



*The ARAMARK Tower
1101 Market Street
Philadelphia, PA 19107-2994*

FOR IMMEDIATE RELEASE

**Before the
Philadelphia Water Commissioner**

In the Matter of the Philadelphia Water :

Department's Proposed Increase in	:	
Rates for Water and Wastewater	:	FY 2005-2008
Utility Services, Request for Emergency	:	
Rate Relief for FY2005	:	

Recommended Decision

Before Henri P. Marcial, Hearing Officer

History of the Proceeding

On January 27, 2004, the Philadelphia Water Department ("PWD" or "Department") initiated this rate proceeding pursuant to Sections 8-407 and 5-801 of the Philadelphia Home Rule Charter and Sections 13-101 and 13-201 of the Philadelphia Code. On February 26, 2004, the PWD filed its rate request with the Department of

Records of the City of Philadelphia. The filing requested the implementation of new rates, to become effective July 1, 2004, in the following service categories:

General Service Water Rates (Sections 301.0, et seq.)

General Service Sewer Rates (Sections 302.0, et seq.)

Miscellaneous Water Charges (Sections 303.0, et seq.)

Miscellaneous Sewer Charges (Sections 304.0, et seq.)

General Fire Service Rates (Sections 308.0, et seq.)

The City of Philadelphia appointed the Hearing Officer and the Public Advocate for the general rate proceeding in early December 2004. Since the time of the initial PWD filing, PWD has proposed certain changes in its rate request. Most importantly, PWD has removed the Lateral Service Program from the initial proposal. This program would have involved the assumption, by the PWD, of responsibility for repairing water and sewer laterals under public right-of-ways up to the curb. This modification resulted in a reduction of the requested revenues by approximately \$70 million for Fiscal Years (“FY”) 2005 through 2008 initially reducing the overall requested revenues for the period to \$237 million.

A Prehearing Conference was held on December 17, 2004. The following parties entered their appearances: Andre C. Dasent, Esq., Frank Breitman, Esq. and Keith J. Jones, Assistance City Solicitor on behalf of the Philadelphia Water Department (PWD); Philip A. Bertocci, Esq. and Thu Tran, Esq. from Community Legal Services as the Public Advocate; and James P. Melia, Esq. on behalf of the Commercial Customer Consortium (“CCC”). At that time, a revised filing was presented by PWD that increased the overall revenue request to approximately \$286 million. In addition, PWD requested that the proceedings be bifurcated and that emergency rate relief for the remainder of

FY2005 be addressed first, on an expedited basis, with the remainder of the proceedings addressing FY2006-2008 to be subsequently conducted at a normal pace. PWD's request was premised on a projected \$16.1 million revenue short fall for FY2005 if new rates were not implemented immediately.^[1] PWD indicated such a short fall would result in a technical default of the Department's obligations under the General Bond Ordinance and certain insurance agreements.

The parties present at the Prehearing Conference orally agreed to a bifurcation of these proceedings. An expedited schedule was established to address PWD's request for \$16.1 million in emergency rate relief for FY2005. Formal and informal discovery was conducted between December 17, 2004 and January 7, 2005. A hearing was held in this matter on January 10, 2005 at the Philadelphia Gas Commission's hearing room located at 1515 Arch Street, 18th Floor, Philadelphia, Pennsylvania. A transcript of some 205 pages was accumulated in the aforesaid hearing. In addition to the statements and exhibits of the parties of record, that were marked for identification and incorporated into the record, several Philadelphia residents also testified regarding the impact of increased rates upon their circumstances. (N.T. 28, 36-51)

Findings of Fact

1. The Department initiated the process to establish new rates, pursuant to Section 5-801 of the Philadelphia Home Rule Charter ("Charter"); and Sections 13-101 and 201 of the Philadelphia Code. PWD Statement 1 at 4.
2. The Department filed with the Department of Records the following proposed regulations promulgated in connection with these proceeds to implement new rates:

General Service Water Rates (Sections 301.0, *et seq.*);

General Service Sewer Rates (Sections 302.0, *et seq.*);

Miscellaneous Water Charges (Sections 303.0, *et seq.*);

Miscellaneous Sewer Charges (Sections 304.0, *et seq.*); and

General Fire Service Rates (Sections 308.0, *et seq.*).

PWD Exhibit 6.

3. The Department of Records duly advertised, in newspapers with a general circulation in the City of Philadelphia, the filing of the proposed regulations and the administrative process via which interested parties could participate in these proceedings.

4. The Public Advocate and the Hearing Officer in this matter were assigned in early December 2004.

5. A Prehearing Conference was conducted on December 17, 2004.

6. A Technical Hearing to examine the propriety of PWD's request for FY2005 rate relief was conducted on January 10, 2005.

7. The Water Department advertised the time and location of the Prehearing Conference and Technical Hearings in the Philadelphia Inquirer, Philadelphia Daily News, Philadelphia Tribune and other publications, all in compliance with the Department's rate regulations governing such proceedings. (N.T. 51-52).

8. The Department needs to collect additional revenues in the aggregate amount of approximately \$16.1 million in FY2005 in order to avoid a technical default on its debt service and other obligations associated with its bond insurance.

9. The revenues requested for FY2005 are a subset of the general revenue request originally contained in the January 27, 2004 Rate Application. PWD Statement 1 at 7.

10. The Department's ability to service debt is currently rated "A-" by Standard and Poors; "A3" by Moody's Investors Service; and "A-" by Fitch. PWD Statement 5 at 3; PWD Exhibit 1 (Standard Interrogatory 10).

11. Technical compliance with rate covenants is essential to maintain the Department's current favorable bond ratings. PWD Statement 1 at 6-7; PWD Statement 5 at 3-7.

12. A technical default by the Department in servicing its debt covenants will result in a downgrade of the Department's credit rating. Such a downgrade will significantly increase the cost of providing service over the long term and this will directly translate to higher revenue and rate requirements being implemented than those currently being proposed. (N.T. 105-110)

13. The existing rate covenants, including that prescribed by the General Water and Sewer Revenue Bond Ordinance of 1989 ("General Bond Ordinance") require, among other things, that the Department's annual net revenues be at least 120 percent of its senior debt service. PWD Statement 1 at 6.

14. The rates and charges established by the Department must also be sufficient to yield net revenues (excluding amounts transferred from the Rate Stabilization Fund to

the Revenue Account) at least equal to 90 percent of the Department's debt service requirements ("90% rule"). PWD Statement 1 at 6.

15. The Department is constrained in its flexibility to forgo rates modifications that are necessary to conservatively meet both operating requirements and the obligations to bond holders. PWD Statement 1 at 4-5.

16. Only 46.5% of the Water Fund budget is directly under the control of the Water Commissioner (conversely 53.5% of payments for services to other departments Law, Finance, etc. are prescribed by ordinance). PWD Statement 1 at 9.

17. The FY2005 Emergency Rate Request is specifically designed to comply with the Department's legal requirements as contained in Section 5-801 of the Charter, as set forth in the Philadelphia Code, Sections 13-101 and 13-201 and the General Water and Sewer Revenue Bond Ordinance of 1989 ("General Bond Ordinance"). PWD Statement 1 at 4-7; PWD Statement 6 (Exhibit JRM-1 – Table 11).

18. The Department's covenants with the Bond Insurers permit it to transfer a total of \$47.182 million at this time from the Rate Stabilization Fund to the Revenue Fund, without violating the 90% Rule reflected in the Bond Insurance agreements. (N.T. 133-136).

19. The Department has the ability to further marshal its discretionary spending by deferring certain Class 200 and 300 initiatives until FY2006. PA Statement 1 at 8; (N.T. 139-143)

20. The Department is not at liberty to direct the use of the Debt Reserve Fund's excess interest. PWD Exhibit 8, (N.T. 152-162)

Discussion

The focus of the January 10, 2005 Technical Hearing and this Recommended Decision is whether the Emergency Rate Relief requested by the Philadelphia Water Department (“PWD” or “Department”) for FY2005 is justified. The standards of review as set forth in the Pennsylvania Public Utility Code will serve as the backdrop for these proceedings.

The Department’s current request is analogous to an application for extraordinary rate relief pursuant to Section 1308(e) of the Public Utility Code, 66 Pa. C.S. §1308(e). Under this section of the Code, a utility, during the pendency of a general rate proceeding, may seek the recovery of that portion of the overall rate relief requested that can be shown to be immediately necessary to maintain financial stability in order to enable it to provide normal services to its customers, avoid reductions to its normal maintenance programs, and avoid substantially reducing personnel.

The burden of proof in a proceeding is upon the proponent of a given rate change, 66 Pa. C.S. § 315(a). Therefore, PWD as the proponent for Emergency Rate relief for FY2005 bears the burden of proving that their request should be granted. Lower Frederick Township v. Pa. PUC, 409 A2d. 505 (Pa. Cmwlt.1980); See *a/so*, Brockway Glass Company v. Pa. PUC, 437 A2d. 1067 (Pa. Cmwlt.1981).

In this context, care must also be exercised to insure that the decision is supported by substantial evidence in the record. More than a mere trace of evidence is required to establish the existence of a fact. See, e.g., Section 704 of the Administrative Agency Law, 2 Pa. C.S. §704; Norfolk & Western Ry. Co. v. PA PUC, 489 Pa. 109, 413

A.2d 1037 (1980); Erie Resistor Corp. v. Unemployment Comp. Bd. of Review, 194 Pa. Superior Ct. 278, 166 A.2d 96 (1961); and Murphy v. Dept. of Public Welfare, White Haven Center, 480 A.2d 382 (Pa. Cmwlth 1984).

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

The standards set by City Council, pursuant to Section 5-801 of the Charter, are set forth in the Philadelphia Code, Sections 13-101 and 13-201 and specifically require the Department to set rates that annually:

- (A) ensure that all operating expenses are met, including interest and sinking fund reserve requirements;
- (B) pay proportionate charges for all services performed for the Department by other departments, boards or commissions of the City; and
- (C) meet its obligations to bondholders by complying with all rates covenants.

PWD Statement 1 at 4-5.

The Department proposes to implement temporary rates effective February 1, 2004 to avoid the prospect of technical default, subject to a true-up or offset, to reflect actual costs that will be carried into one or all of the remaining fiscal periods in the broader proceedings. The implementation of the requested rate relief as soon as possible is calculated to lessen both the immediate rate shock and the long term burden on customers. The short fall in revenue for FY2005 is expected to remain relatively constant. However, implementing rates at a later date only shortens the time in which to

recover the needed revenue. In other words the recovery period is compressed. The percentage increase in overall revenues under this scenario is 9.75% for the last five months of FY2005. If the Department had a full year to recover the needed revenue, it would be less. The inverse is also true. A shorter recovery period forces an increase in the monthly recovery percentage. PWD Statement 1 at 2; PWD Statement 6 at 7; (N.T. 98-99).

In addition to rate compression based on time, there is also rate compression based upon expected actual revenue collection. The historical level of successful revenue collections for the period of February through June is approximately 68% of the service actually billed. Therefore, rates are again adjusted upward to compensate for those ratepayers that do not pay their bills. PWD witness McKinley testified that the proposed rate increase of \$16.1 million, if implemented in February, represents a 15.5% increase for all classes of customers when adjusted for both the time and the collection compression factors. (PWD St. No. 6, pp. 7, 10-11; PWD Statement 1 at (JRM-1, Table 38).

The instant application is complicated by the fact that without prompt rate relief, the Department will be in technical default of its rate covenants with investors. Specifically, the Department must meet debt service coverage requirements on senior debt of 1.20x while complying with the "90% rule." Absent the prompt implementation of the requested rate relief, it will fail to do so (thereby defaulting with regard to its obligations under the Insurance Agreements). As described above and in the testimony and exhibits presented by Department witnesses, the implications of such a default are severe. PWD Statement 1 at 7; PWD Statement 6 at 8; (N.T. 103-110).

Without interim rate relief, PWD will have to disclose an imminent technical default to bondholders raising the prospect of a downgrade in the Department's bond rating. PWD Statement 5 at 6. A downgrade would cost ratepayers in the range of \$500,000 per year (per increment of \$100 million of the principal amount) for future bond issues. Bond issues generally have a 30 year term for fixed rate debt. (N.T. 107-108). The next planned bond issue is for \$250 million in the spring of 2005; with another issue of \$300 million scheduled later during the Rate Period (FY2005-2008). PWD Statement 1 at 9. Assuming a downgrade in bond rating, the next planned bond issue would carry with it a "surcharge" of \$37.5 million associated with such a downgrade; and another \$45.0 million on the second planned transaction. This unnecessarily burdensome expense would be borne by the ratepayers.

Although a 15.5% increase in rates may seem to impose an unwanted burden on ratepayers (N.T. 39-51), this is a minimal short term burden compared to the financial consequences of a technical default. (N.T. 105-111). It is incorrect for one to assume that the financial integrity of the Department is an isolated management concern that has no impact on ratepayers. Ultimately all costs are borne by the ratepayers. The short term benefit of keeping the rates unchanged now does not outweigh the long term detriment and truly burdensome rate requirements that would result from such a course of action. For these reasons I find it in the best overall interest of Philadelphia Ratepayers to grant the instant relief requested by PWD.

The question then shifts to what combination of actions are reasonable and in the best interest of ratepayers for minimizing the revenue short fall. The Public Advocate and Commercial Customer Consortium request that the Hearing Officer recommend a reduction of PWD's proposed FY2005 revenue request by \$7.112 million by requiring the following a

(A) Apply the expected \$4.924 million from the Debt Reserve Fund's excess interest to the Revenue Fund rather than allowing it to go into the City's General Fund; additional downward adjustments to the budget:

(B) Apply the remaining \$0.682 million still available for use in the Rate Stabilization Fund to the Revenue Fund;

(C) Apply \$1.506 million to increase net revenues by further decreasing FY2005 operating expenses.

Regarding the excess interest from the Debt Reserve Fund, the Public Advocate's premise is that the City, as the owner and operator of the utility, should take some responsibility for the Department's financial situation similar to steps taken in the past to assist Philadelphia Gas Works (e.g., grant-back of the \$18 million City Payment). (N.T. 144-145). However, the evidence indicates that the City is unable to assist the Department at this time. (N.T. 155-157). The Department was informed (by letter dated January 7, 2005 from the Budget Director, Diane Reed) that payment of excess interest earnings is to be made to the City for FY2005. PWD Exhibit 8. The Department does not have the authority to unilaterally override the Budget Director's decision. This is also a year end budget adjustment based upon actual interest earnings.^[2] Time is of the essence with regard to FY2005 rate relief. We can not wait to see if these funds will actually be available and whether City Counsel and/or the Administration will authorize their use in such a manner. Therefore, the request of the Public Advocate and the Commercial Customer Consortium that these funds be applied toward reducing the FY2005 revenue gap is denied. However, it is certainly appropriate to revisit this issue in the scope of the broader proceedings especially with regard toward the FY2005 true up. Therefore, the parties are not prejudiced from raising this point again later in the proceedings.

With respect to the remaining adjustments put forth by the Public Advocate and the Commercial Customer Consortium, these suggested modifications certainly fall with

in the discretionary authority of the Department. It is the Advocate's position that the Rate Stabilization Fund should be used to the maximum extent possible for the benefit of customers. In addition, the Advocate also indicates the short term need to lessen the burden of the proposed emergency rate increase on customers outweighs the claims by PWD for some currently scheduled programs designed to increase the efficiency of its operations. I agree.

The Department has stipulated in its brief that it is willing to make these additional adjustment. (PWD Brief p. 12). Therefore, the request to apply additional Rate Stabilization Funds in the amount of \$0.682 million and to further decrease the Department's operating expenses for FY2005 by \$1.506 million is granted.^[3] PWD is hereby directed to adjust its FY2005 budget and the proposed rates accordingly.

It must be emphasized that the current rate relief is only applicable for the five remaining months of FY2005. These proceedings will next address the remainder of the Department's Rate Request (FY2006-2008). Within the scope of the proceeding, a final adjustment for FY2005 actual costs will be made to compensate for any inaccuracies generated by the hasty nature of the instant Emergency Rate Relief proceedings.

There is little more the Department can do in the way of additional spending curtailments. It should be noted that of the \$520.9 million in the Water Fund budget there is actually very little in the way of discretionary spending. Only 46.5% of the Water Fund budget is directly under the control of the Water Commissioner (conversely 53.5% of payments for services to other departments Law, Finance, etc. are prescribed by ordinance). PWD Statement 1 at 9.

Conclusions of Law

1. The Philadelphia Water Commissioner has the authority to grant emergency rate relief to the Philadelphia Water Department for FY2005.
2. The Philadelphia Water Department has presented sufficient evidence to meet its burden in support of its request for emergency rate relief for the remainder of FY2005.
3. The granting of the requested relief in a manner consistent with this Recommended Decision is just and reasonable and in the long term best interest of Philadelphia Ratepayers.

Order

Therefore, it is Ordered:

1. The Public Advocate's and Commercial Customer Consortium's requests are granted in part and to denied in part, consistent with this decision.
2. PWD's request for FY2005 Rate relief is granted in part and denied in part, consistent with this decision.
3. PWD will further reduce the amount of necessary revenue for FY2005 by postponing certain operations initiatives until FY2006.
4. PWD will use the maximum amount of Rate Stabilization Funds allowable to further reduce FY2005 revenue needs.

5. PWD will account for any inaccuracies in the FY2005 Emergency Rate Relief, as granted, in the remainder of the proceedings and apply such adjustments in the subsequent fiscal period(s) (FY2006-2008) as necessary.

Date: January 18, 2005

Henri P. Marcial, Hearing Officer

^[1] The FY2004 Rates are currently in effect until such time as these proceedings may approve a change in rates. Brockway Glass Company v. Pennsylvania PUC, 63 Pa. Commw. 238, 437 A2d 1067 (Pa. Cmwlth. 1981)

^[2] The decision to take the excess interest earnings or “scoop payment” is made by the City as authorized in the General Bond Ordinance (Section 4.12). The timing of the decision is usually in October. Historically, the amount available for the “scoop payment” has been larger than the authorized \$4.994 million. In the past few years, because of declining interest rates, the authorized level for the payment has not been realized. In FY2004, no payment was made at all. (N.T. 152-155).

^[3] It should be noted that the FY2005 decrease in the operating budget will be accomplished by deferring currently scheduled projects until FY2006.