

January 8, 2021

*Via Electronic Filing*

Rosemary Chiavetta, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street  
Harrisburg, PA 17120

In re: Docket No. R-2020-3020256, *et al.*  
Pa. P.U.C., *et al.* v. The City of Bethlehem – Water Department

Dear Secretary Chiavetta:

We are counsel to the City of Bethlehem – Water Department and are submitting, via electronic filing with this letter, the City's Reply Brief in the above matter. Copies of the Reply Brief are being served upon the persons and in the manner set forth on the certificate of service attached to it.

Very truly yours,

THOMAS, NIESEN & THOMAS, LLC

By 

Thomas T. Niesen

cc: Certificate of Service (w/encl.)  
The Honorable Steven K. Haas, Administrative Law Judge (via email, w/encl.)  
Edward J. Boscola, P.E. (via email, w/encl.)

**Before The  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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**Administrative Law Judge  
Steven K. Haas, Presiding**

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<b>Pennsylvania Public Utility Commission</b>	<b>:</b>	<b>R-2020-3020256</b>
<b>Office of Small Business Advocate</b>	<b>:</b>	<b>C-2020-3021576</b>
<b>Office of Consumer Advocate</b>	<b>:</b>	<b>C-2020-3021583</b>
	<b>:</b>	
<b>v.</b>	<b>:</b>	
	<b>:</b>	
<b>City of Bethlehem – Water Department</b>	<b>:</b>	
	<b>:</b>	

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**REPLY BRIEF  
OF  
THE CITY OF BETHLEHEM**

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DATED: January 8, 2021

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## **I. INTRODUCTION**

This proceeding concerns the City of Bethlehem's ("City") Supplement No. 15 to Tariff Water – Pa. P.U.C. No. 6 ("Supplement No. 15"). Supplement No. 15 proposed to increase the City's annual water revenue by \$908,421, based on a future test year ending December 31, 2020.

The City submits this Reply Brief in accordance with the litigation schedule memorialized in the Prehearing Order dated October 8, 2020. The Reply Brief is supplemental to the City's Main Brief and is limited to those matters that warrant additional discussion as a result of the Main Briefs submitted by the Office of Consumer Advocate ("OCA") and the Office of Small Business Advocate ("OSBA").<sup>1</sup>

As set forth herein and in the City's Main Brief, the Public Utility Commission ("Commission") should approve the Joint Petition for Approval of Partial Settlement of Rate Investigation ("Joint Petition") submitted by the City and the Bureau of Investigation and Enforcement ("I&E") providing for an increase in annual revenue for Outside City Service of \$689,932 in lieu of the originally proposed increase of \$908,421, and, in doing so, reject the ratemaking adjustments proposed by OCA and OSBA.

The City submits that the rates proposed in the Joint Petition are just and reasonable and consistent with the Public Utility Code ("Code").

## **II. SUMMARY OF ARGUMENT**

The City has demonstrated through a preponderance of evidence and substantial evidence that its ratemaking claims for Outside City Service are reasonable and appropriate. The ratemaking adjustments proposed by the OCA and OSBA should be given no weight.

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<sup>1</sup> The City's Main Brief followed the required common outline with argument presented by section heading, along with Main Brief Tables, Proposed Findings of Fact, Proposed Conclusions of Law and Proposed Ordering Paragraphs. The section headings from the common outline are also used in this Reply Brief.

The Commission has no authority to deny the City rate relief because of the COVID pandemic. The City has taken reasonable and appropriate steps to assist customers with payment for water service during the pandemic.

The partial settlement proposed by the City and I&E, through which the City has voluntarily reduced its proposed rate increase to \$689,932 from the originally proposed increase of \$908,421, should be approved as the settlement is in the public interest. The proposed settlement revenue and settlement rates are just and reasonable and in compliance with the Code.

### **III. OVERALL POSITION ON RATE INCREASE**

#### **A. The City's Overall Position**

As presented in Section II of its Main Brief, the City's overall position is that the Commission should approve the Joint Petition, without modification, and accept the settlement increase of \$689,932 and the settlement rates proposed in the Joint Petition as just and reasonable and consistent with the Code. In doing so, the Commission should reject the ratemaking adjustments proposed by OCA and OSBA and dismiss their respective Complaints with prejudice.

Approval of the Joint Petition would be consistent with the Commission's approval of a partial settlement in *PGW*<sup>2</sup> and the Recommended Decision of Administrative Law Judge Johnson recommending that the Commission approve a "non-unanimous" settlement in Pennsylvania-American Water Company's pending rate proceeding ("*PAWC*").<sup>3</sup> The partial

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<sup>2</sup> *Pa. P.U.C. v. Philadelphia Gas Works*, Docket No. R-2020-3017206, Opinion and Order entered November 19, 2020 ("*PGW*").

<sup>3</sup> *Pa. P.U.C. v. Pennsylvania-American Water Company*, Docket Nos. R-2020-3019369 and R-2020-3019371, Recommended Decision of Administrative Law Judge Conrad A. Johnson dated December 22, 2020.

settlement proposed by the City and I&E is consistent with the Commission's policy favoring negotiated settlements and in the public interest.

In his Recommended Decision in *PAWC*, Judge Johnson cited *Pa. P.U.C. v. C. S. Water & Sewer Assocs.*, 74 Pa. P.U.C. 767 (1991), and explained that he was bound by Commission policy encouraging settlement and whether the settlement is in the public interest.<sup>4</sup> He then weighed the evidence, considered the competing arguments of the settling and non-settling parties and concluded that the *PAWC* settlement is in the public interest. A similar analysis supports the partial settlement presented by the City and I&E to resolve the issues in this proceeding.<sup>5</sup>

**B. The Overall Position of OCA and OSBA – Impact of COVID Pandemic**

OCA and OSBA ask the Commission to deny the City's rate increase. They contend that any increase in water rates during the COVID pandemic period would not be just and reasonable. The OCA also presents a "business as usual" analysis that concludes that the City has an additional revenue requirement of \$443,666 for jurisdictional service to Outside City Customers.<sup>6</sup> As addressed in Section III of the City's Main Brief, rejecting the City's rate

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<sup>4</sup> *PAWC*, Recommended Decision, mimeo at 126.

<sup>5</sup> The Joint Petition, which was attached as Attachment A to the City's Main Brief, included Statements in Support from the City and I&E addressing how the partial settlement is consistent with Commission policy encouraging settlement and in the public interest. OCA advises that it will address the Joint Petition in its Reply Brief. OCA Main Brief at 8. The City and I&E have the due process opportunity to reply to the OCA by January 12, 2021.

<sup>6</sup> OCA St. No. 2S at 1-2.

increase would be contrary to law. It also would not be supported by the evidence of record.<sup>7</sup> The contentions of OCA and OSBA are addressed further below.<sup>8</sup>

The Commission has no authority under the Code to deny the City's rate increase as proposed by OCA and OSBA. The Commission addressed its statutory ratemaking authority in *PGW* and held that it has *no* authority to alter a utility's substantive right of a rate increase going into effect at the end of the seven-month statutory deadline.<sup>9</sup> A Commission decision adopting the "no increase" proposal submitted by OCA and OSBA would violate the Public Utility Code and the Commission's statutory obligation to set just and reasonable rates.<sup>10</sup>

Additionally, irrespective of the absolute nature of their argument – i.e., a rate increase should be denied due to the unprecedented and continuing COVID pandemic,<sup>11</sup> – OCA and OSBA were parties to a partial settlement in *PGW*, approved by the Commission, which provided for a Phase I increase in rates of \$10,000,000 for PGW, effective January 1, 2021. Clearly, based on the resolution determined to be acceptable by OCA and OSBA in *PGW*, the impact of the COVID pandemic does not warrant denial of a proposed rate increase in each and every circumstance, even if the Commission were to have the authority to deny an increase because of COVID concerns (which it does not).

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<sup>7</sup> As stated in Section III.B of its Main Brief, pages 10 and 11, it is the City's position that the OCA has the burden of proof to support its proposed rejection of the City's rate increase on COVID pandemic grounds. Irrespective of which party has the burden of proof, the City submits that the position of OCA and OSBA is not supported by the evidence of record.

<sup>8</sup> In support of its position, OSBA cites data from the Census Bureau's Small Business Pulse Survey for Pennsylvania (OSBA Main Brief, Section III) and from the Johns Hopkins Coronavirus Resource Center (OSBA Main Brief, Section III). This data is not part of the evidentiary record and should not be considered in support of the OSBA's position.

<sup>9</sup> *PGW*, mimeo at 13.

<sup>10</sup> Although we disagree with it as it is far below the increase in rates supported by the evidence of record, we point out that OCA witness Sherwood's "business as usual," traditional rate base / rate of return analysis shows that the City would be entitled to an increase in rates of \$443,666 for Outside City Service at the end of the seven-month statutory deadline.

<sup>11</sup> See OCA Main Brief at 9 and OSBA Main Brief, Section III.

Here, the City's circumstances do not support the position of OCA and OSBA. Those circumstances are highlighted by the differences between the City and Pennsylvania-American Water Company ("PAWC"). In *PAWC*, the OCA is also seeking to have the Commission reject a rate filing because of COVID concerns.<sup>12</sup> PAWC is the largest publicly owned, water/wastewater utility in Pennsylvania. It is a for profit entity with 740,000 water and wastewater customers.<sup>13</sup> The City, in contrast, is a municipal entity, with only 13,496 Outside City Customers.

More significantly, the City's monthly rates, even at the originally proposed rate level of \$28.52, are *less than half* the existing rates of PAWC at \$64.37.<sup>14</sup> At this substantially lower rate for water service, the COVID pandemic is simply not impacting City ratepayers in the same way as it is impacting PAWC ratepayers. In the context of the COVID pandemic, the City's significantly lower rate level demonstrates that its existing and proposed water rates are just and reasonable. Notably, no customer complaints were filed in opposition to the City's proposed rate increase.

Additionally, in support of its position, the OCA suggests that the City can avoid the need for additional revenue by holding off on all but the absolute necessary system improvement projects.<sup>15</sup> The OCA made this same argument in *PAWC* where the utility has capital projects

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<sup>12</sup> See *PAWC*, mimeo at 107-108

<sup>13</sup> See *PAWC*, mimeo at 3.

<sup>14</sup> See City Main Brief at 13.

<sup>15</sup> OCA Main Brief at 10, 17 and 23. At page 17 of its Main Brief, OCA contends that the City could preserve cash by deferring for several months certain construction projects, such as growth-related projects or longer-term system rehabilitation activities, which are not needed to ensure the current provision of safe and reliable service and that "other large utilities" have been taking advantage of the very low cost of debt and issuing 10-year notes or bonds. The City is *not* a large utility and it has no growth-related projects or longer-term system rehabilitation projects that could be deferred. OCA does not identify any projects that could be deferred.

planned throughout the Commonwealth.<sup>16</sup> The argument has absolutely no relevance here in the City's much smaller service area. The City included just five capital projects in its future test year claim and later withdrew three. The remaining two projects are necessary for continued service. The City has no unnecessary projects to delay. Projects, in fact, have already been delayed because of the COVID pandemic.

In still further support of its request that the Commission reject the City's rate filing because of COVID concerns, the OCA claims that the City's return at present rates of 5.65% (with a capital structure of 52% equity and 48% debt) is "more than adequate" and represents a fair rate of return that balances the interests of consumers and shareholders and would be in the public interest.<sup>17</sup> A return of 5.65% is, however, *less than* the City's embedded cost of long-term debt of 5.77%. A return of 5.65%, which is less than the embedded cost of debt of 5.77%, is not "fair" in any respect but is, rather, unfair in all respects demonstrating the need for immediate rate relief.

Ultimately, the City is a municipal entity, similar, in that respect, to PGW. The Commission approved a partial settlement in *PGW* and the City submits that the Commission should approve the partial settlement submitted here by the City and I&E. While the *PGW* partial settlement has several settlement terms related to the COVID pandemic, the City has implemented its own COVID customer protections without the need for Commission intervention. Significantly, the City is not terminating service to customers. It also is continuing to offer payment arrangements to customers and waiving all new late payment charges. The City

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<sup>16</sup> See *PAWC*, mimeo at 108

<sup>17</sup> OCA Main Brief at 9 and 43. In making this further argument, the OCA confuses the City with a for-profit utility stating that, while perhaps not as much *profit* as Bethlehem would like, an overall return of 5.65% is more than adequate. The City's need for rate relief is not based on a profit motive but rather on the need to maintain a sufficient surplus and adequate debt coverage levels as explained in the City Main Brief, pages 13 and 14.

reported the following to the Commission in its letter dated December 15, 2020 at M-2020-3019244:<sup>18</sup>

1. In order to best serve our customers, the City shall continue with the moratorium on all service terminations regardless of whether or not a customer is classified as a “protected customer” as defined in the Order. This moratorium has been in effect since the March 13, 2020 Emergency Order and shall continue until March 31, 2021 unless modified by PUC.
2. The City shall continue to offer payment arrangements for customers who have difficulty making payments or who otherwise have significant overdue balances. This effort predates the Covid-19 pandemic and shall continue indefinitely.
3. The City shall waive all new late payment charges for all customers until March 31, 2021.

The COVID pandemic has certainly had an impact on Pennsylvania consumers and business but it is *not* reasonable to assume, as the OCA contends,<sup>19</sup> that Bethlehem water customers align with the job and wage loss discussed in the testimony of OCA witness Rubin. The facts and circumstances in Lehigh and Northampton Counties are not unprecedented as presented by City witness Heppenstall and discussed in Section III.B.2 of the City’s Main Brief. Ms. Heppenstall noted that the recovery trend shows a sharp V, which may be heightened further with the development and implementation of a COVID vaccine.

In sum, the position of OCA and OSBA should be given no weight and denied. The Commission has no authority to deny the City rate relief because of the COVID pandemic. The City has taken reasonable and appropriate steps to assist customers with payment for water service during the pandemic. The evidence of record, moreover, does not demonstrate the appropriateness of, or otherwise support, the position of OCA and OSBA.

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<sup>18</sup> City of Bethlehem Hearing Exhibit No. 1.

<sup>19</sup> See OCA Main Brief at 12-13.

**C. Conclusion – Overall Position**

The City submits that the Commission should approve the Joint Petition, without modification, and accept the settlement increase of \$689,932 and the settlement rates proposed in the Joint Petition as just and reasonable and consistent with the Code. For all the reasons set forth above and in the City’s Main Brief, the Commission should reject the position of OCA and OSBA which asks the Commission to deny the City rate relief due to concern with the COVID pandemic.

**IV. ISSUES RESOLVED AMONG THE PARTIES**

The City and I&E have resolved all issues and filed a Joint Petition for Approval of a Partial Settlement of Rate Investigation providing for an increase in annual revenue for Outside City Service of \$689,932 in lieu of the originally proposed increase of \$908,421. The City and OCA have resolved through Stipulation all issues related to the testimony of OCA witness Fought. Other issues, as identified in Section IV of the City’s Main Brief, have been resolved or withdrawn.

**V. RATE BASE**

**A. Projected Plant in Service**

The City withdrew its rate base claim for the Well Generator, the Roof Replacement at the Water Treatment Plant and the Main Replacement at the Hecktown Road Bridge as those projects have been delayed beyond the end of the first quarter 2021. Two projected plant projects remain in controversy: the Water Treatment Emergency Generator (\$956,000) and the Fire Pump Station (\$758,000). Both are key projects as addressed in Section V of the City’s Main Brief and addressed further below.

**1. Water Treatment Emergency Generator**

OCA continues to challenge this necessary capital project arguing that it is not clear from Mr. Spanos' rebuttal testimony that this project will be completed by February 2021.<sup>20</sup> Subsequent to his rebuttal testimony, Mr. Spanos provided a further update on the Water Treatment Emergency Generator in his rejoinder testimony, served December 15, 2020, explaining that the City has taken physical delivery of the Emergency Generator and the associated automatic transfer switch. Both were installed as of December 9, 2020. Scheduling the Generator for operation would now take less than six weeks [from December 15, 2020]<sup>21</sup> with operation, thus, expected by mid/late January 2021.

The City's rate base claim for the Water Treatment Emergency Generator is reasonable and appropriate. Simply stated, the City needs the Emergency Generator. As presented above and in the City's Main Brief, the City's claim is supported by the evidence of record and the Commission's reasoning and decision in *Pa. P.U.C. v. Pennsylvania-American Water Company*, 68 Pa. P.U.C. 343, 351-352 (1988). The City submits that the Commission should accept the City's rate base claim for the Water Treatment Emergency Generator and reject the OCA's proposed adjustment.

**2. Fire Pump Station**

Similarly, OCA continues to challenge this capital project, which is needed to continue to provide reasonable and adequate service to higher elevations, arguing that it is not clear from Mr. Spanos' rebuttal testimony that this project will be completed by February 2021.<sup>22</sup> Subsequent to his rebuttal testimony, Mr. Spanos provided a further update on the Fire Pump Station in his

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<sup>20</sup> OCA Main Brief at 28.

<sup>21</sup> City of Bethlehem St. No. 3RJ at 1-2.

rejoinder testimony, served December 15, 2020, explaining that the City has taken physical delivery of many of the needed valves and pumps related to the Fire Pump Station and that those valves and pumps were ready to be installed as of the end of October.<sup>23</sup> Completion of the Station will occur in short order once the remaining component parts have been received. Delivery of the remaining parts has been delayed only because of COVID circumstances.<sup>24</sup>

The City's rate base claim for the Fire Pump Station is reasonable and appropriate. As presented above and in the City's Main Brief, the City's claim is supported by the evidence of record and the Commission's reasoning and decision in *Pa. P.U.C. v. Pennsylvania-American Water Company*, 68 Pa. P.U.C. 343, 351-352 (1988). The City submits that the Commission should accept the City's rate base claim for the Fire Pump Station and reject the OCA's proposed adjustment.

**B. Cash Working Capital**

The only disagreement with the City's Cash Working Capital ("CWC") claim is that it should be adjusted to reflect OCA's recommended adjustments to operation and maintenance expenses. The City agrees, in theory, that the operating expenses included in the CWC calculation should reflect any changes to those expenses ultimately accepted by the Commission. Inasmuch as the City disagrees, however, with most of the OCA's operation and maintenance expense adjustments, the City disagrees with the OCA's CWC adjustment.

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<sup>22</sup> OCA Main Brief at 28.

<sup>23</sup> City of Bethlehem St. No. 3RJ at 2.

<sup>24</sup> City of Bethlehem St. No. 3RJ at 2.

## VI. REVENUE

Neither OCA nor OSBA proposed any adjustments to the City's pro forma revenue claim under present rates.

## VII. EXPENSES

### A. Operations and Maintenance Expenses – Introduction

Only the following operations and maintenance expenses remain in controversy: Rate Case Expense; Salaries and Wages Expense; East Allen Township Expense; and Water Filtration Expense. Each of the expenses still in controversy was addressed in the City's Main Brief and is addressed further below.

#### 1. Rate Case Expense

The City's claim for rate case expense is based on a three-year (36 month) normalization period. The OCA proposes to increase the normalization period to 52 months based on the average duration between the City's prior three rate cases. The City explained in its Main Brief why the recent period of extended intervals between rate cases was abnormal for the City and should not be the basis for determining the appropriate normalization period.<sup>25</sup> Rate case intervals prior to 2007 would have supported a normalization period of two years or 24 months. The City, however, presented its claim on a more extended 3 year or 36-month period.

The City emphasizes here, as it did in its Main Brief, that, while rate case expense is normalized for recovery over a number of months, the actual cash outlay occurs in real time while the rate case is pending. This difference in timing creates a cash shortfall in relation to the expense. Extending the normalization period as proposed by the OCA exacerbates the effect of the shortfall by also placing the City at risk for under recovery if the rate case interval ends up

being shorter than the assumed normalization period. The proposed three-year (36 month) normalization period is a reasonable projection of rate case intervals based on intervals going back in time.

As a final but significant point, the OCA has severely understated rate case expense even under its 52-month normalization period. OCA states, in its Main Brief, that its original adjustment was \$42,519 but that its revised adjustment, based on “actual rate case expense,” is \$78,325.<sup>26</sup> The “actual rate case expense,” upon which OCA based its revised adjustment, is the expense incurred *but only* through the submission of rejoinder testimony.<sup>27</sup> The City is clearly continuing to incur rate case expense as a result of the continued litigation with OCA and OSBA.<sup>28</sup> The total projected expense through the conclusion of the proceeding is \$414,560 and it is \$414,560 that should be normalized for ratemaking purposes.

## **2. Salaries and Wages Expense**

The City included a union contract wage increase, effective January 1, 2021, in its revenue requirement calculation. The OCA contends that the claim violates the matching principal between revenue and expenses and that the City could have chosen a different test year or a fully projected future test year to capture the wage increase.<sup>29</sup> It is significant that the claim is based on a union contract. As such, the wage increase is known, measurable and certain to occur. As presented here and in the City’s Main Brief, the claim is consistent with past

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<sup>25</sup> City Main Brief, Section VII.A.2.

<sup>26</sup> OCA Main Brief at 41.

<sup>27</sup> City of Bethlehem St. No. 1RJ at 3.

<sup>28</sup> At page 40 of its Main Brief, OCA states that the City’s actual incurred rate case expense is substantially less than its projection of total rate case expense and that the City should have provided a more “reasonable” estimate of its total rate case expense in rejoinder testimony. As it is continuing to litigate with OCA and OSBA, the City continued to project total rate case expense of \$414,560. City of Bethlehem St. No. 1RJ at 3. OCA raised no opposition to the total claim when it was originally presented as the cost to litigate the proceeding.

<sup>29</sup> OCA Main Brief at 32-34.

Commission decisions. In *Pa. P.U.C. v. Keystone Water Company*, 58 Pa. P.U.C. 437, 454-456 (1984), the Commission explained that salary increases taking effect one day after the end of the future test year have been allowed for rate purposes in a number of Commission decisions. A similar claim, was, in fact, allowed in a 1994 City rate proceeding.<sup>30</sup> The City's claim is reasonable and appropriate. OCA's opposition to it should be given no weight.

### **3. Social Security Expense**

As a companion adjustment to its proposed adjustment to Salaries and Wage Expense, the OCA proposes an adjustment to Social Security Expense. The City's claim for the Salaries and Wage Expense, is reasonable and appropriate as presented above. The increase in union wages effective January 1, 2021, should be included in the revenue requirement calculation. The OCA's companion adjustment to remove the related increase to Social Security Expense should be given no weight.

### **4. East Allen Township Expense**

The City's claim for East Allen Township Expense – “equipment maintenance” expense, which remains unresolved, is based on the expense actually incurred during 2019. The OCA proposes to adjust the claim to a “normalized” level based on the three-year average of the expense incurred during 2017, 2018 and 2019.<sup>31</sup> As addressed in the City's Main Brief, the ‘equipment maintenance’ expense incurred in 2019 was the result of emergency repairs, was reasonably incurred and should be accepted as the reasonable and appropriate level of the expense going forward. The OCA's proposed adjustment should be given no weight.

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<sup>30</sup> *Pa. P.U.C. v. City of Bethlehem (Water)*, 160 PUR 4<sup>th</sup> 375, 386 (Pa. P.U.C. 1995)

<sup>31</sup> OCA Main Brief at 36-38.

**5. Water Filtration Expense**

The City's claim for Water Filtration Expense – "equipment maintenance" expense, which remains unresolved, is based on the expense actually incurred during 2019. Similar to its adjustment to "equipment maintenance" expense for East Allen Township, OCA proposes to adjust the claim to a "normalized" level based on the three-year average of the expense incurred during 2017, 2018 and 2019.<sup>32</sup> As addressed in the City's Main Brief, the 'equipment maintenance' expense incurred in 2019 was the result of necessary and emergency repairs in order to operate and maintain an aging plant and infrastructure and meet all regulatory requirements, was reasonably incurred and should be accepted as the reasonable and appropriate level of the expense going forward. The OCA's proposed adjustment should be given no weight.

**B. Depreciation Expense**

The OCA proposes no adjustments to the City's claim for Depreciation Expense other than to reflect the effect of its proposed adjustments to projected plant in service.<sup>33</sup> Inasmuch as the City disagrees with the OCA's proposed adjustments to projected plant in service, it disagrees with the OCA's proposed adjustments to Depreciation Expense. The OCA's proposed adjustment to plant in service and companion adjustment to Depreciation Expense should be given no weight.

**VIII. RATE OF RETURN**

**A. Introduction**

The City claims an overall rate of return of 8.21%, including a cost of common equity capital of 10.20%. Alternatively, if the Commission decides to adjust the City's common equity

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<sup>32</sup> OCA Main Brief at 34-36.

<sup>33</sup> OCA Main Brief at 41.

cost rate to reflect the income tax status of the City's "investors," the City's cost rate for common equity capital is 8.77% with an overall rate of return of 7.42%. OCA disagrees with the City's claim for capital structure ratios and cost of common equity capital. OCA's disagreement with the City is addressed in Section VIII of the City's Main Brief and is addressed further below.

**B. Capital Structure Ratios**

The City's ratemaking capital structure ratios are based on an imputed capital structure at December 31, 2020, of 45% long term debt and 55% equity, representing the current water industry practice and consistent with the Comparable Group's capital structure ratios.<sup>34</sup> The OCA proposes a capital structure of 48% debt and 52% equity based upon the average projected capital structure for Mr. Garrett's comparison group. The most recent data demonstrates that Mr. Garrett's comparison companies are projected to have a common equity ratio of 56.3% common equity, not the relatively low 52% he recommends.

As presented in the City's Main Brief and reasserted above, the ratios of 45% debt and 55% equity as proposed in the City's rate of return claim are supported by the evidence of record, reasonable and appropriate for ratemaking purposes and consistent with Section 1301(b) of the Code.<sup>35</sup> A common equity ratio of 52% as proposed by the OCA understates the appropriate equity ratio contrary to the evidence of record and contrary to Section 1301(b) of the Code, which requires the Commission to employ an imputed capital structure for ratemaking purposes.

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<sup>34</sup> See City Main Brief, Section VIII.B.

<sup>35</sup> City of Bethlehem St. No. 2R at 6-7.

**C. Cost of Debt**

OCA does not oppose the City's embedded cost of debt of 5.77%.<sup>36</sup> A long-term debt cost rate of 5.77% is supported by the evidence of record and reasonable and appropriate for ratemaking purposes.

**D. Cost of Common Equity Capital**

**1. Introduction**

Based upon the results of the Discounted Cash Flow, Capital Asset Pricing Model and Risk Premium models, Mr. Walker determined that his Water Group's common equity cost rate is in the range of 9.8% to 10.4% and that the common equity cost rate for the Water Group is at least 10.10%. Mr. Walker added a 10-basis point risk adjustment to the results to account for the City's greater investment risk, i.e. its small size, visible lower credit rating and the other factors and recommended a 10.20% common equity cost rate for Bureau of Water.<sup>37</sup>

Mr. Walker also presented an alternative recommended common equity cost rate should the Commission decide to adjust the return to reflect the maximum income tax status of City investors. Applying a 14% income tax adjustment to his primary recommendation of 10.20% reduced the common equity return for the City to 8.77%.<sup>38</sup>

The OCA proposes a "market based" cost of equity of 6.0%, based on the testimony of OCA witness Garrett, which is then increased by 250 basis points to produce a common equity return of 8.5%. OCA characterizes the higher return as a "business as usual" cost of equity.<sup>39</sup>

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<sup>36</sup> OCA Main Brief, Section VIII.D.

<sup>37</sup> City of Bethlehem Main Brief, Section VIII.D at 36-38.

<sup>38</sup> City of Bethlehem Main Brief, Section VIII.D at 37.

<sup>39</sup> OCA Main Brief at 49-50.

## **2. Adders**

OCA contends that the City's common equity return of 10.20% includes multiple, unsupported adders (80 basis points for Bethlehem's small size, 20 and 10 basis points for Bethlehem's business risks) that should be rejected.<sup>40</sup> This is simply incorrect and a misstatement of Mr. Walker's testimony. Mr. Walker applied a straight forward 10-basis point adjustment to account for the risk difference between the City's Bureau of Water and the Comparable Water Group. Mr. Walker explained that 10-basis points is a conservative estimate of the risk differential. Adding the 0.10% risk adjustment to the various results of the three models employed by Mr. Walker for the Water Group shows a current range of common equity cost applicable to book value for the Bureau of Water of 10.20% (DCF), 9.90% (CAPM), and 10.50% (RP).<sup>41</sup>

In contrast to the reasonable analysis presented by Mr. Walker in support of a conservative 10-basis point adder to adjust for risk differential, OCA witness Garrett included a 250-basis point adder in his return analysis. With his adder, Mr. Garrett was able to increase the results of his DCF and CAPM methods from 6.0% to 8.5%. It is an extreme adjustment that is entirely subjective. If not absurd on its face, the magnitude of the adder certainly calls into question Mr. Garrett's analysis and his application of the DCF and CAPM methodologies that produce common equity returns of 6.1% (DCF)<sup>42</sup> and 5.9% (CAPM)<sup>43</sup>

## **3. Risk and Return**

In further support of its rate of return analysis, the OCA presents a discussion of business

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<sup>40</sup> OCA Main Brief at 42, citing OCA St. No. 3 at 64-68.

<sup>41</sup> City of Bethlehem St. No. 2 at 61 and Table 9.

<sup>42</sup> OCA Main Brief at 56.

<sup>43</sup> OCA Main Brief at 58.

risk and financial risk. OCA witness Garrett provided a description of the relationship between risk and return explaining that “[r]isk is among the most important factors for the Commission to consider when determining the allowed return. Thus, it is necessary to understand the relationship between risk and return. There is a direct relationship between risk and return: the more (or less) risk an investor assumes, the larger (or smaller) return the investor will demand.”<sup>44</sup>

While acknowledging the significance of risk and the relationship between risk and return, Mr. Garrett failed to include any risk analysis in his return recommendation. In addition to using a comparison group or proxy group to estimate the cost of equity, proxy groups are used as a benchmark to satisfy the long-established guideline of providing a utility the opportunity to earn a return equal to that of similar risk enterprises. Mr. Garrett, however, presented no evidence regarding the similarity, or dissimilarity, of risk between his comparison companies and the Bureau of Water.<sup>45</sup>

Mr. Walker, however, presented a risk analysis of the City’s Bureau of Water and the comparison companies in his direct testimony in sections “Financial Analysis” and “Risk Analysis.” A risk analysis of the Bureau of Water and the comparison companies is essential in determining a fair rate of return because risk and return counterbalance one another. That is, the greater the risk, the higher the required return.<sup>46</sup>

Not having considered a risk analysis, Mr. Garrett, in effect, assumed that the City’s Water Bureau is comparable to the comparison group in terms of risk with the end result being that he understated the City’s cost rate for common equity capital. The Commission, accordingly, should not rely on Mr. Garrett’s recommendations. The financial models used by

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<sup>44</sup> OCA Main Brief, Section VIII.E.2.

<sup>45</sup> City of Bethlehem St. No. 2R at 8.

<sup>46</sup> City of Bethlehem St. No. 2R at 8-9.

Mr. Garrett reflect inputs relative to his comparison companies not the Bureau of Water. The financial models used by Mr. Garrett do not reflect the Bureau of Water smaller size, lower cash flow, lower credit profile, lower debt service coverage and the other risk determinants summarized on Table 5 of Mr. Walker's direct testimony.<sup>47</sup>

**4. Growth Rate**

In its critique of Mr. Walker's DCF analysis, OCA states, incorrectly, that Mr. Walker assumed a growth rate of 9.2%, which is more than two and a half times as high as the projected long-term nominal U.S. GDP growth.<sup>48</sup> Mr. Walker addressed this error in his rebuttal testimony clearly stating that he used a 7.2% growth rate in his DCF model based on the average projected growth in earnings per share. Mr. Walker did not use a 9.2% growth rate in his DCF analysis. As it is inaccurate, the OCA's criticism of Mr. Walker's DCF analysis should be given no weight. Similar to Mr. Walker's DCF growth rate, I&E witness Spadaccio also used published projected growth in earnings per share of his comparison companies and determined a 7.67% growth rate was appropriate for his DCF model. Contrary to Mr. Walker and Mr. Spadaccio, Mr. Garrett's DCF growth rate was based on growth in value of GDP, which is inappropriate and results in an understated common equity cost rate as addressed in the City's Main Brief.<sup>49</sup>

**E. Conclusion – Rate of Return**

The evidence of record demonstrates that the City's overall rate of return is 8.21%, including a cost of common equity capital of 10.20%. Alternatively, if the Commission decides to adjust the City's common equity cost rate to reflect the income tax status of the City's

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<sup>47</sup> City of Bethlehem St. No. 2R at 13.

<sup>48</sup> OCA Main Brief, Section VIII.E.4.b,

<sup>49</sup> City of Bethlehem Main Brief, Section VIII.D.1.b.ii.

“investors,” the City’s cost rate for common equity capital is 8.98% with an overall rate of return of 7.42%.<sup>50</sup> The recommendation of the OCA should be given no weight.

## **IX. TAXES**

The City did not present a ratemaking claim for income taxes and neither OCA<sup>51</sup> nor OSBA<sup>52</sup> addressed or challenged the City’s claim for Taxes, Other Than Income Taxes.

## **X. RATE STRUCTURE / RATE DESIGN**

The City and I&E agreed in the Joint Petition to the scale back of rates as proposed by OSBA witness Kalcic. Prior to the Joint Petition, City witness Heppenstall agreed with Mr. Kalcic’s proposed scale back of rates in her rebuttal testimony. Ms. Heppenstall explained that Mr. Kalcic had revised his cost-of-service study to reflect the 2020 summer peak information for the Sales for Resale class as presented in Exhibit CEH-3R and that the results of Mr. Kalcic’s revised study increased the cost of service for the Sales for Resale class.<sup>53</sup>

### **A. Class Cost of Service**

OCA recites from the cost-of-service testimony of Mr. Mierzwa explaining that he generally agreed with the City’s cost-of-service study; that he was not proposing to modify it; and that, in rebuttal, he indicated his agreement with Mr. Kalcic’s adjustment to reflect the appropriate maximum day and maximum hour factors for wholesale customers.<sup>54</sup> Based on the

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<sup>50</sup> The City’s Rate Study and calculation of revenue requirement are based on the tax adjusted rate of return of 7.42%. City of Bethlehem St. No. 1, Attachment 1 at 4 and Schedule 1, page 3 of 3.

<sup>51</sup> OCA Main Brief, Section IX.

<sup>52</sup> OSBA Main Brief, Section IX.

<sup>53</sup> City of Bethlehem St. No. 1R at 17.

<sup>54</sup> OCA Main Brief, Section X.B.

discussion presented by the OCA, the City submits that there is no cost-of-service issue for resolution.

**B. Revenue Distribution**

OCA recites from the revenue distribution testimony of Mr. Mierzwa explaining that he initially recommended a revenue distribution that would reduce the difference between the Residential class and Industrial class rates and cost of service.<sup>55</sup> The OCA then states that it has determined that it will not oppose the OSBA's scaleback proposal if the Commission approves an increase in rates that is less than the City's initially proposed increase. Based on the discussion presented by the OCA, the City submits that there is no revenue distribution issue for resolution.

**C. Rate Design**

OCA recites from the rate design testimony of Mr. Mierzwa explaining that he initially agreed with the City's proposed rate design.<sup>56</sup> The OCA then states that it has determined that it will not oppose the OSBA's scaleback proposal if the Commission approves an increase in rates that is less than the City's initially proposed increase. Based on the discussion presented by the OCA, the City submits that there is no rate design issue for resolution.

**XI. MISCELLANEOUS ISSUES**

The City and OCA presented their Stipulation resolving issues raised in the testimony of OCA witness Fought. The Stipulation addresses Valve Exercising, Fire Hydrants, Pressure Surveys, Unaccounted for Water, Customer Complaints and Customer Meter Age and the City submits that the Stipulation is reasonable and appropriate.

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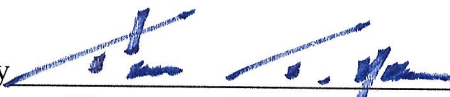
<sup>55</sup> OCA Main Brief, Section X.C.

<sup>56</sup> OCA Main Brief, Section X.D.

## **XII. CONCLUSION**

The City submits that the Commission should approve the Joint Petition for Approval of Partial Settlement of Rate Investigation, without modification, and accept the rates proposed in the Joint Petition as just and reasonable and consistent with the Code. The Joint Petition provides for an increase in annual revenue for Outside City Service of \$689,932 in lieu of the originally proposed increase of \$908,421. In doing so, the Commission should reject the ratemaking adjustments proposed by OCA and by OSBA and dismiss their respective Complaints with prejudice.

Respectfully submitted,

By 

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DATED: January 8, 2021

**Before The  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission	:	R-2020-3020256
Office of Small Business Advocate	:	C-2020-3021576
Office of Consumer Advocate	:	C-2020-3021583
	:	
v.	:	
	:	
City of Bethlehem – Water Department	:	
	:	

**CERTIFICATE OF SERVICE**

I hereby certify that I have this 8<sup>th</sup> day of January 2021, served a true and correct copy of the foregoing Reply Brief of the City of Bethlehem, upon the persons and in the manner indicated below:


**VIA ELECTRONIC MAIL**

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