

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

RECOMMENDED DECISION

Before
Steven K. Haas
Administrative Law Judge

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I. INTRODUCTION

This Recommended Decision recommends approval, without modification, of the Joint Petition for Approval of Partial Settlement of Rate Investigation (Joint Petition or Partial Settlement) between the City of Bethlehem – Water Department (City or Bethlehem) and the Commission’s Bureau of Investigation and Enforcement (I&E) because the Joint Petition is supported by substantial evidence and is in public interest. In the Joint Petition, the City agreed to revise the original annual revenue increase request specified in its Supplement No. 15 to Tariff Water-Pa. P.U.C. No. 6 from \$908,421.00 to \$689,932.00. The settlement rates are presented in Appendix A to the Joint Petition. In addition to the agreement on an overall annual revenue increase, the City and I&E also agree on several other provisions involving a tariff language change, unaccounted for water commitments and the City’s Class Demand Study. The last Commission Public Meeting before the end of the suspension period (April 29, 2021) is on April 15, 2021.

The Pennsylvania Office of Consumer Advocate (OCA) and the Pennsylvania Office of Small Business Advocate (OSBA) are parties to this proceeding but are not signatories to the Joint Petition. In their respective briefs, OCA and OSBA advocated for certain adjustments to various elements comprising the City’s ultimate rate determination. While I am recommending approval of the Joint Petition without modifications, the OCA’s and OSBA’s recommendations will be addressed below, and my recommendation on them will be presented, in the event that the Commission ultimately determines that modifications to the Joint Petition are necessary.

A. History of Proceeding

On July 31, 2020, the City of Bethlehem – Water Department filed Supplement No. 15 to Tariff Water – Pa. P.U.C. No. 6 proposing an annual increase of \$908,421 in water service revenue for Outside City Customers based on a future test year ending December 31, 2020.

The City's filing was assigned Docket No. R-2020-3020256. I&E filed a Notice of Appearance on August 14, 2020. The OSBA and the OCA filed Complaints on August 27, 2020 at C-2020-3021576 and C-2020-3021583, respectively.

By Order entered September 17, 2020, the Public Utility Commission (Commission) suspended Supplement No. 15 and instituted an investigation into the reasonableness of the proposed tariff change. The City filed Supplement No. 16 on September 23, 2020, suspending the application of the proposed water rates until April 29, 2021. I was assigned to this proceeding as the Presiding Officer.

A telephonic prehearing conference was held on October 8, 2020. Counsel for I&E, OCA, OSBA and the City participated in the telephonic conference and a litigation schedule was established. A Scheduling Order memorializing the litigation schedule was issued on October 8, 2020.

Pursuant to the litigation schedule, the City served direct, rebuttal, surrebuttal and rejoinder testimony in support of Supplement No. 15. I&E, OCA and OSBA served direct and surrebuttal testimony. The parties engaged in extensive discovery.

On December 11, 2020, counsel for the City advised me that the City and I&E had achieved a settlement of issues, without joinder of OCA and OSBA. On December 28, 2020, the City and I&E filed their Joint Petition proposing, *inter alia*, an annual increase of \$689,932 in water service revenue for Outside City Customers.

An evidentiary hearing was held on December 17, 2020. Prior to the hearing, the parties agreed to a mutual waiver of cross examination of all witness. The City, I&E, OCA and OSBA participated in the hearing. Testimony and exhibits were stipulated into the evidentiary record.

The City, OCA and OSBA filed main briefs on December 30, 2020, and reply briefs on January 8, 2021. I&E did not file briefs. The record closed on January 12, 2021, the date reply briefs were due.

B. The City's Water System

The City provides water service in the City of Bethlehem and all or parts of eleven other municipalities: (a) in Lehigh County – portions of Salisbury Township, portions of Upper Saucon Township, portions of Hanover Township, and the Borough of Fountain Hill; and (b) in Northampton County – portions of Lower Saucon Township, portions of Bethlehem Township, portions of Hanover Township, East Allen Township, portions of Allen Township, portions of Lower Nazareth Township, and the Borough of Freemansburg. Bethlehem St. No. 4 at 6.

As of December 31, 2019, the City provided water service to 13,496 customers outside the City limits and to 22,940 customers inside the City limits. The City supplies drinking water for residential, commercial, industrial, institutional, resale, and public uses, and for fire protection purposes. Bethlehem St. No. 4 at 6-7.

The City's water system is served by a 23,000-acre watershed in Carbon and Monroe Counties, which watershed includes two man-made reservoirs: Wild Creek reservoir (constructed in 1940 with a storage volume of 3.9 billion gallons); and Penn Forest reservoir (constructed in 1958 with a storage volume of 6 billion gallons). The City has a PA DEP approved Source Water Protection Plan and has been certified by the Forest Stewardship Council for its forest management practices. Bethlehem St. No. 4 at 7.

Raw water is treated at the Bethlehem Water Treatment Plant in Lehigh Township. The plant is a rapid gravity multi-media filtration plant rated at 28.6 MGD. The Plant has undergone substantial process refinement since its opening in 1994. In 2019, the Plant received its twelfth consecutive Area Wide Optimization Program Award for outstanding performance in filtration plant operations. The award is sponsored by United States

Environmental Protection Agency and the Association of State Drinking Water Administrators. Bethlehem St. No. 4 at 8.

The City's water distribution network includes four high pressure zones served by five booster pump stations, particularly in areas south of the Lehigh River and along higher elevations of South Mountain. There are also three other smaller pressure zones controlled by individual pressure regulating valves. Distribution storage is provided by eight tanks and reservoirs with a total capacity of 38.2 million gallons, of which 25.5 million gallons are located south of the Lehigh River to serve the higher-pressure gradients. Bethlehem St. No. 4 at 8-9.

Bethlehem employs a supervisory control and data acquisition (SCADA) system that includes pressure sensors, flow meters, tank levels, valve position indication, and pump controls. The SCADA system is monitored by operators at the Water Treatment Plant and is also accessed remotely by computer tablet or laptop for field operations. Bethlehem St. No. 4 at 9.

The water distribution network is comprised of approximately 550 miles of pipeline, 15,000 valves, and 3,500 fire hydrants. Pipe material consists mostly of ductile iron and cast iron pipe. Much of this infrastructure is decades old with some of the older pipe sections in the city close to 100 years old. Domestic service lines range in size from 3/4-inch to 6-inches in diameter. Bethlehem St. No. 4 at 9.

Peak system demand is supplied by the storage capacity of the transmission mains, storage tanks, and design capacity of the treatment plant. In addition to the main water supply, treatment and distribution system described above, the City operates and maintains four independent community well systems in East Allen Township which serve a combined population of approximately 430 persons, and one consecutive water system serving a population of approximately 725 persons. Bethlehem St. No. 4 at 9.

C. Legal Standards

1. Section 1301

Section 1301(a) of the Public Utility Code (Code) provides that “[e]very rate made, demanded, or received by any public utility ... shall be just and reasonable, and in conformity with [the] regulations or orders of the [C]ommission.” 66 Pa. C.S. § 1301(a). Pursuant to the just and reasonable standard, a utility may obtain “a rate that allows it to recover those expenses that are reasonably necessary to provide service to its customers, as well as a reasonable rate of return on its investment.” *City of Lancaster (Sewer Fund) v. Pa. Pub. Util. Comm’n*, 793 A.2d 978, 982 (Pa. Cmwlth. 2002).

Section 1301(b) of the Code provides that “[i]n determining a just and reasonable rate furnished or rendered by a municipal corporation or by the operating agencies of a municipal corporation providing public utility water or wastewater service beyond its corporate limits, the [C]ommission shall employ an imputed capital structure of comparable public utilities providing water or wastewater service.” 66 Pa. C.S. § 1301(b).

2. Fair Rate of Return Criteria

In determining a fair rate of return, the Commission is guided by the criteria provided by the United States Supreme Court in the landmark cases of *Bluefield Water Works and Improvement Co. v. Pub. Serv. Comm’n of W. Va.*, 262 U.S. 679 (1923) (*Bluefield*) and *Fed. Power Comm’n v. Hope Nat. Gas Co.*, 320 U.S. 591 (1944). In *Bluefield*, the Court stated:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should

be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.^[1]

Public utilities are not guaranteed a specific rate of return. Rather, the regulatory-determined price for service merely allows the regulated entity a fair opportunity to recover all costs associated with providing the service, including a fair rate of return.

3. Burden of Proof

The burden of proof to establish the justness and reasonableness of the utility's rate increase rests upon the public utility. 66 Pa. C.S. § 315(a). The evidence adduced by a utility to meet this burden must be substantial. *Lower Frederick Twp. v. Pa. Pub. Util. Comm'n*, 48 Pa. Cmwlth. 222, 227, 409 A.2d 505, 507 (1980). *See also, Brockway Glass Co. v. Pa. Pub. Util. Comm'n*, 63 Pa. Cmwlth. 238, 437 A.2d 1067 (1981).

In rate proceedings, the burden of proof does not shift to the parties challenging a rate increase. *Pa. Pub. Util. Comm'n v. Aqua Pa., Inc.*, 236 P.U.R.4th 218 (2004). Nonetheless, the Commission has stated that, where a party proposes an adjustment to a ratemaking claim of a utility, the proposing party bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment. *See e.g., Pa. Pub. Util. Comm'n v. PECO*, Docket No. R-891364 (Order entered May 16, 1990); *Pa. Pub. Util. Comm'n v. Breezewood Tel. Co.*, Docket No. R-901666 (Order entered January 31, 1991).

Additionally, Section 315(a) of the Code cannot reasonably be read to place the burden of proof on the utility with respect to an issue the utility did not include in its general rate case filing and which, frequently, the utility would oppose. The mere rejection of evidence contrary to that adduced by the public utility is not an impermissible shifting of the evidentiary

¹ *Bluefield*, 262 U.S. at 692-93.

burden. *Pa. Pub. Util. Comm'n v. Phila. Gas Works*, Docket No. R-2020-3017206 (Opinion and Order entered November 19, 2020) (*PGW*).

Here, the City of Bethlehem – Water Department bears the burden of proof to establish the justness and reasonableness of every element of its requested rate increase. 66 Pa. C.S.A. § 315(a).

4. Settlements

It is the policy of the Commission to encourage settlements, and the Commission has stated that settlement rates are often preferable to those achieved at the conclusion of a fully litigated proceeding. *See* 52 Pa. Code §§ 5.231, 69.401. A full settlement of all the issues in a proceeding eliminates the time, effort and expense that otherwise would have been used in litigating the proceeding, while a partial settlement may significantly reduce the time, effort and expense of litigating a case. *PGW* at 14.

In order to accept a settlement, the Commission must determine that the proposed terms and conditions are in the public interest. *Pa. Pub. Util. Comm'n v. York Water Co.*, Docket No. R-00049165 (Order entered October 4, 2004); *Pa. Pub. Util. Comm'n v. C. S. Water & Sewer Assocs.*, 74 Pa. P.U.C. 767 (1991) (*CS Water & Sewer*). The focus of the inquiry for determining whether a proposed settlement should be approved by the Commission is whether the proposed terms and conditions foster, promote and serve the public interest. *Pa. Pub. Util. Comm'n v. City of Lancaster – Bureau of Water*, Docket Nos. R-2010-2179103 (Order entered July 14, 2011), citing *Warner v. GTE N., Inc.*, Docket No. C-00902815 (Order entered April 1, 1996) and *CS Water & Sewer*.

II. JOINT PETITION FOR APPROVAL OF PARTIAL SETTLEMENT

On December 28, 2020, the City and I&E filed with the Commission their Joint Petition whereby they agreed on an annual revenue increase for service to the City's outside customers. In addition, the City and I&E agreed in the Joint Petition on several other provisions

involving a tariff language change, unaccounted for water treatment and the City's Class Demand Study. The specific terms of the settlement in the Joint Petition are set forth below *in verbatim*. For ease of reference, the headings and paragraph numbering are the same below as they appear in the Joint Petition.

Terms and Conditions of Settlement

16. The terms and conditions comprising this Joint Petition, to which Joint Petitioners agree, are as follows:

(a) Increase in Annual Revenue, Rate Design and Scale Back

Joint Petitioners respectfully request that the Commission act as soon as possible to approve this Joint Petition and grant the City special permission to file a tariff supplement in the form attached hereto as Appendix A, to become effective for service on one day's notice, following entry of a Commission order approving the Joint Petition.

The settlement rates presented in Appendix A are designed to produce additional annual revenue of \$689,932, in lieu of the originally proposed rate increase of \$908,421. The settlement rates are designed reflective of the approximate revenue allocation scale back of rates as proposed by OSBA which incorporates the revised peaking factors for the Sale for Resale class.

A proof of revenue for the Appendix A settlement rates is attached hereto as Appendix B.

(b) Other Tariff Changes – Elimination of Lower Saucon Honor System Rate

Appendix A implements the proposed elimination of the Lower Saucon Honor System Rate as proposed in Supplement No. 15, which Joint Petitioners agree is reasonable and appropriate.

(c) Unaccounted for Water (“UFW”)

Going forward, and starting with the UFW calculation for calendar year 2020, the City will begin using the Commission Section 500 method for the purpose of assisting the Commission in its review of future rate cases. The city will take steps to maintain UFW below 20% and, in its next base rate case, if UFW is above 20%, provide a narrative explanation of possible reasons for it.

(d) Customer Class Demand Study

Joint Petitioners agree that the City's demand study as described in City of Bethlehem Statement No. 1 and presented as Exhibit CEH-2 and revised in Exhibit CEH-3 is acceptable.

Other Provisions

17. Under the presently suspended Supplement No. 15: (1) the quarterly cost of water service to a City residential customer using 12,000 gallons per quarter with a 5/8-inch meter would have increased by \$9.61 from \$75.94 to \$85.55 per quarter or by 12.7%; (2) the monthly cost of water service to a commercial customer using 65,000 gallons per month with a 2-inch meter would have increased by \$47.64 from \$301.93 to \$349.57 or by 15.8%; and (3) the monthly cost of water service to an industrial customer using 228,000 gallons per month with a 1 1/2-meter would have increased by \$167.13 from \$812.96 to 980.09 or by 20.6%.

18. Under the Joint Petition: (1) the quarterly cost of water service to a City residential customer using 12,000 gallons per quarter with a 5/8-inch meter will increase by \$6.19 from \$75.94 to \$82.13 per quarter or by 8.2%; (2) the monthly cost of water service to a commercial customer using 65,000 gallons per month with a 2-inch meter will increase by \$33.15 from \$301.93 to \$3335.08 or by 11.0%; and (3) the monthly cost of water service to an industrial customer using 228,000 gallons per month with a 1 1/2-meter will increase by \$116.28 from \$812.96 to \$929.24 or by 14.3%.

Joint Petition at 3-5. [End of direct quote from Joint Petition]

The settlement between the City and I&E is a "black box" settlement. This means that the settling parties have not negotiated every individual revenue and expense item but, rather, have agreed upon a final revenue increase number based on their respective individual analyses of the various revenue and expense line items.

In discussing the concept of "black box" settlements, the Commission has stated:

We have historically permitted the use of "black box" settlements as a means of promoting settlement among the parties in contentious base rate proceedings. Settlement of rate cases saves a significant amount of time and expense for customers, companies, and the Commission and often results in alternatives that may not have been realized during the litigation process. Determining a company's revenue requirement is a calculation involving many complex and interrelated adjustments that affect expenses, depreciation, rate base, taxes and the company's cost of capital. Reaching

an agreement between various parties on each component of a rate increase can be difficult and impractical in many cases.

Pa. Pub. Util. Comm'n v. Peoples TWP LLC, Docket No. R-2013-2355886, p. 28 (Order entered December 19, 2013).

Statements in Support

In supporting the Joint Petition, the City first notes the Commission's policy of encouraging settlements as a means of reducing the time and expense that would otherwise be expended by the parties in fully litigated proceedings. 52 Pa. Code § 5.231(a). The City then highlights in its Statement in Support the reduction of monthly or quarterly customer bills that will result from approval of the settlement rates versus the rates that would have been implemented under the increase originally proposed in Supplement No. 15. Bethlehem St. in Support at 4-5.

The City describes its negotiations with I&E that resulted in the settlement as follows:

The City's filing was thoroughly investigated by I&E. I&E propounded and the City answered initial and follow up discovery. I&E identified issues in direct testimony and the City replied in rebuttal testimony. It was only after this investigation that the City and I&E were able to engage in substantive discussions and then agree, in settlement, to a reduced increase in annual revenue of \$689,932 for Outside City service. The settlement increase, at a level reduced from the City's original filing, reflects a compromise of the positions of the City and I&E, which, consistent with Commission policy, fosters and promotes the public interest.

Bethlehem St. in Support at 6.

The City further states:

At the originally proposed revenue increase of \$908,421, the City's overall opportunity rate of return would have been 8.24%. At the substantially reduced increase of \$689,932, the overall opportunity rate of

return is 6.72%. While below the return claim originally presented and less than that supported by the testimony of Mr. Walker, the City accepts the reduced return in settlement as it reflects a compromise of the positions of the City and I&E, which, consistent with Commission policy, fosters and promotes the public interest.

Bethlehem St. in Support at 6-7.

In its support of the settlement, I&E states, “I&E represents that the Partial Settlement satisfies all applicable legal standards and results in terms that are preferable to those that may have been achieved at the end of a fully litigated proceeding. Accordingly . . . I&E maintains that the proposed Partial Settlement is in the public interest and requests that the . . . terms be approved by the ALJ and the Commission without modification.” I&E St. in Support at 5.

With respect to the revenue increase set forth in the settlement, I&E states:

The City’s proposed rate increase was \$908,421. However, pursuant to the Joint Petition, settlement rates are designed to produce additional annual operating revenue \$689,932. I&E fully supports the revenue levels compromised upon in the Partial Settlement. I&E’s support is based on its witnesses’ analysis of the ratemaking claims contained in the City’s base rate filing, including operating and maintenance expenses, rate base, taxes, cash working capital, rate structure, capital structure, and cost of equity and debt.

I&E St. in Support at 5-6.

I&E further notes that the agreed upon settlement revenue increase is approximately \$218,000 less than the amount originally sought by the City. I&E St. in Support at 6. I&E concludes, “[b]ased upon I&E’s analysis of the filing, acceptance of this proposed Partial Settlement is in the public interest.” I&E St. in Support at 12.

Scale Back

All parties agree with the scale back provision proposed by the OSBA, which incorporates the change in demand factors for the Sales for Resale class and modifies the increases by customer class based on the cost of service presented on Exhibit CEH-3, page 3 of 3. *See* Bethlehem St. in Support at 7-8; I&E St. in Support at 7-8; OCA M.B. at 66-67.

No parties oppose the OSBA's scale back proposal. The scale back, which is cost based, results in the class settlement increases being within a narrow range of 8.2% to 12.6%. I find this proposal to be in the public interest and recommend that it be approved by the Commission.

Other Tariff Changes – Elimination of Lower Saucon Honor System Rate

The City proposes in its Supplement No. 15 to eliminate the Lower Saucon Honor System Rate. The City explains in its testimony that the installation of three master meters on the distribution mains delivering water to the Lower Saucon Authority Honor system was completed in 2017 and that, as a result, all water service to the system is now fully metered. Bethlehem St. No. 4 at 10; Bethlehem St. in Support at 8. The City states that no customer receives service under the Honor system rate and no revenue from the rate is included in the City's revenue requirement calculation. It further notes that no party to this proceeding opposes the removal of the Honor System rate from the tariff.

Since there are no longer any customers taking service under the Lower Saucon Honor System Rate, and since no parties to this proceeding oppose the removal from the City's tariff of this rate, I recommend that the Elimination of Lower Saucon Honor System Rate be approved by the Commission as reasonable and in the public interest.

Unaccounted For Water

The City's unaccounted for water for the years ending 2017, 2018 and 2019 has averaged 21.1%. I&E St. No. 3 at 14. The Commission's policy statement on water conservation at 52 Pa. Code § 65.20(4) provides, in part, "[l]evels of unaccounted-for water should be kept within reasonable amounts. Levels above 20% have been considered by the Commission to be excessive."

In order to more fully comply with the Commission's policy statement, the City has agreed to take steps to maintain UFW below 20%, and it will begin using the Commission's Section 500 method of calculating UFW. If, in its next base rate case, the City's UFW is above 20%, it will provide a narrative explanation of possible reasons for the excess.

In support of this provision, I&E states in its statement in support, ". . . reducing UFW benefits customers by reducing electric, chemical, and pumping expenses. If the city fails to maintain UFW below 20% by the time of its next base rate proceeding, I&E may recommend an adjustment to the City's next base rate claim to account for excessive UFW. I&E therefore submits that this settlement term is in the public interest . . ." I&E St. in Support at 11.

By this provision, the City is committing to address and correct high UFW water amounts experienced over the past several years, and it is on notice that excessive UFW amounts may be challenged by I&E and other parties in future base rate proceedings. I find that this provision is reasonable and in the public interest; therefore, I recommend its approval by the Commission.

Demand Study

As explained by the City in its Statement in Support:

The City and I&E agree the Demand Study presented in Exhibit CEH-2 and revised in Exhibit CEH-3 is acceptable. The City prepared and submitted the Demand Study pursuant to the Joint Petition for Settlement at Docket No.

R-2013-2390244. The City monitored inside and outside city customers for a total of 161 residential customers, 30 commercial and public customers, 16 industrial customers and all 17 of the sales for resale customers. The results of the Demand Study were used in the City's cost of service study presented in exhibit CEH-2R – Rebuttal Cost of Service Allocation Study for the Test Year Ended December 31, 2020. No party contested the Demand Study. The City submits that the Demand Study should be accepted.

Bethlehem St. in Support at 9.

I&E states, "I&E agrees the City's demand study as described in Bethlehem Statement No. 1 and presented in Exhibits CEH-2 and revised Exhibit CEH-3 is acceptable." I&E St. in Support at 11.

As the City's demand study was submitted in compliance with the Joint Petition for Settlement at Docket No. R-2013-2390244, and no parties contest the study, I find this provision to be reasonable and in the public interest; therefore, I recommend its approval by the Commission.

Disposition

As noted above, I recommend that the Joint Petition be approved without modification as being reasonable and in the public interest. The City's original annual revenue increase proposal as reflected in its Supplement No. 15 was \$908,421, an approximately 10.9% increase over present revenues. After extensive discovery and negotiations with I&E, the City agreed to lower its annual revenue increase request to \$689,932, or approximately 8.4%.

As set forth in the Joint Petition, under the presently suspended Supplement No. 15: (1) the quarterly cost of water service to a City residential customer using 12,000 gallons per quarter with a 5/8-inch meter would have increased by \$9.61 from \$75.94 to \$85.55 per quarter or by 12.7%; (2) the monthly cost of water service to a commercial customer using 65,000 gallons per month with a 2-inch meter would have increased by \$47.64 from \$301.93 to \$349.57 or by 15.8%; and (3) the monthly cost of water service to an industrial customer using 228,000

gallons per month with a 1 1/2-meter would have increased by \$167.13 from \$812.96 to \$980.09 or by 20.6%.

Under the Joint Petition: (1) the quarterly cost of water service to a City residential customer using 12,000 gallons per quarter with a 5/8-inch meter will increase by \$6.19 from \$75.94 to \$82.13 per quarter or by 8.2%; (2) the monthly cost of water service to a commercial customer using 65,000 gallons per month with a 2-inch meter will increase by \$33.15 from \$301.93 to \$335.08 or by 11.0%; and (3) the monthly cost of water service to an industrial customer using 228,000 gallons per month with a 1 1/2-meter will increase by \$116.28 from \$812.96 to \$929.24 or by 14.3%. Joint Petition at 4-5.

The settlement results in a lesser increase in rates by approximately 4.5% (residential), 4.8% (commercial) and 6.3% (industrial) than the rates that would have become effective under the Supplement No. 15 as filed. Accordingly, the settlement results in a substantial rate benefit to the City's customers.

The City claims an overall rate of return of 8.21%, which figure includes a cost of common equity of 10.20%. Bethlehem St. No. 2; Exh. HW-1, Sch. 2; Bethlehem M.B. at 32. It notes that if the Commission decides to adjust the City's common equity 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%. Bethlehem St. No. 2 at 2. As the City's proposed rate of return was challenged by the OCA, this issue will be further addressed below in Section VII.

As a black box settlement, most of the individual revenue and expense line items, as well as other elements of the settlement, are not addressed or analyzed as part of the settlement. Accordingly, I am unable to address them here in recommending that the settlement is in the public interest and should be approved by the Commission. I find that the significantly lower rate increase resulting from the settlement from the rate increases that would have resulted from approval of Supplement No. 15 as filed is in the public interest and supports its approval.

I note further that OCA's original position stated in the direct testimony of its witness, Stacy L. Sherwood, was to recommend an annual revenue increase of \$367,400. OCA St. No. 2 at 3. After further analysis and review of the positions of the other parties, Ms. Sherwood revised her position upward and recommended an annual revenue increase of \$443,666. OCA St. No. 2S at 1. As noted, the City's original position was an increase of \$908,421. This position was reduced as part of its settlement with I&E to a figure of \$689,932. The City's settlement figure of \$689,932 falls near the midpoint between its original request of \$908,421 and the OCA figure of \$443,666, representing in my belief a reasonable compromise of the respective positions of the parties in arriving at a black box settlement.

As noted, however, the OCA and the OSBA, in opposing the settlement, challenged a number of individual rate components. I have addressed these various issues below and offer a recommendation on their resolution for consideration by the Commission in the event it determines not to accept my recommendation of approval of the settlement without modifications. While I have not agreed with the City on all of the contested issues, I believe, nonetheless, that the overall result of the settlement is in the public interest and should be approved without modification by the Commission.

III. RIGHT TO RATE RELIEF DURING COVID PANDEMIC

The OCA argues in this proceeding that the Commission should deny Bethlehem's rate increase request to protect the ratepayers in Bethlehem's service territory who are, and will be, experiencing unemployment and income loss due to the unprecedented and continuing COVID-19 pandemic. OCA arguments are set forth in its Main Brief at pages 9-24. It argues that increasing Bethlehem's water rates during the COVID-19 pandemic is not only unnecessary at this time, but would not lead to just and reasonable rates, given Bethlehem ratepayers' reduced incomes and ability to pay and the economic uncertainties of Bethlehem's future test year (FTY) projections in its rate increase filings.² It further argues that, even with no

² A test year is a twelve-month period during which the balance of assets, expenses and revenues can be reviewed in order to predict the operating results of the utility during the period for which the rates being set will be in effect.

rate increase, Bethlehem could continue operations, recover all of its expenses, and have additional money left over. OCA M.B. at 9; OCA St. No. 1 at 6.

OCA argues that granting no increase at all would still result in a reasonable return in these circumstances. It argues that the cost rates and overall return, under the no increase scenario, would be:

Weight Average Rate of Return				
Capital Component	Proposed Ratio	Cost Rate	14% Tax Adj.	W Cost
Long Term Debt	48.00%	5.77%		2.77%
Fund Equity	<u>52.00%</u>	6.45%	5.55%	<u>2.88%</u>
Total	100.00%			5.65%

OCA Exh. No. 1. OCA argues that, while perhaps not providing as much profit as Bethlehem would like³, an overall return of 5.65% is more than adequate. See OCA App. A.1, Table IA; OCA Exh. No. 1.

OCA argues that the economic repercussions of the COVID-19 pandemic—to the extent yet known—are real and significant in Bethlehem’s service territory and that the Commission must give great weight to the circumstances of consumers during these extraordinary times. It points out that, as of September 2020, the unemployment rates in Lehigh and Northampton Counties, portions of which are served by Bethlehem, were 8.3% and 7.6%, respectively. OCA St. No. 1 at 11. In October, the unemployment rates had fallen to 7.4% and 6.8% respectively. OCA St. No. 1S at 2. For comparison, the unemployment rate in both counties one year earlier was 4.6%. OCA St. No. 1 at 11. The unemployment rate in both counties peaked in April 2020 (16.9% and 16.3 respectively). *Id.* The OCA argues that a water rate increase in the Bethlehem service territory will only increase the financial burden faced by customers experiencing job and wage loss due to the pandemic.

³ The OCA’s revenue requirement recommendation, absent any consideration of the pandemic, results in an overall deficiency of \$443,666 at an overall rate of return of 6.57%. See App. A.2, OCA Table I; OCA St. 2S at 1; Sch. SLS-1; OCA St. 3 at 6; Exh. DJG-17. Bethlehem proposed an overall rate of return of 8.21%. Bethlehem St. 2, Sch. 1.

The OSBA likewise argues against granting a rate increase to the City due to the impacts of the COVID-19 pandemic. OSBA's argument is summarized on page five of its main brief, as it states, “. . . our concern with increasing customer rates at this time is essentially two-fold: how many Commonwealth small businesses will be critically . . . affected by the Covid-19 Pandemic; and how long will this Pandemic last.” OSBA M.B., at 5.

The City, on the other hand, argues that the Commission has no authority under the Code to deny the City's rate increase, as proposed by the OCA. It states, “[w]hile the Commission may have the ability to alter litigation deadlines as a result of the Governor's Proclamation of a Disaster Emergency and the Commission's subsequent Emergency Order as a result of the COVID pandemic, the Commission does not have the authority to alter a utility's substantive right of a rate increase going into effect at the end of the seven-month deadline.” (City M.B., at 7-8); *PGW*, citing *Pa. Pub. Util. Comm'n v. Columbia Gas of Pa. Inc.*, Docket No. R-2020-3018835 (Order on Petition for Reconsideration of Staff Action entered August 20, 2020) at 20-21; *Pa. Pub. Util. Comm'n v. Pa.-Am. Water Co.*, Docket Nos. R-2020-3019369 and R-2020-3019371 (Order on Petition for Reconsideration of Staff Action entered August 20, 2020).

The City argues that approval of the Joint Petition would be consistent with the Commission's approval of the partial settlement in *PGW*. The City further notes that, in his Recommended Decision dated December 22, 2020, at Docket Nos. R-2020-3019369 and R-2020-3019371, Administrative Law Judge Johnson recommended that the Commission approve a “non-unanimous” settlement in Pennsylvania-American Water Company's pending rate proceeding.

The City notes that 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. It argues that a Commission decision adopting the OCA's “no increase” proposal would violate the Public Utility Code and the Commission's statutory obligation to set just and reasonable rates.

The City argues that it has taken steps to assist financially troubled customers. It notes first that it 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 reported the following to the Commission in its letter dated December 15, 2020 at M-2020-3019244:

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.

Bethlehem Exh. No. 1.

In addressing the OCA’s concerns about recent and current unemployment rates, the City argues, while unemployment rates in Lehigh and Northampton Counties as of September 2020 are 8.1% and 7.4%, respectively, the unemployment rate in 2010 reached 10% in Lehigh County and 9.7% in Northampton County as a result of the financial crisis. Thus, while the pandemic circumstances are unique, the high unemployment rate is not an unprecedented economic crisis. The city notes that it filed a rate case in June 2011 and received approval for an increase totaling \$730,000 from the Commission during this period. City of Bethlehem St. No. 1R at 2-3.

The City further argues that, its monthly bills even under proposed rates are among the lowest in the region. It provides the following chart which shows the comparable residential monthly bills at 4,000 gallons of usage for water utilities near and around the Bethlehem service area. Bethlehem St. No. 1R at 4.

Water Provider	Monthly Residential Bill
Bethlehem – Proposed	\$28.52
Aqua PA – Rate Zone 1	\$65.00
Pennsylvania American Water Company	\$64.37
Lehigh County Authority – Central Lehigh	\$24.09
Lehigh County Authority – City of Allentown	\$32.06
Reading Area Water Authority	\$45.32
Schuylkill County Municipal Authority – Pottsville	\$28.17
Easton Suburban Water Authority	\$33.59
Northampton Borough Water Authority	\$29.36
Northampton Borough Water Authority – High Pump District	\$30.72

In sum, the City argues that the Commission has no authority to deny the City rate relief because of the COVID-19 pandemic.

I agree with the City and do not recommend that any adjustments to the annual revenue increase set forth in the Joint Petition be made at this time. As noted above, this issue has been raised and addressed in several recent rate case proceedings. However, there has not yet been a definitive Commission pronouncement on the role, if any, that the impacts of the COVID-19 Pandemic should play in the Commission’s review and resolution of rate increase requests. I agree with the City’s argument that Commission has no current authority under the Code to deny the City’s rate increase on the basis of the COVID-19 Pandemic. As the City noted above, “[w]hile the Commission may have the ability to alter litigation deadlines as a result of the Governor’s Proclamation of a Disaster Emergency and the Commission’s subsequent Emergency Order as a result of the COVID pandemic, the Commission does not have the authority to alter a utility’s substantive right of a rate increase going into effect at the end of the seven-month deadline. *PGW, citing Pa. Pub. Util. Comm’n v. Columbia Gas of Pa. Inc.*, Docket No. R-2020-3018835 (Order on Petition for Reconsideration of Staff Action entered August 20, 2020) at 20-21. Until ultimate guidance on this specific issue is issued by the Commission, I agree with the City and I&E that a “business as usual” approach should be maintained in this proceeding.

IV. ISSUES RESOLVED AMONG THE PARTIES

As indicated in the City's main brief, the City and I&E have resolved all issues and filed the Joint Petition providing for an increase in annual revenue for Outside City Service of \$689,932 in lieu of the originally proposed increase of \$908,421.

As also indicated in the main briefs of the City and OCA, the City and OCA have resolved through Stipulation several issues that were of concern to OCA, including a valve exercising schedule, fire hydrant testing, pressure surveys, unaccounted for water measurement, customer complaints and customer meter age. The City has agreed, with respect to these issues, to make certain revisions or improvements to its procedures to better comply with relevant Commission regulations. The Stipulation is attached to the City's main brief as Attachment B. Because the actions agreed upon by the City ensure that the City's procedures more closely comply with Commission regulations, I find that stipulations are in the public interest and recommend that they be approved by the Commission.

As further noted by the City in its main brief, the following ratemaking adjustments, listed below, originally proposed by OCA have been resolved or withdrawn:

Rate Base

- Well Generator
- Roof Replacement
- Hecktown Road Bridge Main Replacement

Expenses

- Uncollectible Account Expense
- Professional Services Expense
- East Allen Township Expense – Other Expense
- Water Filtration Expense – Oil Expenses
- Chemical Expense – Fluoride
- Chemical Expense – Caustic Soda

These specific issues are addressed briefly later in the appropriate sections of this RD.

With respect to the issue of Revenue Allocation, the Joint Petition for Approval of Partial Settlement adopts the revenue allocation and scale back of revenue proposed by OSBA.

As noted, individual expense and revenue line items are not necessarily specified or addressed in black box settlements. Here, the various issues identified above have either been resolved among the parties or withdrawn and are not the subject of any dispute or challenge. Accordingly, I recommend that they be approved as part of the overall approval of the Joint Petition.

V. RATE BASE

A. Introduction

In its Initial Filing, the City presented a total original cost measure of value claim of \$125,287,005 as of December 31, 2019 and \$127,003,215 as of December 31, 2020. Bethlehem M.B. at 16. For Outside City Service, the City claimed an original cost measure of value of \$48,369,248 as of December 31, 2019 and \$49,031,825 as of December 31, 2020. *Id.* After review of the recommended adjustments by OCA to the projected plant in service and cash working capital, the City reduced its total original cost measure of value claim by \$178,981 to \$126,824,234, as of December 31, 2020. *Id.* However, due to cost allocation changes of the measure of value claim apportioned to Outside City service, the jurisdictional allocation to Outside City Service was increased by \$254,255 to \$49,286,080. *Id.* The measure of value adjustments also includes a \$7,000 increase in the claim for cash working capital (CWC). Bethlehem St. No. 1R at 15.

It is again important to note that the Partial Settlement is a “black box” settlement. The City’s rate base is comprised of the original cost less the ratemaking book reserve for the total utility plant in service less net customers’ advances for construction and net contributions in aid of construction plus cash working capital. The Joint Petitioners, in reaching the Settlement, did not agree to any individual rate base claim. With respect to the non-settling parties, the OSBA did not propose adjustments to the City’s rate base claims, whereas the OCA proposed

several adjustments to the City's rate base claims. The City and the OCA's positions concerning the City's individual rate base claims will be addressed below, but ultimately, as this RD recommends that the black box settlement be approved, no adjustments to the rate base claims are recommended.

B. Projected Plant in Service

The OCA disagreed with the City's level of plant in service in the FTY ending December 31, 2020. The OCA identified five projects that the City included that OCA contends will not be in service until after December 31, 2020. OCA M.B. at 26. OCA witness Sherwood proposed to exclude these five capital projects from the projected plant additions. 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. Bethlehem M.B. at 16-17. Two projected plant projects remain in controversy: the Water Treatment Emergency Generator (\$956,000) and the Fire Pump Station (\$758,000). Bethlehem R.B. at 8.

The OCA submits that the remaining two projects, the Water Treatment Emergency Generator and the Fire Pump Station, should not be included in the FTY as they will be completed outside of the test period (December 31, 2020). OCA M.B. at 26-28. The City submits that the remaining two projects are key projects that should be included in the revenue requirement determination as they will be completed within the first quarter of 2021. The City and the OCA's positions concerning the remaining two projects will be addressed below, but ultimately, as this RD recommends that the black box settlement be approved, no adjustments to the rate base are recommended.

1. Water Treatment Emergency Generator

Position of the Parties

The City argues that the Emergency Generator is a necessary capital item for the City to continue to provide reasonable and adequate service, averring it is needed to ensure the

water treatment plant remains operational during a power outage or failure in electronic components at the plant. Bethlehem M.B. at 17. Further, the City argued, excluding the Emergency Generator from the rate base would create an under recovery or a misaligned recovery until the next rate case—creating an inaccurate level of rate base and depreciation expense going forward. *Id.*

OCA challenges this capital project on the premise it was unclear from City witness Spanos' rebuttal testimony that the Water Treatment Emergency Generator project would be completed by February 2021. OCA M.B. at 26-28. Additionally, the OCA avers that the City has not satisfied its burden of proving "that the property sought to be included in the rate base is used and useful in the public service" before it is entitled to a return from ratepayers for the investment. OCA RB at 18, *citing, Pa. Pub. Util. Comm'n. v. Pa.-Am. Water Co.*, 68 Pa. P.U.C. 343 (1988).

In Rejoinder Testimony, Mr. Spanos provided a further update on the Water Treatment Emergency Generator, explaining that the City has taken physical delivery of the Emergency Generator and the associated automatic transfer switch, both of which were installed as of December 9, 2020. Operation of the Generator is expected by mid/late January 2021. Bethlehem R.B. at 8. To support its position to include the Generator in the rate base, the City cites *Pa. Pub. Util. Comm'n v. Pa.-Am. Water Co.*, 68 Pa. P.U.C. 343, 351-352 (1988), for the principle that a utility is entitled to a return on investment in property which is essential to the continued operation of the utility in rendering service to its ratepayers. Bethlehem M.B. at 18. Mr. Spanos noted that the utility in that proceeding was allowed a claim for projects that would be operating and in service shortly after the end of the test year (approximately three months). *Id.* The City posits the same analysis supports its claim in the instant matter where the Generator will be operating and in service shortly after the end of the FTY (mid/late January) and is essential for continued service. *Id.*

Disposition

The Joint Petitioners, in reaching the Settlement, did not agree to any individual plant in service claim. As such, no adjustment to plant in service is recommended. However, if

the Commission determines that adjustments to the plant in service claims are necessary, it is recommended that the Commission accept the City's measure of value regarding the Emergency Generator. OCA does not dispute the need for the Emergency Generator but couches its exclusion of the Generator from the rate base due to the scheduled completion of the Generator is after December 31, 2020. In *Pa. Pub. Util. Comm'n v. Pa.-Am. Water Co.*, the Commission noted that "it is within our discretion to allow in rate base some expenses six months after the end of the test year but to reject expenses twelve months beyond the end of the test year." *Id.* at 343, citing, *Dauphin Consol. Water Supply Co. v. Pa. Pub. Util. Comm'n*, 55 Pa.Cmwlth. 624, 423 A.2d 1357 (1980). I agree with the City that the purported operational date of the Generator of mid/late January 2021, approximately a month after the end of the test year, is reasonable and that the Emergency Generator is essential for continued service to ensure the water treatment plant remains operational during a power outage or failure in electronic components at the plant.

2. Fire Pump Station

Position of the Parties

The OCA submits that the Fire Pump Station should not be included in the plant in service figure as completion of the project is scheduled after the test period. OCA M.B. at 26-28.

The City submits that the Fire Pump Station should be included in the plant in service figure, contending the station is a necessary system improvement and that installation and construction will be completed once it receives the remaining component parts. Bethlehem M.B. at 17-18. Further, the City argues that the Fire Pump Station is a necessary capital item for the City to continue to provide reasonable and adequate water service to customer in higher elevations. Bethlehem M.B. at 18-19.

Disposition

The Joint Petitioners, in reaching the Settlement, did not agree to any individual plant in service claim. As such, no adjustment to plant in service is recommended. However, if

the Commission determines that adjustments to the plant in service claims are necessary, it is recommended that the Commission accept the OCA's argument to exclude the Fire Pump Station from the rate base. Although the City argued the project will be completed once it receives the remaining component parts, the City has not provided sufficient evidence to indicate an operational date of the Fire Pump Station.

C. Cash Working Capital

The City's rate base claim includes a Cash Working Capital claim of \$576,313. OCA M.B. at 29. The City calculated this Cash Working Capital claim "based upon 12.5%, or one-eighth, of the operations and maintenance (O&M) expense, excluding bad debt expense." OCA St. No. 2 at 12. The parties agree on the one-eighth method and the final adjustment will be based on the final level of expenses. OCA M.B. at 29; Bethlehem M.B. at 20–22.

The Joint Petitioners, in reaching the Settlement, did not agree to a CWC claim. As such, no adjustment to cash working capital is recommended. However, if the Commission determines that an adjustment to the CWC claim is necessary, it is recommended that the Commission reduce or increase, as appropriate, the City's CWC claim by the difference between the City's CWC claim and 12.5% of total adjusted O&M expenses, excluding bad debt expense. Adjustments to O&M expenses are further discussed below.

D. Conclusion – Measures of Value

The Joint Petitioners, in reaching the Settlement, did not agree to a rate base claim. As such, no adjustment to rate base is recommended. However, if the Commission determines that adjustments to the rate base are necessary, it is recommended that the Commission reduce the City's rate base claim by the sum of the net book value of the Fire Pump Station plus the difference between the City's CWC claim and 12.5% of total adjusted O&M expenses, excluding bad debt.

VI. REVENUE

Concerning what level of revenue a utility should be expected to earn, the U.S. Supreme Court stated the following in *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591 (1944) (*Hope Nat. Gas*):

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Hope Nat. Gas at 603 (internal quote omitted).

At present rates, pro forma revenue for inside city service is \$13,501,927 and for outside city (jurisdictional) service is \$8,334,533 as of December 31, 2020. Bethlehem Exhibit No. CEH 1, Schedule 1-R at 2-3. At the proposed rates, which sought to increase the City's jurisdictional water operating revenue to outside city customers by \$908,421 based on a FTY ending December 31, 2020, the revenue requirement for inside city service is \$15,284,620 and for outside city service is \$9,242,954. *Id.* Under the Settlement agreement, which seeks to produce additional annual operating revenue to outside city customers by \$689,932, the pro forma revenue for outside city service is \$9,024,465. Bethlehem M.B. at 23. I&E noted, in support of the Settlement it entered into with the City, that it is in full support of the Settlement revenue increase.

I&E notes that its support for the Settlement revenue increase is based on its witnesses' analysis of the ratemaking claims contained in the City's base rate filing, including operating and maintenance expenses, rate base, taxes, cash working capital, rate structure, capital structure, and cost of equity and debt. I&E St. in Support at 5, 6. The Joint Petitioners agreed that the revenue increase reflected in the Partial Settlement provides the City with sufficient additional revenues to meet its operating and capital expenses and to earn a reasonable return on its investment, while allowing ratepayers to continue to receive safe and reliable service, thus

balancing the interests of the City and its customers in a fair and equitable manner. I&E St. in Support at 6, 7. I&E initially proposed numerous reductions to the City's revenue claim, but ultimately concluded that it is appropriate for the City to receive a rate increase. I&E Reply Comments at 2. The Joint Petitioners were able to agree to an increase to base rates of \$689,932, a rate increase substantially less than the City originally proposed, believing that it was a fair compromise of the positions of both parties.⁴

I agree with the Joint Petitioners that the revenue increase reflected in the Partial Settlement is in the public interest. The Settlement increase of \$689,932, in lieu of the originally proposed increase of \$908,421, reflects a compromise of the positions of the City and I&E. *See Pa. Pub. Util. Comm'n v. C S Water & Sewer Assocs.*, 74 Pa. P.U.C. 767 (Pa. P.U.C. 1991) (The Commission stated that a settlement "reflects a compromise of the positions held by the parties of interest, which, arguably fosters and promotes the public interest."). The public is benefited by this compromise which lowers the proposed rate increase. The Joint Petitioners sufficiently established that the revenue increase proposed in the Partial Settlement provides the City with enough revenues to meet its operating and capital expenses and to earn a reasonable return on its investment, while at the same time allowing ratepayers to continue to receive safe and reliable service. Thus, I recommend the Commission approve the Settlement increase in operating revenues for outside city service of \$689,932.

It should be noted, that in accepting the revenues agreed upon in the Settlement, that the Joint Petitioners did not agree to a revenue requirement. The Partial Settlement agreed upon is a "black box" settlement, wherein the Joint Petitioners did not reach an agreement upon individual issues regarding the revenue requirement. In determining a utility's allowed revenue requirement to be used to establish customer rates, typically the focus of review is upon: the reasonable and prudently incurred operating expenses of the utility; depreciation expense; taxes; the used and useful investments of the utility for providing service to customers, or the utility's rate base; and, the overall rate of return, which is comprised of the return on equity and cost of capital, to be applied to the utility's rate base. *See generally Pa. Pub. Util. Comm'n v. PPL Elec. Utils. Corp.*, Docket No. R-2015-2469275 (Order entered November 19, 2015), adopting the

⁴ Specifically, the revenue settlement amount of \$689,932 is approximately the midpoint between I&E's position of \$474,161 and the City's proposal of \$908,421.

Recommended Decision of ALJ Susan D. Colwell (Issued October 5, 2015) (*Pa. PUC v. PPL Electric*). Additionally, the appropriate allocation of the utility's revenue requirement among its various customer rate classes is a significant part of the review to ensure that the rates established for customers are not unduly discriminatory. *See id.*; *see also* 66 Pa. C.S. § 1304. As noted, I&E carefully analyzed the ratemaking claims contained in the City's base rate filing and found it fair for Bethlehem to receive a rate increase.

VII. EXPENSES

A. Operations and Maintenance Expenses – Introduction

As a matter of constitutional law, a utility is entitled to recover in its rates all legitimate expenses incurred in the rendition of its public utility service. *UGI Corp. v. Pa. Pub. Util. Comm'n*, 410 A.2d 923, 932 (Pa. Cmwlth. 1980). Thus, the general rule is that utilities are permitted to set rates which will recover those operating expenses reasonably necessary to provide service to customers, while earning a fair rate of return on the investment in plant used and useful in providing adequate utility service. *W. Pa. Water Co. v. Pa. Pub. Util. Comm'n*, 422 A.2d 906 (Pa. Cmwlth. 1980); *Butler Twsp. Water Co. v. Pa. Pub. Util. Comm'n*, 81 Pa. Cmwlth. 40, 43-44, 473 A.2d 219, 221 (1984). The objective evaluation of reasonableness is whether the record provides sufficient detail to objectively determine whether the expense is prudently incurred. *Popowsky v. Pa. Pub. Util. Comm'n*, 674 A.2d 1149, 1153-54 (Pa. Cmwlth. 1996). With respect to operating and maintenance expenses, those expenses, if properly incurred, are allowed as part of the overall rate computation. To the extent that expenses are not incurred, imprudently incurred, or abnormally overstated during the test year, they should be disallowed and found not recoverable through rates.

It is again important to note, that the Partial Settlement is a “black box” settlement. The City's revenue requirement consists of operations and maintenance expenses, depreciation expense, taxes other than income, and net operating income. The Joint Petitioners, in reaching the Settlement, did not agree to any individual operations and maintenance expense claims or the depreciation expense claim. With respect to the non-Settling parties, the OSBA did not propose adjustments to the City's individual expense claims, whereas the OCA proposed

several adjustments to the City's individual expense claims. The City and the OCA's positions concerning the City's individual expense claims will be addressed below, but ultimately, as this Recommended Decision recommends that the black box settlement be approved, no adjustments to the individual expense claims are recommended.

1. Uncollectible Account Expense

Position of the Parties

The City made an uncollectible account expense claim of \$109,620, of which \$39,584 is allocated to outside city services. Bethlehem St. No. 1 at 7. The uncollectible account expense claim is equal to the 2019 uncollectible account expense level. OCA St. No. 2 at 4.

The OCA accepted the City's claim for uncollectible account expense and did not propose any adjustments.

Disposition

The City and the OCA agree with respect to the uncollectible account expense claim. Furthermore, the Partial Settlement does not reflect any agreement or disagreement between the Joint Petitioners with respect to this individual expense. The uncollectible account expense claim is supported by substantial evidence and no adjustments to the uncollectible account expense claim are recommended.

2. Rate Case Expense

Position of the Parties

The City made a claim for an annual rate case expense of \$138,187 based on a three-year normalization of total rate case expense of \$414,560. Bethlehem St. No. 1 at 5. The City notes that its last three rate cases, prior to the present rate case, were filed in 2013, 2011,

and 2007, and that prior to 2007 the City filed rate cases every two years. Bethlehem St. No. 1R at 6. The City argues that looking at the historic filing frequency to determine the normalization period would produce an unreasonable result, arguing that the recent period of extended intervals was abnormal for the City and occurred as the City was involved in a long running rate case related dispute with Lower Saucon Township, even after it had settled with the other parties to the case. *Id.* The City further attributes the delay in filing the present rate case to the fact that the 2013 rate case provided settlement terms for the City to meet which took longer than two years to address. *Id.* Two of the terms being a customer demand study that took 14 months to carry out and an evaluation and implementation project to install radio-frequency meter reading technology. *Id.*

Thus, the City believes that a three-year normalization period is reasonable as it acknowledges that rate case expense should be spread over a period of years, but also does not penalize the City for delaying a rate case due to costs, requirements from the previous case, and limited resources, and is more reflective of how the City expects to file rate cases in the future. Bethlehem St. No. 1R at 6.

The OCA proposed an adjustment to the annual rate case expense through using a 52-month normalization period. The 52-month normalization period is based on the average historical time between the City's last three rate filings. OCA St. No. 2 at 10. The OCA argued that the City's position, to normalize the \$414,560 rate case expense over three years, does not accurately reflect the City's filing history. *Id.* The OCA argued that there is Commission precedent to utilize the average period between rate cases to determine the normalization of the rate case expense to match the expense recovery over the average period of time of when cases are filed, rather than speculation by the utility of when it might file cases in the future. OCA St. No. 2S at 3–4. The OCA argued that there can be many reasons why a utility may not file rate cases as frequently as it may project and argued that the City did not state why similar circumstances, which led to the delay in filing the present rate case, will not occur again in the future. OCA R.B. at 27.

The OCA also noted that the City's actual rate case expense as of December 2020 is substantially less than its projection and submits that the City's projection is not supported and

that it should have provided a more reasonable estimate of its total rate case expense. OCA St. No. 2S at 3–4. Specifically, the OCA notes that the amount that the City spent as of early December 2020 on rate case expense is \$259,402. Using the 52-month-normalization period, the OCA argues that the City’s rate case expense claim should be adjusted to \$59,862. *Id.*

In regards to the OCA’s argument regarding the total rate case expense, the City argued that it projects its rate case expense for a fully litigated case of \$414,560. The City argued that the OCA’s revised total rate case expense is the expense occurred only through rejoinder testimony, and that the City continues to incur rate case expense. Bethlehem R.B. at 12.

Disposition

The nature and types of individual expenditures that comprise a utility’s allowable claim for rate case expense are those directly incurred to compile, present, and defend a utility’s request for a base rate increase before the Commission. The actual expenditures and estimated costs typically found in an allowable rate case expense claim include legal fees for outside counsel, fees to outside consultants, and the cost of printing, document assembly, and postage. I&E St. No. 1 at 6.

It is the Commission’s practice to recognize all prudently incurred rate case expense and set a normalization period based upon historic filing frequency. *City of Lancaster v. Pa. Pub. Util. Comm’n*, 793 A.2d 978 (Pa. Cmwlth. 2002). However, the Commission has also recognized that there are exceptions to the general principle that the history of rate filings represents the best evidence for normalization of rate case expense. In *Pa. Pub. Util. Comm’n v. PPL Elec. Utils. Corp.*, Docket No. R-2012-2290597 (Order entered December 28, 2012) (*PPL 2012*), PPL’s request for a two-year period for normalization of rate case expense was granted despite PPL’s historic filing frequency of three years. The Commission was persuaded that PPL’s major capital improvement program addressing aging infrastructure warranted an accelerated normalization period for the rate case expense. In *Pa. Pub. Util. Comm’n v. UGI Utils., Inc. – Electric Division*, R-2017-2640058 (Order entered October 25, 2018), UGI’s request for a three-year period for normalization of rate case expense was granted despite UGI

not having filed for a base rate increase for 22 years. The Commission was persuaded that UGI's ongoing capital improvement costs warranted establishing an amortization period without regard to historic frequency of the Company's base rate filings.

The Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim. As such, no adjustment to the rate case expense is recommended. However, if the Commission determines that adjustments to the individual expense claims are necessary, then it is recommended that the Commission accept the OCA's argument to normalize the rate case expense over a 52-month period. The City has not provided sufficient evidence to warrant deviation from the typical Commission practice to base the normalization period of the rate case expense on the historical frequency of the utility's rate case filings. Although the City argued that time gap between the filing of the present rate case in 2020 and the filing of the last rate case in 2013 was an anomaly, it has not provided sufficient evidence to make a finding that similar circumstances that led to the gap between the rate case filings will not occur again in the future. The City did not support, with evidence, its argument that it will file another rate case within the next three years. As such, there is a strong risk of over-recovery if the City is permitted to normalize the rate case expense over three years.

Concerning the total rate case expense figure, I do find that the City's total rate case expense figure of \$414,560 to be justified as supported by evidence. The OCA's total rate case expense figure of \$259,402, which is the rate case expense as of early December 2020, does not take into account the continued litigation of this case past early December 2020. Since early December, the City has submitted Main and Reply Briefs and has continued to litigate this proceeding. As such, if the Commission determines that adjustments to the individual expense claims is needed, then I recommend that the City's rate case expense claim of \$414,560 be normalized over 52 months.

3. Professional Services Expense

Position of the Parties

The City presented a claim for professional services expense of \$59,560 related to a Customer Demand Study, which it normalized over ten years (\$5,956). Bethlehem Sch. 6, at 2. The OCA adjusted the pre-normalized claim by \$570 after reviewing invoices provided in the City's response to I&E-RE-30. The City accepted the adjustment, reducing the normalized expense claim by \$570. As such, the claim for professional services expense is \$58,990, to be normalized over ten years.

Disposition

The City and the OCA agree with respect to the professional services expense claim. The Partial Settlement does not reflect any agreement or disagreement between the Joint Petitioners with respect to this individual expense. The professional services expense claim is supported by substantial evidence and no adjustments to the professional services expense claim are recommended.

4. Salaries and Wage Expenses

Position of the Parties

The City presented a claim of \$4,064,529 for salaries and wage expenses. The salaries and wages reflect the pro forma labor expense for the City's water employees based on wage rates effective as of January 1, 2021. The pro forma salaries and wages were projected in 2020 based on the City's 2020 Budget. The increase to salaries and wages in 2021 was based on the City's union contract of 2.0%. Bethlehem St. No 1. at 6.

The City argued that it is fair to include a union contract wage increase, effective January 1, 2021, in its revenue requirement calculation. The City argued that the wage increase is known, measurable and certain to occur as the union contract wage increase takes effect on

January 1, 2021, just one day past the end of the FTY. Bethlehem, M.B. at 27. The City argued that the ratemaking process is not so rigid that this known, measurable and certain wage increase cannot be part of the revenue requirement determination. *Id.* The City cites to *Pa. Pub. Util. Comm'n v. Keystone Water Co.*, 58 Pa. P.U.C. 437, 454-456 (1984) for the proposition that salary increases taking effect one day after the end of the FTY have been allowed by the Commission for rate purposes. *Id.*

The OCA proposes an adjustment of \$79,698 (\$4,064,529 - \$3,984,831) to the salaries and wages expense. The adjustment based on the amount allocated to outside-city customers is \$30,802. OCA St. No. 2 at 7, 8. The OCA's adjustment excludes the adjustment to salaries and wages for wage increases effective January 1, 2021. The OCA argued that the City's claim violates the matching principal of ratemaking which requires revenues and expenses to be from the same period. OCA St. No. 2 at 8. The OCA points out that the City chose to use a FTY that corresponds to the calendar year and reflects the accounting results during that 12-month period and not beyond that period. OCA M.B. at 32–34 (*citing* OCA St. No. 2S at 4). As a result, the OCA argues that the consideration of expenses to be included in the FTY is limited to those incurred as of December 31, 2020." OCA St. No. 2S at 4.

The OCA cites to *Pa. Pub. Util. Comm'n v. City of Lancaster – Sewer Fund*, Docket No. R-00049862 (Opinion and Order Aug. 26, 2005), *aff'd* in relevant part, *rev'd* in part 1968 C.D. 2005 (Pa. Cmwlth. 2006) (*Lancaster 2005*), in which the Commission adopted an adjustment to exclude a post-test year debt service payment that fell outside of the test year. *Lancaster 2005*, slip op. of Commission at 119–21. The Commission held that consideration of a post-test year debt service payment, which reached beyond the historic test year figures used for all the other rate-making elements, was contrary to basic ratemaking principles. *Id.* at 70. The Commission reasoned that the City failed to elect a future test year that would have included May 2005 revenue, expense and capital data and it did not adequately justify to the Commission that it was appropriate to use a post-test year expense level for one single item. *Id.* at 32.

The OCA also notes that the City had the option of filing a Fully Forecasted Future Test Year, which it chose not to do. The OCA also argues that the Commission should

not apply an exception to the matchmaking principle, given the negative effects of the COVID-19 pandemic. OCA St. 1 No. at 26.

Disposition

The Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim. As such, no adjustment to salaries and wages expense is recommended. However, if the Commission determines that adjustments to the individual expense claims are necessary, then I agree with the City on this issue.

The point of conflict between the City and the OCA is whether the union contract expense, which is slated to go into effect on January 1, 2021, should be included in the City's salaries and wages expense figure. The question to be answered is whether an exception should be made to the matching principle which holds that expenses and revenues should be synchronized as of the end of the test period. I believe that an exception should be made in this instance. As cited by the City, the Commission has permitted salary increases taking effect one day after the end of the FTY to be included in the revenue requirement in previous rate proceedings. It is crucial to note, as the City points out, that the union wage increase is an expense that is known, measurable and certain to occur, as it is slated to go into effect one day after the end of the FTY. Concerning the OCA's argument that an exception should also not be granted because of the COVID-19, as I have stated previously in this proceeding, I believe a business-as-usual approach should be maintained in this proceeding despite the existence of the COVID-19 pandemic. The Joint Petitioners have concluded, and I agree, that the City is entitled to a rate increase in this proceeding.

As such, if the Commission determines that adjustments to the individual expense claims are necessary, then I recommend that no adjustments should be made to salaries and wages expenses claim.

5. Social Security Expense

Position of the Parties

The City made a claim of \$310,936 for social security expense. Bethlehem, Sch. 6-R at 4. The social security expense includes an increase in union contract wages, which is slated to go into effect on January 1, 2021. Bethlehem M.B. at 28.

The OCA proposes an adjustment of \$6,096 to the social security expense claim. The adjustment based on the amount allocated to outside-city customers is \$2,356. The OCA's adjustment to social security expense is adjusted as a complement to the OCA's adjustment to salaries and wages expense. That is, the OCA's adjustment removes the increase in social security expenses related to the union contract wages slated to go into effect on January 1, 2021. OCA M.B. at 32.

Disposition

The Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim. As such, no adjustment to the social security expense is recommended. However, if the Commission determines that adjustments to the individual expense claims are necessary, then I side with the City on this issue, for the same reasons as discussed in the salaries and wages expenses section, above. Therefore, I recommend that no adjustments should be made to the City's social security expense claim.

6. East Allen Township Expense

Position of the Parties

The City made a claim of \$225,171 for the East Allen Township expense. Bethlehem, Sch. 3-R at 1. This expense consists of subcategories, two of which are the "equipment maintenance expense" and the "other expenses" categories. *Id.* The claimed amounts for those two subcategories are \$34,605 and \$165,147, respectively. *Id.*

The OCA recommended adjustments to the East Allen Township expense based on the normalization of the equipment maintenance expense and other expenses subcategories under the East Allen Township expense. Thus, the OCA recommended a total adjustment of \$45,212 to the East Allen Township expense, of which \$16,692 is to be allocated to outside-city customers. OCA St. No. 2 at 9. In surrebuttal however, the OCA eliminated its adjustment relating to other expenses and limited its adjustment to normalization of the equipment maintenance expense. As such, the adjustment to the claim proposed by the OCA totals \$17,838 of which \$6,586 is allocated to jurisdictional outside city service. The adjustment figure is based on the three-year average of the equipment maintenance expense incurred during 2017, 2018 and 2019 (\$4,048, \$11,648, and \$34,605 respectively). OCA St. No. 2S at 6.

The City disagrees with normalization of the equipment maintenance expense and believes its figure of \$34,605 (equal to the expense incurred in 2019) for the expense is reasonable. The City notes that the equipment maintenance expense incurred in 2019 was the result of emergency repairs and that the City experiences emergency equipment repairs every year in order to operate and maintain an aging plant and infrastructure and meet all regulatory requirements. Bethlehem M.B. at 29. Thus, the City argues that the level of incurred expense in 2019 was reasonably incurred and should be accepted as the reasonable and appropriate level of the expense going forward. *Id.*

The OCA disagreed with the City's argument concerning the equipment maintenance expense, stating that regularly occurring expenses should be normalized so that expenses are fairly recovered on an annual basis. OCA M.B. at 35. The OCA notes that the ratemaking technique of normalization is "used to smooth out the effects of an expense item that occurs at regular intervals, but in irregular amounts, and is a proper adjustment to make the test year expense representative of normal operations," citing to *Pa. Pub. Util. Comm'n v. Total Env't Sols., Inc.*, 2008 Pa. PUC. LEXIS 42, *98 (2008). The OCA argued that it is not reasonable to expect that the annual equipment maintenance expense will remain at the 2019 levels given the historical expenses in prior years. OCA St. No. 2S at 5–6. Thus, the OCA recommends that the FTY expenses be adjusted to reflect a normalized level of expense to account for fluctuations and one-time expenses in equipment maintenance expense. OCA M.B. at 36.

Disposition

The Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim. As such, no adjustment to the East Allen Township expense is recommended. However, if the Commission determines that adjustments to the individual expense claims are necessary, then I agree with the OCA on this issue. The City did not present sufficient evidence for a finding to be made that the equipment maintenance expense incurred in 2019 will be level of the expense going forward. The equipment maintenance expense levels through 2017 – 2019 (\$4,048, \$11,648, and \$34,605) reveal that although the expense has been increasing each year, the expense incurred in 2019 is an irregularity. The City attributed the 2019 expense to the need to perform emergency repairs on an aging infrastructure and claimed that it will experience emergency repairs every year, but did not explain why repairs would remain at the level they were in 2019. The expense figure for the FTY should be calculated through normalizing the past three years, as to smooth out the effect of the irregular 2019 equipment maintenance expense and to prevent overcollection with respect to this expense.

As such, if the Commission determines that adjustments to the individual expense claims are necessary, then I recommend that the East Allen Township expense claim be adjusted by \$6,586 allocated to jurisdictional outside city service.

7. Water Filtration Expense

The OCA proposed adjustments to the department contracts, heating oil and equipment maintenance categories of the water filtration expense totaling \$40,577 of which \$14,981 was allocated to jurisdictional outside city service. As noted below, the OCA removed its adjustment to the heating oil expense category of the water filtration expense, leaving an adjustment to water filtration expense of \$24,728, of which \$9,130 should be allocated to outside city customers. OCA St. No. 2S at 7. The OCA's adjustments, as will be discussed below, adjusted the water filtration expenses to reflect normalization of the expenses over a three-year period. The Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim. As such, I recommend that no adjustments to the water filtration expense be made. However, if the Commission determines that adjustments to the individual expense claims are

necessary, then I side with the OCA on this issue, and recommend that the water filtration expense be adjusted by \$9,130 allocated to outside city customers.

a. Department Contracts

Position of the Parties

The City made a claim of \$196,413, of which \$79,272 is allocated to jurisdictional outside city service, for the department contracts expense. Bethlehem M.B. at 29.

The OCA recommended an adjustment of \$3,677 to the department contracts expense. OCA St. No. 2 at 10. After realizing that it had utilized the wrong values for the department contracts in its direct testimony, the OCA updated its figures. OCA St. No. 2S at 7. Following updating its figures, the OCA's adjustment to department contracts expense is \$1,270, of which \$469 was allocated to jurisdictional outside city service. OCA Schedule SLS-4S at Line Nos. 8 and 24. The OCA's recommended adjustment is based on normalization of the department contracts expense over a three-year period. *Id.*

In support of its recommended adjustment, which normalizes the department contracts expense, the OCA notes that several of the expenses included in the expenses for the water filtration vary annually, as the City stated in its response to several of I&E's interrogatories that costs can vary from year-to-year depending on the needs of the system. OCA St. No. 2 at 9-10. Specifically, the OCA notes, that the City "identified that the department contracts expense, heating oil expense, and equipment maintenance expense include either one-time expense or fluctuating expenses." OCA St. No. 2 at 10. Thus, the OCA recommended that the department contracts expense be normalized over a three-year period to account for the fluctuations and one-time expenses.

Disposition

The Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim. As such, no adjustment to the department contracts expense is recommended.

However, if the Commission determines that adjustments to the individual expense claims are necessary, then it is recommended that the Commission accept the OCA's adjustment to the department contracts expense. The City did not provide sufficient evidence to show that the department contracts expense is a normally occurring prudent expense, but in fact admitted in its response to I&E's interrogatories that its department contracts expense contains fluctuating expenses. Therefore, I agree with the OCA's argument to normalize the expense over a period of three years. Normalizing the expense will transform this fluctuating expense into a "normal" annual test year expense allowance, preventing over recovery.

Therefore, if the Commission determines that adjustments to individual expense claims are necessary, then I recommend that the department contracts expense be adjusted by \$1,270, of which \$469 is allocated to jurisdictional outside city service.

b. Heating Oil

Position of the Parties

The OCA recommended an adjustment of \$13,442 to the heating oil expense. OCA St. No. 2 at 10. The adjustment is based on normalization of the heating oil expense.

In support of its recommended adjustment, which normalizes the heating oil expense, the OCA notes that several of the expenses included in the expenses for the water filtration vary annually, as the City stated in its response to several of I&E's interrogatories that costs can vary from year-to-year depending on the needs of the system. OCA St. No. 2 at 9-10. Specifically, the OCA notes, that the City "identified that the department contracts expense, heating oil expense, and equipment maintenance expense include either one-time expense or fluctuating expenses." OCA St. No. 2 at 10. Thus, the OCA recommended that the heating oil expense be normalized over a three-year period to account for the fluctuations and one-time expenses.

The City disagreed with the OCA's position to normalize the heating oil expense, arguing that the expense did not fluctuate over the years 2017 through 2019, but rather increased

from year to year. Bethlehem M.B. at 30. The OCA accepted the City's argument and removed its adjustment to normalize heating oil expense.

Disposition

The City and the OCA agree with respect to this expense. Therefore, if the Commission determines that adjustments are necessary to the individual expense claims, then I recommend that no adjustment be made to the heating oil expense. The City proved, and the OCA agreed, that the heating oil expense is not a fluctuating expense but has been increasing annually. Thus, no normalization of this expense is necessary.

c. Equipment Maintenance

Position of the Parties

The City's equipment maintenance expense is based on the expense actually incurred in 2019. Bethlehem M.B. at 30. The City noted that the expense incurred in 2019 was due to necessary and emergency repairs to its plant and infrastructure. *Id.* The City admits that the expense incurred in 2019 was higher than the expense in the previous two years but claims that it experiences necessary and emergency equipment repairs every year in order to operate and maintain an aging plant and infrastructure and meet all regulatory requirements. *Id.* Thus, the City argues that the level of incurred expense in 2019 was reasonably incurred and should be accepted as the reasonable and appropriate level of the expense going forward. *Id.*

The OCA recommended an adjustment of \$23,458 to the equipment maintenance expense, of which \$8,661 is allocated to jurisdictional Outside City Service. OCA Schedule SLS-4S at Line Nos. 17 and 24. The adjustment is based on normalization of the equipment maintenance expense over a period of three years.

In support of its recommended adjustment, which normalizes the equipment maintenance expense, the OCA notes that several of the expenses included in the expenses for the water filtration vary annually, as the City stated in its response to several of I&E's

interrogatories that costs can vary from year-to-year depending on the needs of the system. OCA St. No. 2 at 9-10. Specifically, the OCA notes, that the City “identified that the department contracts expense, heating oil expense, and equipment maintenance expense include either one-time expense or fluctuating expenses.” OCA St. No. 2 at 10. Thus, the OCA recommended that the equipment maintenance expense be normalized over a three-year period to account for the fluctuations and one-time expenses.

The City disagreed with the OCA’s position to normalize the equipment maintenance arguing, that the equipment maintenance expense incurred in 2019 (highest during the 2017-2019 period) was due to necessary and emergency repairs, and that the City experiences necessary and emergency equipment repairs every year in order to operate and maintain an aging plant and infrastructure and meet all regulatory requirements. Thus, the City argues that the level of incurred expense in 2019 was reasonably incurred and should be accepted as the reasonable and appropriate level of the expense going forward. Bethlehem M.B. at 30.

Disposition

The Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim. As such, no adjustment to the equipment maintenance expense is recommended. However, if the Commission determines that adjustments to the individual expense claims are necessary, then it is recommended that the Commission accept the OCA’s adjustment to the equipment maintenance expense. The City did not provide sufficient evidence to show that the 2019 equipment maintenance expense is representative of the level of the expense moving forward. Thus, I agree with the OCA’s position to normalize the expense over a period of three years to account for the irregular level of the expense in 2019.

Therefore, if the Commission determines that adjustments to individual expense claims are necessary, then I recommend that the equipment maintenance be adjusted by \$8,661 allocated to jurisdictional outside city service.

8. Chemical Expense

Position of the Parties

The City presented a total chemical expense claim of \$214,414, of which \$79,162 is jurisdictional for outside city service. Bethlehem M.B. at 31.

The OCA agreed with the City's claim for chemical expense. OCA St. No. 2S at 8.

Disposition

The City and the OCA agree with respect to this expense. Therefore, if the Commission determines that adjustments are necessary to the individual expense claims, then I recommend that no adjustment be made to the chemical expense claim. The City provided, and the OCA agrees, sufficient evidence exists to support this claim.

B. Depreciation Expense

Position of the Parties

In its initial filing, the City presented *total* pro forma depreciation expense of \$2,613,365 for the HTY and \$2,675,569 for the FTY. The allocation to outside city services was \$1,012,772 for the HTY and \$1,036,879 for the FTY. Bethlehem Sch. 1 at 1, 3.

The City revised its claim for FTY depreciation expense in its Rebuttal Rate Study based on adjustments to utility plant in service as of the FTY. Bethlehem M.B. at 31. Due to the changes in cost allocation, the jurisdictional allocation increased by \$6,596. The City's revised claim for *total* pro forma depreciation expense is \$2,672,182 for the FTY. Bethlehem Sch. 1-R at 1. The allocation to outside city services was revised to \$1,043,475 for the FTY Depreciation Expense. Bethlehem Sch. 1-R at 1, 3.

The OCA seeks to reduce FTY depreciation expense related to plant in service reductions. Bethlehem St. No. 3-R at 1. The OCA initially highlighted five specific projects to exclude from the forecasted plant additions that total \$1,901,378. Bethlehem St. No. 3-R at 2. Those projects relate to a well generator (\$75,000) in Account 312.13; an emergency generator (\$956,000) and roof replacement (\$40,000) at the water treatment plant in Account 312.30; fire pump station engineering and construction (\$758,000) in Account 316; and the Hecktown Road Bridge main replacement project (\$72,378) in Account 322. *Id.* As a result of the exclusion of the five projects from the forecasted plant additions, the depreciation expense reduction proposed by the OCA approximates \$25,000 annually. *Id.* In rebuttal, the City noted that the well generator, roof replacement and Hecktown Road Bridge main replacement had been delayed and would not be completed before the end of the first quarter 2021 and, therefore, it is reasonable to remove these additions out of the projected rate base. Bethlehem St. No. 3-R at 4. Subsequently, Bethlehem recalculated its depreciation expense after removing these three projects, resulting in a depreciation expense reduction of \$3,387 from the City's initial position. Bethlehem St. No. 3-R at 4-5.

In surrebuttal, OCA noted the depreciation expense for the remaining two contested projects, the emergency generator and the fire pump station, was \$24,049, of which \$9,892 was allocated to Outside-City customers. OCA Schedule SLS-8S at Line No. 7. The OCA averred the Outside-City allocated values for these projects are \$5,668 and \$4,224, respectively. *Id.*

Disposition

A utility seeking to recover a depreciation deficiency from rates has the burden of proving that the deficiency is genuine. *Pa. Power & Light Co. v. Pa. Pub. Util. Comm'n*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973). The genuineness of a deficiency is proved by the utility's demonstrating that it has not received revenues sufficient to pay all of its operating expenses together with a fair return on its rate base during the years when the deficiency was created. See generally, *U.S. Steel Corp. v. Pa. Pub. Util. Comm'n*, *supra.*; *Pa. Power & Light Co.*, *supra.*

The Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim. As such, no adjustment to the depreciation expense is recommended. However, if the Commission determines that adjustments to the individual expense claims are necessary, then it is recommended that the Commission reduce the City's depreciation expense claim by the depreciation expense associated with the fire pump station (\$4,224). In my discussion concerning the plant in service claims, I determined that the OCA's arguments regarding the emergency generator should be rejected, but that the OCA's arguments regarding the fire pump station should be accepted. As such, it is recommended that the related depreciation expense adjustment for the emergency generator be rejected and that the related depreciation expense for the fire pump station be accepted.

VIII. RATE OF RETURN

A public utility seeking a general rate increase is entitled to an opportunity to earn a fair rate of return on the value of the property dedicated to public service. *Pa. Gas & Water Co. v. Pa. Pub. Util. Comm'n*, 341 A.2d 239 (Pa. Cmwlth. 1975). In determining what constitutes a fair rate of return, the Commission is guided by the criteria set forth in *Bluefield*, *supra.*, and *Hope Nat. Gas*, *supra.*⁵

The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties (262 U.S. at 693). These principles have been adopted and applied by the appellate courts of Pennsylvania in numerous cases. *See e.g., Riverton Consol. Water Co. v. Pa. Pub. Util. Comm'n*, 140 A.2d 114 (Pa. Super. 1958); *Pittsburgh v. Pa. Pub. Util. Comm'n*, 126 A.2d 777 (Pa. Super. 1956); *Lower Paxton Twp. v. Pa. Pub. Util. Comm'n*, 317 A.2d 917 (Pa. Cmwlth. 1974). The Commission has wide discretion, because of its administrative expertise, in determining the cost of capital. *Equitable Gas Co. v. Pa. Pub. Util. Comm'n*, 405 A.2d 1055 (Pa. Cmwlth. 1979).

⁵ See quote from *Bluefield* in Section I.(C). above.

The City claims an overall rate of return of 8.21%, which figure includes a cost of common equity of 10.20%. Bethlehem St. No. 2; Exh. HW-1, Sch. 2; Bethlehem M.B. at 32. It notes that if the Commission decides to adjust the city’s common equity 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%. Bethlehem St. No. 2 at 2.

The OCA provides various criticisms of City Witness Walker’s testimony regarding rate of return. However, under the black box partial settlement, there was no agreement as to any of the rate of return components; only a revenue number was specified. OCA submits the revenue requirement should be no higher than \$443,666 under a business-as-usual approach. OCA MB at 4.

The OCA has determined its recommended rate of return as follows:

Capital Component	Proposed Ratio	Cost Rate	Tax Adjusted	Weighted Cost
Long Term Debt	48.0%	5.77%		2.77%
Fund Equity	52.0%	8.50%	7.31%	3.80%
Total	100.0%			6.57%

OCA Witness Garrett used the Discounted Cash Flow (DCF) model and the Capital Asset Pricing Model (CAPM) in determining a market based cost of equity of 6.0%. OCA St. No. 3 at 6. Mr. Garrett recommended a “business as usual” cost of equity of 8.50%, noting that his recommendation was based on the concept of gradualism and the concern that awarding a return of 6.0% [under the business as usual scenario] would be a substantial movement away from the status quo. OCA MB at 49. An awarded return on equity (ROE) of 8.5% represents a gradual, yet decisive move toward Bethlehem’s market-based cost of equity, while providing Bethlehem’s shareholders with the opportunity to earn a return that is above 250 basis points above Bethlehem’s market-based cost of equity OCA St. No. 3 at 10.

Mr. Garrett used a Quarterly Approximation DCF Model that accounts for the quarterly growth of dividends. OCA St. No. 3 at 30. The DCF model is based on the concept that says that “the value of a security is equal to the present value of the future cash flow that it generates.” *Id.* Cash flow from stocks is in the form of dividends paid to investors. *Id.* Mr. Garrett explained that there are “three primary inputs in the DCF model⁶: (1) stock price; (2) dividend; and (3) long-term growth rate.” OCA St. 3 at 30. The stock price and dividend are recorded data for the proxy group while the growth rate projection needs to be estimated. *Id.* at 30-31; OCA M.B. at 53-54.

The City notes that OCA Witness Garrett recommends a market value DCF of 6.1% for his proxy group, which is 355-basis points less than the market value DCF of the I&E witness and, obviously, far below any zone of reasonableness. Mr. Garrett’s market value DCF of 6.1% is a result of his inappropriate reliance on two inputs or factors: sole reliance on an inappropriate, short term, 30-day yield measurement component, and an inappropriate growth component based on a 30-year measure of growth for the overall national economy as measured by the nominal growth in economic output (GDP). Bethlehem M.B. at 39.

Mr. Garret noted the primary factor difference between his analysis and that of Mr. Walker was the long-term growth inputs. OCA M.B. at 54. To estimate the long-term growth rate used in the stable-growth DCF model, a fundamental concept in finance must be kept in mind, that is, “that no firm can grow forever at a rate higher than the growth rate of the economy in which it operates.” OCA St. 3 at 39. The terminal growth rate used in the DCF model should not exceed the aggregate economic growth rate, especially because public utilities have defined service territories. *Id.* Mr. Garrett states that it is reasonable to assume that a regulated utility would grow at a rate that is less than the U.S. economic growth rate, often measured by the Gross Domestic Product (GDP). OCA M.B. at 55.

Mr. Walker states the growth in the value of GDP for the overall national economy does *not* provide a reasonable measure for the growth of the comparison companies. Over the past 30 years (1989-2019), nominal GDP increased by 280% while the comparison

⁶ The Quarterly Approximation DCF Model is shown in Equation 2. OCA St.No. 3 at 31.

companies' revenues increased 510%, or 82% more than GDP. The comparison companies are expected to continue to grow faster than the overall economy for the next several decades, if not for the next century, through consolidation and acquisition of Government controlled water/wastewater establishments and small investor-owned utilities. Bethlehem M.B. at 39-40.

Mr. Walker further opines that Mr. Garrett's DCF growth estimate is unrealistically low and it is also not used by investors. Investors' expectations are based on expected future growth, *not* Mr. Garrett's unique growth rate. Analysts' forecasts are relied upon by investors when they price utility stocks.⁷ Value Line's projected earned returns on common equity for Mr. Garrett's proxy group, upon which investors would rely, range from 9.5% to 14.0%, while Mr. Garrett's DCF recommendation is 6.1%. Bethlehem MB at 40.

I agree that Mr. Garret's long-term growth rate does not appear appropriate. Given that the revenues of the comparison companies outgrew GDP by 82% over the last 30 years, it does not appear reasonable that a GDP forecast is a reasonable long-term growth rate. I also note that Mr. Walker and the I&E witness both used published projected growth in earnings per share of their comparison companies in their DCF methods. While I make no judgement on the other elements of Mr. Garrett's DCF calculation, it does appear that the primary difference of Mr. Garret's DCF calculation was the long-term growth rate. Thus, I do not find the DCF calculation appropriate.

The Commission has indicated in previous proceedings its preference to rely upon the DCF methodology over other methods such as the Risk Premium (RP) and Capital Asset Pricing Model (CAPM) in determining the rate of return. In *PPL's 2012* and *2004* base rate cases, the Commission reaffirmed its reliance upon the DCF method. *PPL 2012; Pa. Pub. Util. Comm'n v. PPL Elec. Util. Corp.*, 237 PUR 4th 419 (Pa. PUC 2004). The Commission additionally noted, however, that while it is not required, other methodologies can be used to check DCF results. OCA MB at 46.

⁷ Mr. Walker and the I&E witness both used published projected growth in earnings per share of their comparison companies in their DCF methods. Bethlehem St. No. 2 at 18.

As I have not found Mr. Garrett’s DCF result appropriate, I will not examine the CAPM calculation. I note that Mr. Garrett produced a CAPM calculation of 5.9%. Exh. DJG-11. Additionally, as I have not endorsed any particular return on equity, it is not necessary to examine testimony regarding capital structures.

The Parties to the rate case have recommended the following rates of return:

Rate of Return (ROR)	
<u>Party</u>	<u>ROR</u>
City	8.21% ⁸
City (tax-adjusted)	7.42% ⁹
I&E	6.75% ¹⁰
OCA	6.57% ¹¹

The OCA offered no specific criticism of the settlement, other than that it provides a higher than reasonable revenue requirement. OCA RB at 2.

I&E was mindful of both *Bluefield* and *Hope Nat. Gas* in making its recommendations in this proceeding. Specifically, I&E witness Anthony Spadaccio calculated an appropriate rate of return for the City, including a recommended return on equity using the Discounted Cash Flow (DCF) methodology frequently used by the Commission.¹² Consistent with *Bluefield* and *Hope Nat. Gas*, a DCF analysis provides the City with an opportunity to earn a return on investment similar to a proxy group of enterprises with corresponding risks and

⁸ City MB at 36.

⁹ City MB at 37.

¹⁰ I&E St. No. 2 at 6.

¹¹ OCA MB at 42.

¹² I&E St. No. 1; I&E Exh. No. 1.

uncertainties. Although the settlement revenue requirement does not entirely reflect I&E's analysis, as explained above, it is a reasonable compromise between positions. Additionally, this is a black box settlement, and there is no agreement upon individual issues regarding revenue requirement. However, the City indicated in its Statement in Support to the settlement that the rate of return under the settlement was 6.72%. (Bethlehem St. in Support at 7).

The OCA opposes the Partial Settlement because "the level of the rate increase and lack of other provisions that have been raised in this proceeding are fatal flaws that render the Partial Settlement not in the public interest". OCA R.B. at 9. Regarding revenue requirement, OCA avers the City's existing rates are adequate because they produce an overall rate of return of 5.65%. OCA R.B. at 9-10. However, I&E's DCF analysis, as explained above, demonstrates a rate of return of 6.75% is reasonable. OCA's own "business as usual" analysis reflects a rate of return of 6.57%. *See* OCA R.B. at 10. OCA also avers increasing base rates by \$689,932 "is not supported by the evidence of record in this case." OCA R.B. at 12. Both the City and I&E dispute this conclusion.

The Joint Petitioners, in reaching the Settlement, did not agree to any particular rate of return. However, if the Commission determines a rate of return is necessary in calculating a revenue requirement, I find the City's proposed rate of return to be reasonable and in the public interest and recommend that it be approved by the Commission.

IX. TAXES

The City did not present a ratemaking claim for income taxes. It presented *total* Taxes, Other Than Income Taxes of \$47,584, Bethlehem St. No. 1, Attachment 1, Schedule 1 page 1 of 3 and Exhibit CEH-1R, Schedule 1-R, page 1 of 3. of which \$17,568 was allocated to jurisdictional Outside City Service. Bethlehem St. No. 1, Attachment 1, Schedule 1 page 3 of 3 and Exhibit CEH-1R, Schedule 1-R, page 3 of 3. The City's claim was not challenged by either OCA or OSBA.

X. RATE STRUCTURE / RATE DESIGN

A. Allocated Cost of Service Study

The primary purpose of an allocated cost of service study (ACOSS) is to assist in the design of a utility's rates by identifying all capital and operating costs incurred by the utility in the provision of service to its customers, then directly assigning, or allocating, these various costs to the individual rate classes based on principles of cost causation in order to calculate the rate of return provided by each class. The rate of return identified for each class is then compared to a system average rate of return to determine if each rate class is under-paying or over-paying its allocated cost of service. This information is then used to determine the manner in which the proposed rate increase should be allocated among the various rate classes. The allocation should be based on how the various rate classes caused the costs to be incurred.

In allocating a rate increase among various rate classes, the Commission may consider a number of factors, including such things as cost of service by rate class, the value of service, gradualism and conservation considerations. The Pennsylvania Commonwealth Court has concluded, however, that the concept of class cost of service is the "polestar" of utility ratemaking and is the primary consideration. In its 2006 decision, the Commonwealth Court, in considering a substantial difference in the rate of return by class of a utility's customers, and the concept of gradualism, concluded that the proposed rate of return difference should not stand. The court stated:

[W]hile permitted, gradualism is but one of many factors to be considered and weighed by the Commission in determining rate designs, and principles of gradualism cannot be allowed to trump all other valid ratemaking concerns and do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time.

Lloyd v. Pa. Pub. Util. Comm'n, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006).

The City's witness, Constance E. Heppenstall, a senior project manager with Gannett Fleming, prepared the City's ACOSS. The ACOSS was submitted as Bethlehem Exhibit CEH-1 – Cost of Service Allocation Study, for the FTY ending December 31, 2020. The

City's ACOSS was subsequently updated to reflect data collected from additional monitoring of Sales for Resale, also known as Resale, Other Water Utility or Wholesale, customers and submitted as Bethlehem Exhibit CEH-2R – Rebuttal Cost of Service Allocation Study. The City made additional revisions based on continued monitoring of the Sales for Resale customers through August 31, 2020. Bethlehem St. No. 1R at 16-17. The City discovered, through the continued monitoring, that the initial peak for the Sales for Resale customers was understated. Bethlehem St. No. 1R, at 15. Ms. Heppenstall averred the revisions for the ACOSS reflected the change of the peaking factors as well as changes to the revenue requirement. Bethlehem St. No. 1R at 15-16.

OCA witness Jerome D. Mierzwa, a principal with Exeter Associates, presented testimony concerning the assignment of costs associated with unaccounted for water (UFW) to Wholesale customers. Mr. Mierzwa indicated UFW includes water that is lost due to leaks in the City's transmission and distribution mains and customer service lines and that in the City's ACOSS, the costs associated with producing water are generally allocated to customer classes based on the water consumption of each class. OCA St. No. 4 at. 8. Mr. Mierzwa also argued that Wholesale customers should not be responsible for a share of UFW costs that occur on service lines since Wholesale customers are not served through service lines but are served directly from transmission or distribution mains. *Id.* However, Mr. Mierzwa indicated that a detailed analysis of UFW would be required to modify the City's ACOSS and that the impact on the City's proposed revenue distribution for Wholesale customers would be immaterial and therefore did not propose to modify the ACOSS. *Id.*

OSBA witness Brian Kalcic, a principal with Excel Consulting, indicated that the City identified an error in its original ACOSS pertaining to an understatement of the peak day and peak hour ratios used for the Sales for Resale customer class. OSBA St. No. 1 at 4.

I&E witness Esyan A. Sakaya indicated the City utilized the Base-Extra Capacity Method in the ACOSS and that the Base-Extra Capacity Method identifies costs and allocates them to the functional cost categories of base cost, extra capacity cost, customer cost and fire hydrant cost. I&E St. No. 3 at 16. I&E did not make any specific recommendations about the City's ACOSS.

The settlement does not provide any indication as to how specific costs are allocated among the various customer classes served by Bethlehem. However, considering the City's revised ACOSS and the cost of service positions of the various parties, I find that the Settlement provides for an appropriate resolution to the parties concerns regarding the City's ACOSS. Accordingly, I find that the settlement rates provide appropriate primary consideration to cost causation principles in tandem with secondary considerations for the value of service, gradualism and conservation.

B. Revenue Allocation

The primary goal in revenue allocation is to have rates reflect the actual cost of service to the various customer classes. A proposed revenue allocation will only be found to be reasonable if it moves distribution rates for each class closer to the full cost of providing service. *Pa. Pub. Util. Comm'n v. PPL Elec. Utils. Corp.*, Docket No. R-00049255, 2007 Pa. PUC LEXIS 55 (Order on Remand entered July 25, 2007).

The City provided evidence that, under proposed rates, jurisdictional revenues from the residential, commercial/public, and private fire customer classes would exceed their respective costs of service, whereas revenues from the industrial and other water utilities customer classes would be below their respective costs of service. Bethlehem Exh. CEH-2R, Sch. A-R. The City also provided evidence that, under proposed rates, revenues from all customer classes except other water utilities would increase more than the average increase in revenues for all customer classes combined. *Id.* Further, the City argues that only the outside City cost of service should be considered when setting rates and revenue distributions. Bethlehem St. No. 1SR at 4.

In contrast, OCA witness Mr. Mierzwa examined the City's proposed revenue distribution and asserts, and when looked at on a combined basis (Inside and Outside City customers), the revenues collected from Residential customers would exceed the indicated cost of service while the revenues collected from Commercial/Public and Industrial customers would be less than the cost of service. OCA St. No. 4 at 10-11. Mr. Mierzwa stated, in recognizing the principal of gradualism, that the increases should be limited to 1.5 to 2.0 times the system

average increase. OCA St. No. 4 at 11. Specifically, Mr. Mierzwa recommended a revenue distribution that OCA contends reduces the difference between the Residential class and Industrial class rates and cost of service. OCA M.B. at 66.

OSBA indicated that to determine a just and reasonable revenue allocation, OSBA witness Mr. Kalcic calculated the level of the outside-City class revenues subsidies associated with the City's current and proposed class revenue levels. OSBA M.B. Sch. BK-3. Mr. Kalcic explained that all outside-City customer classes except for Other Water Utilities would be moving closer to cost of service under the City's proposed revenue allocation, although the rate of movement toward cost of service is not uniform among such classes. OSBA St. 1 at 7. OSBA argued that due to the City's limited rate structure, it is not possible to move the non-Resale classes towards cost of service in a more uniform fashion. *Id.* Ultimately, Mr. Kalcic set forth his recommended revenue allocation among the City's various customer classes moving the City's Resale customer class closer to the City's (corrected) cost of service than originally proposed by the City. OSBA M.B. Sch. BK-4. All of Mr. Kalcic's revenue allocation analysis used the City's requested revenue increase. OSBA proposed modifications to the City's ACOSS that impacted the proposed allocation of revenues. OSBA St. 1 at 8. OSBA explained its proposed revenue allocation as follows:

My recommended revenue allocation was derived via two steps. First, I assigned a cost-based increase of 16.7% to the Resale class, as given by the City's corrected COSS. This step provides for an additional \$123,612 increase to the Resale class, compared to the City's proposal, which is available as rate relief to other classes.

Second, I assigned the \$123,612 of rate relief from Step 1 to the inside- and outside-City residential classes, in proportion to their respective levels of consumption, so as to facilitate implementing the OSBA's recommended outside-City residential increase.

OSBA St. 1 at 8.

In submitting the Joint Petition with the City, I&E has indicated the settlement rates are designed reflective of the approximate revenue allocation as proposed by OSBA's Schedule BK-4 which incorporates the revised peaking factors for the Sales for Resale class. Joint Petition, Appendix A.

The City avers that although OSBA is not a party to the Settlement, I&E and the City accepted the OSBA's scale back as appropriate for settlement purposes. Bethlehem Statement in Support, at 7. City witness Heppenstall also agreed that Mr. Kalcic's recommended revenue allocation appropriately reflects the appropriate change in the cost of service as it considers the full cost to serve the Sales for Resale class. Bethlehem St. 1R at. 17. Likewise, OCA does not oppose the OSBA's scale back proposal. OCA M.B. at 66.

The settlement does not provide any indication as to how specific costs are allocated among the various customer classes served by Bethlehem and the extent to which revenues are allocated among customer classes to align with those costs. However, based on the discussions presented by the parties, I believe that the Settlement is an appropriate compromise of the parties' positions regarding revenue allocation and, therefore, recommend that the settlement be approved. Indeed, the evidentiary record establishes that the City's proposed increase in rates for the other water utilities customer class, when compared with the City's revised ACOSS, does not follow cost causation principles and should be modified. I&E has convincingly indicated that settlement rates are designed to be reflective of the approximate revenue allocation proposed by OSBA and, correspondingly, the City indicated that it accepted the OSBA's scale back as appropriate for settlement purposes. As a result, I find that settlement rates provide appropriate primary consideration to cost causation principles in tandem with secondary considerations for the value of service, gradualism and conservation.

C. Rate Design and Scale Back

The City's witness, Ms. Heppenstall, indicated the proposed rate design for outside-City customers maintained a monthly or quarterly customer charge by meter size applicable to all classifications plus a separate, single block consumption rate applicable to each of the residential, non-residential and sales for resale classifications. Bethlehem St. 1 at 17. Ms. Heppenstall indicated that all customer charges were left unchanged and the existing single block consumption rate structure was retained for consumption charges and that the proposed rates move revenue toward the cost of service. *Id.* The City also left private fire line rates and public fire hydrant rates unchanged. Bethlehem St. 1 at 19.

The OCA's witness, Mr. Mierzwa, agreed with the City's approach to maintain all existing monthly customer charges and increase volumetric rates to recover any increase authorized in this proceeding. OCA St. 4 at 13. The OSBA's witness, Mr. Kalcic, recommended that any increases should be scaled back proportionately. OSBA St. 1 at 9, OSBA M.B. at 9.

In the partial settlement with I&E, the City agreed to the scale back of rates as proposed by OSBA witness Mr. Kalcic. Bethlehem M.B. at 46. To recover the rate increase under the settlement, the City and I&E agreed to increase the single block consumption rate for all customer classes while leaving the customer charges unchanged. Bethlehem M.B. at 46. OCA also determined that it will not oppose the scale back approach supported by the City and OSBA if an increase approved by the Commission is less than the City's initially proposed increase. OCA M.B. at 67.

Based on the discussions presented by the parties, I believe the Settlement is an appropriate resolution of the parties' positions regarding rate design and scaling back of rates. The settlement follows the widely accepted approach among the parties of maintaining existing monthly customer charges while increasing volumetric rates. Likewise, while the parties may not all agree as to the amount of the increase that should be approved, the City noted the settlement scales back the rates through the method proposed by OSBA. I find that OSBA's scale back proposal should be employed when establishing rates in this proceeding. If the Commission should seek to adjust Bethlehem's authorized revenues in this proceeding, it is recommended that the Commission scale back the rate increase among the customer classes in accordance with the OSBA's proposal.

XI. MISCELLANEOUS ISSUES

As noted in Section III above, miscellaneous issues raised in the testimony of OCA witness Fought have been resolved by Stipulation with the OCA. The Stipulation addresses valve exercising, fire hydrants, pressure surveys, unaccounted for water, customer complaints and customer meter age. The City agrees that the Stipulation is reasonable and appropriate and should be accepted in resolution of issues raised by Mr. Fought. No other party contests the issues subject to the stipulations. Because, as discussed above, the actions agreed upon by the

City ensure that the City's procedures more closely comply with Commission regulations, I find that stipulations are in the public interest and recommend that they be approved by the Commission.

XII. CONCLUSION

For the reasons set forth above, I recommend that the Commission approve the Joint Petition for Partial Settlement of Rate Investigation in its entirety without modification. If the Commission determines that modifications are necessary, I recommend that the adjustments addressed above in response to specific challenges raised by OCA and OSBA be approved. 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.

XIII. CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the subject matter and parties to this proceeding. 66 Pa.C.S. §§ 701, 1308(d).

2. Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the Commission. 66 Pa.C.S. § 1301.

3. It is the policy of the Commission to encourage settlements. Settlement rates are often preferable to those achieved at the conclusion of a fully litigated proceeding. 52 Pa. Code §§ 5.231, 69.401.

4. To determine whether a settlement should be approved, the Commission must decide whether the settlement promotes the public interest. *Pa. Pub. Util. Comm'n v. C. S. Water & Sewer Assocs.*, 74 Pa. P.U.C. 767 (1991); *Pa. Pub. Util. Comm'n v. Phila. Elec. Co.*, 60 Pa PUC 1 (1985).

5. The City of Bethlehem has met its burden of proof and demonstrated through a preponderance of evidence and substantial evidence that its ratemaking claims for Outside City Service are reasonable and appropriate.

6. The Commission has no authority to deny the City of Bethlehem rate relief because of the COVID-19 pandemic.

7. The partial settlement proposed by the City of Bethlehem and the Bureau of Investigation and Enforcement, which provides for an increase in annual revenue for Outside City Service of \$689,932 in lieu of the originally proposed increase of \$908,421, is 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 Public Utility Code.

XIV. ORDER

THEREFORE,

IT IS RECOMMENDED:

1. Bethlehem shall not place into effect the rates, rules and regulations contained in Supplement No. 15, which has been found to be unjust, unreasonable and, therefore, unlawful.

2. That the Joint Petition for Approval of Partial Settlement of Rate Investigation of the City of Bethlehem and the Bureau of Investigation and Enforcement including all terms and conditions, be approved, without modification.

3. That the City of Bethlehem is authorized to file a tariff supplement containing the rates, rules and regulations as presented in Appendix A to the Joint Petition to

produce an increase in operating revenues of \$689,932 for Outside City Service to become effective at least on one day's notice after entry of the Commission's Order approving the Settlement.

4. That the Stipulation between the City of Bethlehem and the Office of Consumer Advocate as presented in Attachment B to the City's Main Brief be approved as though each term therein were the subject of an individual ordering paragraph.

5. That the formal complaint of the Office of Small Business Advocate at Docket No. C-2020-3021576 be dismissed and marked closed by the Commission's Secretary's Bureau.

6. That the formal complaint of the Office of Consumer Advocate at Docket No. C-2020-3021583 be dismissed and marked closed by the Commission's Secretary's Bureau.

7. That upon acceptance of the tariff, tariff supplement or tariff revision filed by the City of Bethlehem consistent with the Commission's Order, the proceeding at Docket No. R-2020-3020256 shall be marked closed.

Dated: February 11, 2021

/s/
Steven K. Haas
Administrative Law Judge