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1 I. **STATEMENT OF QUALIFICATIONS**

2 Q. **Please state your name and business address.**

3 A. My name is Michael A. Bleiweis and my business address is 243 Banks  
4 Road, Easton, Connecticut.

5 Q. **By whom are you employed?**

6 A. I am an independent financial and regulatory consultant. Previously, I was  
7 a principal of The Woodside Group, Inc.

8 Q. **On what financial and regulatory subject matters do you specialize?**

9 A. I specialize in providing financial consulting services in municipal utility  
10 budget proceedings and public utility rate cases. Over the course of my  
11 career, my services have been utilized by various consumer advocate and  
12 public interest groups, as well as by public utilities.

13 Q. **For whom are you testifying in this proceeding?**

14 A. I am testifying on behalf of the Public Advocate.

15 Q. **What is your educational background?**

16 A. I am a graduate of Syracuse University with a Bachelor of Arts degree in  
17 Political Science and of New York University Graduate School of Business  
18 Administration with a Masters of Business Administration degree in  
19 Financial Analysis and Securities Analysis.

1 **Q. What has been your business experience?**

2 A. In 1973, I was employed as an economic research consultant with the firm  
3 of National Economic Research Associates (NERA) where I was involved  
4 in the preparation of rate of return exhibits that were based upon computer  
5 modeling for various utility companies.

6 In 1974, I joined the firm of Citizens Utilities Company as a Revenue  
7 Requirements Analyst. My duties included the preparation of financial  
8 exhibits and testimony for various electric, water, gas and sewer company  
9 rate cases.

10 In 1977, I joined American Water Works Service Company as Director of  
11 Rates and Revenue of the Eastern and New England Divisions of  
12 American Water Works Company, Inc. I was charged with the  
13 responsibility of preparing financial exhibits, supporting data and testimony  
14 for use in rate hearings for a total of thirteen water companies in New  
15 England, New York and New Jersey.

16 From 1979 to 2002 I was a principal of The Woodside Group. In January  
17 of 2003, I became an independent consultant.

18 **Q. Please describe further your experience in regulatory matters.**

19 A. Attached as Appendix A is a listing of the proceedings in which I have  
20 testified or participated concerning the proper determination of revenue  
21 requirements and other rate-related topics, including the 1985, 1990,  
22 1992, 2001 and 2005 rate increase proceedings for the Philadelphia  
23 Water Department.

1 **II. WATER DEPARTMENT PROPOSAL**

2 **Q. Please describe the Philadelphia Water Department's (PWD) revenue**  
3 **increase proposal for this proceeding.**

4 A. As shown on the Direct Testimony of Mr. McKinley, Table 11 of Exhibit  
5 JRM-1, lines 4-7, the Water Department proposes to increase total overall  
6 revenues in each fiscal year 2009 to 2012 by 6.40%. As shown below, the  
7 cumulative total revenue increase over the four-year "rate period" is  
8 proposed to be \$316.956 million.

<b><u>REVENUE INCREASE \$</u></b>	
<b><u>FISCAL YEAR</u></b>	<b><u>REVENUE INCREASE (\$000)</u></b>
2009	\$30,261
2010	\$62,000
2011	\$95,228
2012	\$129,467
TOTAL	\$319,956

9

10 As shown on Tables 12 and 13 of Exhibit JRM-1 and below, revenues for  
11 water operations and wastewater operations for fiscal years 2009-2012  
12 are not being proposed to increase equally. Water service revenues are  
13 being proposed to increase by about two times the percentage increase  
14 proposed for wastewater revenues.

15

<b><u>REVENUE INCREASE %</u></b>				
	<b><u>FY2009</u></b>	<b><u>FY2010</u></b>	<b><u>FY2011</u></b>	<b><u>FY2012</u></b>
Water	9.60%	9.60%	9.60%	9.60%
Wastewater	4.56%	4.48%	4.40%	4.30%

1

2 **Q. What number of years is being proposed for the “Rate Period” in this**  
3 **proceeding?**

4 A. The proposed “Rate Period” for this proceeding consists of four years,  
5 fiscal years 2009-2012, which is the same length of time utilized in the  
6 2004-05 rate proceeding. In the last several rate proceedings the Public  
7 Advocate has proposed a shorter Rate Period arguing that the longer the  
8 rate period, the less reliable is the Department’s complex forecast  
9 methodology. As will be discussed below, that same argument holds for  
10 this proceeding, as well.

1 **III. WATER DEPARTMENT BOOKS**

2 **Q. Mr. Bleiweis, in your Direct Testimony for several prior PWD rate**  
3 **proceedings, you presented a discussion as to how the Water**  
4 **Department keeps its books and the effect this has on the proposed**  
5 **rate increases. Please summarize this discussion, once again.**

6 A. Similar to all departments of the City of Philadelphia, the Water  
7 Department keeps its books on what is termed a “legally enacted” or  
8 “modified accrual” basis.

9 In general, a legally enacted basis is equivalent to a cash basis<sup>1</sup>. Unlike  
10 investor-owned utilities which are required to keep their books on an  
11 accrual basis<sup>2</sup>, the Water Department records revenues when they are  
12 received, rather than when they are billed. Expenses are recorded on an  
13 encumbrance basis, which is essentially equivalent to an accrual basis-  
14 when the payment obligation is incurred.

15 **Q. For purposes of this rate proceeding, why does it matter how the**  
16 **Department keeps its books?**

---

<sup>1</sup> For a more complete explanation of the “legally enacted basis”, see the PWD 2007 Annual Financial Report, page 23.

<sup>2</sup> “In accrual basis accounting, revenues are recognized in the accounting period in which they are earned and expenses are recognized at the time the liabilities are incurred.” PWD 2007 Annual Financial Report, page 23.

1 A. There are several considerations. First, on the revenue side, since  
2 revenues are recorded when they are received, there is no provision on  
3 the Department's books for bad debts or uncollectible accounts.  
4 Therefore, as will be discussed below, in forecasting future revenues for  
5 ratemaking purposes for the PWD, a major consideration is what portion  
6 of billed revenues will actually be collected.

7 Second, it is normal accounting for utilities to amortize non-recurring  
8 expenditures both on their books and for ratemaking purposes. For  
9 example, the expenses incurred for presenting a rate case (legal,  
10 consultants, etc.) are usually amortized over the historical filing period  
11 between rate cases. However, as stated on the reply to PA-MAB-9:

12 The City prepares its financial statements and performs most of its  
13 accounting utilizing Generally Accepted Accounting Principles for  
14 Governments. Therefore, for accounting purposes the Department  
15 routinely provides for amortization and depreciation. However, the  
16 Department's bond indentures specifically require it to maintain and  
17 calculate coverage on the "legally enacted basis" of accounting. The  
18 "legally enacted basis" is a very conservative method of accounting and  
19 does not generally provide for expense amortizations or accrual of non-  
20 governmental revenue items. Emphasis added.

21 **Q. What is the effect of this accounting methodology?**

22 A. The effect of this accounting methodology is that the booked expense that  
23 would normally be amortized is overstated in the year that the expense is  
24 incurred. Since expenses are overstated, income (revenues minus  
25 expenses) is understated and the income available to meet bond-related  
26 debt service coverage ratios is similarly understated. As stated above,

1           this type of accounting is inherently conservative and has the effect of  
2           overstating the revenue requirement for the test year and beyond if such  
3           expenditures are not adjusted for ratemaking purposes.

1 IV. **TEST YEAR**

2 Q. **What is the purpose of a test year in a ratemaking proceeding?**

3 A. Under standard ratemaking practice, the revenues and expenses that are  
4 projected to occur during a twelve-month period are used as a basis for  
5 determining the need for incremental revenues. The allowed rates remain  
6 in place, not just for the test year, but for all subsequent years until rates  
7 from a future rate case become effective. Since rates could be in effect  
8 for a considerable period of time, it is extremely important that the test  
9 year financial data is representative of the utility's operating conditions for  
10 the immediate future. If the test year data is not representative of  
11 immediate future operating conditions, then adjustments are normally  
12 made to revenues and expenses to correct this mismatch. It is also  
13 important that both adjusted and unadjusted test year data meet the  
14 widely-accepted regulatory principle of being "known and measurable".  
15 As will be subsequently discussed, the four-year forecast methodology  
16 utilized by the Department as the basis for the four proposed revenue  
17 increases fails to meet this regulatory principle.

18 Q. **What "test year" has the Department utilized upon which to base its  
19 revenue increase proposals?**

20 A. In the manner in which the Department has structured this rate proposal,  
21 **there is no test year** in the traditional meaning of that term. Instead the  
22 PWD is utilizing four "test years" upon which to base its rate proposal. As

1 will be explained below, each test year is “fully forecasted”, that is, no  
2 actual data is utilized in any test year except for some beginning fund  
3 balances for fiscal year 2009. Each proposed increase is based upon  
4 satisfying coverage and other requirements on an individual year basis.

5 Although some public utility commissions set rates on the basis of an  
6 historical test year, the use of one fully forecasted test year is not an  
7 uncommon practice. However, the utilization of four test years for  
8 ratemaking purposes is not a common practice. In fact, in my many years  
9 of participation in utility regulation, this is the only utility I know that utilizes  
10 such a procedure.

11 **Q. Why does it matter whether a utility’s rate proposal is adjudicated**  
12 **based upon one, or more than one test year?**

13 A. As stated above, it is a generally accepted ratemaking principle that test  
14 year adjustments must be “known and measurable” at the time of the  
15 filing. This means that adjustments can not be based upon conjecture or  
16 even informed judgment. A good example of a known and measurable  
17 adjustment is one made to annualize wages based upon a signed union  
18 contract. Just the expectation of a wage increase is not acceptable for  
19 ratemaking purposes. In this proceeding, the Department has adjusted  
20 wages during the four-year forecast period based upon an unsigned wage

1 contract.<sup>3</sup> The department claims that the forecast wage increases and  
2 lump sum payments are based upon similar increases in previous wage  
3 contracts but, at this time, it is impossible to determine the actual wage  
4 increases that will be included in the new contract. If such future wage  
5 claims were presented before a public utility commission, they would not  
6 be accepted both because the amount of the annual wage increases are  
7 unknown and because the claimed wage increases occur well beyond the  
8 end of the “test year”.

9 In my opinion, there must be a “cut-off point” upon which to determine  
10 rates. In my over 30 years of ratemaking experience, this point has  
11 generally been at or shortly after the end of the test year. Rates should  
12 never be based on claims for such an extended period as four years.  
13 Further, rates should never reflect a series of rate increases as the  
14 Department proposes for this proceeding. Such speculation is patently  
15 unfair to ratepayers.

16 I will further discuss test year issues later in my testimony.

---

<sup>3</sup> As discussed later in this testimony, the Department and its union have agreed to a one-year no raise contract with an \$1,100 lump sum payment.

1 **V. REVENUES**

2 **Q. Please explain how the Department determined revenues under**  
3 **existing rates.**

4 A. As shown on Table 11 of Exhibit JRM-1, revenues under existing rates  
5 (lines 1-3) refers to the revenues the PWD projects to receive for FY2009,  
6 FY2010, FY2011 and FY2012, if there is no change in rates. Revenues  
7 under existing rates were generally determined by projecting numbers of  
8 customers and usage per customer. Once this data is projected, billed  
9 revenues can be determined by pricing out total usage using current rates.

10 **Q. How were the projected numbers of customers determined?**

11 A. Projected numbers of customers were determined based upon data  
12 shown on Workpaper Cust-8<sup>4</sup>. Basically, the historic change in numbers  
13 of customers by customer class and meter size from 2002 to 2007 was  
14 analyzed. Based upon this data, the Department projected annual  
15 changes in numbers of customers.

16 **Q. Just to be clear, were the same changes in numbers of customers**  
17 **forecast for each year?**

---

<sup>4</sup> All references to workpapers refer to the documentation contained in the binder entitled Black & Veatch Calculations Supporting March 2008 Direct Testimony and Exhibits of J. Rowe McKinley.

1 A. Yes. For example, the number of General Service customers using 5/8”  
2 meters was forecast in Workpaper Cust-8 to decline by 600 for each fiscal  
3 year 2009-2012.

4 **Q. Realistically, will the projected numbers of customers vary from that**  
5 **forecast?**

6 A. Of course- for example, over the past three years the number of General  
7 Service customers using 5/8” meters declined by 311, 746 and 598,  
8 respectively<sup>5</sup>. Obviously, it is impossible to determine exact future  
9 changes in numbers of customers.

10 **Q. How was usage per customer determined?**

11 A. Basically, usage per customer was determined in the same manner as  
12 projected numbers of customers, that is, projected usage was based upon  
13 actual usage over the past six years. The Department is projecting that  
14 annual usage for customers having 5/8” meters will decrease one percent  
15 per year over the forecast period.

16 **Q. The Department notes on the reply to PA-MAB-41 that “the projected**  
17 **1% decrease is less than the actual effective annual decrease**  
18 **experienced from FY 2002 to FY 2007.” Does this mean that actual**

---

<sup>5</sup> The three-year average decline is, therefore, 552. It is unclear why the Department chose to utilize a decline of 600 customers per year.

1           **usage per customer will continue to decrease by at least one percent**  
2           **per year indefinitely?**

3    A.    Of course not. Water usage is especially affected by weather and, in  
4           recent years, by the use of water saving devices. But at some point the  
5           decline in usage will level off as the number of water saving devices  
6           reaches a saturation point. There is just no reliable way to determine  
7           when this leveling off will occur and, therefore, what actual usage per  
8           customer will be in future years.

9    **Q.    How are pro forma revenues determined for water and sewer utilities**  
10       **that appear before the Pennsylvania PUC?**

11   A.    In general, revenues are annualized based upon actual numbers of  
12          customers and usage at the end of the historic test year or customers and  
13          usage forecast at the end of the future test year. The PUC will not accept  
14          projections of numbers of customers and usage beyond the future test  
15          year because such projections are too speculative and are neither known  
16          nor measurable.

17   **Q.    In the Black & Veatch model, once billed revenue is determined, how**  
18       **is collected revenue determined?**

19   A.    Collected revenue, or revenue actually received and booked on a cash  
20          basis in a given year, is determined by applying “collection factors” to  
21          billed revenue. As shown on Workpaper Wrev-6 of the Black & Veatch

1 supporting workpapers and as explained on the reply to PA-MAB-19a, for  
2 this proceeding the Department applied a factor of 85.5% to current year  
3 billings, 9.00% to billings from the first prior year and 2.5% to billings from  
4 the second prior year and beyond, or a total of 97.00%.

5 **Q. How do these collection factors compare to those utilized in the**  
6 **2004-05 rate proceeding?**

7 A. In the prior rate proceeding, the Department applied a factor of 84.5% to  
8 current year billings, 8.75% to billings from the first prior year and 2.5% to  
9 billings from the second prior year and beyond, or a total of 95.75%.

10 **Q. Do you believe that the claimed 97% overall factor is proper for**  
11 **ratemaking purposes?**

12 A. No, I do not. Even though the overall factor utilized in this proceeding has  
13 increased from that utilized in the prior proceeding, the current year factor  
14 of 85.50% is not representative of actual collection percentages obtained  
15 over the past several years. Below is a table showing actual current year  
16 collection factors over the past five years.

1

<b><u>COLLECTION %</u></b>	
<b><u>Year</u></b>	<b><u>Current Year Collection %</u></b>
2003	88.76%
2004	85.40%
2005	86.11%
2006	85.39%
2007	85.88%
Average 2003-2007	86.31%

2 **Source: Workpaper Wrev-6 & PA-MAB-19**

3 Thus, over the past five years, the current year collection percentage has  
4 averaged 86.31%, as compared to the 85.50% utilized by the Department  
5 in each of the forecast years.

6 **Q. Is the Department's new billing system expected to enhance**  
7 **collection capability?**

8 A. Yes. The reply to PA-MAB-3e states:

9 This past January, the department's new billing system went on line. This  
10 system enhances the Water Revenue Bureau's (WRB) ability to track  
11 customer billing history and enables it to automatically flag delinquent  
12 accounts as soon as this status is triggered. As we move forward, PWD  
13 and WRB plan to better integrate early notification of customer billing  
14 delinquency with the department's enforcement shut-off unit.

15 **Q. Based upon the above discussion, what collection factors do you**  
16 **recommend be utilized for ratemaking purposes?**

17 A. I recommend that a factor of 86% be applied to current year billings. This  
18 factor takes into effect the collection factors that have actually occurred

1 over the past few years and provides an incentive to the Department and  
2 the Water Revenue Bureau to do a better job in their collection efforts. I  
3 agree that utilization of an 8.75% factor applied to billings from the first  
4 prior year and a 2.5% factor applied to billings from the second prior year  
5 and beyond is reasonable for ratemaking purposes.

1 VI. **EXPENSES**

2 Q. **Before describing how proposed Total Operating Expenses were**  
3 **determined for the forecast period, please describe what types of**  
4 **expenses are included in this total.**

5 A. Total Operating Expenses, as shown on Exhibit JRM-1, Table 11, line 21,  
6 are composed of:

- 7 1) Class 100-400 operating expenses for each Department  
8 division, PLUS;  
9 2) Interdepartmental Charges, PLUS;  
10 3) Fringe Benefits, LESS  
11 4) Liquidated Encumbrances.

12 A. **Actual vs. Budgeted Factors**

13 1. **Class 200, 300 & 400 Expenses**

14 Q. **Before describing the forecast methodology, please describe how**  
15 **the Water Department's expenses are categorized.**

16 A. For each of the Water Department's divisions<sup>6</sup>, expenses are categorized  
17 into expense classes as follows:

---

<sup>6</sup> The divisions are Human Resources, Finance & Administration, Planning & Engineering, Information Science & Technology, Operations and Customer Affairs.

- 1 Class 100- Personal Services
- 2 Class 200- Purchase of Services
- 3 Class 300- Materials & Supplies
- 4 Class 400- Equipment
- 5 Class 500- Contributions, etc.
- 6 Class 800- Payments to Other Funds.

7 **Q. Please describe the methodology utilized in the Black & Veatch**  
8 **model to determine FY2009 expenses for ratemaking purposes.**

9 A. The determination of operating expenses for ratemaking purposes is  
10 basically a two-step process. First, factors are applied to budgeted  
11 FY2009 expenses by division and expense class in order to adjust for  
12 historical levels of actual vs. budgeted expenditures, that is, very often the  
13 Department does not spend the full budgeted amount for a particular  
14 budget category.

15 **Q. How are these actual vs. budgeted factors determined?**

16 A. Actual vs. budgeted data are examined for various time periods. As  
17 shown on Workpaper Omone-4, these time periods are “2002-2007  
18 Weighted 5 Yr. Avg”, “2005-2007 Weighted 3 Yr. Avg” and “2006-2007  
19 Weighted 2 Yr. Avg”.

1 **Q. How does the Department decide which of the various averages to**  
2 **use in establishing a budget factor for any single expense class in a**  
3 **particular division?**

4 A. As stated on the reply to PA-MAB-44:

5 “Column 10 of Workpaper OMone-4, entitled "USE FOR FUTURE  
6 PROJECTIONS," was determined based on a review of historical actual to  
7 budget ratios based on historical expenses. The review of historical  
8 results takes into consideration the historical results, trends in results, and  
9 experience and judgment, generally with more weight being given to more  
10 recent 2-3 years of experience. In addition to the review of historical  
11 factors, the actual to budget factors for Operations reflect discussions with  
12 Water Department staff which indicated that anticipated future actual to  
13 budget relationships will generally exceed experienced historical levels.”  
14 Emphasis added.

15 **Q. Please comment on this reply and on the general methodology**  
16 **utilized by the Department.**

17 A. Based upon the data presented on Workpaper OMone-4, it is evident that  
18 the Department does not necessarily adopt any of the averages that have  
19 been examined. For example, for Class 200-All Other<sup>7</sup> expenses for the  
20 Operations division, the three actual-to-budgeted percentages stated  
21 above were 91.64% (5-year), 87.99% (3-year) and 94.72% (2-year).  
22 Even, as stated above, the Department gives more weight to “to more  
23 recent 2-3 years of experience”, the percentage utilized for “future  
24 projections” was 97.5%, much higher than the three percentages stated

---

<sup>7</sup> For Operations, Class 200 expenses are broken down into Class 200-Power, Class 200-All Other and Class 200-Chemicals.

1 above. Keep in mind that the higher the actual-to-budget percentage, the  
2 higher is the projected expense and the higher is the ultimate revenue  
3 requirement. In this case the 97.5% factor is applied to the second largest  
4 expense category (\$44,309,700) besides Personal Services expenses. A  
5 simple average of the 2-year and 3-year data would result in a percentage  
6 of 91.36%, rather than the 97.5% utilized by the Department, resulting in a  
7 reduction in expense from \$43.2 million to \$40.5 million, a reduction of  
8 \$2.7 million.

9 **Q. Do you still believe, as you have stated in past proceedings, that the**  
10 **methodology utilized by Black & Veatch is “excessively subjective”?**

11 A. Yes. The future projections are not necessarily based on average actual-  
12 to-budget percentages. From the quote above, it is not clear how the  
13 percentages are determined but it is clear that the percentages are not  
14 determined on a consistent basis. In the 2004-05 rate proceeding I stated  
15 that “it would be logical to consistently use a 5-year weighted average  
16 percentage. This measure contains the most data and, therefore,  
17 smoothes out aberrations over time.” Though I still believe this is a  
18 relevant methodology, the overall problem is that no methodology meets  
19 the regulatory threshold of being known and measurable and not meeting  
20 this threshold results in inequitable ratepayer charges.

21 Further, the fact that the Water Department staff “indicated that anticipated  
22 future actual to budget relationships will generally exceed experienced

1 historical levels” should hold very little weight. This “anticipation” has not  
2 been supported by the Department and, of course, the Department can  
3 not know that this increase will actually occur.

4 **Q. Based upon the above discussion, what do you recommend?**

5 A. Unless there is a compelling reason, I recommend that a simple average  
6 of two-year and three-year data be utilized for ratemaking purposes. This  
7 is a simple methodology that can be consistently applied obviating the  
8 need to make a judgment upon each and every expense class for each  
9 Water Department division.

1 **2. Class 100-Personal Services**

2 **Q. Was an exception made by the Department for the calculation of the**  
3 **budget-to-actual factor for Class 100, Personal Services expenses**  
4 **(salaries & wages)?**

5 A. Yes. As shown on Workpaper Omone-7, the budget-to-actual factor for  
6 Class 100 was increased by 0.5% for each year of the forecast period.  
7 For example, for the Operations division, which has the highest expense  
8 for Class 100, the factor increased from 96.6% for FY2009, to 97.1% for  
9 FY2010, to 97.6% for FY2011, to 98.1% for FY2012.

10 **Q. What is this 0.5% annual increase supposed to represent?**

11 A. The reply to PA-MAB-24d states:

12 “The 0.5% allowance is provided for the filling of vacant budgeted  
13 positions beyond FY 2010. The 0.5% allowance reflects the addition of  
14 approximately 10 positions per year.”

15 **Q. What information has the Department provided supporting this**  
16 **statement?**

17 A. The Department has provided no supporting information for this statement  
18 except to say that a number of employees who currently work in the  
19 biosolids operation are expected to transfer to other divisions and will fill  
20 existing vacancies.

1 Q. What has been the history regarding the actual number of  
2 employees at fiscal year-end over the past five years?

3 A. As shown below, the number of employees at fiscal year-end has actually  
4 declined each year since FY2003.<sup>8</sup>

PWD Personal Services Actual Positions at June 30	
FY2003	1,852
FY2004	1,795
FY2005	1,759
FY2006	1,732
FY2007	1,724

Source: City Budget, Section 54, page 7.

5

6 Q. Were salary increases projected by the Department over the four-  
7 year forecast period?

8 A. Yes. As stated by Mr. McKinley in his Direct Testimony, pages 15-16:

9 The existing labor agreement with the unions to which the majority of the  
10 Water Department's personnel belong terminates at the end of Fiscal Year  
11 2008. For personal services inflation allowances in subsequent years, we  
12 used recent labor union contracts as a guide in making our future  
13 projections. The recent labor agreements included a one-time payment to  
14 all employees in the first year of the agreement. Accordingly, the  
15 projected Fiscal Year 2009 expenses for personal services reflect an  
16 estimated payment of \$1,500 per employee. Subsequent to Fiscal Year  
17 2009, the following annual inflation allowances were assumed, again  
18 following previous labor agreements, which reflected lower percentage

---

<sup>8</sup> Actually, positions at fiscal year-end have declined each fiscal year-end since FY2001. See attached schedule and the Direct Testimony of Michael A. Bleiweis, page 16, in the 2004 rate proceeding.

1 increases in the early years and increasing percentage increases in the  
2 latter years of the agreements... Emphasis Added.

3

<b><u>PERSONAL SERVICES</u></b>	
<b><u>Fiscal Year</u></b>	<b><u>Personal Services Annual Inflation</u></b>
2010	2.0%
2011	3.0%
2012	4.0%

4 **Q. Since Mr. McKinley's Direct Testimony was written, have the City and**  
5 **the Department's union agreed to a wage contract?**

6 A. Yes. The City and District Council 33 have agreed to an one-year, no  
7 raise contract that also provides for an \$1,100 bonus.<sup>9</sup>

8 **Q. Based upon the above discussions, what do you recommend?**

9 A. First, I recommend that if the Department's four-year projection  
10 methodology is utilized, then more weight should be given to the more  
11 recent actual-to-budget percentages. For example, as stated above, the  
12 Operations Division Class 100 Personal Services expenses are the largest  
13 in the Water Department. A simple average of the 2-year and 3-year data  
14 would result in a percentage of 93.9%, rather than the 96.6% utilized by  
15 the Department. Below is a table showing actual to budget percentages,

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<sup>9</sup> Philadelphia Inquirer, July 25, 2008 ("Phila. and its largest union reach 1-year deal").

1 the projection used by the Department and my recommendation based  
2 upon the most current percentages.

<b><u>OPERATIONS DIVISION</u></b>				
<b><u>5-Year Ave</u></b>	<b><u>3-Year Ave</u></b>	<b><u>2-Year Ave.</u></b>	<b><u>Dept. Projection</u></b>	<b><u>PA Projection</u></b>
95.17%	93.85%	93.95%	96.6%	93.9%

3 **Source: OMone-4**

4 Again, please keep in mind that the higher the percentage, the higher is  
5 the projected expense and the higher is the revenue requirement. Also to  
6 be considered is that the total Class 100, Personal Services expenses are  
7 the largest for the Department. Therefore, utilization of higher  
8 percentages than warranted results in much larger expenses on a percent  
9 to total basis.

10 Second, I recommend that the actual-to-budget percentages should not be  
11 increased by 0.5% per year. As shown above, actual historical data does  
12 not support this increase.

13 Third, the model should be revised to reflect the one-year, no raise  
14 contract and the \$1,100 lump sum payment. No wage increases should  
15 be recognized for FY2010, 2011 and 2012 since such increases are  
16 neither known nor measurable.

1 **B. Growth Factors & Non-Recurring Expenditures**

2 **Q. What is the second step in the Department's determination of**  
3 **operating expenses for ratemaking purposes?**

4 A. Weighted average increases in actual expenditures for the periods  
5 FY2003-2007, FY2004-FY2007, FY2005-FY2007 and FY2006-FY2007  
6 were examined. Based upon this data, growth factors were determined.  
7 These growth factors were applied against FY2009 budgeted expenses,  
8 adjusted by the previously discussed actual vs. budgeted factors, to  
9 determine projected expenses for each fiscal year 2009-2012.

10 **Q. Before discussing how these growth factors were chosen, please**  
11 **discuss two issues regarding the utilization of FY2009 expenses as a**  
12 **base.**

13 A. First, it must be recognized that in developing their model, Black & Veatch  
14 utilized budgeted data that was available to them at the time the model  
15 was prepared. As I understand it, the budget was finalized after the  
16 completion of the model. In my opinion, the model should be revised to  
17 include the finalized budget data.

18 Second, it must be understood that the FY2009 budget includes "non-  
19 recurring expenditures".

1 **Q. Please explain what you mean by “non-recurring expenditures”.**

2 A. Certain expenditures occur on a regular, recurring basis, that is, by the  
3 nature of the Department water and wastewater business, expenses occur  
4 each and every year. Some examples of recurring expenditures would be  
5 for salaries and related expenses, chemicals, power, etc. Other  
6 expenditures occur only on a one-time basis. An example of a non-  
7 recurring expenditure would be expenses for a special project.

8 **Q. For ratemaking purposes, why is it important to determine whether**  
9 **budgeted expenses are recurring or non-recurring?**

10 A. Rates should only be based upon recurring expenditures. It is normal in  
11 PUC rate proceedings to adjust out those expenses which are non-  
12 recurring. In this way ratepayers do not pay for special projects which will  
13 not have a recurring effect on the running of the business. Ratemaking  
14 dictates that test year expenses must be both known and measurable and  
15 representative of immediate future periods.

16 **Q. Has the Department made any adjustments to eliminate non-**  
17 **recurring expenditures for ratemaking purposes?**

18 A. To the best of my knowledge, the Department has made some non-  
19 recurring expense adjustments but has omitted others.

1 **Q. Please explain.**

2 A. The reply to PA-MAB-60a states:

3 Black & Veatch adjusted its revenue requirement projections for  
4 elimination of non-recurring items as identified in the Department's "add  
5 packages" as developed at the time of the rate analysis. In addition, the  
6 revenue requirement analysis does not include a provision for new  
7 initiatives and new non-recurring items. Historically, Black & Veatch has  
8 not adjusted its revenue requirement projections for the elimination of  
9 nominal nonrecurring items. Based on many years of analysis, Black &  
10 Veatch has concluded that PWD's annual budget is likely to include  
11 numerous non-recurring cost items. Emphasis added.

12 **Q. What are the “add packages” referred to above?**

13 A. The add packages are justifications for new expenditures that are included  
14 in the proposed budget. Justification sheets for these packages, which  
15 were supplied informally by the Department, identify the proposed  
16 budgeted expenditures as being either “recurring” or “non-recurring”.

17 **Q. Did Black & Veatch include a column in their workpapers entitled**  
18 **“Non-Recurring Adjustments”?**

19 A. Yes, Column 15 of Workpaper OMone-7 totals \$4.3 million. However, as  
20 explained on the replies to PA-MAB-43a and PA-MAB-3a, \$3 million of  
21 this total referred to the Class 100 one-time \$1,500 bonus that was  
22 previously discussed and accounted for in the determination of Personal  
23 Services expenses. Thus, a net total of only \$1.3 million (\$4.3 million less  
24 \$3 million) is recognized by Black & Veatch as being non-recurring.

1 Q. Were non-recurring expenses included in the exhibits of Mr. Clare  
2 and identified on the replies to PA-MAB-56 & 57?

3 A. Yes. Exhibit JC-2 includes a line item entitled "Elimination of Non-  
4 Recurring Events" in the amount of \$1,628,180. The replies to PA-MAB-  
5 56 & 57 identify those line items on Exhibits JC-2 and JC-3 which are non-  
6 recurring.<sup>10</sup>

7 Q. Did you review the budget increase packages to reconcile the \$1.6  
8 million figure stated above?

9 A. Yes. The result of my review was that the budget increase packages  
10 include a minimum of \$3.102 million of non-recurring project costs for  
11 Class 200, Purchase of Services, as follows:

<b><u>Non-Recurring Project Costs</u></b>		
<b><u>Division</u></b>	<b><u>Project</u></b>	<b><u>200</u></b>
Finance	PW Strategic Plan	\$100,000
Finance	L/T Financial Rate Plan & Affordability Analysis	200,000
Finance	Stormwater Reallocation Implementation	200,000
Plan & Eng	Nutrients/PCB Tdml & Flow Agreement Support	150,000
Plan & Eng	Lims Software	400,000
Plan & Eng	Stormwater Reallocation Mitigation Assistance	500,000
Plan & Eng	Energy/Audit Feasibility Study	250,000
Plan & Eng	PWD Stormwater Development Website	750,000
Plan & Eng	Stormwater Technical Plan Review Support	500,000
Operations	GPS Installation	<u>52,000</u>
	TOTAL	<u>\$3,102,200</u>

**Source: Budget Increase Packages**

<sup>10</sup> Exhibit JC-2 and JC-3 attached to the Direct Testimony of Joseph Clare identify projects included in the FY2009 budget that were not included in the FY2008 estimated expense for Class 200 and Classes 300-400, respectively; that is, Exhibits JC-2 & 3 build up the FY2008 estimated expense to the FY2009 budgeted expense.

1 **Q. Why do you say “a minimum” of \$3.102 million?**

2 A. When asked to provide budget increase packages for line items that were  
3 not previously provided, the reply to PA-MAB-62 stated:

4 “All FY 2009 increase packages have already been provided.

5 No increase packages were prepared for some items because they were  
6 too small to require an increase package (e.g., Increase Temp Pay in  
7 Security, Printing Employee Manuals); other items represented cost  
8 increases for existing budget items (PECO Increase, PGW Increase,  
9 Sludge Removal Costs, Increase Other Chemical Costs); still others  
10 represented items that were previously approved in the budget, but which  
11 had not yet been implemented and therefore had no estimated prior year  
12 obligations (Real Time Update-Shut Offs, Public Outreach-Phase 2  
13 Stormwater, Provision for New Billing System, Street Side Wok Order  
14 System and Real Time Update-Shut Offs).”

15 Therefore, it is possible that some of the items for which there is no  
16 increase package may also be non-recurring. Further, the replies to PA-  
17 MAB-56 & 57 identify all of these projects as being recurring but some of  
18 the projects identified as “recurring” on the reply to PA-MAB-56 were  
19 identified as being “non-recurring” in the budget increase packages.

20 **Q. Is there another issue regarding a specific project included in the**  
21 **budget increase packages?**

22 A. Yes. Exhibits JC-1, 2 & 3<sup>11</sup> contain a line item entitled “Water Security  
23 Grant” totaling \$3,873,537. This project is described in the Budget  
24 Increase Packages as follows:

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<sup>11</sup> Direct Testimony of Joseph S. Clare, III

1 “Anticipated costs of this project are allocated among 10 primary areas:  
2 ON-LINE WATER QUALITY MONITORING, SAMPLING AND ANALYSIS,  
3 ENHANCED SECURITY MONITORING, CUSTOMER COMPLAINTS  
4 SURVEILLANCE, PUBLIC HEALTH SURVEILLANCE, SYSTEM  
5 ENGINEERING, CONSEQUENCE MANAGEMENT, PROJECT  
6 MANAGEMENT AND PLANNING, REVIEW AND EVALUATION, and  
7 TRACKING ENVIRONMENTAL RESULTS...

8 This increase covers FY 2009 activities proposed under the Water  
9 Security Initiative Pilot grant (a 3-year program). The grant supports a  
10 broad range of activities related to enhancing PWD's ability to detect and  
11 respond effectively to a water contamination event, and provides for  
12 transfer of this knowledge and experience to the drinking water sector.  
13 BLS [Bureau of Laboratory Services] submitted the grant application to the  
14 USEPA in September 2007 and will know the award status by the end of  
15 this fiscal year...

16 Our application requested EPA funds totaling \$10,459,220 for the 3-year  
17 period and demonstrated \$6,016,715 of in-kind services (mostly salaries).  
18 BLS is budgeting \$3,911,901 to cover activities in the first year of the  
19 grant. Out of this amount, \$858,420 represents the department plans to  
20 do, regardless of whether it wins the award or not. The remainder  
21 (\$3,053,481) would be severed from the increase package if the grant is  
22 not awarded.

23 Thus, there are several issues regarding this project. First, the project is  
24 to last three years. Therefore, if the four-year forecast methodology is to  
25 be utilized, the project cost included in the fourth year must be eliminated.  
26 Second, the reply to PA-MAB-76 includes a letter from the USEPA  
27 recommending funding for the project. However, the total funding has  
28 been reduced from \$10.5 million to \$9.5 million. Third, the reply to PA-  
29 MAB-76 includes schedules showing “Non-federal funding” of \$3,117,218  
30 so the \$3.9 million figure in the quote above must be revised. Fourth, the  
31 reply to PA-MAB-76 includes a schedule showing “Forecasted Cash  
32 Needs” for the first year of the project of \$3,149,240 for “Federal” and  
33 \$1,039,073 for “Non-Federal”. Thus, it is not clear if the \$3.117 million

1 figure stated above is the total amount for three years or an annual  
2 amount.

3 **Q. Based upon the above discussion, what do you recommend?**

4 A. The above discussion points out the extreme difficulty of utilizing data that  
5 has been forecast over a four-year period. There are just too many  
6 possibilities of project changes, such as the change for the water security  
7 project, for rates to be based on such an uncertain methodology.

8 At a minimum, I recommend that budgeted Class 200 expenses for  
9 FY2009 be reduced by \$3.12 million before growth factors are applied.  
10 Once information regarding the water security grant is known, the model  
11 should be adjusted to reflect the issues discussed above.

12 **Q. How were these so-called “growth factors” chosen?**

13 A. As discussed above, for Class 100 (Personal Services), 2.0%, 3.0% and  
14 4.0% growth factors were used for fiscal years FY2010-FY2012. As  
15 discussed above, these factors reflect projected wage increases to be  
16 included in the new union contract.

17 A 3.0% overall factor was utilized for Class 200 (Purchase of Services),  
18 Class 300 (Materials & Supplies) Class 400 (Equipment) budgeted  
19 expenses with the following exceptions: a 2.5% factor was used for Class  
20 200-Power for FY2010, a 11.9% overall factor for FY2011 and a 16.53%

1 overall factor for FY2012; a 9% factor was used for Class 300 Chemicals  
2 for each fiscal year 2010-2012.

3 **Q. What is the basis for the 3% overall factors?**

4 A. The reply to PA-MAB-42b only states:

5 “The projected annual increases in costs by cost center and class  
6 presented in Columns 5 to 8 are developed based on a review of historical  
7 actual experience, historical labor agreements, and industry cost index  
8 data.”

9 Also, the reply to PA-MAB-27 states:

10 “The projected annual increase of 3.0 percent was developed based on  
11 PWD staff experience and the Producer Price Index for inorganic  
12 chemicals. Note that the average annual growth for FY 2003 to FY 2007  
13 is 3.23%.”

14 **Q. What is your response to these statements?**

15 A. Though the Department may have some historic basis for choosing these  
16 factors, it is evident that, once again these factors were based upon what I  
17 would term merely “subjective judgment” at best and speculation at worst.  
18 Certainly, rates should not be based on such an all encompassing  
19 measurement as the Consumer Price Index which has little relationship to  
20 the types of expenditures made by a large water/wastewater utility.

1 **Q. Do you have any comments on the factors utilized for Power?**

2 A. Regarding forecast Power factors, the reply to PA-MAB-25 a, b & c states”

3 The projected annual increase of 2.5 percent was provided in discussions  
4 with PWD staff based on their experience and the discounts presently  
5 reflected in the rate tariff with PECO. Philadelphia region Consumer Price  
6 Index for electricity has experienced a 4.95% effective average annual  
7 increase over the past five years...The 11.9% increase is the overall  
8 anticipated increase of the projected power costs based on half of the year  
9 at the projected power costs inflated at 2.5% from FY 2010 and half of the  
10 year at the anticipated annualized power costs of \$25.5 million based on  
11 the Departments estimated power costs without the current PECO  
12 discounts...“ The projected 7.5% annual increase for Fiscal Years 2012 to  
13 FY 2014 was provided in discussions with PWD staff based on their  
14 experience. Emphasis added.

15 Again, the department is basing rates, not on known and measurable  
16 data, but rather upon discussions, price indices and anticipated increases.

17 **Q. How would pro forma power costs (generally referred to as**  
18 **purchased power) normally be determined in a rate case before the**  
19 **PUC?**

20 A. Power costs would normally be determined by applying actual known  
21 rates to actual usage or average usage over an historical time period.  
22 Anticipated power rate increases would not be considered.

23 **Q. In your experience, are you aware of any other utility that utilizes**  
24 **multiple test years and growth factors similar to those proposed by**  
25 **the Department to determine rates?**

1 A. No, this ratemaking methodology is unique to the PWD. Though utilities  
2 do use a future test year, generally that test year is based upon actual  
3 historic test year data adjusted for the future, not upon a budget. In my  
4 experience, I have never encountered **any** utility that utilizes multiple test  
5 years to determine a series of rate increases.

6 I find it to be a major problem of equity to the ratepayer that using the  
7 Department's methodology introduces such a large degree of subjectivity  
8 into the ratemaking process. Though a certain amount of subjectivity is  
9 necessary in developing rates, using inflation factors to determine future  
10 budgets over a multi-year period is highly suspect. The problem is one of  
11 piling estimates upon estimates, in this case, starting with budgeted data  
12 (which is an estimate in itself), applying one set of estimated factors to  
13 adjust the base estimates to actual and then applying another set of  
14 estimates to adjust for growth.

15 **Q. Based upon the above discussion, what do you recommend?**

16 A. The reply to PA-MAB-27 contains the following table in support of the use  
17 of a 3.0% growth factor for most non-Class 100 expenditures:

1

<b><u>CONSUMER PRICE INDEX</u></b>		
<b><u>Fiscal Year</u></b>	<b>Consumer Price Index All Urban Consumers <u>Philadelphia Area</u></b>	
	<b><u>Raw Number</u></b>	<b><u>% Change</u></b>
2002	184.9	
2003	188.8	2.11%
2004	196.5	4.06%
2005	204.2	3.92%
2006	212.1	3.87%
2007	216.7	2.19%
Avg.		3.23%

2           The major problem with utilizing a CPI for All Urban Consumers is that  
3           much of the increase is due to increases in costs for food and energy. As  
4           discussed above, the Department has already accounted for growth in  
5           power, separately. If such an index is to be utilized, it should exclude food  
6           and energy costs. Below is the same table as above for “All Items Less  
7           Food and Energy”:

1

<b><u>CONSUMER PRICE INDEX</u></b>		
<b><u>Fiscal Year</u></b>	<b>Consumer Price Index All Items Less Food &amp; Energy <u>Philadelphia Area</u></b>	
	<b><u>Raw Number</u></b>	<b><u>% Change</u></b>
2002	199.1	
2003	201.9	1.41%
2004	208.8	3.42%
2005	215.3	3.11%
2006	221.7	2.97%
2007	225.6	1.76%
Avg.		2.53%

2           Therefore, I recommend that a 2.5% growth factor be applied to those  
3           expenditure classes for which the Department has applied a 3.0% factor.

4           Regarding Power and Chemical costs, since none of the Department's  
5           projections is known and measurable, I would apply the same 2.5% factor  
6           as recommended above.

1 **C. Interdepartmental Charges**

2 **Q. You have explained how Class 100-400 expenditures were projected.**  
3 **Class 500 (Indemnities) and Class 800 (Interdepartmental Charges)**  
4 **were also projected. First, please define interdepartmental charges**  
5 **as the term applies to the Black & Veatch model.**

6 A. As shown on Black & Veatch Workpaper Omone-9, the model includes  
7 Interdepartmental Charges for payments to the General Fund (Office of  
8 Fleet Management, Streets Department, Director of Finance and  
9 Administration, etc.), Water Revenue Bureau, Law Department, Public  
10 Properties, and Indemnities<sup>12</sup>. In general, certain services are performed  
11 for the Water Department by other agencies of City government for which  
12 the Water Department is charged.

13 **Q. How were these interdepartmental charges projected for ratemaking**  
14 **purposes?**

15 A. The reply to PA-MAB-29 states:

16 The projected FY 2009 Interdepartmental Charges are estimated based  
17 on the FY 2009 budget for Payment to the General Fund and  
18 Interdepartmental Charges and estimated actual to budget ratios. In  
19 addition, Interdepartmental Charges includes an allocation of fringes  
20 based on the Class 100 costs included in the Interdepartmental Charges  
21 for Water Revenue Bureau and Law Department and the projected fringe  
22 benefit ratio (as discussed in PA-MAB-28). The FY 2010 to FY 2014

---

<sup>12</sup> Projected expenses for the Water Revenue Bureau increase from \$20.3 million in FY2009 to \$22.2 million in FY2012 (Workpaper OMone-9).

1 Interdepartmental charges are projected based on the estimated FY 2009  
2 Interdepartmental Charges, projected inflation factors, and projected fringe  
3 ratio.

4 **Q. How were the actual-to-budget factors that were applied to the**  
5 **FY2009 budgeted figures determined?**

6 A. The reply to PA-MAB-45b states:

7 The Budget Factor presented in Column 2 of OMone-9 was determined  
8 based on a review of historical actual to budget ratios based on historical  
9 expenses. The review of historical results takes into consideration the  
10 historical results, trends in results, and experience and judgment,  
11 generally with more weight being given to more recent 2-3 years of  
12 experience.”

13 So, once more, subjective judgment, often in favor of the Department,  
14 enters into the ratemaking process.

15 **Q. What growth factors were utilized in determining Interdepartmental**  
16 **Charges for the forecast period?**

17 A. Class 100 charges were inflated by the same 2%, 3% and 4% factors as  
18 applied for the various divisions. All other expenses were inflated by 3%  
19 per year.

20 **Q. What do you recommend?**

21 A. To be consistent with my recommendations above, I recommend that no  
22 growth factors be utilized for Class 100 (Personal Services) expenses  
23 since no wage contract has been signed beyond FY2009. Further, I

- 1 recommend that a 2.5% growth factor be applied to all other expenses
- 2 after adjusting for budget-to-actual.

1 **D. Indemnity Charges**

2 **Q. What amount of Indemnity Charges was utilized for FY2005?**

3 A. As shown on Workpapers OMone-9 and OMtwo-3, \$6,270,000 was  
4 utilized for FY2009 Indemnity Charges. This amount was determined by  
5 applying a 95% actual to budget factor to the FY2008 budgeted expense  
6 of \$6,600,000. However, the reply to PA-MAB-45a, shows the FY2008  
7 budgeted Indemnities expense to be \$6,500,000, not \$6,600,000. A 3%  
8 growth factor was applied for each of the next three years.

9 As shown on the reply to PA-MAB-58 and below, the actual indemnity  
10 expense has not equaled or exceeded the budgeted expense since  
11 FY1995. In fact, the actual expense has exceeded the budgeted expense  
12 only three times since FY1986.

1

<b><u>INDEMNITIES</u></b>				
<b><u>FISCAL</u></b> <b><u>YEAR</u></b>	<b><u>BUDGET</u></b>	<b><u>OBLIGATIONS</u></b>	<b><u>PLUS/(MINUS)</u></b>	<b><u>% actual/ budget</u></b>
1986	2,420,000	50,436	(2,369,564)	2.08%
1987	2,420,000	1,506,250	(913,750)	62.24%
1988	2,420,000	2,948,373	528,373	121.83%
1989	2,000,000	4,348,872	2,348,872	217.44%
1990	4,502,000	2,851,289	(1,650,711)	63.33%
1991	5,000,000	4,624,607	(375,393)	92.49%
1992	5,000,000	4,999,205	(795)	99.98%
1993	5,000,000	9,285,038	4,285,038	185.70%
1994	6,500,000	6,472,905	(27,095)	99.58%
1995	7,500,000	8,428,786	928,786	112.38%
1996	6,500,000	3,724,287	(2,775,713)	57.30%
1997	6,500,000	4,751,555	(1,748,445)	73.10%
1998	6,500,000	5,591,358	(908,642)	86.02%
1999	6,500,000	4,558,851	(1,941,149)	70.14%
2000	6,500,000	4,821,795	(1,678,205)	74.18%
2001	6,500,000	4,209,762	(2,290,238)	64.77%
2002	6,500,000	3,734,724	(2,765,276)	57.46%
2003	6,500,000	3,857,912	(2,642,088)	59.35%
2004	6,500,000	2,880,450	(3,619,550)	44.31%
2005	6,500,000	2,412,874	(4,087,126)	37.12%
2006	6,500,000	4,218,828	(2,281,172)	64.91%
2007	6,500,000	2,376,893	(4,123,107)	36.57%

2

3 **Q. Similar to the Department's general forecast methodology, have you**  
4 **calculated the average actual-to-budget factor for Indemnities over**  
5 **the past five years?**

6 **A. Yes. As shown below, the five-year average ratio is calculated to be**  
7 **48.45%.**

1

<b><u>INDEMNITIES</u></b>				
<b><u>FISCAL</u></b>				<b><u>% actual/</u></b>
<b><u>YEAR</u></b>	<b><u>BUDGET</u></b>	<b><u>OBLIGATIONS</u></b>	<b><u>PLUS/(MINUS)</u></b>	<b><u>budget</u></b>
2003	6,500,000	3,857,912	(2,642,088)	59.35%
2004	6,500,000	2,880,450	(3,619,550)	44.31%
2005	6,500,000	2,412,874	(4,087,126)	37.12%
2006	6,500,000	4,218,828	(2,281,172)	64.91%
2007	6,500,000	2,376,893	(4,123,107)	36.57%
Total	32,500,000	15,746,957	-16,753,043	48.45%

2

3 **Q. Based upon the above discussion, what do you recommend?**

4 A. I recommend that for FY2009, a 48.45% factor be applied to the FY2008  
5 budgeted indemnity expense of \$6.5 million. The result is an expense of  
6 \$3,149,300. To be consistent with my recommendation above regarding  
7 growth factors, a 2.5% growth factor, rather than a 3% growth factor,  
8 should be applied for each of the next three years.

1 **E. Fringe Benefits**

2 **Q. How were fringe benefit expenses determined?**

3 A. As stated on the reply to PA-MAB-28:

4 The FY 2009 fringe benefit ratio was calculated based on the projected  
5 fringe benefit costs (\$76.800 million) and the projected Class 100 costs  
6 (\$105.253 million). The projected FY 2009 fringe benefit costs were  
7 estimated based on the FY 2009 budget (\$73.806 million) and an actual to  
8 budget factor of 104%. The fringe benefit ratio is anticipated to increase  
9 by 4.0% per year based on the City's 5-Year Plan for Fiscal Years 2009  
10 through 2013 which has been provided as Attachment 10 in response to  
11 Standard Interrogatory 38. (Emphasis added.)

12 **Q. So am I correct that neither the Department nor Black& Veatch has**  
13 **done an independent evaluation of current and future fringe benefit**  
14 **charges?**

15 A. To the best of my understanding, that is correct. Here we are adding  
16 another layer of projections whereby the Department is relying on the City  
17 to project future fringe benefits<sup>13</sup>. In my view the City projections are no  
18 more reliable than that of the Department and considering their City-wide  
19 scope, may be even less reliable.

---

<sup>13</sup> "The city and its largest union last night agreed to a no-raise, one-year contract that Mayor Nutter said offers an opportunity for management and labor to tackle the long-term costs of health care and pensions." Philadelphia Inquirer, July 25, 2008, "Phila. and its largest union reach 1-year deal".

1 **Q. What do you recommend?**

2 A. I recommend that no inflation factor be allowed for ratemaking purposes.

3 The Department has simply supplied no support for this factor other than

4 to say it is included in the City's five-year plan. Such a statement does not

5 even come close to meeting the known and measurable regulatory

6 standard.

1 **F. Debt Service**

2 **Q. Now that you have discussed projections of Operation and**  
3 **Maintenance expenses, please explain how charges for debt service**  
4 **were developed.**

5 A. Debt service charges reflect principal and interest on outstanding and  
6 projected bond issues. The funds from these debt issues are utilized for  
7 capital spending. As shown on Workpaper Rrev-12, the FY2009-FY2012  
8 rate period reflects the issuance of a \$325 million revenue bond issue  
9 during fiscal year 2009 at a 5% interest rate and a \$350 million revenue  
10 bond issue during FY2012 at a 5.5% interest rate.

11 The reply to PA-MAB-32a states that "(t)he 5% interest rate is what the  
12 Water Department believes they can attain in today's financial market."  
13 The reply to PA-MAB-32b states that "(a)n allowance for an increase in  
14 the interest rate to 5.5% is based on judgment as to the market conditions  
15 in the future." Emphasis added.

16 **Q. Do these projected interest rates appear reasonable?**

17 A. Based upon my review of current market conditions, a 5% interest rate  
18 appears reasonable for the spring of FY2009 issue. However, the use of  
19 a 5.5% interest rate for the FY2012 issue is mere speculation.

20 The use of a projected interest rate for the 2012 bond issue again  
21 corroborates the subjective judgment involved in utilizing the B&V model

1 for ratemaking purposes. Certainly considering the volatility of today's  
2 financial markets, it is almost an impossibility that forecast interest rates  
3 three years from now can meet the "known and measurable" regulatory  
4 standard.

5 **Q. Based upon the above discussion, what do you recommend?**

6 A. Since the 5.5% interest rate for the 2012 bond issue is mere speculation, I  
7 recommend that, if the four-year methodology is utilized, a 5% interest  
8 rate be utilized.

1 **G. Transfer to City General Fund**

2 **Q. As shown on Table 11 of Exhibit JRM-1, line 36, the PWD anticipates**  
3 **making \$12 million in payments during the four year rate period to**  
4 **the City General Fund, \$2.568 million in the test year FY2009. Please**  
5 **comment.**

6 **A.** This transfer represents excess interest in the Debt Reserve Account.  
7 The source of this interest are debt service funds derived from PWD  
8 customer payments. Counsel informs me that although payment of this  
9 excess interest up to a maximum annual amount of \$4.924 million to the  
10 City is not illegal, it would be permissible for the PWD to transfer it instead  
11 to the Revenue Fund, where it could be used for purposes of direct benefit  
12 to customers. From a policy standpoint, of course, there is little if any  
13 justification for transfer of this excess interest to the City's General Fund,  
14 since customers, not the City, have paid and are required to pay all the  
15 operating and capital costs of the Philadelphia Water Department,  
16 including payment to various City departments for services provided by  
17 those departments.

1 **H. Capital Improvements**

2 **Q. As discussed above, the proceeds from bond issues are utilized to**  
3 **fund the Department’s capital improvement program. Please provide**  
4 **the total projected capital improvement program for the four-year**  
5 **forecast period**

6 A. As shown on Workpaper Rreq-7, the Department’s total capital  
7 improvement program for the period FY2009-FY2012 is as follows:

<b><u>CAPITAL IMPROVEMENT PROGRAM (\$000)</u></b>			
<b><u>FY2009</u></b>	<b><u>FY2010</u></b>	<b><u>FY2011</u></b>	<b><u>FY2012</u></b>
\$145,250	\$152,230	\$161,470	\$166,470

8

9 **Q. What is the source of these figures?**

10 A. As I understand it based upon the reply to PA-MAB-49a, the source of  
11 these figures is the document entitled “City of Philadelphia The  
12 Recommended FY2009-2014 Capital Program”. This is a forecast only. It  
13 does not represent approved budgeted capital expenditures that have  
14 actually been reviewed and approved by City Council.

15 **Q. As the consultant to the Public Advocate for many years in capital**  
16 **budget proceedings regarding the Philadelphia Gas Works, has it**  
17 **been your experience that forecast capital budgets can drastically**  
18 **change over time?**

1 A. Yes. It has been my experience that even forecasting expenditures over a  
2 one-year period can be difficult due to changes in project scope and  
3 operating conditions. An accurate forecast over a longer period such as  
4 four or five years is almost impossible.

5 **Q. Has Black & Veatch entered even additional speculation into the**  
6 **capital budget equation by providing for a 4% inflation factor?**

7 A. Yes.

8 **Q. What is the basis for the 4% inflation factor?**

9 A. The reply to PA-MAB-30 states:

10 The annual inflation allowance of 4 percent was developed based on a  
11 review of the ENR Construction Cost Index and the Handy-Whitman  
12 Construction Cost Index. The following tables present the various Handy  
13 Whitman and ENR construction cost indices for FY 2002 to FY 2007 and  
14 the average annual growth experienced during the historical period. Note  
15 that the 4 percent inflation factor utilized for the rate study is less than the  
16 effective average annual growth of all the construction cost indices  
17 provided.

18 **Q. Have you reviewed the tables referred to above?**

19 A. Yes. It has been my experience that there is almost always a problem  
20 when utilizing indices to project future expenditures since, as described  
21 above regarding the CPI, the indices are very often not specific to the  
22 expenditure data which is being "inflated". There can also be a problem  
23 when the data is skewed.

1 In this instance, three of the five tables presented are skewed by  
2 abnormally high data for 2005. An extreme example is the table based on  
3 the Cost of Construction of transmission plant as duplicated below.

<b><u>H.W. Index</u></b> <b><u>Cost of Construction</u></b> <b><u>Transmission Plant</u></b>		
<b><u>Fiscal Year</u></b>	<b><u>Raw Number</u></b>	<b><u>% Change</u></b>
2002	394	
2003	404	2.54%
2004	421	4.21%
2005	509	<b>20.90%</b>
2006	530	4.13%
2007	528	-0.38%
Avg.		6.03%

4 If the abnormal 2005 percent change were excluded, the average change  
5 would be 2.63%.

6 **Q. Based upon the above discussion, what do you recommend?**

7 A. I recommend that no inflation factor to be applied to the City budget  
8 figures because any inflation factor would be just too unreliable for  
9 ratemaking purposes. Adding such an inflation allowance to the already  
10 speculative budget figures, which may have already taken projected  
11 inflation into account, enters another layer of uncertainty into data upon  
12 which rates are proposed to be based.

1 **VII. REVENUE REQUIREMENT**

2 **Q. Now that you have discussed how revenues and expenses were**  
3 **developed for ratemaking purposes by Black & Veatch and the**  
4 **Department, please provide your understanding of how the**  
5 **Department's proposed revenue requirement was developed.**

6 A. The Excel model that calculated the proposed revenue requirement  
7 depends upon several factors that are fixed, that is known, and several  
8 factors that are variable, that is, that require unacceptable levels of  
9 subjectivity.

10 Fixed factors are those that are required by various bond ordinances. The  
11 fixed factors include the following:

- 12 • a 1.20x debt coverage on total senior debt service;
- 13 • a Capital Account Deposit of one percent of net plant, property and  
14 equipment;
- 15 • transfers to the City General Fund;
- 16 • a cap on the amount to be utilized from the Rate Stabilization Fund  
17 based upon net revenues being 90% of debt service.

18 The variable factors include:

- 19 • amounts transferred to the Construction Fund;

1           • amounts utilized from the Rate Stabilization Fund considering the  
2           cap restriction stated above but having a goal to maintain a  
3           minimum fund balance of \$5 million at the end of the four-year  
4           projection period PA-MAB-73, 74 & 75;

5           • amounts transferred to the Residual Fund having a goal to maintain  
6           a minimum fund balance of \$5 million PA-MAB-73, 74 & 75.

7   **Q.    Considering the above fixed and variable factors, what are the major**  
8   **determinants of the Department’s proposed series of rate increases?**

9   A.    The calculation of the proposed increase is based upon several factors:  
10   first, the budgeted amount of service revenues, fund interest income,  
11   operating expenses and debt service; second, budgeted deposits into the  
12   various funds; and, third the rate covenants discussed above.

13   To be more specific, the major determinants of the proposed rate  
14   increases are the increased coverage requirement due to the new bond  
15   issues, which are necessitated by forecast capital spending, and the  
16   projected inflationary increases in O&M expenses.

17   Further, the amount of each year’s requested increase is based on the  
18   Department’s proposal to levelize the total revenue increases for fiscal  
19   years 2009-2012 at 6.40%.

1 **Q. Please define what you mean by a “levelized” increase.**

2 A. As described above, the Department is proposing a four-year period over  
3 which to increase annual revenues by 6.4% per year. Rather than  
4 increase overall revenues a different percentage each year in order to  
5 recover the proposed increase, the Department has chosen to increase  
6 overall revenues by an approximately equal, or levelized percentage, over  
7 each of the next four fiscal years 2009-2012.

8 **Q. The PWD’s revenue requirement and projected rates, as set forth in**  
9 **this filing, assume that the first of four annual rate increases would**  
10 **become effective on July 1, 2008. It now appears that new rates are**  
11 **likely to become effective November 1, 2008. Has the PWD taken a**  
12 **position on whether to request rate compression so that it may**  
13 **recover in the remaining eight months of the year the twelve months**  
14 **of incremental revenue projected for FY2009 on Table 11.**

15 A. So far as I know, that is still an open question. However, I do not believe  
16 that rate compression is appropriate, necessary or fair in this case. It is  
17 not appropriate, because the PWD does not need the total proposed  
18 FY2009 additional revenue to achieve either its coverage or cash  
19 requirements. If the PWD had no revenue increase this year, it projects  
20 that it would achieve a debt service ratio of 1.18x, just missing its required  
21 debt service ratio of 1.2x. PA-MAB-73. By my calculations, even without  
22 increasing the FY2009 transfer from the RSF to the Revenue Fund, the

1 PWD could satisfy its FY2009 coverage requirements with just increased  
2 revenues of \$3.45 million of the total proposed. If it transferred \$3.45  
3 million more from the RSF (which it is permitted to do), it would actually  
4 need no rate increase this year.

1 **VIII. FORECAST METHODOLOGY**

2 **Q. You stated above that in your regulatory experience, you have never**  
3 **participated in a rate proceeding, other than that for the Water**  
4 **Department, in which a utility either proposed, or was granted, a**  
5 **series of rate increases. Why do you believe that such a rate**  
6 **methodology is inappropriate, especially for this proceeding?**

7 A. The concept of utilizing a single test year for the purpose of determining  
8 the need for incremental rates is the standard of utility regulation. The  
9 reason for this standard is that under utility law, a utility is never  
10 guaranteed that it will earn the rate of return or receive the cash flow that  
11 is allowed by a public utility commission as the result of a rate proceeding.  
12 Rather, the utility is given the opportunity to earn that rate of return or  
13 receive that cash flow.

14 In reality, over time, the utility may over or under earn the rate of return  
15 that it is granted. If the rate of return is over-earned, it is extremely rare  
16 that a commission would require the utility to return some of the over-  
17 earnings to its customers. Conversely, if the rate of return is under-  
18 earned, the utility is not allowed to unilaterally raise its rates to the level  
19 that would allow it earn its authorized rate of return. Rather, the utility then  
20 has the choice of filing once again for a rate increase.

21 In this proceeding, as it has in past proceedings, the Department is  
22 proposing a series of pre-authorized rate increases to take effect without

1 submission to systematic public scrutiny or rate setting procedures Even  
2 the municipal Philadelphia Gas Works (PGW), both before and after it  
3 became regulated by the Pennsylvania Public Utility Commission, could  
4 only file for one increase at a time.

5 **Q. Is part of your concern over this type of regulatory and ratemaking**  
6 **procedure due to the methodology utilized to determine the level of**  
7 **future rate increases?**

8 A. Yes. As I have stated above, I am concerned that a series of overly  
9 subjective judgments were involved in the development of projected fiscal  
10 year data especially regarding collection factors, inflation factors, budget-  
11 to-actual factors and the cost of the bond issues. In my experience, it is  
12 unusual for a utility to both request a series of rate increases in one rate  
13 proceeding and to base those requests on future periods developed by  
14 utilizing inflation factors. Though some subjectivity is normally involved in  
15 the ratemaking process, this four-year proposal violates the ratemaking  
16 requirement that rates be based on costs that are “known and  
17 measurable”.

18 In my opinion, the basic methodology utilized by Black & Veatch is more  
19 suitable for developing a financial forecast than it is as a basis for  
20 determining rates. PGW develops its financial forecast in a similar  
21 manner by applying inflation rates to a base period. However, the  
22 Philadelphia Gas Commission (PGC) only uses this forecast as a general

1 guide. Even when the PGC regulated PGW, such a forecast was never  
2 utilized for ratemaking purposes.

3 **Q. Didn't the Pennsylvania Public Utility Commission recently rule upon**  
4 **PGW's attempt to base a proposed rate increase on a forecast**  
5 **period?**

6 A. Yes. In late 2006, PGW filed for a rate increase at Docket No. R-  
7 00061931 based upon a five-year forecast. In ruling against the use of a  
8 five year forecast the Commission stated:

9 The test year concept is a basic tenet of ratemaking that forms a sound  
10 and reasonable basis for establishing a representative level of prospective  
11 rates. It allows for a reasonable measure of predictability and semi-  
12 permanence in ratemaking. We are cognizant of the Company's current  
13 financial situation and goals; however, we do not find them to justify  
14 peering five years into the future on such uncertain circumstances. We  
15 agree with the opposing Parties that the use of a five-year forecast is too  
16 speculative and unreliable for the setting of rates. (Emphasis added.)<sup>14</sup>

17 I submit that the same reasoning in the Order above regarding speculation  
18 and unreliability applies to the Water Department's series of proposed  
19 increases.

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<sup>14</sup> Pa.PUC vs. 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.

1 **Q. Mr. Bleiweis, in order to test the Black & Veatch revenue requirement**  
2 **methodology, did you request that the Department provide a**  
3 **schedule similar to Exhibit JRM-1, Table 11 containing actual data**  
4 **versus projected data for each fiscal year 2004 through 2007?**

5 A. Yes. That was my request in PA-MAB-18. As can be seen on the  
6 attached Exhibits MAB-2a and MAB-2b, there are very significant  
7 differences between the projections contained in the 2004-2005 Table 11  
8 for fiscal year-end 2008 and the actual FY2008 revenue and expense  
9 estimates contained on the current Table 11.

10 **Q. Why were you seeking this information?**

11 A. Such a schedule would have permitted a more precise understanding of  
12 why there was such a large difference between the PWD's projections  
13 back in 2004-05 and the actual results since then – to determine what  
14 areas of expenses and revenues were either over or under estimated,  
15 resulting in the large discrepancies which are evident in the two Table  
16 11's.

17 **Q. Did you obtain a complete answer to your request?**

18 A. No. The PWD responded to PA-MAB-18 as follows:

19 Such schedules are not prepared or available for actual historical costs. A  
20 schedule similar to "Table 11" showing actual costs for the period FY 2005  
21 through FY 2007 and preliminary estimated actual for FY 2008 is attached  
22 hereto.

1 The schedule that was provided contained some actual data but not on a  
2 line-for-line basis.<sup>15</sup> Yet, it is still possible to glean some relevant  
3 information.

4 For example, the following is a comparison of “Total Operating Expenses”  
5 for the three years 2005-2007<sup>16</sup>:

<b><u>TOTAL OPERATING EXPENSES (\$000)</u></b>				
	<b><u>Projected</u></b>	<b><u>Actual</u></b>	<b><u>Actual less Projected</u></b>	<b><u>%</u></b>
<b>2005</b>	\$277,274	\$265,085	\$(12,189)	(4.40%)
<b>2006</b>	\$284,361	\$256,713	\$(27,648)	(9.72%)
<b>2007</b>	\$291,277	\$286,554	\$(4,723)	(1.62%)
<b>TOTAL</b>	\$852,912	\$808,352	\$(44,560)	(5.22%)

6 Thus, in each of the three years, projected total operating expenses  
7 exceeded projected total operating expenses.

8 **Q. How did the actual year-end balances in the Rate Stabilization Fund**  
9 **(RSF) compare to the balances projected in Table 11 of the last**  
10 **Order?**

11 A. The variances in the actual RSF balances compared to the projected  
12 balances are considerable.

---

<sup>15</sup> It is not clear to me why all actual data is not available. Surely, the Department must have actual data in some similar format that it utilizes internally.

<sup>16</sup> I have not compared data for FY2008 since it is only preliminary and subject to change.

<b><u>RATE STABILIZATION FUND (\$000)</u></b>			
	<b><u>Projected</u></b>	<b><u>Actual</u></b>	<b><u>Actual less Projected</u></b>
<b>2005</b>	\$99,141	\$128,902	\$29,761
<b>2006</b>	\$85,596	\$153,909	\$68,313
<b>2007</b>	\$60,724	\$185,609	\$124,885

1            Thus, by the end of the third year that new rates were in effect, the actual  
2            balance in the Rate Stabilization Fund was almost \$125 million greater  
3            than projected in the last rate proceeding.

4    **Q.    What is the ultimate effect on ratepayers of the Department having**  
5    **such a larger RSF balance than projected?**

6    A.    Based upon rates allowed by the Water Commissioner, the model was  
7    structured so that the RSF would have an approximate \$13.5 million  
8    balance at the end of the four-year rate period. The actual \$125 million  
9    “excess” in the RSF was basically funded by ratepayers and essentially  
10   means that rates over the four year period were substantially higher than  
11   they needed to be. Further, according to the proposed Table 11 in this  
12   case, that balance is projected to be \$149.6 million at fiscal year-end  
13   FY2008, \$136.1 million more than projected.

1 **Q. Couldn't certain financial circumstances have changed over the four-**  
2 **year period that caused the variance in the RSF to be so much higher**  
3 **than projected?**

4 A. Yes, that is exactly my point. For example it is my understanding that  
5 capital spending was reduced for some portion of the forecast period  
6 which would have resulted in more cash available to the Department.  
7 Also, "self-generated capital funding" was "higher than anticipated"  
8 because "although the projected dispersements (expenditures) were \$67.8  
9 million less than projected the receipts were only \$14.4 million less than  
10 projected, resulting in a higher than projected fund balance of \$53.4  
11 million." <sup>17</sup>. Certainly, many other financial factors would have varied over  
12 the four-year period. It is reasonable to assume, that, like the RSF  
13 balance, the variances would increase more at the end of the period than  
14 at the beginning of the period.

15 **Q. As stated above, the final 2005 Table 11 established rates at a level**  
16 **which was projected to result in a \$13.5 million RSF balance at the**  
17 **end of the four-year rate period (FY2008 year-end). However, the**  
18 **2008 Table 11 proposed in this case projects a \$47.7 million RSF**  
19 **balance at the end of the four-year rate period (FY2012 year-end).**  
20 **Please comment on this difference.**

---

<sup>17</sup> See the reply to PA-MAB-13.

1 A. The replies to PA-MAB-73 & 74 state that the financial model has been  
2 designed to establish rates at a level which would result in around a \$45  
3 million RSF balance at FY2012 year-end. In this rate proceeding, the  
4 PWD is offering justifications for its projected RSF balances which the  
5 Department has not made or emphasized in prior cases. The Department  
6 now claims that it must have at least this level in the RSF in order to  
7 assure that it will have sufficient cash working capital during the course of  
8 each fiscal year.

9 **Q. Do you believe that utilizing the RSF as a source of working capital is**  
10 **appropriate?**

11 A. No. As the name implies, the purpose of the RSF is to stabilize rates,  
12 and to protect customers from experiencing high rate increases over a  
13 short period of time, as is proposed in this case. Although the RSF may  
14 have as a side effect the function of providing some cash working capital  
15 for the Department, that is not the standard that should be used for setting  
16 the RSF fund levels.

17 As stated above, it must be understood that the financial model has been  
18 structured so that the RSF balance at fiscal year-end 2012 is  
19 approximately \$45 million. Thus, the model does not withdraw the  
20 maximum that is legally permissible in any one year. For example,  
21 Workpaper Rreq-22 shows a withdrawal from the RSF of \$23.59 million for  
22 FY2009 even though the maximum allowed withdrawal is \$51.585 million.

1 Of course, over the four-year projection period, such a withdrawal would  
2 result in lesser amounts able to be withdrawn and possibly a lesser  
3 balance at fiscal year-end 2012 than the proposed \$45 million. But if rates  
4 are not structured over a four-year period, but rather over a one or two-  
5 year period as I propose, then the maximum amount allowable could be  
6 withdrawn from the RSF.

7 In addition, if the function of the RSF is to supply cash working capital, the  
8 PWD has not supported its position that it needs this level of cash working  
9 capital.

10 The Department has provided no support for the projected \$47.734 million  
11 FY2012 RSF year-end balance other than a 1992 lead/lag study  
12 performed by Deloitte & Touche which calculated a “working capital  
13 requirement” of \$29,556,000 under monthly billing. (See the reply to PA-  
14 MAB-16b.) Again, if a lesser RSF balance than the \$47.734 million was  
15 utilized and additional funds were withdrawn from the RSF as allowed,  
16 projected revenue increases would be less than requested.

1 **Q. As a matter of general ratemaking principle, is it appropriate for a**  
2 **public utility to require customers to provide cash working capital?**

3 A. No. Generally, the ratemaking principle is that customers must pay for the  
4 cost of cash working capital, that is, for the debt service cost to fund a  
5 short-term commercial paper program. To be sure, there is a cost to  
6 borrowing money. However, the PWD has the ability to borrow money at  
7 a much lower rate than most PWD residential customers. It seems likely  
8 that if customers were required to pay only the debt service for a short-  
9 term commercial paper program, these costs would be lower than for  
10 providing the cash working capital itself. The reply to PA-MAB-77 states  
11 that the Department has not investigated this option as a way of  
12 minimizing rates.

1 **IX. RECOMMENDATIONS**

2 **A. The Rate Period**

3 **Q. In this Direct Testimony, you have pointed out a large number of**  
4 **financial variables that have been projected in the Black & Veatch**  
5 **model and soundly criticized the use of a four-year forecast period.**  
6 **Can you recommend an alternative methodology?**

7 A. Yes. My primary recommendation is to adjudicate rates for this  
8 Department no different than rates are adjudicated for the Philadelphia  
9 Gas Works and other utilities in Pennsylvania, that is, rates should be  
10 determined based upon a fully forecast, budgeted test year containing,  
11 annualizations for revenues and expenses, amortization of relevant  
12 expenditures and non-recurring adjustments. I see no reason why this  
13 could not be accomplished and such a methodology would probably result  
14 in less rate case preparation effort than that which is currently performed  
15 by Black & Veatch. The contrasts between the relatively scientific  
16 character of the Pennsylvania Public Utility Commission endorsed test  
17 year method and the unbelievably complicated and subjective method  
18 utilized by the PWD all serve to expose the weaknesses of the  
19 Department method and its unfairness to customers.

20 As an alternative, if the Commissioner chooses not to follow well-  
21 established utility precedent concerning the development of rates on the  
22 basis of a single test year, I recommend that the rate order in this case

1 extend only to fiscal years 2009 and 2010. Beyond the two year period,  
2 the model's results simply become too speculative and too subjective to  
3 be of any practical use in determining just and reasonable rates. In no  
4 case should the Commissioner authorize a series of stepped rate  
5 increases that extend over a four-year period of speculative costs and  
6 revenues.

1 **B. Recommended Adjustments**

2 **Q. Based upon the above discussions, what are your recommended**  
3 **adjustments?**

4 A. I recommend the following:

- 5 1. the model should be revised to include the finalized FY2009 budget  
6 data;
- 7 2. a collection factor of 86% should be applied to current year billed  
8 revenues because it is representative of actual collection  
9 percentages obtained over the past several years;
- 10 3. a simple average of two-year and three-year data should be utilized  
11 to determine actual-to-budget percentages since this is a simple  
12 methodology that can be consistently applied obviating the need to  
13 make a judgment upon each and every expense class for each  
14 Water Department division;
- 15 4. the actual-to-budget percentages should not be increased by 0.5%  
16 per year since , the number of employees at fiscal year-end has  
17 actually declined each year since FY2003;
- 18 5. FY2009 Personal Services expenses should be revised to reflect  
19 no wage increase and a \$1,100 lump sum payment; no wage

- 1 increases beyond FY2009 should be recognized because such  
2 increases are not known and measurable;
- 3 6. since the Water Security Grant project is to last three years, costs  
4 included in the fourth year should be eliminated;
- 5 7. the reduction in total Water Security Grant funding from \$10.5  
6 million to \$9.5 million should be reflected;
- 7 8. non-federal funding for the Water Security Grant project must be  
8 reduced from \$3,911,901 to \$3,117,218;
- 9 9. the Department should clarify the actual expenditure for the Water  
10 Security Grant project and adjust the model accordingly;
- 11 10. budgeted Class 200 expenses for FY2009 should be reduced by  
12 \$3.12 million before growth factors are applied in order to recognize  
13 non-recurring expenditures;
- 14 11. a 2.5% growth factor should be applied to those expenditure  
15 classes for which the Department has applied a 3.0% factor since  
16 the 3.0% growth factor was based upon incorrect CPI data;
- 17 12. regarding Power and Chemical costs, since none of the  
18 Department's projections is known and measurable, the same 2.5%  
19 factor as recommended above (11) should be applied;

- 1           13.    regarding Interdepartmental Charges, no growth factors should be  
2                            utilized for Class 100 expenses until actual wage increases are  
3                            known; a 2.5% growth factor should be applied to all other  
4                            expenses after adjusting for budget-to-actual;
- 5           14.    for FY2009, a 48.45% factor should be applied to the FY2008  
6                            budgeted Indemnity expense of \$6.5 million since this percentage  
7                            represents the five-year average ratio of actual to budget charges;  
8                            a 2.5% growth factor, rather than a 3% growth factor, should be  
9                            applied for each of the next three years to be consistent with the  
10                           overall recommended growth factor;
- 11          15.    regarding Fringe Benefits, no inflation factor should be allowed for  
12                            ratemaking purposes since the Department has simply supplied no  
13                            support for a factor other than to say it is included in the City's five-  
14                            year plan;
- 15          16.    regarding the projected annual transfers of excess debt reserve  
16                            fund interest to the City General Fund (\$2.6 million in FY2009, \$2.8  
17                            million in FY2010, \$2.8 million in FY2011 and \$3.9 million in  
18                            FY2012), these payments should not be transferred to the City's  
19                            General Fund but should be deposited in the Revenue Fund for the  
20                            benefit of customers;
- 21          17.    regarding Capital Improvements, no inflation factor should be  
22                            applied to the City budget figures because inflation factors have

1 already been incorporated in the City budget figures and/or inflation  
2 factors for forecast purposes are not reliable for ratemaking  
3 purposes;

4 18. a 5% interest rate should be utilized for the FY2009 bond issue;  
5 however, since the 5.5% interest rate for the 2012 bond issue is  
6 mere speculation, a 5% interest rate should be utilized for that  
7 issue, also;

8 19. rate compression is neither appropriate, necessary nor fair in this  
9 case because the PWD does not need the total proposed FY2009  
10 additional revenue to achieve either its coverage or cash  
11 requirements;

12 20. withdrawals from the Rate Stabilization Fund should be based upon  
13 the maximum amount legally permissible and a minimum cash  
14 working capital requirement, since the Department has provided no  
15 support, other than a 1992 lead/lag study, for its proposed \$45  
16 million balance at fiscal year-end 2012 and considering that, as  
17 filed, Table 11 of the 2005 rate proceeding reflected only a  
18 \$371,000 RSF balance at the end of the fourth projected fiscal year  
19 (FY2008)<sup>18</sup>.

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<sup>18</sup> See Exhibit MAB-2c.

1 **Q. Are you able to determine the specific customer rates that would**  
2 **result from your recommendations?**

3 A. No. The PWD and Black & Veatch have denied direct access to the  
4 financial model on claimed “proprietary” grounds. While Black & Veatch  
5 will respond to our requests for additional runs involving Table 11, this  
6 process involves several days for each request and does not permit ready  
7 adjustment of the various assumptions in play. We have only learned of  
8 many of the assumptions implicit in the proposed Table 11 within the past  
9 few days. Moreover, we understand that a run of the model for all rate  
10 classes is a substantial enterprise. For this reason, the Public Advocate is  
11 not able to recommend specific alternatives to Table 11, Table 38 and  
12 similar Tables, although we have identified specific adjustments to  
13 revenues and expenses which underlie these tables.

14 In addition, since the Advocate’s recommendations involve several  
15 contingencies – for example, whether the rate period should be limited to  
16 FY2009, indeed whether there should be any rate increase in FY2009;  
17 whether it should be limited to FY2009 and FY2010, more than one run of  
18 the data would be required for the Advocate’s adjustments alone.

19 The Advocate expects to promulgate discovery requests after the filing of  
20 this testimony to further explore the implications of his recommendations.

21 At the same time, the Advocate is aware that other parties may desire that

1 other versions of Table 11 be produced to reflect various adjustments that  
2 they favor.

3 As a result, we foresee that the Hearing Officer may assist in identifying  
4 runs of the model that should be done prior to the evidentiary hearings, to  
5 assist the parties in exploring all the implications of the various  
6 alternatives to the current filing. The Advocate stands ready to participate  
7 in a conference regarding these issues.

8 **Q. Does that conclude your Direct Testimony for this proceeding?**

9 A. Yes, it does. However, I reserve the right to supplement this testimony as  
10 other information becomes available.

11

**MICHAEL A. BLEIWEIS**  
**CONSULTING EXPERIENCE**

1 **PENNSYLVANIA**

2 Philadelphia Water Department..... 1985 Rate Increase  
3 1990 Rate Increase  
4 1992 Rate Increase  
5 2001 Rate Increase  
6 2005 Rate Increase

7 The York Water Company .....Docket No. 00061322

8 Pennsylvania-American Water Co. ....Docket No. R-880916  
9 .....Docket No. R-00072229

10 United Water Pennsylvania, Inc.....Docket No. R-00051186

11 Pennsylvania Gas & Water Co. (Gas and Water) Docket Nos.: R-821961  
12 R-822102  
13 R-891261

14 Newtown Artesian Water Co.....Docket No. R-911977

15 Indian Rock Water Company .....Docket No. R-911971

16 Philadelphia Suburban Water Co.....Docket No. R-891270

17 Western Pennsylvania Water Co.-  
18 Butler District .....Docket No. R-832381

19 Shenango Valley Water Company .....Docket No. R-00922420

20 Borough of Media Water Works .....Docket No. R-00943098

21 Philadelphia Gas Works..... 1986 Base Rate Increase  
22 1988 Base Rate Increase  
23 1990 Base Rate Increase  
24 1991 Base Rate Increase  
25 2001 Restructuring Docket No. M-00021612  
26 2001 Rate Increase Docket No. R-00006042  
27 2002 Extraordinary Rate Relief Docket No. R-00017034  
28 2004 CRRC Docket Nos. R-00049157 and P-00042090  
29 2006-07 Base Rate Increase Docket No. R-00061931  
30 1993-94 Operating and Capital Budgets  
31 1994-95 Operating and Capital Budgets  
32 1995-96 Operating and Capital Budgets

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**CONSULTING EXPERIENCE**

1 **PENNSYLVANIA**

2 Philadelphia Gas Works 1996-97 Operating and Capital Budgets  
3 1997-98 Operating and Capital Budgets  
4 1998-99 Operating and Capital Budgets  
5 1999-00 Operating and Capital Budgets  
6 2000-01 Operating and Capital Budgets  
7 ..... 2001-02 Operating and Capital Budgets  
8 2002-03 Operating and Capital Budgets  
9 2003-04 Operating and Capital Budgets  
10 2004-05 Operating and Capital Budgets  
11 2005-06 Operating and Capital Budgets  
12 2006-07 Operating and Capital Budgets

13 Philadelphia Electric Co. (Elec. and Gas) ..... Docket Nos.: R-80061225  
14 R-811626  
15 R-811719  
16 R-822291  
17 R-832410  
18 R-842590  
19 R-850152  
20 R-860346-1307(f)  
21 R-880955-1307(f)  
22 R-891290-1307(f)  
23 R-911976-1307(f)

24 Equitable Gas Company ..... Docket No. R-80041169

25 Duquesne Light Company ..... Docket Nos.: R-811470  
26 R-832337  
27 M-00930404C001

28 West Penn Power Company ..... Docket Nos.: R-811836  
29 R-901609

30 The Peoples Natural Gas Co. .... Docket No. R-821906

31  
32 Metropolitan Edison Company ..... Docket No. R-842770

33 Pennsylvania Electric Co. .... Docket No. R-842771

34 UGI Corporation ..... Docket No. R-860344-1307(f)  
35 R-00932862

**MICHAEL A. BLEIWEIS**  
**CONSULTING EXPERIENCE**

1 **PENNSYLVANIA**

2 Columbia Gas of Pennsylvania ..... Docket Nos.: R-860527  
3 R-87058  
4 R-901873  
5 R-911921-1307(f)  
6 R-932597-1307(f)

7 T.W. Phillips Gas and Oil Co. .... Docket Nos.: R-88194  
8 R-891566

9 Apollo Gas Company ..... Docket No. R-092254

10 Pennsylvania Power & Light Company ..... Docket No. M-00930406C0001

11 PFG Gas, Inc./North Penn Gas, Inc. .... Docket No. R-00953524

12 Pike County Light & Power Co. .... Docket No. R-00049884

13 **NEW JERSEY**

14 Commonwealth Water Company ..... Docket Nos.: 784-274  
15 819-781  
16 842-100  
17 WR8503245

18 Elizabethtown Water Company ..... Docket Nos.: 802-76  
19 818-735  
20 WR8504330

21 Mt. Holly Water Company ..... Docket Nos.: 805-314  
22 819-801

23 Monmouth Consolidated Water Company ..... Docket Nos.: 819-816  
24 828-723  
25 831-1113  
26 850-3267

27 Public Service Electric and Gas Co. .... Docket No. 812-76

28 Atlantic City Electric Company ..... Docket Nos.: 7911-9511  
29 839-753(LEAC)  
30 8410-1079(LEAC)  
31 ER8504434

**MICHAEL A. BLEIWEIS**  
**CONSULTING EXPERIENCE**

1 **NEW JERSEY**

2 Atlantic City Electric Company 8609980-4981  
3 8709-1159&1160  
4 8809-1053  
5 ER90091090J  
6 ER92020253J

7 Jersey Central Power and Light Co. ....Docket Nos.: 811-25  
8 831-110  
9 8507698  
10 8601121(LEAC)  
11 ER87111295(LEAC)  
12 ER91121820J

13 Rockland Electric Company ..... Docket No. 827-612

14 Middlesex Water Company .....Docket Nos.: 829-707  
15 845-402

16 New Jersey Natural Gas Company .....Docket Nos.: 831-46  
17 838-687 (LPGA)

18 Hackensack Water Company .....Docket Nos.: 837-622  
19 847-698

20  
21 Elizabethtown Gas Company ..... Docket Nos.: GR86121374  
22 GR88080913(LPGA)  
23 GR8812-1321  
24 GR8801-0217

25 Toms River Water Company .....Docket No. WR92010081

26 **IDAHO**

27 Idaho Electric Company ) .....Docket Nos.: 100726)  
28 ) ..... 100727)  
29 Idaho Water Company ) ..... 100728)



**MICHAEL A. BLEIWEIS**  
**CONSULTING EXPERIENCE**

1 **SOUTH CAROLINA**

- 2 South Carolina Pipeline Corp..... Docket No. 88-652-G
- 3 South Carolina Electric and Gas Co. ....Docket Nos.: 88-695-G
- 4 92-009-G
- 5 Peoples Natural Gas Co. of SC ..... Docket No. 89-12-G
- 6 Carolina Water Service ..... Docket No. 93-738-W/S
- 7 2000-0207-W/S
- 8 Tega Cay Water Service, Inc. .... Docket No. 96-137-W/S
- 9 Palmetto Utilities, Inc. ....Docket No. 98-653-S
- 10 Harbor Island Utilities, Inc. .... Docket No. 97-262-W/S
- 11 Sigfield Water Company, Inc. ....Docket No. 97-131-W
- 12 United Utilities Company..... Docket No. 2000-0210-W/S

13 **MAINE**

- 14 Central Maine Power Co..... Docket No. 92-345

15 Mr. Bleiweis has also supervised or participated in the preparation of rate cases for  
16 companies in the states of Arizona, California and New York.

17