

PROPOSED FINDINGS OF FACT

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.

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. The Department of Records duly advertised the filing of the proposed regulations and the administrative process via which interested parties could participate in these proceedings.

5. The Water Department further advertised the technical hearings and public input hearings that were held on the dates specified below:

Public Input Hearings

July 21, 22, 24, 25, 31

Technical Hearings

August 12, 13, 14

6. 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. Community Legal Services was also appointed to serve as Public Advocate in the rate hearings.

7. In addition to the Public Advocate, the Commercial Customer Consortium (“CCC”), Philadelphia Large Users Group (“PLUG”), Penn Future/Next Great City Stormwater, and Philadelphia Housing Authority (“PHA”) along with those individuals who testified at the public input hearings.

8. Three technical hearings were held in connection with the rate case and a transcript of some 735 pages was accumulated in these hearings alone.

Description of Rate Increase

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

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

Purpose of Proposal for Rate Relief

11. 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.

12. 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).

13. The Department specifically needs rate relief during this four year period 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.

Rate Covenants

14. In addition to the above operating requirements, the Department must generate sufficient revenues to comply with its rate and insurance covenants.

15. 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.

16. 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).

17. In addition to the covenant 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"), 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.

Rate Relief Needed to Fulfill Rate Covenants and Maintain Credit Rating

18. The Department must increase rates to meet its rate covenants with investors. Same is necessary as a condition precedent to maintaining its favorable credit rating and funding its capital program.

19. 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.

20. 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; and would like to do so at the least cost to our customers.

21. In addition to the above referenced program of renewal and replacement of existing infrastructure, the Department must also employ capital funds to pay many of the costs associated with escalating environmental regulations (including those related to the stormwater management program). PWD Statement 2 at 7.

Rate Relief Needed to Continue Quality Utility Service

22. The Department's request for rate relief is also needed to fund continuing efforts to improve water quality. *Id.* at 3.

23. The Department is committed to producing and delivering high quality drinking water to Philadelphia. *Id.* at 3-5.

24. 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.

25. The Department cannot continue the above efforts without additional revenues to fund the increasing costs of operations. Rate relief must be approved to permit the Department to fully pursue its plan to preserve and improve water quality.

Request for Rate Relief Made After Reducing Financial and Operating Expenses

26. The Department's request for rate relief was formulated only after it had taken every reasonable measure to reduce financial and operating expenses. PWD Statement 1 at 4.

27. Cumulative savings derived from the efforts of the Department in recent years have kept utility charges at minimum levels and have allowed the Department to remain competitive. *Id.*

28. Even with the approval of increased rates, the Department will still be one of the least expensive providers of water and wastewater services in the region. *Id.* at 8.

Projections of Operating Expenses Are Reasonable

29. Projected operation and maintenance expenses for the Rate Period utilize the FY 2009 operating budget as a starting point. PWD Statement 5 at 15.

30. FY 2009 operating expenditure levels are, in the first instance, based upon a City Council appropriation to the Water Fund, as required by the Charter. It is from this approved appropriation level that estimated levels of expenditure are made for the Rate Period based upon budget projections.

31. In addition to budget projections, Black & Veatch and the Department analyzed historical actual expenditures versus budgeted expenses for each of the various budgetary categories or classes such as personal services, purchases of services, materials and supplies, equipment and interdepartmental charges to adjust FY 2009 budget to an estimated expenditure level for the Rate Period. *Id.*

32. In projecting expenditures for each category of the budget, the Department and Black & Veatch used increases projected to occur during the Rate Period (e.g., the impact of changes in electric power costs, PPI increases in chemical costs, etc.) as well as general growth factors conservatively estimated based upon historical experience and corroborated by reliable indices of inflation. *Id.* at 16.

33. For personal services, the following increases were reflected: (A) a \$1,500 one-time payment to all employees in FY 2009; and (B) 2%, 3% and 4% increases in FY 2010, 2011 and 2012, respectively. A growth factor of 0.5% was also applied which reflects a net addition of approximately 10 filled positions each year.

34. Fringe benefits (which are directly related to personal services expenses) were estimated to rise from 73.0% in FY 2009 to 88.8% in FY 2014. *Id.* at 16-17.

35. With regard to electric power costs, the Department projects an annual increase of 2.5% from FY 2009 until mid-2011 based upon a review of historic trends. Thereafter, due to the discontinuation of the Department's discount agreement with PECO, power costs are projected to increase by 11.9% in mid-2011 and 16.5% in FY 2012. PWD Statement 5 at 16; PWD Exhibit 8 (PA-MAB-25); Tr. 280.

36. An annual increase of 9.0% was assumed for chemical expense beginning in FY 2010. PWD Statement 5 at 16.

37. For other expense categories, based upon the past three years of history as well as other indices of inflation, a 3.0% rate or increase is utilized. *Id.*

38. The inflation factors utilized by the Department also reasonably tracks other indices of inflation (CPI – All Urban Consumers in Philadelphia Area, CPI) which has been rising at approximately a 3.0% rate. The recent NACWA and PPI cost indices demonstrate that the proposed inflation rate may be understated. PWD Statement 5 at 16; PWD Exhibit 25 (Tab 12); PWD Exhibit 8 (PA-MAB-27).

39. Inter-departmental charges (dominated by personal services Class 100) reflect inflation factors of 2%, 3%, and 4% in FY 2010, 2011 and 2012, respectively, for personal services expenses and a 3% increase per year for all other costs.

40. In addition to operating expenses and associated inflation and growth factors, debt service costs are projected in the filing to increase during FY 2009-2012. Projected future bonds are driving the increase in debt service costs. Projected debt service in connection with new

bonds is \$21.1 million in FY 2010; \$21.1 million in FY 2011; and \$21.1 million in FY 2012. PWD Statement 5 at 18.

41. The Department plans to issue approximately \$325 Million in additional long-term debt in early calendar year 2009 and an additional \$350 million in FY 2012 to fund its capital program. PWD Statement 1 at 8; PWD Statement 5 at 18.

42. The rate filing assumes, based upon estimated market conditions that new bonds can be sold in early calendar year 2009 at a blended interest rate of 5%. The revenue impact of the 2012 bond transaction will be outside the Rate Period (debt service associated with second bond deal will be due in FY 2013). PWD Statement 5 at 18; Tr. 246-247.

43. In addition to the aforementioned revenue requirements, there are two additional revenue requirements. The first is the excess interest earnings payment to the City. This payment reflects application of the 1974 General Ordinance, as amended and supplemented, that in any fiscal year in which a balance exists in the Department's Operating Fund, a payment may be made to the City's General Fund which does not exceed the lowest of (i) the amount of interest earnings on Sinking Fund Reserves transferred to the Operating Fund during the fiscal year or (ii) the amount of interest earnings on the Capital Improvements Fund transferred to the Operating Fund during the fiscal year, or (iii) \$4,994,000. PWD Statement 5 at 20.

44. Projected annual payments of excess interest earnings to the City are \$2.568 million in FY 2009; \$2.782 million in FY 2010; \$2.782 million in FY 2011; and \$3.790 million in FY 2012. PWD Statement 5 at 20 (Exhibit JRM-1 – Tables 12 and 13).

45. The second additional revenue requirement is the required Capital Account Deposit. Under the 1989 General Ordinance, the City is required to make a Capital Account Deposit in each fiscal year, in an amount not less than one percent of the total value of the net assets of the Department. PWD Statement 5 at 21.

46. The Capital Account Deposits are to be used by the Department to finance capital improvements for the water and wastewater systems. The required deposits during the Rate Period are set forth below:

Fiscal Year 2009	\$ 18,179,000
Fiscal Year 2010	18,570,000
Fiscal Year 2011	18,961,000
Fiscal Year 2012	19,352,000

47. Table 11 (PWD Statement 5, Exhibit JRM-1) presents a cash flow statement of projected revenues and revenue and rate covenant requirements for water and wastewater utility operations for the period of FY 2009-2012 under the framework of the 1989 General Ordinance.

48. The table provides an indication that the Department's projected revenues with rate relief comply with the requirements of the 1989 General Ordinance (absent any adverse

financial developments of the magnitude summarized in the Negative Events Impacting the Rate Increase Proposal). PWD Exhibit 25 (Tab 1).

49. As indicated on Lines 4 through 9 of Table 11, annual increases in revenue are required beginning in Fiscal Year 2009. Levelized annual increases of 6.4% are needed in FY 2009-2012.

50. As indicated in Lines 27 and 33 of Table 11, the minimum debt service coverage requirements would be met with these overall levels of increase (under conditions known at the date of filing this case).

51. Annual cash requirements for the combined water and wastewater utilities will meet with the required levels of increase as indicated by the positive balances shown on Line 35 of Table 11, allowing only for a working capital allowance of \$45 million at the end of the Rate Period. PWD Statement 5 (Exhibit JRM-1, Table 11).

52. In view of the deterioration in the financial condition of the Department since the formulation of the rate filing (because of the delay in implementing of rates; new shut-off restrictions, inflationary increases, etc.) proposed revenue projections that realistically assess future conditions based upon recent history are a critical concern, as the Department still must meet the requirements of the Charter, Philadelphia Code and its bond covenants even though the circumstances presented have changed.

Department Proposed Adjustments

53. The Department has agreed to adjust the rate filing in the following areas:

Rate Compression	\$15.0 million reduction to proposed revenues due to the delay in rate filing implementation.
Personnel Costs	\$1.0 million downward adjustment to revenue requirements due to implementation of \$1,100 bonus (as opposed to projected \$1,500 bonus).
Indemnities	\$2.0 million one-time reduction in Indemnities expense given historic experience.

54. The Department believes that the foregoing adjustments represent all that it can prudently give in view of events since the rate filing which will make financial management of the Department increasing difficult over the four year rate period.

Additional Adjustments Unwarranted

55. The Public Advocate seems oblivious to the Department's predicament in recommending numerous aggressive adjustments to the Department's projected expense levels as summarized below:

Public Advocate Proposed Adjustments to Department Expenses (\$000)

	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
Budget Factors				
Actual/Budget Factors (Class 100-400)	(6,061)	(6,264)	(6,597)	(6,967)
Personal Service/Interdepartmental Expenses				
Eliminate Salary Increases/No Inflation	(744)	(3,431)	(9,542)	(17,936)
Eliminate Staffing Level Increases	(127)	(1,000)	(1,926)	(2,934)
Eliminate Fringe Inflation	0	(3,148)	(6,646)	(10,627)
Non-Recurring Expenses				
Eliminate Non-Recurring Costs	0	(2,684)	(2,763)	(2,846)
Growth Factors				
Reduce Other Inflation (2.5%)	0	(529)	(1,089)	(1,678)
Reduce Electric Cost Inflation (2.5%)	0	0	(1,890)	(5,150)
Reduce Chemical Cost Inflation (2.5%)	0	(1,499)	(3,170)	(5,030)
Miscellaneous				
Reduce Indemnities Expense	(3,073)	(3,149)	(3,228)	(3,308)
Eliminate Excess Interest Earnings Transfer	(2,568)	(2,782)	(2,782)	(3,790)

PWD Exhibit 32 (Schedule 3)

56. The Public Advocate has proposed \$149 million in adjustments to the rate filing. The numerous adjustments to the revenue requirements will only assure dramatic revenue increases in future years, as demonstrated by PWD Exhibit 32 (Schedule 4). In addition to the adjustments in the above table, the Advocate's collection factor adjustment artificially increases revenues by \$2.09 million, \$2.07 million, \$2.05 million and \$2.03 million in FY 2009, 2010, 2011 and 2012, respectively. PWD Exhibit 32 (Schedule 3). Further, the Advocate's use of final FY 2009 budgeted expenditures yields an additional \$3.38 million reduction in expense levels.

57. The Advocate recommends that the Department return for another rate increase within the next one or two years. Under a two year scenario, the percentage increase in FY 2011 will likely be in the order of 14.3% (rather than the levelized 6.4% increase proposed by the Department). *Id.*

Actual/Budget Factors

58. The Public Advocate criticizes the Department's use of actual-to-budget factors in the rate filing, indicating that such factors are highly subjective. PA Statement 1 at 20.

59. The Department determines actual-to-budget factors taking into consideration reviews of historical data including data going back as far as five years. This review takes into consideration historical results, trends in results and experience and judgment. More weight is given to the more recent 2-3 years of experience – but trends and longer term experience are not completely discounted.

60. Public Advocate witness, Michael Bleiweis, proposes to use a simple average of two and three year data to determine actual-to-budget expenses for Classes 100-400 in this case. He believes this will reduce the subjectivity in the analysis.

61. The Advocate recommended use of a five year average in the last case. Tr. 245. The Advocate maintained last time that use of such an average would reduce subjectivity and smooth any aberrations in expenditures to arrive at more normalized levels of spending for use in ratemaking. The Advocate rejects this approach now and instead embraces a different methodology (simple average of the most recent 2 and 3 year period data).

62. It turns out that the simple average of the historical 2 and 3 year period data yields a significantly bigger adjustment in this case (\$7.4 million higher) than the five year average. The Advocate definitely finds this attractive.

63. The Advocate indicates that “unless there is a compelling reason” otherwise, his recommendation (to use the simple average of the two and three year period data) should be adopted in this case. PA Statement 1 at 21.

64. The Department maintains that there is a compelling reason to do otherwise. Senior management has used its operational knowledge of the utility to arrive at a realistic determination of the revenue requirement. It has not only reviewed two and three year data but other historic data to realistically assess and determine appropriate levels of expenditure for ratemaking purposes.

Personal Services

65. The Advocate is also critical of the Department's projected expenditures for salaries and benefits for its approximately 1,965 employees (water fund and capital fund employees).

66. The Department has forecast salary increases for its employees in-line with recent experience with its unionized workforce. Increases in salaries and benefits are projected for FY 2010, 2011 and 2012 at 2, 3, and 4 percent, respectively.

67. Recent history indicates that salary levels for semi-skilled workers (predominant labor category) have increased by roughly 2.3-3.0% annually (including bonuses) over the past three wage agreements (since 1998). PWD Exhibit 25 (Tab 7). The Department's forecast is consistent with this history.

68. In the last case, Mr. Bleiweis applied a five year average of personnel costs to determine the reasonableness of the Department's projections. Utilizing such an average (including salary bonuses) would yield a 3% average increase over the period FY 2005-2009. The Department's estimates are reasonable by the test applied by the Advocate in the last proceeding.

69. The Advocate indicates in this case that we cannot know with absolute certainty what the terms of future labor agreements will be.

70. There is always uncertainty, however. Even when labor agreements are negotiated for fixed terms, they are often opened and re-negotiated before the term has expired, as a way to avoid labor strife.

71. The Department must use the information available to make an informed judgment of future labor expenses to be used for ratemaking in the circumstances presented.

72. Recent history (whether utilizing a five year average or longer period) yields the same result of a roughly 3% annual increase in wages/benefits. The projections utilized in the rate filing parallel the terms of the last agreement with steps of 2, 3 and 4 percent. PWD Exhibit 25 (Tabs 7-8).

73. The Department's approach (using 2, 3, 4% increases) is actually cheaper for customers than applying an annual 3% increase as would be indicated by the experience of the recent past – because of the compound effect of the increase over succeeding years of the rate period.

74. The Advocate raises similar criticisms of Inter-departmental expense projections (which are dominated by personal services costs) in opposing the 2, 3 and 4 percent factors applied in FY 2010, 2011 and 2012, respectively for such personal services costs. PA Statement 1 at 39-40. The Department is also consistent in its opposition to the Advocate (same reasons) as to this issue.

75. The Advocate also recommends that no inflation factor be applied to fringe benefits in this case indicating that, other than the Five Year Plan, the Department offered no substantiation for this increased level of expenditure. PA Statement 1 at 44-45; 70.

76. In addition to the City's Five Year Plan, the Department presented its FY 2007 Financial Report, the Report of the PEW Charitable Trusts, "Philadelphia's Quiet Crisis: The Rising Costs of Employee Benefits" and the rebuttal testimony and exhibits of Deputy Commissioner Joseph Clare on this point. PWD Exhibit 25 (Tab 25); Tr. 289-294.

77. The Department's projections of the escalation of fringe benefits is premised in the first instance upon the City's Five Year Plan (prepared under the direction of the current City Finance Director) and its ongoing knowledge of the issue based upon numerous documents tracking payroll and fringe benefits, as summarized in the Summary of payroll and Fringe Benefits Costs FY 2003-2009; and Fringe Benefit memoranda routinely received by the Deputy Water Commissioner from the Office of the Finance Director documenting trends in such costs. PWD Exhibit 25 (Tab 15).

78. Total benefits as a percentage of payroll have been rising precipitously for a number of years and now comprise at least 73% of personal services expense and are projected to rise to 88.8% by 2014. PWD Statement 5 at 16.

79. Expenditures for benefits have also been outpacing the budget (actual benefit expenses have exceeded the budget in FY 2006, 2007 and 2008). PWD Exhibit 25 (Tab 15).

80. Pension expense has also exceeded budgeted levels since FY 2006. As documented in the Department FY 2007 Financial Report, City pension costs have escalated from \$392.3 million in FY 2005 to \$556.3 million in FY 2007. PWD Exhibit 25 (Tab 16).

81. Pension expenses are not trending flat or downward and represent a major financial challenge for the Department; and same represent roughly one-third of non-uniformed employee pension costs are related to the Department. Tr. 291.

82. The Department must be able to meet this obligation to its employees which is estimated to increase roughly in-line with projected wage increases.

Reduction in Vacancies

83. The Advocate also contends that no adjustment should be made to recognize the projected reduction in vacancies in the Department. PA Statement 1 at 22.

84. The rate filing projects that roughly 30 vacant positions (10 positions per year) will be filled over the period FY 2010-2012. That is the premise for the 0.5% growth factor adjustment. *Id.*

85. The Department has already filled at least 23 positions since July 1, 2008 and expects greater cooperation from the City's Personnel Office in filling many additional vacancies. Tr. 231-235

86. The Hearing Officer should be aware that Department has had numerous vacancies because of past City hiring freezes that have left it to operate at personnel levels far below the optimum. It is finally making good progress in filling these positions. Tr. 266-267.

87. The Advocate's position is at odds with the actual progress being realized in filling vacant positions. PWD Exhibit 25 (Tab 6).

88. The Department's progress in filling vacant positions over the last five fiscal years and, taken together with recent success in filling 23 vacant positions, suggests that the projected reduction in vacancies (utilizing the 0.5% growth factor) is reasonable.

Non-Recurring Expenses

89. The Department has made an adjustment for non-recurring expenditures in the rate filing based upon its judgment and evaluation of proposed new projects reflected in the FY 2009 Operating Budget.

90. Some projects (that the Advocate may view as non-recurring) were left in the projections for subsequent fiscal years for ratemaking purposes based upon the belief that these projects would either be continued in future budgets or that there would be some comparable programs to take their place. The amount of these projects total approximately \$1.802 million.

91. Non-recurring projects in the FY 2009 Operating Budget which were excluded for purposes of projecting revenue requirements for FY 2010 and future years, amounting to \$1.3 million, include the following projects: PWD Strategic Plan; L/T Financial Plan and Affordability Analysis; Energy/Audit Feasibility Study; and SW Development Website). There was no further allowance made in the rate filing for new programs beyond FY 2009.

92. The total amount of new programs included in the FY 2009 Operating Budget is approximately \$27 million, of which \$3.102 million was related to non-recurring expenses.

93. The Public Advocate is critical of the foregoing and recommends that expense projections for ratemaking be reduced by \$3.102 million to reflect non-recurring expenses. PA Statement 1 at 29. PA Statement 1 at 29.

94. The adjustment fails to take into account the fact that (a) \$1.3 million of the above expenditures have already been excluded from the rate plan; (b) in every budget there are non-recurring new programs the cost of which is at the level or exceeds the level of expenditure above; and (c) the above non-recurring project costs pale in comparison to the total increased program expenditures (\$27 million) included in the FY 2009 budget. Tr. 276.

95. The amount in dispute is \$1.802 million (\$3.102 million in expenditures identified by the Advocate less \$1.3 million). This amount is comparable to levels of non-recurring expenditures in every budget. Average expenditures over the last five years were \$2.0 million annually. PWD Exhibit 25 (Tab 9).

96. The increase packages (additional new program expenditures) not included in future years beyond FY 2009 more than offset the non-recurring items identified by the Advocate above.

97. A graphic depiction of the comparison of new programs expenditures and non-recurring expenses is set forth on PWD Exhibit 25 (Tab 9). As shown on the table included in that exhibit for FY 2009, the non-recurring element (as calculated by the Department) represented approximately 6% of new program expenditures – and were obviously more than

offset by new programs not included in the rate filing. Even according to the Advocate's estimate of non-recurring expenses (\$3.102 million), this item is offset by several fold. *Id.*

Growth Factors

98. Growth factors are applied to FY 2009 budgeted expenses to determine projected expenses for the Rate Period.

99. The growth factor employed in development of the revenue requirement for Class 200-400 in this instance (excluding chemical and electric utility costs), is 3.0%. Same was developed based upon three years of history within the Department for growth in expenses, as well as a review of various cost indices, including the Producer Price Index (PPI) for the past three years. PWD Statement 5 at 16.

100. The Public Advocate is critical of the use of the growth factors proposed for Class 200-400 and argues that, if such an adjustment is to be made, a factor should be utilized based upon the Consumer Price Index (CPI) minus food and energy components.

101. The Advocate believes that the growth factor employed by the Department overstates the level of inflation that can be expected during the Rate Period.

102. The Department believes that utilizing the CPI index (minus food and energy components) is inappropriate, as there is a significant component of energy costs that directly or indirectly drive expense levels upward (e.g., costs of many materials and supplies are also driven up by rising fuel prices).

103. The PPI is a more meaningful measure of inflation for the Department. PWD Statement 5 at 16.

104. If one chose to rely on the CPI (minus food and energy components), including the most recent data from 2008, an average inflation rate for the last five years of approximately 2.8% would be the result, not the 2.5% factor recommended by the Public Advocate. PWD 25 (Tab 12).

105. The Department's growth factor utilized for Class 200-400 is in line with a number of measures of inflation -- it is understated compared to the NACWA Index which indicates that an increase in inflation of 6.4% (average level of inflation 2005-2007) would be appropriate or the CPI (All Urban Consumers in Philadelphia Area) which indicates a 3.32% increase in inflation (average level of inflation 2005-2007). PWD Exhibit 8 (PA-MAB-27).

Power Costs

106. The Department projected electric power costs to increase by 2.5% from FY 2009 until mid-year 2011 based upon a review of historic trends. Power costs from mid-year FY 2011-2012 reflect an increase in power costs based upon the expiration of the current contract agreements with PECO Energy (which expire in December, 2010).

107. The expiration of the current 15% discount in rates is a known event. Tr. 284-285.

108. Power costs for FY 2012 are conservatively projected to increase by 11.9% in FY 2011 and 16.5% in 2012. PWD Statement 5 at 16; PWD Exhibit 8 (PA-MAB-25); Tr. 280.

109. The Department has learned from PECO that its electric bill will likely increase from current \$18 million levels to \$25 million annually (39% increase). Tr. 280.

110. The percentage increase included in the revenue requirement for FY 2011-2012 is plainly less than the amount that rates could increase.

111. The assumptions underlying this growth factor are reasonable (understated) and should be approved.

112. The Advocate recommends a 2.5% growth factor be utilized for power costs throughout the Rate Period.

113. In view of the upcoming PECO rate increase and the magnitude of electric power costs for the utility, such a recommendation is irresponsible.

114. A reasonable estimate of electric costs should be in-line with near-term reality. PECO Energy has already announced its intentions after a moratorium on rate increases for this utility that exceeds ten years.

115. The PUC action will likely grant some rate relief (of the 39% rate increase request it has stated it will propose) upwards of the amounts projected by the Department (11.9% in FY 2011 and 16.5% in FY 2012).

116. The Department's estimate is the most reasonable alternative presented in this record and should be adopted.

Chemical Costs

117. The Department projected chemical costs to increase by 9% annually beginning in FY 2010 based upon the PPI and Department experience. PWD Statement 5 at 16.

118. The Public Advocate recommends that a 2.5% growth factor be utilized for these costs as none of the Department's estimates are known and measurable. PA Statement 1 at 37.

119. The Department relies upon the PPI and its own experience in conservatively estimating an increase in chemical costs at 9% annually.

120. Its chemical contracts are tied to the PPI. Tr. 281.

121. Examination of the increase in this index is an appropriate test of the reasonableness of Department projections. In this instance, the PPI has increased on an average annual basis over the period FY 2003-2008 by 8.8%.

122. Department's estimate (9%) is in-line with the main barometer of increases in this area (particularly given that the Department's chemical contracts are tied to this index). This projection should be adopted as reasonable.

Indemnities Charges

123. The Department projected indemnities expense at \$6.5 million. This amount was determined by applying a 95% actual-to-budget factor to budgeted expense levels. PWD Exhibit 5 (B&V Workpapers – Omone-9 and OMtwo-3); PWD Exhibit 8 (PA-MAB-45; 58).

124. Public Advocate witness Michael Bleiweis is critical of this expense and recommends that a 48.45% factor be applied to budgeted indemnities expense for ratemaking purposes.

125. Mr. Bleiweis uses a five year average of indemnities expense as the basis for his recommendation. His recommendation would lower indemnities expense by \$3.4 million. PA Statement 1 at 43.

126. The Department is opposed to the Public Advocate's position, as it is self-insured. In view of this status, the Department must maintain adequate reserves to insulate itself against losses in a given fiscal year that could compromise its ability to provide service or place it in jeopardy of missing its coverage requirement.

127. Indemnity claims are the upshot of litigation which are not as predictable as other operating expenses. One claim can cause the Department to exceed its reserves (that's the nature of litigation).

128. Indemnities expense already exceeds \$5.9 million in FY 2008. Tr. 286.

129. The Department is amenable to compromise by accepting a one-time reduction of this claimed expense in the total amount of \$2.0 million over the Rate Period. This expense would also be subject to a 3% growth factor, as proposed in the rate filing.

Excess Interest Earnings

130. The Department has included in its revenue requirements an interest earnings payment to the City (sometimes referred to as the "scoop payment"). This payment is made pursuant to the 1974 General Ordinance, as amended and supplemented.

131. The Ordinance requires that a payment be made 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.

132. Projected annual payments during the Rate Period are set forth below:

FY 2009	\$ 2,568,000
FY 2010	\$ 2,782,000
FY 2011	\$ 2,782,000
FY 2012	\$ 3,790,000

PWD Statement 5 at 20 (Exhibit JRM-1 – Tables 12 and 13).

133. The determination of whether the transfer of excess interest earnings is made is based upon the decision of the Finance Director.

134. The Public Advocate is critical of the transfer to the General Fund and recommends instead that the monies be transferred to the Revenue Fund where it could benefit customers. PA Statement 1 at 48.

135. This matter is beyond the Department’s discretion. Tr. 248.

Collection Factor

136. The Department uses a 97% overall collection factor in this rate filing. This total collection factor is comprised of an 85.5% current collection factor, a 9.0% first prior year collection factor and a 2.5% second prior year collection factor.

137. The Public Advocate believes an 86.0% current collection factor is achievable based upon an average of performance during the period FY 2003-2007.

138. The Advocate relies upon a flawed calculation of the current collection factor to reach this conclusion.

139. Actually achieved current collection percentages are set forth below:

2003	84.78%
2004	85.40%
2005	86.11%
2006	85.39%
2007	85.88%

PWD Exhibit 25 (Tab 4).

140. This above data indicates that 85.5% is the appropriate collection factor to utilize based upon the correct calculation of the five year average that the Advocate recommends. The Advocate has not disputed the corrected calculation of the applicable five year average. Tr. 219.

141. To the degree the Advocate wants to adhere to his initial recommendation (86%) as a goal, then he is contradicting his own position concerning the consistent use of averages in municipal ratemaking projections. Tr. 265.

142. The goal he has set, in this instance, departs from the experience of the last five years.

143. In continuing to advance this recommendation, he is also discounting the impact of price elasticity of demand (given higher rates may be implemented), the current recessionary economy, new shut-off restrictions (which bar termination of service during two-thirds of the year), among other considerations. See, Tr. 225-226.

144. The Public Advocate believes that the new billing system will enable the Department to achieve the 86% collection factor. Tr. 224.

145. The anticipated positive impact of the new billing system has not been the experienced to date. Tr. 124.

Rate Stabilization Fund Adjustment

146. The Commercial Customer Coalition (“CCC”) also advances a revenue adjustment concerning the Rate Stabilization Fund (RSF). It is their contention that the RSF should be used to further offset the FY 2009 revenue requirement and mitigate the need for a compression adjustment to rates. CCC Statement DMK-1 at 5-6.

147. The Department views this recommendation as parallel to its own compression adjustment and concurs that the RSF can be appropriately used for this purpose.

Cost Allocation/Rate Design

148. The Department’s proposed cost allocation and rate design should be approved as same are premised upon cost causation.

149. The Department’s ratemaking authority is constrained by the standard that rates should not be unreasonably prejudicial or disadvantageous to a class of service.

150. The Department’s rates are devised with use of the most complete information available.

151. Absent ideal data parameters, reasonable judgment is used in making allocations and establishing rates. The important concern is that the end result is a reasonable one.

152. The water and wastewater cost of service studies consist of essentially three components (1) the determination of the cost of service to be recovered from charges for water and wastewater service; (2) the allocation of cost of service to functional cost components which

recognizes the system characteristics; and (3) the distribution of functionalized cost of service components to customer classes. PWD Statement 5 at 22.

153. The total revenue requirements to be derived from charges for water and wastewater service are synonymous with, and are the definition of, the total cost of service. As a basis for developing an equitable rate structure, these costs are allocable to the various customer classifications according to respective service requirements. *Id.* at 22.

154. For the water utility, allocations of these requirements to customer classes should take into account the quantity of water use, relative peak capacity requirements placed on the system, the number and size of services to customers, and proprietary interest in the system investment. *Id.*

155. For the wastewater utility, factors considered in estimating service requirements of each customer class include the annual volume and peak rates of sanitary wastewater, infiltration, and stormwater flows; wastewater strengths; the number and sizes of customers served; and proprietary interest in system investment. *Id.*

156. After the allocation of costs to functional cost components, the same are distributed to customer classes. To do this, customers with similar characteristics are assigned to specific classes. Units of service for each class are determined for each of the functional cost component categories. The unit costs of service are determined by dividing the allocated cost of service by the sum of the units of service for all customer classes for each particular cost component. The unit costs are then applied to the units of service for each class with the total class cost of service being the sum of the allocated costs for all cost components. The units of service of each customer class provide a means of proportionate distribution of costs previously allocated to functional cost components to the customer classes.

157. Analysis of resulting costs of service to each customer class provides the basis for design of the proposed rate schedules. In this case, rate schedules for water and wastewater service to retail customers were designed to consist of a service charge and volume charges applicable to billable usage for each utility. A surcharge rate applicable to customers with high strength wastewater is also included in the proposed wastewater rate schedule. *Id.* at 14.

158. Proposed charges for water and wastewater service recognize that eligible senior citizens, charities and schools (among others) are provided service at a discounted rate. In addition, the proposed rate design recognizes the requirements of the Home Rule Charter, Philadelphia Code and 1989 General Ordinance that the Department impose, charge and collect in each fiscal year rates sufficient to generate revenues to meet operating requirements, debt service and its rate covenants. Accordingly proposed rates reflect historic patterns of collections.

Public Advocate Recommendations (Rate Design/Cost Allocation)

159. Public Advocate witness Jerome Mierzwa generally endorses the Department's recommended cost allocation and rate design.

160. He specifically concludes that the use of the “base-extra capacity” method of cost allocation is reasonable (as one of the two most commonly accepted cost of service methodologies). PA Statement 2 at 4.

161. He also observes that such methodology, as applied by the Department in this case, is consistent with the standards of the American Water Works Association’s Manual M1 (*Principles of Water Rates, Fees and Charges* – more commonly referred to as the Water Rates Manual). *Id.* at 5.

162. The Public Advocate witness also finds that the cost allocations for wastewater service, as used by the Department, are reasonable and consistent with industry practice. PA Statement 2 at 10.

163. Mr. Mierzwa makes one practical criticism concerning fire connection charges, as he saw no reason for public and private fire connection charges to be decreased while other charges are being increased, only to be adjusted upwards again in the near term. Instead, the Public Advocate witness indicates that these rates should be maintained at current levels for the present and increased later in the Rate Period. *Id.* at 7.

164. The Department concurs with this recommendation.

Commercial Customer Coalition Recommendations

New Customer Classes

165. Mr. Kalbarczyk recommends that customer classes be expanded to provide more specific groups of customers taking into consideration unique characteristics, service requirements and other factors related to larger meter customers.

166. At a minimum, he believes that classes should include separate groupings for small and large industrials, large hospitals, universities and other categories in order to be appropriately differentiated from other customers. CCC Statement DMK-1 at 6.

167. The CCC witness points out that it is important to create separate classes of customers to track cost causation. It is his continuing belief that larger customers are subsidizing residential customers.

168. This general thesis was rejected by the Commissioner Brunwasser in the last rate proceeding. 2005 Rate Decision at 14-15.

169. CCC assumes that larger customers are subsidizing residential customers when that has not historically been the case; and no evidence has been presented to document otherwise.

170. The Public Advocate’s rate design/cost allocation witness (despite the protestations of Mr. Kalbarczyk) has once again indicated in this record that the cost of service

calculations are consistent with generally accepted cost based ratemaking principles and that the rate design is appropriate. PA Statement 2 at 5; 10-11.

171. The Department utilized the AWWA sponsored base-extra capacity method for its cost allocation process. Tr. 482.

172. The stumbling block presented is the costly process of setting up a new rate classification system and to what end. Assuming discount policies are not abandoned, there will never be a level playing field for all customers.

Maximum Day and Hour Peaking Factors

173. Mr. Kalbarczyk criticizes the Department's use of the maximum day and hour peaking factors for water cost allocation.

174. The Department utilizes maximum day and hour demand factors of 2.0 and 3.6, respectively, for the residential class in the rate study.

175. Mr. Kalbarczyk believes that typical maximum day and hour demand factors for the residential class are around 2.5 and 5, respectively, in his experience in other jurisdictions. CCC Statement DMK-1 at 24.

176. He observes that the higher the demand factors, the greater the cost assigned. He concludes that the Department's use of lower demand factors for the residential class artificially increases the cost responsibility of other classes. *Id.*

177. The Department maintains that Mr. Kalbarczyk's experience, as documented in his resume, is dominated by smaller jurisdictions such as the Borough of Ambler, the Borough of Schuylkill Haven and the City of Lancaster. Those jurisdictions are more characteristically suburban in nature, with significantly larger parcel sizes and higher discretionary (peak) usage by their residential customers, as driven largely by lawn irrigation. Tr. 393; 489.

178. Philadelphia is quite different with its smaller properties (largely row homes) and extremely small level of discretionary water use such as lawn watering (due to small green spaces, if any). As a consequence, residential customers in Philadelphia do not have the large differences between peak day and peak hour usage which is typically seen in more suburban water utility systems. Tr. 393-394.

179. Mr. Kalbarczyk extrapolates from his own experience in suburban jurisdictions that residential peaking factors in Philadelphia must be the same as he has observed in his work experience. This is not the case. Urban jurisdictions, like Philadelphia, are much different than the more suburban clients listed in Mr. Kalbarczyk's resume of experience. Tr. 404-405; 410.

180. The CCC witness also indicates that demand studies by class should be undertaken to establish the relationship of non-coincidental maximum day and maximum hour demands by class relative to coincidental peak demands on the system.

181. He omits to state, however, that this is a very expensive undertaking and that municipal utilities rarely undertake such studies. Tr. 398; 401.

182. In the absence of such demand studies, Mr. McKinley corroborates the reasonableness of demand factor assumptions by his review of diversity considerations on the system (i.e., recognizing that not all customer classes peak at the same time).

183. The relationship of the sum of the non-coincidental class peak demands relative to the coincidental system peak demand indicates the level of diversity on the system. In this instance, the relationship is between 1.05 to 1.40. Tr. 396.

184. This establishes the range to test the reasonableness of demand factors employed. The demand factors used in this case (and previous rate cases) fall within this range.

185. Mr. Kalbarczyk opines, without substantial basis, that the residential peaking factors should be higher.

186. In absence of a demand study, his thesis remains unproven.

187. Relevant information available to the Department (corroborated by system diversity considerations) indicates that the demand factors utilized in the cost of service are appropriate and valid metrics for the purposes intended.

Fixed/Variable Cost of Service Methodology

188. Mr. Kalbarczyk also criticizes the Department's wastewater cost allocation methodology for not recognizing variable peaking factors by class. CCC Statement DMK-1 at 28.

189. He observes that the Department's wastewater cost of service study first allocated costs on a functional cost basis and then allocated various capacity related costs to the customer classes using the same capacity (or peaking) factor for each customer class (unlike the water cost of service study which reflected higher peaking factors for residential customers and lower peaking factors for commercial and industrial customers). *Id.*

190. Mr. Kalbarczyk believes that the Department's approach is flawed because it ignores (what he presumes are) lower peaking factors for commercial and industrial customers.

191. Former Commissioner Kishinchand acknowledged this CCC criticism of the Department's wastewater cost of service methodology in the 2001 proceeding, but indicated that peaks on the wastewater system were not likely caused by sanitary flows (with presumed variable peaking factors), but by stormwater flows. 2001 Rate Decision at 14.

192. Department witness J. Rowe McKinley confirms this fact (peaks in on wastewater system are not explained by sanitary flows which pale in comparison to stormwater flows) in the hearings in this case. Tr. 489-490; 558-559.

193. Mr. McKinley plainly indicates that water related peaking factors have no relevance to the wastewater system – specifically indicating that “discretionary use” such as lawn irrigation is largely responsible for creating peak demands on the water system. Water volumes associated with this discretionary use are not returned to the wastewater system. Tr. 489; 494.

194. This basic fact negates the existence of significant peaking factors between customer classes on the wastewater system.

195. Particularly in the context of combined sewers for sanitary and stormwater flows (as exist in Philadelphia), it is obvious that sewers are sized for storm or flood conditions. Sanitary flows are only a fraction of stormwater flows. See, Tr. 490; 558.

196. This obvious fact may account for the scarcity of data documenting variable peaking factors for wastewater. Tr. 544.

197. Mr. Kalbarczyk also concedes that none of the municipal clients listed on his resume use the fixed/variable rate methodology he proposes here.

198. Use of this method of cost allocation should be rejected as unsupported by the record.

Customer Billing and Collection Costs

199. Mr. Kalbarczyk is critical of the Department’s cost of service study indicating that it inappropriately allocates costs associated with customer billing and collections to customer classes based upon equivalent number of bills. His premise is that larger customers have more favorable collection factors. CCC Statement DMK-1 at 21-22.

200. The Department allocates customer costs (e.g., meter related, billing collecting and accounting expenses) on the basis of the number and size of water meters in service and the number of bills rendered. The estimated number of equivalent bills for each classification is based upon the number of bills rendered and the estimated ratios of meter reading, billing and collection costs of customers with larger meters to such costs attributable to customers with a 5/8 inch meter. The ratios used for this determination are set forth in PWD Statement 5 (Exhibit JRM-1 – Table 19).

201. Mr. Kalbarczyk is critical of the use of equivalent bill ratios because it places greater cost responsibility on larger customers. However, as noted in the record the costs related to meter reading, customer service and other considerations for larger customers are also larger. Tr. 415; PWD Exhibit 12 (CCC-II-6).

202. Mr. Kalbarczyk nonetheless maintains that larger users percentage increase in this rate proceeding should be lower as they have a higher revenue collection factor compared to residential customers. He hypothetically assumes that commercial and industrial customers have a 99% collection factor to make his point that their percentage increase in this proceeding should be lower. CCC Statement DMK-1 at 23.

203. The problem is, of course, proving this generalization.

204. Among the classifications of commercial and industrial properties are small businesses (corner groceries, beauty shops, laundromats) and vacant properties that do not uniformly have higher collection factors. To assume a 99% collection factor for this group in a recessionary economy is a real leap of faith.

205. The Water Revenue Bureau also pursues delinquent commercial and governmental accounts (using collection agencies in some instances) confirming that larger customers are not uniformly creditworthy, as Mr. Kalbarczyk is assuming.

206. Residential customers (as a classification) are not the sole culprit in addressing collections issues.

Lower Tail Block Rates

207. Mr. Kalbarczyk recommends “due to flaws and shortcomings” of the Department’s rate filing and absent a fully adjusted cost of service study to address CCC concerns, a lower volumetric rate for the second, third and fourth steps of the declining rate structure should be adopted.

208. This over-arching recommendation is made without record support.

209. The Department’s water volume charge rate structure is in four usage blocks. Residential usage is almost exclusively in the first block. Larger users have some usage in the initial blocks, but because of their volume of usage, they predominately use water in the third and fourth blocks.

210. CCC specifically recommends that the existing rates when adjusted should retain the existing ratio between the first block to the remaining second, third and fourth blocks. CCC Statement DMK-1 at 7.

211. The problem with this approach is that it departs from cost of service ratemaking.

212. Mr. McKinley indicated in this record that in the rate study in 2001, there were much higher peak demands than exist on the system today. For example, the 75/25 relationship between base and maximum day demands that we see today was in the range of 70/30 previously. Tr. 483.

213. These changes in system demand characteristics are appropriately reflected in the rate blocks. In other words, as peak demands moderate, the steps in the rate structure become more compressed because more costs are being shifted to the base cost component which is a common cost to all four of the rate blocks. Tr. 483-484.

214. The cost of service study (utilizing an AWWA sponsored methodology) supports the Department's determination of rate blocks associated with water usage.

Conjunctive Billing

215. Mr. Kalbarczyk recommends that conjunctive billing be permitted for commercial and industrial customers that receive service through multiple meters.

216. Conjunctive billing would allow customers to combine volumes from multiple meters to qualify for the volume discounts in the rate blocks under the water rate design. CCC contends that conjunctive billing would allow the Department to recognize the economies of scale it benefits from serving these customers. CCC Statement DMK-1 at 33-34.

217. The Department has established the usage blocks in its water rate design to track cost causation. That is why there is a declining block structure.

218. The usage for larger customers is mostly in the third and fourth blocks. The usage in the fourth block is essentially the base cost of water. Tr. 483.

219. Mr. Kalbarczyk's proposal states plainly that he wants a discounted rate for his constituents below the base cost of water. The Department cannot give away water (below cost) without other customer groups subsidizing the effort. This proposal cannot be reconciled with cost of service principles.

Customer Service

220. Public Advocate witness Roger Colton is critical of the Department and the Water Revenue Bureau with regard to customer service issues. PA statement 3 at 13.

221. Mr. Colton indicates that the Department has an affirmative obligation to provide equitable customer service; and that equitable service involves addressing and meeting the disparate customer service needs of this utility's service territory. He further notes that, as a municipal utility, the Department has a further obligation to act in an open, transparent, reasonable manner toward its citizen/customers. *Id.* at 5.

222. The Public Advocate witness selects specific components of the Department's customer service delivery for review including administration of its (a) deferred payment plans; (b) the Water Revenue Assistance Program ("WRAP"); (c) appeals and disputes; and (d) tenant issues. *Id.* at 13-50. Mr. Colton also draws upon anecdotal evidence from the public hearings to illustrate the need for reforms in customer service. *Id.* at 41-43.

223. The Department and Water Revenue Bureau are fully supportive of the Public Advocate's position (in principle) and have invited the Advocate to participate in a mediation (or collaborative) to be promptly convened by the Hearing Officer to address shared concerns as outlined in the Commissioner's testimony. PWD Statement 6 at 4.

224. The newly appointed Revenue Commissioner, Keith J. Richardson and Deputy Commissioner Michelle Bethel¹ appeared at the hearings to affirm their commitment undertaking a full review of customer services offered to make sure same are consistent with or on a path toward "best practices" for a municipal utility. Both indicated that they were anxious to explore with the Public Advocate specific ways to improve customer services related to direct customer contacts, informal dispute resolution, administrative appeals, customer assistance programs and so many other areas as a part of their review of the Water Revenue Bureau. Their shared goal is to achieve a higher level of customer service at the Bureau. See, PWD Statement 6 at 3.

225. Commissioner Richardson also noted in his testimony that the customer complaints raised in the rate proceeding were all being addressed. At the time of the submission of his testimony five complaints had been resolved; and documentation of same was included in Exhibit B to his testimony. The balance of such complaints has been resolved since the hearings, as identified in PWD Exhibit 37 (TR-2). As stated by the Commissioner, the Water Revenue Bureau takes each one of these complaints very seriously and will address all underlying concerns about the quality of customer service illustrated by same. PWD Statement 6 at 2-3.

Proposed Rate Plan

226. The Department's overall framework for new rates (multiple year rate plan) is reasonable and should not be changed.

227. Policy reasons underpinning the use of a multiple year rate plan include its facilitation of the Department's ability to levelize rates so that customers and the utility can plan accordingly. The Department also lives within the constraints of revenue levels granted for the rate period approved. This gives predictability to the rate process.

228. Customers have a reasonable expectation that rate increases should be implemented gradually. PWD Exhibit 32 (Schedule 4) illustrates this point. In the scenario presented in that Table 11 run, a revenue increase of 14.3% is necessitated in FY 2011 (utilizing the Advocate's revenue requirement assumptions).

229. The Department would like to avoid such a sharp increase in rates in a given year by following its four year rate plan with levelized increases coordinated with the careful management of the Rate Stabilization Fund.

230. The Department has historically utilized the RSF as a source of working capital. The Department estimates this present need at \$45 million. This estimate is consistent with the

¹ Commissioner Richardson was appointed by Mayor Michael A. Nutter in January, 2008. Deputy Commissioner Bethel was appointed in July, 2008 to oversee the Water Revenue Bureau.

lead-lag study undertaken in the 1990's establishing a \$30 million working capital need when the Department's revenues and revenue requirements were significantly lower.

231. Adequate working capital of 30-60 days would be prudent. Tr. 156. Given the Department's current revenue levels, by this measure, a working capital need of \$45-90 million is justified. The results of a recently completed lead-lag study by Mitchell & Titus confirms that a working capital allowance of some \$89 million is appropriate. Tr. 151-156. Please note that the current use of a \$45 million working capital allowance also serves as a cushion against unexpected events (e.g., FSA downgrade), so that the Department will always be a going concern.

232. The investment community also takes substantial comfort in the fact that the RSF is prudently managed, as they know that reserves are important to any enterprise. Investors also know that there is a real possibility of error in realizing anticipated revenues given the payment and collection patterns, local shut-off restrictions, the current economy, interest rates and inflation in material and supplies (largely chemical costs).

233. The financial health of the utility can turn quickly from relative prosperity to grave uncertainty. The testimony of the City's financial advisor, Anthony Griffith, underscores this point. Tr. 324. Financial reserves are important. The Moody's and Standard & Poor's rating agency reports also stress the importance of maintaining satisfactory coverage as the RSF is drawn down. PWD Exhibit 35.

234. Public Advocate witness, Michael A. Bleiweis, recommends use of either a single or two year time horizon for new rates. PA Statement 1 at 66-67. This position has been repeatedly rejected in prior rate cases and should not be sanctioned now.

235. A single or two year rate plan would have the Department perennially engaged in the rate process. There is a major expense tied to this proceeding (\$1.6 million and climbing) tied not only to the cost of litigation but the inordinate amount of time expended by Department employees who also have to run the utility (Deputy Commissioners McCarty and Clare among many others).

236. The structure of the instant rate increase is consistent with prior Department multiple year rate filings, and with the City's overall long-term budget planning process. The Department should not be second-guessed in managing its financial plan – such decisions appropriately reside with senior management.

237. In 1993, Commissioner Kumar Kishinchand approved the Department's first multiple year rate filing premised upon levelizing annual increased revenue requirements over a three year period. The Public Advocate opposed the use of a multiple year rate plan in that case; and his position was rejected.²

² *In Re Matter of a Proposed Increase in Rates for Water and Wastewater Utilities* (FY 1993-1996), Rate Decision at 11-12.

238. Similarly, in FY 2001, the Department proposed a four year rate process to levelize the required increase in annual revenue. Commissioner Kishinchand again approved the use of a multiple year rate plan over the objection of the Public Advocate.³

239. In FY 2005, the Department again proposed a four year rate filing. The proposed average increase in annual revenue requirements in that case was 5.7% over four years. The Advocate again raised his concerns about multiple year rate filings in that proceeding and was rejected by Commissioner Bernard Brunwasser.⁴

240. In all cases identified above, legal and policy concerns weighed heavily in favor of a multiple test year approach to ratemaking which was implemented in the final rate decision in each case.⁵ It is the Department's position that this issue has been determined with finality in this jurisdiction.⁶ The Department contends that even in administrative proceedings, litigation of the same issue between the same parties is collaterally estopped at some point. At the very least, the Hearing Officer should be guided by the precedent of the last three rate decisions in approving the utilization of the four year rate plan.

PROPOSED CONCLUSIONS OF LAW

1. 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.

2. 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.

3. The City Council standards referenced above are set forth in the Philadelphia Code, Sections 13-101 and 13-201.

4. The City Council standards applicable to water (Section 13-101) and wastewater rates (Section 13-201) conservatively 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.

³ *In Re Matter of a Proposed Increase in Rates for Water and Wastewater Utilities* (FY 2001-2004), Rate Decision at 8.

⁴ *In Re Matter of a Proposed Increase in Rates for Water and Wastewater Utilities* (FY 2005-2008), Final Rate Decision at 10.

⁵ As stated previously, policy reasons underpinning the use of a multiple year rate plan include its facilitation of the Department's ability to levelize rates so that customers and the utility can plan accordingly. The Department has also used the rate period to phase-in significant reforms such as those related to stormwater cost allocation in this case.

⁶ Per the Department's Memorandum of Law concerning the alternate rate plans identified during the course of the proceeding, the Department believes that prior precedent should guide the Hearing Officer in this case (as a single and two year rate formulation has been rejected repeatedly in prior rate decisions).

Rates and charges may provide for sufficient revenue to stabilize them over a reasonable number of years.

5. Department must also collect sufficient revenues to meet its rate covenants, including that prescribed by the Restated General Water and Wastewater Revenue Bond Ordinance of 1989 (“1989 General Ordinance”) which requires, among other things, that the Department’s annual net revenues be at least 120 percent of its senior debt service. Also, 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 Rate Covenant”).

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

7. The proposed rate filing is designed to specifically comply with all of the above legal requirements.