer in originating his proposal is for the protection of the ratepayer and the Department.<sup>13</sup>

63. The Hearing Officer finds that the procedure recommended herein is not precluded in any way or barred by the Water Department Regulations and in fact finds support in the jurisdiction provided to the Hearing Officer in such regulations.

64. The Hearing Officer finds that the “true-up” proceeding envisioned for spring 2010 is not a new rate proceeding, but merely a continuation of the present case and “nothing never seen before” in the arena of administrative adjudication.

65. Since it is not a new proceeding, the Department is not legally bound to make any of the filings that would be required with respect to a new rate case.

---

<sup>13</sup> The Hearing Officer is mindful of the drastic scenarios in PWD Exhibit 25 (Tab 1), which has been referred to as the “sky is falling” chart. (N.T. 785:8). At present those possible scenarios do not meet the known and measurable cost test and could not be constitutionally considered if rates for FY2011 and FY2012 were set now. An opposite result may obtain in the “true-up” proceeding.

66. All formal filings relevant to and required by the temporarily delayed proceeding were accomplished at the time this case was initiated with Department of Records in April 2008 and City Council in May 2008.

67. The Hearing Officer finds that the Department will not be obligated to advertise<sup>14</sup> the “true-up” proceedings since notice has already been given to the public of the initial rate filing, which was much larger than the amount that will be available for rate relief in the spring 2010 process.<sup>15</sup>

68. The Hearing Officer rejects the Department’s objections to this proposal, which included, *inter alia*, the cost of the proceeding, involvement in an ongoing rate case, need for rates to be set over a four-year period, desire of the public that rate increases be equal for budgeting purposes, and that by changing the rate period, the Hearing Officer is usurping the role of management. (PWD Initial Brief, 20).

69. The Hearing Officer finds that the cost involved in such a “true-up” proceeding will be minimal when compared to the amount of rate relief requested for FY2011 and FY2012 (presently \$224.695 million), especially since the Hearing Officer recommends that the process to be an extremely abbreviated one and limited only to rates.

70. The Hearing Officer finds that while such a proceeding will require involvement of Department personnel, the extent of involvement of such personnel will be minimal because of the limited scope of the proceeding and its summary nature.

71. The “true-up” proceeding will not address operations, rate structure, and all other areas that are addressed in this recommendation.

---

<sup>14</sup> However, even if advertising were required, the Public Advocate opines that “customers would gladly accept relatively small extra costs in order to get a final order” yielding rates not more than reasonably necessary. (PA Main Brief, 70).

<sup>15</sup> The Hearing Officer envisions that the amount available for rate relief would be determined by subtracting the amount of rate relief determined by the Commissioner from the total amount requested at the time of the initial filing.

72. All recommendations of the Hearing Officer with respect to issues other than rates for FY2011 and FY2012 will be the subject of a final determination made by the Water Commissioner, which will cover the period FY2009-FY2012, and remain the law of the case until another new filing is made and another determination is made by the Commissioner.

73. While the Hearing Officer recognizes the Department's desire for rates to be set over a four-year period, consideration of the hearing record, which includes an 1100% variance in the RSF balance projection, the collection of \$22 million to service debt not incurred, combined with current economic conditions, tip the scales strongly in favor of the procedure suggested by the Hearing Officer in order to adhere to the constitutional mandate of just and reasonable rates and the statutory and common law principle that rates should be based up on known and measurable costs.

74. This recommendation of the Hearing Officer is motivated by and designed to protect the public by ensuring that the ratepayers do not pay more than the bare minimum, while also protecting the safety of the Department to ensure that it is given the revenue it requires.

75. The Department has stated that their customers would prefer to have known similar rate increases over a four year period so that they might budget their expenditures. (PWD Initial Brief, 19).

76. The Department has produced no empirical data to support such a conclusion, and in fact, given current economic circumstances, common sense suggests that many ratepayers would prefer to pay less now and more in the future when conditions will hopefully improve. (N.T. 857:4-13).

77. Another thrust of the Department's objection to the Hearing Officer's proposal is that it constitutes an *ultra vires* act on his part by allegedly usurping the business judgment of the

management of the Department by determining that the rate period should be two instead of four years. (PWD Initial Brief, 20).

78. The rate period, as with every other aspect of the rate plan offered by the Department, is before the Hearing Officer for his consideration and recommendation.

79. The Department seemingly does not recognize that the Hearing Officer is not altering the four year period to a two year period, as the Public Advocate would have him do. Moreover, unlike the Public Advocate's recommendation, no new formal rate filing will be required for the FY2011-FY2012 rate period.

80. The Hearing Officer's plan is rather simple: a temporary delay regarding the issuance of his recommendation for the amount of rate relief that will be allowed in the final two years of the rate plan proposed by the Department.

81. As the Public Advocate observed, it would be absurd that had the Department suggested a ten year plan, that the Hearing Officer would be precluded from making an alternate suggested period in his recommendation. (N.T. 821:19)

82. The Hearing Officer specifically finds that the term of the rate increase is not unilaterally determined by the Department's management and instead is subject to the Hearing Officer's recommendation.

83. Such issue, however, is mooted by the fact that the Hearing Officer is not recommending that the rate period be changed, but rather that the timing of the rate recommendation regarding the second half of the period be postponed in order for the Hearing Officer to rely upon updated actual data.

84. The Department's position that the four year period should be approved because it was approved in past cases ignores the fact that this is a new case with new facts. Moreover, in

both of the prior cases the Hearing Officer approved of the four year plan, where instantly he recommends delaying consideration of the increase for the final two years of the rate plan.

**H. Rate Relief for FY2009**

85. The Department's initial requested rate increase for FY2009 was \$30.261 million. (PWD St. 5, Exhibit JRM-1, Table 11).

86. After the closing of the record, the Department, in its Initial Brief at page 29, unilaterally reduced the requested increase for FY2009 by:

- (a) not seeking compression rates and eliminating \$15 million lost due to the delayed implementation of the new rates;
- (b) conceding a reduction of \$1 million for the FY2009 labor agreement that was agreed upon during the course of this proceeding; and
- (c) reducing by \$500,000 the anticipated expense for indemnities.

87. In the Department's Reply Brief at page 5, it further reduced its revenue request by \$806,000 based upon final FY2009 budget figures.

88. The foregoing voluntary concessions, which total \$17.306 million, have reduced on a *pro tanto* basis the actual request for FY2009 from \$30.261 million to \$12.955 million.

89. The briefs and reply briefs of the parties set forth in detail their rationale for adoption of and denial of specified revenue and expense requirements.

90. The Hearing Officer has reviewed them in detail and carefully considered the arguments made by the parties.

91. The Hearing Officer is mindful of the fact that the concession by the Department with regard to rate compression will require a transfer from the RSF of approximately \$15 million simply to meet the revenue need caused by the untimeliness of the implementation of

these rates.

92. The Hearing Officer is also mindful of the fact that such sum is in addition to the approximately \$24 million RSF transfer that the Department projected at the time of the filing of this case. (Table 11).

93. The Public Advocate recommends that the RSF transfer be further increased to the extent allowable under the 90% rule so as to preclude any increase in rates.

94. The Hearing Officer finds that such suggestion is short-sighted and does not take into consideration the many advantages to the utility and to the ratepayer that accrue as a result of maintenance of a healthy RSF.

95. The Hearing Officer rejects the suggestion that any increased need for rate relief be funded solely through the RSF as fiscally unsound.

96. Given the extensive amount of concessions that the Department has made with respect to FY2009<sup>16</sup>, and based upon the record, the Hearing Officer finds that the limited further modifications to the rate plan hereafter recommended are all that is warranted and justified respecting the revised revenue request for such period.

#### ***Fire Protection Service***

97. The Hearing Officer finds that the reduction suggested by the Department for public and private fire protection service is ill-timed, and does not comply with general principles of rate-making in that it is projected to be increased in the later years of the rate plan.

98. As didactically observed by the Public Advocate in his brief, these rates are expected to rise so that in FY2012 they will exceed the current rates. (PA Initial Brief, 65).

99. The Hearing Officer agrees with the recommendation of the Public Advocate and

---

<sup>16</sup> It is pertinent to note that such concessions did not “fall out of the sky.” In fact, their *sine qua non* was the participation and advocacy of the Public Advocate and CCC in this proceeding.

concludes that it will be more reasonable to maintain fire service rates at their current levels.<sup>17</sup>

100. This change in the rate plan will add \$1.5 million (N.T. 904:17) to the amount of revenue the Department will receive and concurrently reduces their actual net requirement to \$11.455 million.

***Indemnities Expense***

101. The Hearing Officer finds that a further reduction in the indemnities expense is warranted by historical data respecting this expense line item.

102. Commissioner Brunwasser, in his July 22, 2005 decision at page 13, estimated the indemnities expense at \$5 million. Based upon this record, including past history, the Hearing Officer agrees with the Commissioner's recommendation for this case. This adjustment will reduce the revenue need by \$1 million.

103. This expense adjustment for indemnity results in reducing the FY2009 revenue requirement to \$10.455 million.

***Collection Factors***

104. The Public Advocate recommends that revenues be increased approximately \$2 million per year to reflect additional revenues based upon its recommended collection factor.

105. The Hearing Officer partially adopts such recommendation and finds that \$1 million should be added in revenue.

106. This recommendation is based on a variety of factors, including better collections because of the new computer system, 99% coverage of the automated reading program and collection of a portion of the over \$2 million debt owed by the Philadelphia Housing Authority and increased vigilance in collection of the largest outstanding accounts.

107. This collection adjustment reduces the net revenue requirement to approximately

---

<sup>17</sup> This recommendation was ultimately agreed to by the Department in its Initial Brief at page 50.

\$9.455 million.

108. Accordingly, the Hearing Officer recommends that rates be increased by \$9.455 million for FY2009.

109. Because this rate relief will not be spread across the entire year, the foregoing rate allowance will result in increased rates for the balance of FY2009 approximating 4%.

110. The 4% increase is to be contrasted with the net rate increase currently requested by the Department, which would require a 5.5% overall increase for the balance of FY2009.

111. It is also pertinent to note that the actual average increase for ratepayers for all of FY2009 is approximately 2%, in contrast to the 6.4% originally requested.

112. Although other modifications or adjustments requested by the parties for FY2009 in their testimony or their briefs were carefully considered by the Hearing Officer, it is recommended that all those that are not specifically mentioned be denied.

#### **I. Rate Relief for FY2010**

113. The Department's initial request for FY2010 was \$62 million. This consists of the rate increase compounding the 6.4% that it originally projected for FY2009, as well as a new increase in FY2010 of 6.4% which was projected to yield \$31.961 million. (PWD St. 5, Exhibit JRM-1, Table 11).

114. The Department voluntarily reduced<sup>18</sup> such request by \$826,000 based upon final FY2009 budget and \$500,000 in indemnities expense reduction.

115. Therefore, the net actual revenue request of the Department for FY2010 is \$60.674 million.

#### ***Fire Protection Service***

116. The Hearing Officer adopts the same rationale set forth previously for FY2009

---

<sup>18</sup> See previous footnote 17.

with respect to fire protection rates for FY2010.

117. This recommendation, which will keep fire protection rates at their current level, will result in additional revenue of \$1.0 million (N.T. 904:18) for FY2010 and reduce the net revenue need to \$59.674 million.

***Indemnities Expense***

118. Based upon the rationale set forth with regard to indemnities for FY2009, the Hearing Officer recommends that such expense be reduced by an additional \$1 million for FY2010.

***Budget-to-actual Factors***

119. For FY2010, the Public Advocate requests an adjustment for budget-to-actual factors in the amount of \$7.264 million.

120. This adjustment is based upon criticisms of the methodology utilized by the Department in estimating budget-to-actual factors<sup>19</sup> that will occur in the future.

121. After carefully weighing the analysis submitted by the Department, as well as the Public Advocate, it is found that neither one is fatally flawed, and that there are meritorious aspects to each position.

122. Given the foregoing circumstances, the Hearing Officer recommends a weighing of such positions and recommends a reduction in allowable expenses based upon budget-to-actual factors in the amount of \$3.632 million.

***Non-recurring Expenses***

123. The Public Advocate has requested that a reduction be made for non-recurring expenses and requested that such expenses be reduced in FY2010 by the sum of \$2.684 million

---

<sup>19</sup> The fact that such factors are presently not known and not measurable is another factor relied upon by the Hearing Officer in making his proposal for a two year initial recommendation.

for this expense category.

124. The Department counters this argument in two separate and distinct ways.

125. First, it contends that while non-recurring expenses are contained in the rate plan, the Department will undoubtedly encounter expenses that were not budgeted for in the fiscal year thereby canceling out a need for adjustment in this category.

126. The Hearing Officer agrees with the Public Advocate on this issue and finds that rates cannot be set on expenses which will undoubtedly occur, but which are totally unknown and not specifically budgeted for at the time rates are set.

127. The second point made by the Department is its analysis of the amount of non-recurring costs for FY2010. Contrary to the Public Advocate's estimate of \$2.684 million of non-recurring costs, the Department estimates them at \$1.8 million.

128. The Hearing Officer agrees and adopts the analysis of the Department regarding the amount of such non-recurring costs and therefore recommends that an expense adjustment be made in the amount of \$1.8 million.

### ***Collection Factors***

129. Based upon the rationale set forth in Paragraph 106, *supra*, the Hearing Officer partially adopts the recommendation of the Public Advocate and finds that \$1 million should be added in revenue.

130. After considering the foregoing adjustments, we are left with a net revenue requirement of \$52.242 million.

131. It is estimated by the Department that a 5% increase in rates for FY2010, coupled with the increase recommended by the Hearing Officer for FY2009, will produce net revenue of \$43.181 million.

132. Based on the entire record, including the facts which were subject to administrative notice, the Hearing Officer finds that, in light of the tenuous balancing test that must be accomplished between the needs of the public and the utility, a 5% increase for FY2010 is just and reasonable under the circumstances.

133. The difference in revenue required and any increase allowed shall be funded by the RSF.

134. Accordingly, the Hearing Officer recommends a rate increase of 5% for FY2010, which shall be in addition to the rate increase allowed in FY2009 and collected in FY2009 and FY2010.

135. Although other modifications or adjustments requested by the parties for FY2010 in their testimony or their briefs were carefully considered by the Hearing Officer, it is recommended that all those that are not specifically mentioned be denied.

**J. Excess Interest Earnings (a.k.a. “scoop payment”)**

136. Pursuant to the 1974 General Ordinance, as amended and supplemented, the Department makes a payment to the City’s General Fund in any fiscal year when a balance exists in the Department’s Operating Fund which does not exceed the lowest of (a) the amount of interest earnings on the Sinking Fund Reserve transferred to the Operating Fund during the fiscal year, or (b) \$4.994 million.

137. The Public Advocate recommends that such monies be transferred to the Revenue Fund instead of the City’s General Fund, since their source is the ratepayer and not the general public. (PA Initial Brief, 42).

138. While this argument is *prima facie* meritorious, determining payment is not within the discretion of the Department. The authority to direct such funds has by City Council

been ceded to the City Finance Director, who has already included receipt of these payments in its Five Year Plan and the Mayor's Operating Budget. (PWD Initial Brief, 45).

139. The Hearing Officer finds that the Department has no actual control over these monies and recommends that the "scoop" payment continue to be paid to the City's General Fund.

**K. Water Revenue Bureau**

140. At the Public Hearings it became clear that an important focus of this proceeding was the service provided by the Water Revenue Bureau ("WRB), which is responsible for all collections made by the Department.

141. All discussion in this decision with respect to the WRB must be caveated by the fact that although the Department pays for the WRB employees and is responsible in these hearings for the actions of the WRB employees, the WRB is not under the direct control of Water Department management.

142. Pursuant to the Philadelphia Charter, all revenue collections are under the purview of the Revenue Department and its commissioner.

143. The management of the Department is not able on its own to correct the service deficiencies of the WRB that were detailed on this record.

144. In response to issues involving the WRB, newly appointed Revenue Commissioner Keith Richardson presented prepared testimony and submitted himself to cross-examination by the Public Advocate and all other parties.

145. During the Technical Hearings, Commissioner Richardson stated several times that he was committed to improving the situation with the WRB. Counsel stipulated to the

Commissioner's good faith and all involved complimented his positive and refreshing approach. (N.T. 579:4)<sup>20</sup>.

146. The Commissioner acknowledged that he was "on the clock" (N.T. 621:23), and assured those present that his mandate from the mayor is "to move in the direction of providing high-quality service to the customers of the City." (N.T. 585:8).

147. When asked if that included a reasonably continuous service commitment, Commissioner Richardson stated he is "trying to strive for better than reasonable." (N.T. 585:23).

148. Among those changes envisioned by the Commissioner is a better marketing plan to disseminate information regarding the WRAP program.

149. To be effective, water customers must be aware of WRAP's existence, and it must be user-friendly. (N.T. 603:21).

150. The Revenue Commissioner believes that knowledgeable personnel are essential to the success of any plan to improve the WRB, including its WRAP program, and agrees to insure that employees are properly trained.

151. In addition, the Commissioner stated on the record that he is committed to the implementation of an appeal process within the WRB, and hopes to make progress in implementing this within fiscal year 2009. (N.T. 600:2).

152. In an effort to effectuate progress in the WRB, the parties have agreed to plenary mediation of all service issues. (N.T. 617:6).

---

<sup>20</sup> At the technical hearings, the Public Advocate embraced the testimony of Commissioner Richardson as follows: "I am going to begin by just making a few remarks to say that we appreciate already the interest that you have shown in this proceeding, including the fact that you were here on the first day of this hearing, even though you weren't being called to testify on that particular day, and that you also, through counsel, arranged a meeting with the Public Advocate and the Water Department even prior to the time that the Hearing Officer made a formal request that you put in testimony in this case concerning the adequacy of the service provided by the Water Revenue Bureau. From our perspective, we appreciate that show of interest and concern and we see that as the possible beginnings of a new day." (N.T. 575:21)

153. The scope and procedure will be determined on a priority basis at a conference presently set for October 30, 2008. The Hearing Officer will preside over the mediation to ensure its implementation yields substantive improvements in the service provided by the WRB.

154. The Public Advocate has requested during cross-examination, as well as in its brief, that the Hearing Officer require specific changes and agreements by the WRB.

155. In view of the jurisdictional issues between the authority of the Department and Revenue Commissioner, the Hearing Officer abstains from recommending the relief requested in this area.

156. The Hearing Officer has had the opportunity to interact with the Revenue Commissioner and Deputy Commissioner Michelle Bethel, who was recently appointed to oversee of the WRB.<sup>21</sup>

157. It is found that the agreement of record of the Department and Revenue Commissioner to mediate in good faith more than adequately meets the needs of the public at this juncture.

158. Accordingly, the Hearing Officer rejects the recommendations of the Public Advocate for specific mandates.

**L. Philadelphia Housing Authority's Discount**

159. The Philadelphia Housing Authority ("PHA") has requested an increase in their discount from 5% to 25%.

160. The present discount afforded to the PHA and the larger discount afforded to charitable entities is not a matter within the purview of the Hearing Officer.

161. The amount of allowable discount to the PHA is subject to legislative enactment

---

<sup>21</sup> Commissioner Richardson noted: "Our direction as this administration is to move in the direction of providing high-quality service to the customers of the City. That is our intention. That is why Ms. Bethel has been brought here with her 14 years of customer service experience working at the State level." (N.T. 585:8).

by City Council, and if a change is to be made it is to be done so by such body.

162. The Hearing Officer therefore agrees with the Department and the Public Advocate that he is without jurisdiction to change the amount of the discount and that such discount should remain as is subject to further action by City Council.

**M. Philadelphia Large Users Group (“PLUG”) Settlement**

163. At the June 6, 2008 Pre-Hearing Conference, Charis Mincavage, Esquire and Shelby A. Linton-Keddie, Esquire entered their appearances on behalf of Philadelphia Large Users Group (“PLUG”).

164. Prior to the commencement of the Technical Hearings, counsel for the Department and PLUG notified the Hearing Officer that those two parties had reached a settlement.

165. At the August 11, 2008 Pre Technical Hearing Conference, counsel provided to the Hearing Officer the original Joint Statement for Settlement Between The Philadelphia Water Department and Philadelphia Large Users Group Outlining Settlement (“Joint Statement”), which had been executed by counsel for both parties on August 11, 2008.

166. The Hearing Officer has thoroughly reviewed the Joint Statement and accompanying Settlement Term Sheet, collectively marked PLUG-1 and entered into the record for these proceedings.

167. At the oral argument, the Hearing Officer queried counsel regarding the settlement and there no objections to its approval.

168. The Hearing Officer finds that the Public will not be adversely affected in any way by the settlement.

169. The Hearing Officer hereby recommends that the Water Commissioner approve

the foregoing settlement with the caveat that any implementation of the provisions of the settlement should also be afforded to CCC, since both parties are comprised of similar commercial and industrial users.

**N. Cost Allocation and Rate Design**

170. The Hearing Officer finds that the Department's proposed allocation and rate design are properly based upon the appropriate principles of cost causation.

171. Therefore the Hearing Officer recommends that the proposed cost allocation and rate design plan of the Department should be adopted in its entirety.

172. The Department's recommended cost allocation design is not only supported by its own expert, but also finds support in the Public Advocate witness Jerome Mierzwa (PA Statement 2 at 4), since overall, the Public Advocate expert concurs with the recommendations made by the Department.

173. As in the past, the general gist of the CCC recommendation is to shift a greater share of the rate increase to smaller customers. (CCC Statement DMK-1 at 7).

174. The irony presented by the testimony on behalf of CCC is that almost all of its members are recipients of the charitable discount and thus the beneficiaries of unequal treatment.

175. The contention that larger customers are generally subsidizing residential customers was firmly rejected by Water Commissioner Brunwasser in the last proceeding, wherein he stated the following:

The CCC has raised concerns about the subsidization of residential customers (5/8 inch meters) by larger commercial and industrial customers...As the Hearing Officer has indicated, the Hearing Record does not support this conclusion. Testimony was provided by the Department's expert...and by both the Public Advocate's cost of service experts, Mr. Galligan and Mr. Catlin, that the rate design is appropriate. Mr. Galligan concluded that the Department's cost of service calculations were consistent with

generally accepted cost based ratemaking principles... Mr. Catlin also concluded that the City ratemaking method is acceptable. By phasing-in cost of service adjustments, the City utilized the principle of gradualism that is recommended by the CCC's expert, Mr. Kalbarczyk...An exact balance of all costs by meter size would require a level of analysis, complication and cost well beyond the limits of general standards for ratemaking. It would be wrong to conclude that the subsidization of residential customers has been ongoing for some period of time. Quite the opposite – a significant balancing of storm water costs was undertaken during the previous rate period with the result that larger customers are now paying their fair share.

Water Commissioner's Rate Determination for FY 2006-2008, July 22, 2005 at 14-15.

176. This rationale is adopted by the Hearing Officer instantly.

177. The Hearing Officer does not agree with CCC's recommendation regarding maximum day and hour peaking factors.

178. The frailty of Mr. Kalbarczyk's contention is that unlike many suburban and smaller utilities, residential customers in the City of Philadelphia do not have large differences between peak day and peak hour usages.

179. It is found that the fixed/variable cost of service methodology recommended by the CCC is not "doable" for a utility the size of the Department, and is therefore rejected.

180. The CCC recommends a change in cost related to customer billing and collections.

181. This recommendation lacks any substantive evidentiary basis on this record and accordingly should be denied.

182. The CCC has submitted rate design issues with regard to lower tail blocks and conjunctive billing.

183. Based upon the current proposal of the Department, water is charged for the fourth block at essentially its base costs.

184. If the Department were to follow the recommendations of Mr. Kalbarczyk in these areas, it would be selling water for below cost and therefore directly subsidizing the larger users at the cost of the smaller ones. Accordingly, this proposal must be rejected.

**O. Other Relief Requested by CCC**

185. Six CCC member representatives filed prepared testimony in this case, and three representatives subjected themselves to cross-examination at the request of the parties.

186. Based on the members' testimony and argument from counsel, the Hearing Officer hereby recommends the following:

- a. The Department will form a large user group, schedule meetings on a reasonable basis, and provide reasonable updates to CCC and Commissioner Brunwasser on the progress of implementing this recommendation.
- b. The Department will establish customer service representatives for large customers. As an interim step, the Department will identify contact persons for large customers who will be available to deal with issues concerning customer service.
- c. The Department will review the customer requests for water conservation programs for large customers.
- d. The Department will investigate and resolve the issues complicating the installation of waterless urinals in the Department's service area.
- e. The Department will complete the prior commitments to assist ICE to verify correct meter size and publicize the charitable discount to its members. The Department will do a mailing to those congregations

identified by ICE telling them of the opportunities to have meter sizes checked and the availability of the charitable discount. The Department will appoint a responsible person to direct this effort and identify that person to ICE.

- f. The Department will consider the changes to the customer billing statements identified on pages 6-7 of the ICE testimony. (CCC St. No. 5). The Department will consider whether this additional information should be included in its customer billing statements.

187. At the behest of counsel for CCC, the Hearing Officer has taken notice that the Commissioner rate determination from the 2005 case contains several directions to the Department which have not yet been completed. The Department therefore is directed to continue to address the following open items from the 2005 rate determination:

- a. The Department and the Water Revenue Bureau shall compile collection data in a way that will make it possible for collection factors to be developed for each customer class to determine the relative cost of collecting revenue from the classes as proposed by CCC.
- b. The Department shall investigate the feasibility of obtaining information as proposed by CCC for an analysis to be undertaken to refine the costs of service relationship to meter and to define the Department's understanding of meter costs by customer class.
- c. The Department and its consultants shall investigate the appropriateness of a sanitary wastewater peaking factor for non-wholesale customers in the wastewater cost of service study.

- d. The Department and the Water Revenue Bureau shall undertake efforts to investigate and/or evaluate (a) the development of separate collection factors for the classes of customers, (b) the refinement of metering costs associated with the classes of customers; and (c) the development of peaking factors for sanitary sewer services.

188. The Department is further directed to provide a report to CCC on the status of these prior directions within one year of the issuance of the Water Commissioner's decision in this case.

189. The Department is directed to present testimony in its next rate case which identifies the directives contained in the prior Commissioner determination, as well as all Commissioner directives in this case. Such testimony shall identify the status of the Department's action on those open matters and actions the Department has taken on each directive since the issuance of the Water Commissioner's decision in this case.

190. The Hearing Officer recommends that the parties submit a status report on all open items to the Commissioner within one year of the date of his determination.

#### **IV. DISCUSSION**<sup>22</sup>

##### **A. Description of the Utilities**

###### **1. *Water System***

The water system provides water service to retail customers in the City over a 130 square mile service area. In addition, the system provides water service to Bucks County Water and

---

<sup>22</sup> The Hearing Officer's custom in preparing Hearing Reports is more "finding" and less "discussion." Extensive discussion would serve no useful purpose since it would merely "rehash" the findings and the Hearing Officer's rationale, which are contained therein. Moreover, the excellent briefs prepared by all parties are available to the Commissioner for his reference if clarification is required. Finally, extensive recitation of legal authority would be surplusage since such principles are cogently articulated by the parties. Ultimately, however, the decision reached by the Hearing Officer is primarily a factual determination of what he determines is just and reasonable in the implementation of his Quixotic balancing test between the needs of the ratepayer and the utility.

Sewer Authority and Aqua Pennsylvania pursuant to agreements for wholesale water service. The water system obtains 56% of its water from the Delaware River and the balance from the Schuylkill River. It is currently authorized by the applicable regulatory authorities to withdraw up to 390 MGD from the Delaware River and 258 MGD from the Schuylkill River.

Water treatment is provided to the Department's 472,800 retail customers by three water treatment plants. The combined rated capacity of these plants is 540 MGD; and their combined maximum capacity is 683 MGD. The water system's infrastructure also includes 3,160 miles of mains and 28,000 fire hydrants. PWD Exhibit 7 (SI-8 - Official Statement, Water and Wastewater Revenue Bonds, Series 2007A and 2007B at Bond Engineering Report, pp. III-1 through III-27).

## **2. Wastewater System**

The wastewater system service area totals some 360 miles, of which 130 square miles are in the City; and 230 square miles are in suburban areas. Service to suburban areas is provided under agreements with adjacent municipalities and municipal authorities. Wastewater service is provided by three water pollution control plants, a biosolids handling facility, 16 pumping stations, 75,000 stormwater inlets and approximately 3,000 miles of sewer. (*Id*).

The water pollution control plants consist of the Northeast and Southwest plants, each with secondary treatment capacity of 210 MGD and 200 MGD respectively; and the Southeast plant with 112 MGD secondary treatment capacity. The biosolids handling facility includes an operation and maintenance center, dewatering facility, receiving and mixing facility, barging and docking facilities and a pipeline between the Southwest plant and the biosolids facility. PWD Exhibit 7 (SI-8 - Official Statement, Water and Wastewater Revenue Bonds, Series 2007A and 2007B at Bond Engineering Report, pp. IV-1 through IV-38).

Much of the conveyance and collection system serving the water and wastewater utilities is aged and perennially in need of repair and upgrades. The water treatment and water pollution control plants are also in constant need of refurbishing and improvement. The foregoing is the focus of the Department's Capital Improvement Program.

**B. Philadelphia Water Department Management**

This report would be deficient if it did not adequately address the competence and integrity of the Philadelphia Water Department management. From the top down, the key personnel in management have demonstrated their skill in operating and maintaining a vital utility for the citizens of the City of Philadelphia. The breadth and scope of their duties and responsibilities can only be succinctly addressed in this Report, but should not be overlooked. Many of these individuals have devoted an entire career to the Department, and deserve recognition for same.

Throughout these proceedings, it has become quite clear that the Department has successfully built its reputation throughout the financial community. The ratings from S&P, Moody's, and others reflect the devotion by management to improvement. Together with the development of its financial reputation, the Department has also demonstrated that it is a utility that provides a high quality product.

**C. Water Revenue Bureau**

The Public Advocate made it clear in this proceeding that special attention to the Water Revenue Bureau was required. While the Public Advocate has requested that the Hearing Officer require specific action by the WRB, past history discloses that directives in the Hearing Officer report do not receive the attention contemplated. Moreover, between rate cases there is no procedure or mechanism to monitor such directives. In view of the foregoing, the Hearing

Officer has chosen not to mandate specific actions.

Charged with the task of addressing WRB issues is the newly-appointed Revenue Commissioner, Keith Richardson. During the Technical Hearings, Commissioner Richardson stated several times that he was committed to improving the situation with the WRB. Counsel stipulated to the Commissioner's good faith and all involved complimented his positive and refreshing approach. The Commissioner acknowledged that he was "on the clock" (N.T. 621:23), and assured those present that his direction in this administration is "to move in the direction of providing high-quality service to the customers of the City." When asked if that included a reasonably continuous service commitment, Commissioner Richardson stated that reasonable means continuing to provide high-quality service, so he is "trying to strive for better than reasonable." (N.T. 585:23).

Among those changes envisioned by the Commissioner is a better marketing plan to disseminate information regarding the WRAP program. To be effective, water customers must be aware of WRAP's existence, and it must be user-friendly. The Commissioner is prepared to request and train additional personnel. The Hearing Officer believes that knowledgeable personnel are essential to the success of any plan to improve the WRB, including its WRAP program.

In addition, the Commissioner stated on the record that he is committed to the implementation of an appeal process within the WRB, and hopes to make progress in completing such process in fiscal year 2009.

In the Hearing Officer's opinion a more enlightened way of resolving issues and "getting things done" has been put into place.<sup>23</sup> The parties have agreed to plenary mediation of all issues regarding the WRB which were raised in this proceeding. Moreover, the Hearing Officer will

---

<sup>23</sup> A conference with the parties and the Hearing Officer has been scheduled for October 30, 2008.

continue to preside over that facet of the proceeding to ensure its implementation. The Hearing Officer has great expectations for this collaborative process, which breaks new ground for the ongoing relationship between the Public Advocate and the Department.

**D. Present State of the Economy**

It is not “business as usual” for the Department or its ratepayers. On the contrary, the Philadelphia area, as well as the entire country, is facing extreme difficult economic times. The following represent examples of economic hardships, of which the Hearing Officer takes administrative notice, which must not and cannot be ignored in this proceeding:

**1. Unemployment**

The United States Department of Labor issued for August 2008 an unemployment rate of 6.1%. This is the highest unemployment rate since 2003. Based on current trends, there is a possibility of reaching 8% unemployment. (*Wall Street Journal*, September 5, 2008)

**2. Housing Crisis**

Foreclosure filings (default notices, auction sale notices and bank repossessions) were reported on 649,917 properties nationwide during the first quarter, which is a 23% increase from the previous quarter and a 112% increase from the first quarter of 2007. One in every 194 U.S. households received a foreclosure filing during the first quarter.

(<http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=4566&acct=64847>)

The crisis is so dire that the Philadelphia County Court of Common Pleas has implemented the *Residential Mortgage Foreclosure*

*Diversion Pilot Program* adopted by Joint General Court Regulation No. 2008-01. This judicial intervention is extraordinary and illustrative of the severity of this crisis.

**3. Poverty**

Philadelphia remains the ninth poorest big city in the United States, with nearly one in four people living in poverty. The statistics for 2008 will be worse than 2006 and 2007. (*Philadelphia Inquirer*, August 27, 2008)

**4. Bankruptcy Proceedings**

For the twelve months ending March 31, 2007, there were 9,067 bankruptcy actions filed in the Pennsylvania Eastern District. For the twelve months ending March 31, 2008, there were 10,346 filed. This represents an increase of 14.1% in the past year. The total increase for the entire country from 2007 to 2008 was a staggering 29.7%.

**5. Price of Gasoline**

Although the price of gasoline has actually decreased recently, the recent history of its prices should be noted. A gallon of regular unleaded gasoline in September 2006 was \$2.70. The price increased to \$3.30 in June 2007, came down to \$2.80 in September 2007, and increased to over \$4.10 in June 2008. In the beginning of September 2008, a gallon cost \$3.75, which is 39% higher than two years ago. Forecasting the price of gasoline which affects both the ratepayers and the utility in six months and

twelve months is almost impossible.<sup>24</sup>

(<http://tonto.eia.doe.gov/oog/info/gdu/gasdiesel.asp>)

## **6. Inflation**

From July 2004 to July 2008, inflation was 16.14%. From July 2007 to July 2008, inflation was 5.6%. ([http://inflationdata.com/Inflation/Inflation\\_Calculators/Inflation\\_Rate\\_Calculator.asp#results](http://inflationdata.com/Inflation/Inflation_Calculators/Inflation_Rate_Calculator.asp#results)) Average hourly earnings are not keeping up with inflation.

## **7. Consumer Price Index**

The CPI for all food is forecast to increase 5% to 6% in 2008, having risen 4% in 2007.

## **8. Cost of Living Adjustments**

For beneficiaries of social security retirement (SS) and supplemental security income (SSI), a cost of living adjustment of 2.3% was given for 2008. For years 2007, 2006, and 2005, the adjustment was 3.3%, 4.1%, and 2.7%, respectively. It should be noted that these increases are less than the increases in inflation, CPI, and the Water Department's proposed rate change.

(<http://www.ssa.gov/cola/colafacts2008.htm>)

## **9. City of Philadelphia Economic Woes**

Now facing a \$450 million shortfall in his five-year spending plan, Mayor Nutter recently warned: "The most charitable thing you can say

---

<sup>24</sup> The fact that the price of oil, which has a direct impact on the cost of fuel used by the Department, as well as on the price of chemicals which is a major expense for the Department, was at a record high of \$147.27/barrel on July 11, 2008, and fell to an 8-month low of \$87.81/barrel on October 6, 2008, is further support for the Hearing Officer's conclusion that significant projections in the rate plan are clearly speculative and a delay of the decision on the FY2011 and FY2012 rates is a prudent course of action and a "win-win" for the ratepayer and Department.

about our economy is we're living in perilous times." (*Philadelphia Inquirer*, September 15, 2008)

Mayor Nutter is directing city departments to cut spending by 1 to 10 percent, and layoffs are possible.<sup>25</sup> As an example of such cuts, the mayor withdrew an offer for the creation of a new position as a communications aide to Managing Director Camille Barnett. The nixed position was to have been a significant position, promoting the 311 call system and PhillyStat (the data-management system).

#### **10. Ability to Pay**

The Hearing Officer must weigh the Department's position that ability to pay is not a factor to be considered in ratemaking, while also taking into consideration the burden on the citizenry of the Philadelphia that rate increases will invariably create. As demonstrated by the following quotes from individuals who appeared at the Public Input Hearings, it is vital to protect the individual ratepayer's access to a "life necessity" and ensure that the Department receives only what it needs.

At the Public Input Hearing on Monday, July 21, 2008 at the YMCA at 1400 N. Broad Street, Erma Olifant provided the following statement representative of countless of Philadelphians:

Well, I'm here in concern of this because a lot of my neighbors as well as myself, we are senior citizens, we are on a fixed income. You know, everything, I mean, to keep going up like this. Okay, Social Security, they give you a 2.5% raise and then take 1.5% for Medicare if you have to pay like Medicare. The fuel is up, the electric, you know,

---

<sup>25</sup> Although the Department is funded by the Water Fund and not the General Fund of the City, it must, to some extent, heed the warnings of the mayor and, as a city department, do as suggested earlier: "act accordingly."

everything is up. And everything is going up and the increases that they give us are not, like we're not getting, you know. We're still like getting behind because it's not adding up. And just like all working people, I mean, of course, as I say, I'm on Social Security, but a lot of the working people, they're not getting raises. I think a lot of them are losing jobs. I have friends and stuff that's like losing jobs. Some people, your real estate is going up, but you're not getting more money, so how can you continue to pay out more and more, more here, there, or anywhere else, and then you're not getting more? It's impossible.

(N.T. 34:17)

At the Public Input Hearing on Thursday, July 24, 2008 at the YMCA at 5120 Chestnut Street, the Hearing Officer also received the following testimony:

I am Martha Spears and I am a senior citizen myself and I just can't afford an increase in my water bill because I'm a widower by myself and I just can't afford no more bills. I just can't afford it. So I oppose it.

(N.T. 23:24)

My name is Patricia Sullivan. I'm a homeowner. I'm definitely against the increase. Everything is going up. I'm on a fixed income. I'm a retiree. Everything goes up but your salary, the gas, the food, everything. How much more are they going to tax the poor average working person? We just can't afford it. I mean, with everything we're faced with now, I feel like we're in a depression. Everything keeps going up and up. They're talking about the tolls are going up. We just can't afford it. Everything goes up but the salaries. So how much are they going to squeeze out of one paycheck or one income? Give us a break. Okay? I'm really upset about this. I'm on a fixed income.

(N.T. 54:8)

I'm a widow and I can't afford an increase in my water bill. I am by myself. I don't have a husband.

(N.T. 56:18 [Blanche Long])

I don't know about you people, but I have not had a job yet in my life and I'm 52 years old, I'll be 53 next

month, where I have got a 7% raise in a year. I have not had a job yet where over four years I received a 30% increase in my salary.

(N.T. 59:14 [Duane Holmes])

At the Public Input Hearing on Friday, July 26, 2008 at the JNA Institute of Culinary Arts at 1212 South Broad Street, the Hearing Officer also received the following testimony:

Now, my income is not as high as your projected increases. I'm on Social Security. For 2007 my increase was 3.3%, not your rate increase of 4.2%. For 2008 I only received 2.3%, not the 6.7% that the Water Department his us with. So I have budget. You guys have a budget. You increase my rate, I have to play around with my budget, and there's only so far my budget will extend.

(N.T. 26:4 [Bob Falkowski])

**E. Basis for Establishment of Rates**

It is not disputed that the Department is authorized to impose, charge and collect sufficient revenues to pay annual operating expenses, debt service and fulfill bond covenants. These requirements are the hallmarks to maintaining and operating the Department.

The Department's principal covenants<sup>26</sup> are set forth in and required by the General Ordinance and the FGIC/FSA Covenant entered into in connection with the issuance of Series 1993 and 2003 Bonds. The rate covenant contained in the General Ordinance requires the Department to establish rates sufficient to yield Net Revenues in each fiscal year (after payment of operating expenses) at least equal to 1.20 times the Senior Debt Service Requirements for such fiscal year (both as defined in the General Ordinance). In addition, net revenues in each fiscal year must be at least equal to 1.00 times (i) Total Debt Service Requirements for such fiscal year; (ii) amounts required to be deposited in the Debt Reserve Account during such fiscal

---

<sup>26</sup> The Department's bond covenants are enacted by Ordinance of City Council and then made a part of the transaction for the issuance of long-term debt. These covenants are binding upon the Department as prescribed by City Council and enforceable by bondholders as a part of the contract embodied in the bond.

year; (iii) principal or redemption price of and interest on General Obligation Bonds issued by the Department and payable in such fiscal year; (iv) debt service requirements on interim debt payable in such fiscal year; and (v) the Capital Fund Deposit Amount for such fiscal year, less amounts transferred from the Residual Fund to the Capital Account during such fiscal year. PWD Statement 5 at 8; PWD Exhibit 7 (SI-8 - PWD Official Statement, 2007A and 2007B Bonds at 14).

In addition to the covenants described above, for each fiscal year ending on or after June 30, 2000, the Department is required by the Fiscal Agent, for the benefit of Financial Guaranty Insurance Company (“FGIC”) and thereafter to Financial Security Assurance, Inc. (“FSA”) through their insurance on the Series 2003 bonds, to establish rates and charges for the use of the water and wastewater systems sufficient to yield Net Revenue (excluding amounts transferred from the Rate Stabilization Fund into the Revenue Fund during the fiscal year) at least equal to 90 percent of the Senior Debt Service Requirements (excluding Debt Service due on any Subordinated Bonds) in such fiscal year for so long as the Series 1993 Bonds insured by FGIC and Series 2003 Bonds insured by FSA are outstanding. (PWD Statement 5 at 9).

In order to comply with its rate covenants with investors, the Department must sufficiently increase its rates. Such compliance is necessary as a condition precedent to maintaining its favorable credit rating and funding its capital program. There is no doubt that its favorable bond ratings should not be jeopardized. (PWD Statement 1 at 6).

**F. Rates Must Be Reasonable**

It is absolutely essential, and constitutionally mandated, that these rate proceedings result in a new rate that is “just and reasonable.” This standard is applicable to municipally owned utilities like the Philadelphia Water Department with the same force and effect as to an investor

owned utility such as PECO Energy. (American Aniline Products, Inc. v. Lock Haven, 135 A. 726 (Pa. 1927)). In so doing, the ratemaker must ensure that both the utility and the ratepayer are adequately protected. In performing that task, the ratemaker must balance the interests of customers in efficient utility service at the lowest possible rates, and the interest of the utility in obtaining sufficient revenues to conduct its operations, maintain its financial integrity and achieve access to the financial markets for revenue bonds at reasonable rates. (Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944)).

In the case Public Advocate v. Philadelphia Gas Commission, 674 A.2d 1056 (Pa. 1996), the Pennsylvania Supreme Court reemphasized the importance of the “just and reasonable” standard: “this Court is mindful that no applicable constitutional requirement is more exacting than the requirement of ‘just and reasonable’ rates.” Underscoring this standard is the Philadelphia Code §13-101(2)(d), which requires the Department’s rates to be “just, reasonable and non-discriminatory.”

A balance must be struck between recognizing that ratemaking is not an exact science, but that rates must be established on a reasonably scientific basis. (See City of Johnstown v. Pennsylvania Public Utility Commission, 133 A.2d 246 (Pa.Super. 1957)). The Hearing Officer recognizes that rates are designed on a foundation of empirical data, which data is known and measurable, *as well as* on some forecasting and projections. Instantly, the Department has advanced the use of a multi-year test year concept to determine its rates. In response, the Public Advocate has stated that the test year concept requires that rates be established on the basis of a single test year, with minimal reference to anticipated financial changes which may occur in the post-test year period.

In 2006, the Philadelphia Gas Works (“PGW”) filed for a \$100 million rate increase

basing its claimed revenue requirement on a five year forecast of its needs. In ruling against the rate increase, and awarding only \$25 million, the Public Utility Commission stated:

The test year concept is a basic tenet of ratemaking that forms a sound and reasonable basis for establishing a representative level of prospective rates. It allows for a reasonable measure of predictability and semi-permanence in ratemaking. We are cognizant of the Company's current financial situation and goals; however, we do not find them to justify peering five years into the future on such uncertain circumstances. We agree with the opposing Parties that the use of a five-year forecast is too speculative and unreliable for the setting of rates.

Pa. PUC v. Philadelphia Gas Works, PUC Docket No. R-00061931 (Order entered September 28, 2007) at 18; appeal pending, Philadelphia Gas Works et al v. Pa. PUC, Commonwealth Court No. 1914 C.D. 2007.

Based on the foregoing, the Public Advocate opines that the use of a multi-year test year deviates from relying on data that is known and measurable. The Hearing Officer partially concurs since strict adherence to a single test year and the creation of rates based on only known and measurable data would not provide the Department with the revenue it needs and is required to collect. These competing needs, which are compounded by historical economic uncertainty, are the foundations of the Hearing Officer's proposal.

**G. Hearing Officer's Proposal to Recommend Rates for FY2009 and FY2010 and Presently Delay the Determination of Rates for FY2011 and FY2012**

As stated above, there is no way to project with absolute accuracy the revenue requirements of the Department over four years. While some data is known and measurable, there are certain variables that are compounded by current economic conditions which render such projections speculative. Underestimating the Department's needs would be catastrophic to its ability to operate. Overestimating the Department's needs would unconstitutionally and unfairly burden the ratepayer.

Given the current state of the economy, the Hearing Officer is not professionally comfortable in assuming the risk to the utility or ratepayer of underestimating or overestimating revenue needs for FY2011 and FY2012 based upon data that may, and probably will, be materially different when the rates go into effect.

The Department has argued that other municipalities utilize a multi-year plan. Such argument is anecdotal. Without knowing more details about the rate proceedings in these municipalities, the Hearing Officer cannot rely upon such purported evidence. The Department has advanced the legal argument that the Public Advocate is collaterally estopped from seeking to avoid the multi-year approach. Such argument is not applicable in this proceeding, as no rights of individual private litigants have been adjudicated. As the Public Advocate points out in its Initial Brief at 69, the parties in the instant proceeding are not identical to those in prior proceedings. The Public Advocate represents a very diverse and dynamic constituency. Furthermore, the Public Advocate is free to propose alternative ratemaking methodologies, so long as such scenarios conform with existing laws and regulations.

The Hearing Officer has no desire to “run the utility,” but he does have a desire and mandate to recommend rates which meet the standards set by the Constitution and the Philadelphia Water Department’s regulations. Senior management is not the final arbiter of rates. The rate process is not an *ipse dixit* proceeding based on what management thinks the rates should be. Just and reasonable rates are for the Department to request, for the Hearing Officer to recommend, and for the Water Commissioner to determine.

In its Initial Brief, the Department cites as a reason to avoid anything less than a four-

year plan is the “major” expense of approximately \$1.6 million in costs<sup>27</sup> to the ratepayers to sustain this proceeding. It should be noted that during the technical hearings, when questioned about the \$146 million discrepancy in the Rate Stabilization Fund, the Department’s expert advanced the theory that in the overall scheme of \$2 billion in revenue and \$2 billion in costs over four years:

[there] is maybe a 3% differential over the whole four years. So I don’t really characterize that as a big number.

(N.T. 164:16 – J.R. McKinley). In view of Mr. McKinley’s approach, he certainly would not characterize \$1.6 million as a “major” expense, since it is only 0.04% (four one-hundredths of a percent) of \$4 billion over four years.

Contrary to the position of the Department, the rate period is an issue to be determined during this proceeding. The Department cannot simply dictate the framework and timeline for the rate period. If this were true, as the Public Advocate stated during Oral Argument, “that would mean that the Department could come in with a ten-year rate period and we wouldn’t have anything to say about it. It would be said that it’s not the prerogative of us.” (N.T. 821:19). The Hearing Officer partially adopts the logic of the Public Advocate. However, as previously noted, the rate period is actually not being changed; only the timing of the recommendation.

The Department should not view the Hearing Officer’s proposal as a penalty. It is anything but a penalty. By revisiting the rate plan prior to FY2011, the Hearing Officer can provide a “safety valve” to the Department. If emergent events occur, or if current projections fall short, revisiting the plan can ensure adequate protection for the Department, while simultaneously ensuring that the ratepayers do not over pay for the utility.

---

<sup>27</sup> The Hearing Officer suggests that this argument is misplaced because of the expedited and summary nature of the future proceeding suggested. As set forth previously, it is anticipated that the cost to the Department would be a small fraction of the cost of the instant rate case expense.

In his testimony, Deputy Commissioner Clare stated that:

...I think from a policy standpoint, in terms of a four year filing, there are many, many things that happen in a four-year filing that cut the Water Department's way and they cut the consumers' way.

(N.T. 68:16). In light of Mr. Clare's acknowledgement of the uncertainty of what could transpire in the next four years, and in light of the recent events in our economy, the Hearing Officer believes he is simply exercising well-reasoned judgment and prudence in recommending that the proposed rate increase be limited to FY2009 and FY2010 at this time, and that the data be updated before recommending the rates for FY2011 and FY2012.

It must not be forgotten that water service is absolutely essential. It is more important than telephone, electric, and natural gas. The citizenry cannot live without water, and therefore the Department's revenue needs must be adequately protected. Conversely, the Department cannot operate without its ratepayers, many of whom will be severely adversely impacted by any increase in rates. A better balance between their competing needs can be accomplished by reliance on better data. That is all the Hearing Officer is proposing.

#### **H. Rate Stabilization Fund**

A focal point of these proceedings has been the Department's Rate Stabilization Fund. As previously observed, the fact that the balance of this fund at the end of FY2008 constitutes a variance from the projection made in the last case of 1100% is the "smoking gun" of this record. When asked, Mr. McKinley stated that he was unaware of any projection with such a disconcerting variance. (N.T. 167:3). As has been said *ad nauseam* throughout this recommendation, the RSF balance is one of the foundations of the Hearing Officer's suggestion that his rate recommendation for FY2011 and FY2012 be temporarily delayed. However, more must be said. The RSF, in concept, is not a bad thing, and in fact, serves the purpose for which it

was envisioned by City Council. It is an important safeguard to both the public and the Department. Although not necessary to the rate determination for FY2009 and FY2010, an issue has arisen with regard the reasonable balance to be kept in the RSF for FY2011 and FY2012.

The Public Advocate contends that the Department's contention of a \$45 million RSF is unwarranted. One of the reasons in support of such argument is the contention that funds may be borrowed for working capital at a cost much less to the Department than the cost to the ratepayers of maintaining such balance. However, such argument is without evidentiary support and one which the Hearing Officer has great difficulty accepting based upon the testimony in the record regarding the increased cost of the variable rate bonds. The parties have advanced many other arguments in their briefs, which the Hearing Officer has carefully reviewed, regarding whether the maintenance of a RSF balance of \$45 million is reasonable. The Hearing Officer finds that it is.

The "true-up" proceeding that is suggested for the spring 2010 is to be one of an expedited nature. It would be inconsistent with the intent of the Hearing Officer if the parties were required to litigate at that time the justness and fairness of maintaining a \$45 million balance in the RSF. Accordingly, it is recommended that as part of the Commissioner's Rate Determination that he specifically find that maintaining the \$45 million balance in the RSF is a reasonable act of managerial discretion on the part of the Department for FY2011 and FY2012.

## **V. CONCLUSIONS OF LAW**

1. The Department initiated the process to establish new rates, pursuant to Section 5-801 of the Philadelphia Home Rule Charter ("Charter"); and Sections 13-101 and 201 of the Philadelphia Code.
2. The Department must comply with its obligations under the General Ordinance,

insurance agreements, and bond covenants, as well as the United States Constitution and the Constitution of the Commonwealth of Pennsylvania.

3. Taken together, the foregoing governing legal standards constrain the Department to fix and regulate rates so as to meet operating requirements and obligations to investors through creation of a stable revenue stream over a reasonable period of years.

4. The instant rate filing must specifically comply with all of the above legal requirements and the just and reasonable standard.

5. The Department has supported its request for increased rates for FY2009 and FY2010 with “substantial” evidence.

6. Constitutional and *stare decisis* authority require that the decision regarding rates for FY2011 and FY2012 be delayed.

7. The Department’s rate request for FY2009 and FY2010, as modified in this Recommended Decision, is “just and reasonable”.

## ORDER

Therefore, it is Ordered:

1. The Public Advocate's and Commercial Customer Consortium's requests are granted in part and denied in part, consistent with this decision.
2. The Philadelphia Water Department's request for rate relief for FY2009 and FY2010 is granted in part and denied in part, consistent with this decision.
3. The Philadelphia Water Department's request for rate relief for FY2011 and FY2012 is hereby delayed and shall be determined when the proceeding is reconvened in February 2010, consistent with this decision.
4. The Joint Statement for Settlement Between The Philadelphia Water Department and Philadelphia Large Users Group Outlining Settlement dated August 11, 2008 is hereby approved.
5. The Philadelphia Water Department's proposed cost allocation and rate design plan should be adopted in its entirety
6. Relief is granted to the Commercial Customer Consortium consistent with this decision.
7. The parties shall file any Exceptions hereto on or before October 17, 2008. Exceptions should be sent to the direct attention of the Water Commissioner with a courtesy copy to the Hearing Officer and all parties of record.

/s/

---

Harris T. Bock, Esq.  
*Hearing Officer*

Dated: October 7, 2008