

COMMONWEALTH OF PENNSYLVANIA



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February 24, 2021

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

Re: Pennsylvania Public Utility Commission
v.
The City of Bethlehem – Water Department
Docket No. R-2020-3020256

Dear Secretary Chiavetta:

Attached for electronic filing please find the Office of Consumer Advocate's Exceptions in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Very truly yours,

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Enclosures:

cc: The Honorable Steven K. Haas (**email only**)
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Certificate of Service

*304307

CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission :
v. : Docket No. R-2020-3020256
The City of Bethlehem – Water Department :

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Advocate’s Exceptions, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 24th day of February 2021.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-2020-3020256
 :
 The City of Bethlehem – Water Department :

EXCEPTIONS
OF THE
OFFICE OF CONSUMER ADVOCATE

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I. INTRODUCTION

On February 11, 2021, the Public Utility Commission's (PUC or Commission) Office of Administrative Law Judge issued the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Steven K. Haas regarding the City of Bethlehem – Water Department's (City) proposed rate increase for water service to its PUC-jurisdictional customers. The ALJ recommended that the Joint Petition for Approval of Partial Settlement of Rate Investigation (Joint Petition or Partial Settlement) be approved without modification. The ALJ also addressed the OCA's adjustments to Bethlehem's claims.

Under the Partial Settlement, customers would face substantial rate increases. The City originally proposed a revenue increase of \$908,421 (10.9%). R.D. at 14. Under the Non-Unanimous Settlement, the City will increase revenues on April 29, 2021, the effective date of new rates, by \$689,932 (8.4%). Id. Rates for the average customers in the residential, commercial, and industrial classes would increase by 12.7%, 15.8%, and 20.6% respectively. Id. at 14-15.

In these Exceptions, the Office of Consumer Advocate (OCA) will address the ALJ's recommendation to approve any increase as Bethlehem's customers remain in the midst of the COVID-19 pandemic. In addition, the OCA will address the ALJ's recommendation to approve the Partial Settlement and the resulting rate increases for the City's PUC-jurisdictional customers. The OCA also will address the ALJ's specific recommendations regarding the adjustments proposed by the OCA to the City's rate filing. These issues are fundamental to determining a reasonable revenue requirement, whether or not the Settlement is approved. As set forth below and in the OCA's Main Brief, Reply Brief, including OCA's opposition to the Partial Settlement, the OCA hereby respectfully requests that the Commission reject the Partial Settlement. While there are provisions that resolve issues in a manner consistent with the OCA's position in this case,

the level of the rate increase is a fatal flaw that renders the Partial Settlement in its current form not in the public interest. Customers are facing extraordinary financial and social challenges. The record shows that, in the near term, the City's current rates are adequate to provide safe and reliable service and provide sufficient coverage of its debt service. If the City is concerned about operating revenues during this uncertain time and moving forward, it could defer new construction projects that are not necessary to ensure the current provision of safe and reliable service to existing customers. After the COVID-19 pandemic has passed, the City can file again for a rate increase when the City's financial projections will be founded on more stable, and thus reliable, economic conditions. If the Commission determines to allow any rate increase, under a business as usual approach to ratemaking, the evidence supports a lower revenue requirement than the Partial Settlement, as set forth in the OCA's Main and Reply Briefs.

II. EXCEPTIONS

Exception #1: The ALJ Erred by Approving the Substantial Rate Increase Contained in the Partial Settlement. R.D. at 7-20, OCA M.B. at 9-24; OCA R.B. at 3-9.

The ALJ did not give proper weight to the financial circumstances facing consumers which is necessary in determining just and reasonable rates. As set forth in the OCA's Briefs, it is not just and reasonable for the City to increase its rates at this time. Further, the level of the rate increase and the lack of other provisions that have been raised in this proceeding are fatal flaws that render the Partial Settlement not in the public interest.¹ Denying the City's requested rate increase due to the current economic and societal conditions is based on the record evidence that establishes that the City would earn an overall return of 5.65% under existing rates. The OCA's "business as usual" 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. Although less than a "business as usual return" of 6.57%, the no increase overall return of 5.65% is a fair rate of return because it is sufficient for the City to cover its debt costs, operation and maintenance expenses and provide safe, adequate and reliable service in these unique circumstances. OCA St. 1S at 5; OCA M.B. at 15-22.

After the COVID-19 pandemic has passed, the City can file again for rate increases when the City's financial projections will be founded on more stable, and thus reliable, economic conditions. In these extraordinary times, denying the City's rate increase is a reasonable—and

¹ The OCA and the City entered into a stipulation to address the quality of service issues that were raised in OCA witness Fought's testimony. OCA St. 5 and 5S.

temporary—outcome until fewer customers are suffering financially and the future is more ascertainable for ratemaking.

For the reasons set forth below, the OCA respectfully submits that the Partial Settlement should be rejected. Denying the Partial Settlement, would be an appropriate and valid exercise of the Commission’s authority in this proceeding.

A. The Record Evidence Supports the OCA’s Position That Increasing Rates During This Financially Challenging Time For Ratepayers Would Not Lead to Just and Reasonable Rates.

The ALJ erroneously agreed with the City and I&E that a “business as usual” approach should be used in this proceeding rather than recognizing the impact of the COVID-19 pandemic on the City’s PUC-jurisdictional ratepayers. R.D. at 20. As discussed in the OCA’s Briefs and below, this conclusion is contrary to the Public Utility Code and case law. In addition, the OCA submits that in determining that the Partial Settlement revenue increase was in the public interest, the ALJ did not give proper weight to the ratepayers’ interests, including the financial circumstances facing consumers, which is necessary in determining just and reasonable rates.

1. The Economic Hardships of Bethlehem’s Ratepayers During and After This Pandemic Should Play a Prevalent Role in the Commission’s Decision on Increasing Rates.

The economic repercussions of the COVID-19 pandemic—to the extent yet known—are real and significant in Bethlehem’s service territory, and the OCA submits that the Commission must give great weight to the circumstances of consumers during these extraordinary times. As of September 2020, the unemployment rates in Lehigh and Northampton Counties, portions of which are served by the Bethlehem, were 8.3% and 7.6%, respectively. OCA St. 1 at 11. In October, the unemployment rates had fallen to 7.4% and 6.8% respectively. OCA St. 1S at 2. For comparison,

the unemployment rate in both counties one year earlier was 4.6%. OCA St. 1 at 11. The unemployment rate in both counties peaked in April 2020 (16.9% and 16.3 respectively). Id.

As a consequence of the massive job losses across Pennsylvania, there were 30 times as many initial unemployment claims during the week ending March 21, 2020 and 33 times as many during the next week ending March 28, 2020 than the amount during the week ending March 7, 2020 as shown in shown in OCA St. 1 S, Sch. SJR-1 (Updated). As shown on the updated Figure 3, at the end of November, unemployment claims, although less than in March had started to climb again and were at about 23,000 initial claims per week.² OCA St. 1S at 2, Sch. SJR-1 Updated. Mr. Rubin explained that in the space of about eight months (mid-March through mid-November), “approximately 42 percent of Pennsylvania’s workforce filed an unemployment claim.” OCA St. 1S at 2.

According to a survey conducted by the U.S. Census Bureau, approximately 46.9% of Pennsylvania households experienced wage loss since March 13, 2020 and during the period ending October 12, 2020, the percentage remained “fairly constant at about 47% of households, as shown on Figure 3.” OCA St. 1 at 13; Figure 3. In his Surrebuttal Testimony, Mr. Rubin provided an update, through the two-week period ending November 23, that shows that 46% of Pennsylvania households have lost some of their employment income. OCA St. 1S at 2; Sch. SJR-6S.

² When Mr. Rubin filed his direct testimony, initial unemployment claims had dipped below 20,000 for the first time since mid-March. OCA St. 1S at 2.

Given the substantial reductions in employment and wages, there is an unusually large pool of ratepayers unable to afford utility bills. To address the prospect of Pennsylvanians experiencing job and wage loss to afford bill payments, Mr. Rubin cites the U.S. Census Bureau's Household Pulse Survey, testifying:

Only 53% of Pennsylvanians who lost income said they used their normal source of income to pay bills in the previous week. About 23% cited unemployment benefits and 26% referred to the CARES Act stimulus payments. More people, however, relied on credit card debt or loans (including loans from family or friends) (44%) or money from savings or asset sales (35%) than relied on short-term government benefits.

OCA St. 1 at 15. Mr. Rubin noted that 24% of Pennsylvania's workforce expected to suffer additional income loss during October and November. OCA St. 1 at 14. Mr. Rubin noted that the lower a household's income, the greater the impact of the pandemic on income loss. Id. at 15. Similarly households headed by a person who the Census Bureau classifies as Black or Hispanic are "much more likely to have experienced an income loss – and to expect additional income loss into mid-November than are households headed by a person classified as White, Non-Hispanic." Id.

For utility bills specifically, Mr. Rubin testified:

A recent survey conducted by the Electric Power Research Institute ("EPRI") found that about two-thirds of people who lost their jobs during the pandemic are concerned about being able to pay their energy bills. Moreover, more than 20% of survey respondents reported that their energy bills were higher because of the pandemic. Interestingly, the survey also found that more than 25% of people who lost their jobs are planning to skip at least one utility bill payment, but a much lower percentage were planning to contact their utilities for assistance.

Id. at 15-16 (footnote omitted); Sch. SJR-5, pp. 3, 7, 12. The OCA submits that Bethlehem's customers, a significant portion of whom it is reasonable to assume are experiencing a situation

that aligns with the pandemic-related job and wage loss mentioned in Mr. Rubin's testimony, cannot reasonably withstand a water rate increase at this time.

The OCA submits that a water rate increase in the Bethlehem service territory will not only increase the financial burden faced by customers experiencing job and wage loss due to the pandemic, but will likely increase that burden particularly on those individuals belonging to low-income and Black or Hispanic households.

In addition to residential customers, businesses in Bethlehem's service territory have also been impacted substantially from the pandemic. Mr. Rubin testified:

A recently initiated small-business survey by the U.S. Census Bureau provides insights into the condition of small businesses in Pennsylvania. The Census Bureau estimates that, as of the week ending May 2, 2020, 31.6% of small businesses in Pennsylvania said they would not return to normal operations for more than six months and 6.6% of the Commonwealth's small businesses expected to never return to their pre-pandemic level of operations. By the week ending October 12, 2020, the small-business outlook was considerably worse with more than 51% of businesses selecting these two categories.

OCA St. 1 at 16 (footnotes omitted); Figure 4. In his Surrebuttal Testimony, Mr. Rubin explained that the outlook for small business is worse than when he prepared his direct testimony:

The most recent results are for the week ending November 29. The survey now shows that 48% of Pennsylvania's small businesses said they would take at least 6 months to recover, with another 10.4% saying they would never fully recover from the pandemic. The last two weeks of November show the worst small business outlook (more than 58% of small businesses in dire circumstances) during the entire survey period.

OCA St. 1S at 2.

From the above information, drawn from surveys and reports on the economic well-being of households and businesses both in Bethlehem's service territory and in Pennsylvania from the

start of the pandemic, Mr. Rubin recommends that rates in Bethlehem's service territory not be raised at this time unless the Commission finds that some increase is necessary for the City to meet its obligations under its lease with the Bethlehem Authority. OCA St. 1 at 4. This data, collectively, demonstrates why the economic hardships faced by customers in Bethlehem's service territory should not be added to by any increase in Bethlehem's rates at this time.

In rebuttal, Bethlehem witness Heppenstall did not rebut the data or the factual conclusions reached by Mr. Rubin. OCA St. 1S at 4. Rather, Ms. Heppenstall focused on the unemployment rate. City St. 1R at 2-5. Ms. Heppenstall characterized the unemployment rates as not "unique" to this period. Id. at 2. She pointed to the unemployment rate in 2010 which was 10% in Lehigh County and 9.7% in Northampton County. Id. According to Ms. Heppenstall that information "shows that this period of challenges is not unique." Id. Ms. Heppenstall also states that the unemployment rate has improved since March 2020 when it was at 16.1%. City St. 1R at 3. County level unemployment data for November will not be available until January. However, as Mr. Rubin pointed out, although dipping in early fall, initial unemployment claims had started to increase again in the first three weeks of November. OCA St. 1S at 2.

Ms. Heppenstall did not discuss the other economic indicators addressed by Mr. Rubin including "the partial loss of income by nearly half of Pennsylvania wage-earners, the devastating effect of the pandemic on small businesses, and the extent of the decline in economic activity in Pennsylvania." OCA St. 1S at 4. Based on the unemployment rate, Ms. Heppenstall concludes that "This recovery appears to be swift." City St. 1R at 3. Ms. Heppenstall's conclusion is not consistent with the data presented by Mr. Rubin in direct and updated in surrebuttal testimony. Ms. Heppenstall's narrow focus on one of the many factors presented by Mr. Rubin does not refute that the proposed increase has not been shown to be necessary during the ongoing pandemic.

In rebuttal, Ms. Heppenstall states that the City's debt service coverage ratio, at 1.3x, is low compared to its peers. City St. 1R at 5. The OCA notes that the City's coverage ratio is more than the minimum coverage ratio it is required to have. Finally, as Mr. Rubin noted (OCA St. 1 at 27), the City was able to issue \$6.5 million in AA-rated bonds during 2020 at interest rates ranging for 0.5% to 1.6%, so it appears to be in reasonable financial standing.

Raising rates on Bethlehem's customers while many are experiencing job and wage loss would only serve to further diminish customers' currently-reduced incomes and financial resources. The OCA submits that the unprecedented situation at hand provides ample basis for the Commission to deny such an increase during this time.

2. Rejecting Bethlehem's Rate Increase Request During an Unprecedented and Economically Devastating Pandemic Would Result in Just and Reasonable Rates.

Mr. Rubin recommends that the Commission not focus, in this proceeding, on Bethlehem's historic costs, or on cost projections prepared before the pandemic, under a business as usual approach. OCA St. 1 at 19. Rather, the Commission "must focus on what rates are reasonable for consumers to pay under these extraordinary conditions." Id. While this is not the Commission's standard approach to ratemaking, these ratemaking conditions are not standard by any means. Based on the reasons discussed below, it is both legal and practical for the Commission to consider the unprecedented public health and economic crisis and the grave economic environment and financial hardships faced by Bethlehem's customers in denying Bethlehem any rate increases at

this time. Such consideration will still result in just and reasonable rates and indeed, is necessary to determining just and reasonable rates at this time.³ Mr. Rubin explained as follows:

Now is not the time to impose additional, unavoidable costs on consumers. Residential customers are experiencing unprecedented levels of unemployment and other economic dislocation (such as reduced hours of work), while many are battling the COVID-19 infection. Businesses of all sizes, as well as local governments, schools, universities, and nonprofit organizations are struggling to remain viable. I expect many will not be able to survive or, if they do, it might take them months or years to return to pre-pandemic levels of operations. To put all of this in terms of utility ratemaking: it would be neither just nor reasonable for the City to increase its rates at this time.

³In further support of his recommendation against the rate increase requested by Bethlehem, Mr. Rubin cites many examples where utilities have either withdrawn or deferred filing rate increase requests to provide relief to their customers who are likely spending more time at home and/or experiencing some level of income loss during this pandemic including Hydro One, a large electric utility in Ontario, Canada, and the Halifax, Nova Scotia Regional Water Commission. OCA St. 1 at 22-23. Other public utilities, including some in Pennsylvania, have recognized the increased hardships that would be placed on their customers if they were to charge higher rates at the time. Mr. Rubin provides the following examples in his testimony:

- Dominion Energy in South Carolina is pushing back the effective date for its rate increase to March 1, 2021, instead of January 1, 2021.
- Minnesota Power significantly reduced its requested rate increase and is refunding more than \$12 million to customers to help alleviate pandemic-related financial concerns.
- California Water Service Co. is eliminating all scheduled rate increases during 2020.
- Chelan County (Washington) Public Utility District is postponing previously approved increases in electric, water, and wastewater rates by six months to provide customers some relief during the pandemic.
- The City of Austin (Texas) reduced its electricity rates by about 4%, eliminated the residential price increment for usage in excess of 1,000 kilowatt-hours per month, and reduced rates for residential water and wastewater consumption by 10%.
- PEPCO, the electric utility serving the District of Columbia and surrounding areas, announced on June 1st that it would forego a \$25 million rate increase scheduled for this year in D.C., make a shareholder donation to its low-income assistance fund, and take other actions to assist customers during the pandemic.
- A report by Moody's Investors Service expects similar delays in numerous electric, gas, and water utility rate proceedings throughout the U.S. as a way of providing some relief to consumers during the pandemic.
- Philadelphia Water Department withdrew its pending request for increases in water, wastewater, and stormwater rates that would have become effective in September 2020 and September 2021. In a June 2020 filing, the utility cited "the on-going pandemic and the uncertainty over the anticipated duration of continuing emergency measures.

OCA St. 1 at 23-24 (footnotes omitted).

OCA St. 1 at 24 (footnotes omitted).

3. Bethlehem Does Not Need to Increase Rates Right Now.

OCA witness Rubin found that, not only is Bethlehem's continued pursuit of its proposed rate increase suspect due to the drastic change in the economic environment, but Bethlehem would have enough revenue to continue safe and reliable operations if its rates were to remain unchanged.

On the topic of Bethlehem's alleged need to increase rates, Mr. Rubin testified:

As I understand it, the water system is owned by the Bethlehem Authority ("the Authority") that leases the system, and the right to operate it, to the City. Under the lease agreement, the City is required to pay the Authority 105% of the Authority's debt service payments. According to the Authority's annual filing with the Pa. Department of Community and Economic Development for 2019, its annual debt service is \$8,451,550. Thus, the City's required lease payment is 1.05 times that amount or \$8,874,128.

According to the City's rate study, under pro forma present rates for the future test year (FTY) ending December 31, 2020, the City would have \$10,450,387 in funds available to pay the lease payment, which is \$1.5 million more than required. Thus, without any rate increase, the City would be able to meet all of its expenses, pay the required amount to the Authority under the lease, and have additional cash flow of at least \$1.5 million.

OCA St. 1 at 24-25 (footnotes omitted). Even assuming some of Bethlehem's projections are accurate, OCA Witness Stacy Sherwood concluded that Bethlehem had a revenue deficiency of \$443,666 under traditional ratemaking, but that number remains speculative given the uncertainty of the projections and future operations. OCA St. 2S at 1-2; OCA Sch. SLS-1S at 2. Simply put, in the near term, Bethlehem's rates are adequate at this time. After the COVID-19 pandemic has passed, Bethlehem can file again for rate increases when the Company's financial projections will be founded on more stable, and thus predictable, economic conditions. Under normal circumstances, it would be reasonable for the Commission to approve an increase in Bethlehem's jurisdictional rates. OCA St. 1 at 25-26. Mr. Rubin explained that these are not normal conditions:

Businesses, small and large, throughout Pennsylvania are facing the very real prospect of not being able to pay their out-of-pocket expenses and laying off most or all of their workforce. They are facing negative returns on their investments. That is the real-world competitive market that regulation is trying to mirror.

OCA St. 1 at 26.

The current and projected ratepayer affordability of rates gives strong weight to the conclusion that granting Bethlehem's rate requests in this proceeding would unnecessarily harm ratepayers and not result in just and reasonable rates. If, however, the economic situation worsens significantly and cash flow becomes a concern for Bethlehem, the City could preserve cash by deferring for several months certain construction projects, such as growth-related projects or longer-term system rehabilitation activities, which are not needed to ensure the current provision of safe and reliable service to existing customers. OCA St. 1 at 30. In addition, Mr. Rubin explained that other large utilities have been taking advantage of the very low cost of debt and issuing 10-year notes or bonds at what are historically low interest rates. Id. He explained that low-cost, long-term financing can help provide cash flow needed to keep existing rates in effect throughout the pandemic without suffering significant economic harm.⁴ Id. Given the vast uncertainty and lack of support for Bethlehem's claimed costs, the OCA submits that rate increases at this time are not necessary or reasonable.

B. Case Law From Similar Economic Circumstances Provides Precedent For the Commission to Deny A Rate Increase Due to Extreme Customer Hardships.

A rejection of Bethlehem's rate increases due to the economic hardships and uncertainties accompanying the COVID-19 pandemic as well as the uncertainties surrounding the FTY

⁴ Mr. Rubin noted that he had seen recent headlines for a gas utility issuing debt at a 2.2% interest rate and a utility in the southern U.S. issuing debt at 1.75%. OCA St. 1 at 30, n. 38 and 39. Bethlehem's weighted cost of debt is in the range of 4.5%. Id. at n. 40; Bethlehem Exh. 3-A, p. 70.

projections, while not common by any means, would be a legally viable and not an unprecedented ratemaking solution during this abnormal time. OCA St. 1 at 22-24. When it comes to ratemaking, “[a]ll that is protected against, in a constitutional sense, is that the rates fixed by the Commission be higher than a confiscatory level.” Federal Power Comm’n v. Texaco, Inc., 417 U.S. 380, 392-92 (1974) (citing FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 585 (1942)). On the topic of rate of return, the U.S. Supreme Court has held:

[t]he 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.

Bluefield Water Works & Improvement Co. v. Public Serv. Comm’n, 262 U.S. 679, 693 (1923).

The Court has also held that, “whether a particular rate is ‘unjust’ or ‘unreasonable’ will depend to some extent on what is a fair rate of return given the risks under a particular rate setting, and on the amount of capital upon which the investors are entitled to earn on that return.” Duquesne Light Co. v. Barasch, 488 U.S. 299, 310 (1989) (Duquesne).

It is clear that the Commission is required to balance the consumer and utility’s interests. “The rate-making process . . . , *i.e.*, the fixing of ‘just and reasonable’ rates, involves a balancing of the investor and consumer interests . . . and does not insure that the business shall produce revenues.” Federal Power Comm’n v. Hope Natural Gas Co., 320 U.S. 591 (1944) (Hope). “The owners of a property dedicated to the public service cannot be said to suffer injury if a rate is fixed for an experimental period, which probably will produce a fair return on the present fair value of their property.” Market St. R. Co. v. Railroad Comm’n of Ca., 324 U.S. 548 (1945).

During the last large-scale nationwide pandemic, the Influenza of 1918, the Supreme Judicial Court of Massachusetts upheld a public service commission ratemaking order that was not

expected to permit the utility to earn a profit due to the abnormal times. Donham v. Public Serv. Comm'n, 232 Mass. 309, 317, 122 N.E. 397, 401 (1919) (Donham). The court's stated:

To be just and reasonable, within the meaning of the constitutional guaranty, the rates must be prescribed with reasonable regard for the cost to the carrier of the service rendered and for the value of the property employed therein; but this does not mean that regard is to be had only for the interests of the carrier, or that the rates must necessarily be such as to render its business profitable, for reasonable regard must also be had for the value of the service to the public. And where the cost to the carrier is not kept within reasonable limits, or where for any reasons its business cannot reasonably be so conducted as to render it profitable the misfortune must fall upon the carrier, as would be the case if it were engaged in any other line of business.

Id., 232 Mass at 317, 122 N.E. at 401 (emphases added; quoting from Missouri, Kansas & Topeka Railway Co. v. Interstate Commerce Comm'n, 164 Fed. 645 (1908)). Although the utility was facing hardships of its own, the court noted that it did not deprive the commission of its regulatory responsibility to “exercise its judgment for the protection of the public interests when it does not reduce substantially the revenue proposed to be exacted from the public by the owners of the public utility.” Donham, 232 Mass. at 326, 122 N.E. at 405. In addition, the court emphasized that the rates were “likely to be impermanent and experimental.” Id. In reference to this case, Mr. Rubin testified that:

[t]he idea that ratemaking must adapt to extraordinary conditions is neither new nor novel. A century ago during another serious pandemic, regulators adapted, took actions that provided relief to the public, and did not inflict long-term harm on the utility.

OCA St. 1 at 24.

Here in Pennsylvania during the Great Depression, the Public Service Commission (PSC) called on utilities to reduce rates so that they would earn no more than 6% on their rate base. Re Utility Rates During Economic Emergency, 3 P.U.R. NS 123 (Pa. PSC 1934) (attached as

Appendix E); In recognition that societal economic conditions should affect utility ratemaking, the PSC stated, “this Commission should take cognizance of the present economic conditions prevailing in the United States and as such economic conditions particularly affect the welfare of the people of this commonwealth.” Id. at 124. Similar to the result of the case in Massachusetts during the Influenza and the PSC’s action in response to the Great Depression, the OCA’s proposal to deny Bethlehem’s proposed increases in rates reflects both a viable and reasonable solution to the abnormal and unexpected set of circumstances under which the Commission is currently tasked with developing just and reasonable rates for a population of ratepayers financially distressed by a nationwide pandemic.

Denying Bethlehem’s requested rate increase due to the current societal economic conditions would be an appropriate and valid exercise of the Commission’s authority in this proceeding. Section 315(a) of the Public Utility Code places the burden of proving the reasonableness of a proposed rate on the utility. 66 Pa. C.S. § 315(a). The evidence necessary to meet that burden must be substantial. Lower Frederick Twp. Water Co. v. Pa. P.U.C., 48 Pa. Commw. 222, 409 A.2d 505, 507 (Pa. Cmwlth. 1980). In this case, Bethlehem has not proven that rate increases would be just and reasonable at this time.

The Commission would be fully within its authority to reject Bethlehem’s rate increase requests due to the current economic conditions because (1) rates would not be confiscatory as it is projected that the Company would continue to earn a profit in the near future and (2) simply put, it is only the opportunity to earn a fair return that a utility is entitled to. As the U.S. Supreme Court held in Hope, the “lowest reasonable rate” is one that is not confiscatory in the constitutional sense. Hope, 320 U.S. at 586. The OCA’s calculations demonstrate that, at Bethlehem’s current rates, it will still earn a 7.70% and 2.84% overall rate of return for water and wastewater, respectively. See

OCA App. A.1, Table I Total Water and Table I Total Wastewater. While this may not be a desirable rate of return for the Company, it is sufficient compensation in the constitutional sense and fully within the Commission’s authority.

C. The Principles of Public Utility Regulation Support the OCA’s Position That Increasing Rates During This Financially Challenging Time For Ratepayers Would Not Lead to Just and Reasonable Rates.

The ALJ agreed with the City’s position that the Commission does not have the authority to deny a rate increase based on the COVID-19 pandemic. R.D. at 20. To understand how just and reasonable rates are affected by a major economic event such as the COVID-19 pandemic, Mr. Rubin presented a valuable review of the regulated-monopoly framework of public utilities in this country and the determination of just and reasonable rates. OCA St. 1 at 4-9. Mr. Rubin testified that, “At its core, regulation is designed to protect utility consumers from what otherwise would be the unfettered power of a monopoly to set prices and the conditions of service.” OCA St. 1 at 5. Mr. Rubin explained that utility regulators should attempt to set rates within the “zone of reasonableness” which captures the interests of the ratepayers, the utility’s investors, officers and employees, and local governments whose residents are served by the utility. Id. at 6. Mr. Rubin explained that, under normal conditions, there is often an area of overlap of interests between utility customers and the utility, including its investors. Id.; Fig. 1. Within that area, regulators are provided a range of rates that utility customers would be willing and able to pay for service and investors would consider a reasonable return on their investment. Id. at 7.

However, Mr. Rubin testified, under certain conditions the two ranges may not overlap—creating no “zone of reasonableness” at all. Id. at 7. When this occurs, regulators are tasked with setting rates outside of one of the ranges, or both. Id. Under the above-described economic conditions faced by Bethlehem’s customers brought on by the pandemic, the range of rates the

customers would be willing and able to pay for service has shifted away from the range of rates which would, in the eyes of the utility, provide a reasonable return on investment.

Given the description of significant income loss experienced in Bethlehem's service territory discussed in Section III.B above, the OCA submits that keeping rates constant is a reasonable balance and completely lawful exercise of Commission authority. While this is not the profit Bethlehem would prefer, there is no reasonable basis for the City to have a higher return at this time. The OCA emphasizes that this is a temporary measure until future conditions are known.

As Mr. Rubin explained, regulation must always consider current economic conditions.

Mr. Rubin testified:

If regulation is supposed to be a substitute for market forces, then we must recognize that, except for those commodities experiencing significant imbalances of supply and demand due to the pandemic, competitive businesses cannot sustainably raise prices when their customers' incomes have decreased significantly. Simply stated, what may have been a "just and reasonable" rate earlier this year may be unreasonable today.

OCA St. 1 at 10 (emphasis added). Mr. Rubin also stated:

Importantly, though, regulation is not designed to insulate the utility or its investors from normal market forces, technological improvements, or general economic conditions. If market forces (such as technological change) result in significant reductions in the demand for service, then the utility may not be able to recover its costs. That is not a failure of regulation, but a natural evolution of the market -- businesses fail if they cannot keep up with changes in consumers' preferences or respond to technological innovations.

Similarly, if economic conditions change such that rates become unaffordable to many customers, rates may need to be reduced in order to remain "just and reasonable from the perspective of customers.

Id. at 5 (emphasis added).

D. The Projections in Bethlehem's Early Pandemic Filing Cannot Be Given Any Credence in Determining Future Rates in a Vastly Different Economic Environment.

The OCA submits that the lack of reliability of Bethlehem's FTY projections in its filing submitted a few months after the pandemic reached its service territory is another basis for Bethlehem's rate increases to be rejected. Mr. Rubin testified:

The City filed this case on July 31, 2020, when its service area -- indeed the entire world -- was being devastated with the worst pandemic in a century. While I understand that it takes months to prepare a rate filing, and that Bethlehem may have prepared this case assuming "business as usual," there was nothing that compelled it to actually file the case. To state the obvious, life and business in the City's service territory are now anything but normal.

In particular, I am very concerned about the impact that significant rate increases would have on Bethlehem's customers at this time. To be blunt, this is not the time to impose higher costs on either people or businesses.

OCA St. 1 at 12. The OCA submits that the changes and uncertainties in FTY assumptions, including interest rates, construction expenditures, and other elements that enter into the ratemaking process, could not be accurately projected in the months leading up to Bethlehem's July filing or relied upon to make reasonable findings or conclusions in this proceeding.

Given the devastating financial impacts on customers and the uncertain economic future of the next few years and the unreliability of the projections, Mr. Rubin concluded:

Faced with this unprecedented public health and economic crisis, I respectfully submit that the Commission cannot treat this case as "business as usual." Almost no other business in Lehigh and Northampton Counties is conducting business as usual; residential consumers are using the City's services differently than they do during normal circumstances (few if any people are usually at home 24 hours per day, 7 days a week, preparing every meal at home, and so on).

Respectfully, the Commission cannot focus on Bethlehem's historic costs, or on cost projections prepared before the pandemic, and assume that the resulting rates will be "just and reasonable." The Commission must focus on what rates are reasonable for consumers to pay under these extraordinary conditions.

Id. at 19. This rate increase was requested at a time of extreme uncertainty not only in terms of the economy at large, but also in terms of projected customer usage, projected expenses, projected capital expenditures, and revenue required to provide service.

Thus, rejecting Bethlehem's requested rate increase at this time is an appropriate result during the COVID-19 pandemic and an appropriate response to the market imbalance caused by Bethlehem's customers' reduced ability to pay utility bills. As explained above, this can be done and Bethlehem would still have sufficient income.

OCA presented substantial evidence establishing the economic impact on ratepayers as well as the basis for the Commission to determine that no increase in rates at this time would result in just and reasonable rates. See OCA St. 1 and 1S. After reflecting OCA's accounting adjustments, the effect of Mr. Rubin's recommendation that no increase be granted unless an increase were necessary for the City to meet its financial obligations under the lease with the Bethlehem Authority, the effect would be a return on equity of 6.45% and an overall return of 5.65%. OCA Hearing Exh. # 1; OCA St. 1S at 5; OCA St. 2S at 2. Mr. Rubin concluded, "In light of the devastating effects of the pandemic on the City's customers, I consider this to be a just and reasonable result." OCA St. 1S at 5. The OCA therefore submits that the Commission should not accept Bethlehem's projections and should deny Bethlehem's requested rate increase.

E. The ALJ's Determination Is Not Consistent With The Record.

The ALJ agreed with Bethlehem's argument that the Commission did not have authority to deny the rate increase in this proceeding, even if the denial results in a just and reasonable return. Bethlehem argued that the Commission "has no authority under the Code to deny the

City’s rate increase as proposed by the OCA.”⁵ City M.B. at 10. The City’s position, adopted by the ALJ, ignores a fundamental premise of ratemaking. The filing of a rate increase does not guarantee that the utility will receive any rate increase at the end of the seven-month suspension period. OCA R.B. at 3. The apparent presumption that filing a rate increase guarantees that a rate increase will be approved is without merit. The evidence in each case will determine what increase, if any, is approved at the end of the suspension period. *Id.* The OCA has explained the legal framework in which the Commission addresses a rate increase request. OCA M.B. at 18–21; OCA St. 1 at 22–24. Bethlehem’s argument that the Commission is required to approve a rate increase at the end of the seven-month suspension period is inconsistent with these basic principles. When it comes to ratemaking, “[a]ll that is protected against, in a constitutional sense, is that the rates fixed by the Commission be higher than a confiscatory level.” Federal Power Comm’n v. Texaco, Inc., 417 U.S. 380, 392–92 (1974) (citing FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 585 (1942)). OCA R.B. at 4. On the topic of rate of return, the U.S. Supreme Court has held:

[t]he 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.

⁵ Bethlehem argued that the Commission addressed its statutory ratemaking authority in a recent Philadelphia Gas Works case. City M.B. at 11. In Pa. P.U.C. v. Philadelphia Gas Works, Docket No. R-2020-3017206 (Opinion and Order Nov. 19, 2020) (PGW), the Commission ruled on whether a rate increase was required to go into effect at the end of the seven-month suspension period in light of the Governor’s Proclamation of a Disaster Emergency. PGW, slip op. at 12–13. Bethlehem’s reliance on this decision is incorrect. OCA R.B. at 3. The Commission’s discussion in PGW is focused on the **timing** of the effective date of a rate increase in the context of the Governor’s Proclamation, but does not guarantee that **any** rate increase will be approved at the end of the seven-month suspension period. *Id.*

Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n, 262 U.S. 679, 693 (1923).

The Court has also held that, “whether a particular rate is ‘unjust’ or ‘unreasonable’ will depend to some extent on what is a fair rate of return given the risks under a particular rate setting, and on the amount of capital upon which the investors are entitled to earn on that return.” Duquesne Light Co. v. Barasch, 488 U.S. 299, 310 (1989) (Duquesne). OCA M.B. at 18–19. The OCA’s position that no increase should be granted to the City at this time is consistent with the seminal cases on rate of return.

It is clear that the Commission is required to balance the consumer and utility’s interests. “The rate-making process..., *i.e.*, the fixing of ‘just and reasonable’ rates, involves a balancing of the investor and consumer interests . . . and does not insure that the business shall produce revenues.” Federal Power Comm’n v. Hope Natural Gas Co., 320 U.S. 591 (1944) (Hope). “The owners of a property dedicated to the public service cannot be said to suffer injury if a rate is fixed for an experimental period, which probably will produce a fair return on the present fair value of their property.” Market St. R. Co. v. Railroad Comm’n of Ca., 324 U.S. 548 (1945). OCA M.B. at 19; OCA R.B. at 4-5.

During the last large-scale nationwide pandemic, the Influenza of 1918, the Supreme Judicial Court of Massachusetts upheld a public service commission ratemaking order that was not expected to permit the utility to earn a profit due to the abnormal times. Donham v. Public Serv. Comm’n, 232 Mass. 309, 317, 122 N.E. 397, 401 (1919) (Donham). The court stated:

To be just and reasonable, within the meaning of the constitutional guaranty, the rates must be prescribed with reasonable regard for the cost to the carrier of the service rendered and for the value of the property employed therein; but this does not mean that regard is to be had only for the interests of the carrier, or that the rates must necessarily be such as to render its business profitable, for reasonable regard must also be had for the value of the service to the public. And where the cost to the carrier is not kept within reasonable limits, or where for any reasons its business cannot reasonably be so conducted as to render it profitable the misfortune must

fall upon the carrier, as would be the case if it were engaged in any other line of business.

Id., (emphases added) (quoting Missouri, Kansas & Topeka Railway Co. v. Interstate Commerce Comm'n, 164 Fed. 645 (1908)). Although the utility was facing hardships of its own, the court noted that it did not deprive the commission of its regulatory responsibility to “exercise its judgment for the protection of the public interests when it does not reduce substantially the revenue proposed to be exacted from the public by the owners of the public utility.” Donham, 232 Mass. at 326, 122 N.E. at 405. In addition, the court emphasized that the rates were “likely to be impermanent and experimental.” Id. In reference to this case, Mr. Rubin testified that:

[t]he idea that ratemaking must adapt to extraordinary conditions is neither new nor novel. A century ago during another serious pandemic, regulators adapted, took actions that provided relief to the public, and did not inflict long-term harm on the utility.

OCA St. 1 at 24.

Here in Pennsylvania during the Great Depression, the Public Service Commission (PSC) called on utilities to reduce rates so that they would earn no more than 6% on their rate base. Re Utility Rates During Economic Emergency, 3 P.U.R. NS 123 (Pa. PSC 1934) (attached to OCA’s Main Brief as Appendix E). In recognition that societal economic conditions should affect utility ratemaking, the PSC stated, “this Commission should take cognizance of the present economic conditions prevailing in the United States and as such economic conditions particularly affect the welfare of the people of this commonwealth.” Id. at 124.

Similar to the result of the case in Massachusetts during the Influenza and the PSC’s action in response to the Great Depression, the OCA’s proposal to deny Bethlehem’s proposed increase in rates reflects both a viable and reasonable solution to the abnormal and unexpected set of

circumstances under which the Commission is currently tasked with developing just and reasonable rates for a population of ratepayers financially distressed by a nationwide pandemic. OCA R.B. at 6. It is clear from the case law that denying Bethlehem's requested rate increase due to the current societal economic conditions would be an appropriate and valid exercise of the Commission's authority in this proceeding. Id. Moreover, the OCA presented substantial, credible and extensive evidence that supports the assertion that a denial of the rate increase, as discussed below, results in a reasonable return at this time.

The OCA specifically addressed Bethlehem's need for a rate increase and is not recommending that Bethlehem should have rates that are inadequate to ensure the provision of safe and reliable service to its customers. As described in the OCA's testimony, Bethlehem could continue operations, recover all of its expenses, and have additional money left over. OCA St. 1 at 26. In these extraordinary times, denying Bethlehem's rate increase is a reasonable—and temporary—outcome until fewer customers are suffering financially and the future is more ascertainable for ratemaking.

OCA's primary position, no increase in rates, would result in a reasonable return in these circumstances. OCA R.B. at 7; OCA Hearing Exh. #1. Specifically, the costs rates and overall return, under the no increase scenario would be:

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

OCA Hearing Exh. # 1. While perhaps not as much profit as Bethlehem would like⁶, an overall return of 5.65% is more than adequate in these times. See OCA App. A.1, Table IA; OCA Hearing Exh. #1. The overall return of 5.65% resulting if the rate increase is denied, is only 92 basis points lower than the OCA’s financial expert recommended (6.57%) under the “business as usual” approach. See OCA St. 3 at 6; OCA R.B. at 8.⁷ As OCA Witness Rubin stated: “Most Pennsylvania businesses would be absolutely thrilled if they could pay all their bills, make all of their debt payments, and still have enough money left over. When compared to the economic devastation gripping its service territory, I cannot find anything just or reasonable about increasing Bethlehem’s water rates at this time.” OCA St. 1 at 26.

As Mr. Rubin further explained, when the Company’s case is properly adjusted to remove improper expenses and capital costs, the Company’s financial situation is reasonable. Mr. Rubin testified:

⁶ 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%. City St. 2, Sch. 1

⁷ As explained by OCA expert witness Garrett, the market-derived cost of equity is only the starting point for fair rate of return. See OCA St. 3 at 12–13.

Further, I am advised that after reflecting the OCA's accounting adjustments using a rate base - rate of return approach, the effect of my recommendation would be that Bethlehem would recover all of its allowable operating expenses, its full hypothetical cost of debt, and a return on equity of approximately 6.45%. In light of the devastating effects of the pandemic on the City's customers, I consider this to be a just and reasonable result.

OCA St. 1S at 5. The OCA submits that the Commission should exercise its authority to deny Bethlehem's rate increase request for the reasons set forth above and in Mr. Rubin's testimony.

In summary, there is substantial evidentiary support in the record showing that denying Bethlehem's rate increase is consistent with the Commission's authority to set just and reasonable rates. Bethlehem could continue operations, recover all of its expenses, and earn a profit with no revenue increase. In these extraordinary times, denying Bethlehem's rate increase is a reasonable—and temporary—outcome until fewer customers are suffering financially and the future is more ascertainable for ratemaking.

F. Even Under a Business As Usual Ratemaking Approach, the Recommended Increase Is Unreasonable.

The OCA submits that, due to the pandemic, no rate increase should be permitted at this time. Maintaining current rates is a reasonable—and temporary—outcome until fewer customers are suffering financially and the future is more ascertainable for ratemaking. However, that is not the only basis for rejecting the Partial Settlement. The evidence of record does not support a \$689,932 increase. The OCA has presented testimony on revenue requirement, including cost of capital that establishes the revenue increase should be no more than \$443,666.⁸ See OCA M.B., App. A.2, Tables I-VI. Consistent with the Bethlehem filing, Ms. Sherwood used an HTY “that corresponds to the year ended December 31, 2019 with pro forma adjustments and a . . . FTY . . . that corresponds to the year ended December 31, 2020 as the basis for determining Bethlehem’s revenue requirement for its PUC-jurisdictional customers and the revenue increase necessary to recover that requirement.” OCA St. 2 at 2. In the case that the ALJ’s recommendation of the adoption of the Partial Settlement is rejected, the ALJ recommended adopting some of the OCA’s adjustments which support the OCA’s \$443,666 revenue requirement. See R.D. However, if the Partial Settlement is rejected, the ALJ recommended denying some of the OCA’s adjustments, which the OCA addresses in the following sections.

Exception #2: The Recommended Decision’s Determination Regarding the Water Treatment Emergency Generator Is Not Supported by the Evidentiary Record. R.D. at 23-25; OCA M.B. at 26-28; OCA R.B. at 8.

The City claimed that the Water Treatment Plant (WTP) Emergency Generator should be included in the plant in service figure, arguing that it is a necessary capital item and that scheduling

⁸The revenue requirement shown in Appendix A.2, Table 1 is \$446,173, or \$2,507 more than is shown in Ms. Sherwood’s Surrebuttal Schedules. The difference is that the Surrebuttal schedules round to two places after the decimal and the Tables go to eight places after the decimal.

the generator for operation, which was delayed because of the COVID-19 pandemic, would take less than six weeks as of December 15, 2020. City M.B. at 17. However, the OCA submits that the WTP Emergency Generator should not be included in the plant in service figure because it was unclear from City witness Spanos' rebuttal testimony when the project would be completed. OCA M.B. at 26-28. Further, the OCA established that it is well-settled law that the utility has the 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 R.B. at 18 (citing Pa. P.U.C. v. Pennsylvania-American Water Company, 97 PUR4th 469 (1988)). The City has not shown that the project will be used and useful in the test year selected by the City. The OCA also argued that it would be unreasonable to include this project in the test year based on the City's speculation as to when it will be complete and in service, considering that the reason it was delayed, COVID-19, continues to cast uncertainty over different aspects of everyday life.

The Recommended Decision adopts the City's position that the generator will be in service by January 2021 and that it is within the Commission's 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." R.D. at 25 (quoting Pa. Pub. Util. Comm'n v. Pa.-Am. Water Co., 97 PUR4th 469 (1988)). However, as noted in the OCA's Reply Brief, in Pennsylvania-American Water Company, "certain vital components" of the disputed project were going to be completed and in service as of the end of the future test year. OCA R.B. at 18 (citing Pennsylvania-American Water Company, 97 PUR4th at 469). In the present case, no "vital components" of the disputed project were completed and in service as of the end of the future test year. Further, as argued in the OCA's Main Brief, while the City's rationale for including this project is that it "would have been completed had the unforeseen circumstances in 2020 not occurred," "the unforeseen circumstances

that delayed the project . . . in 2020 are still an issue heading into 2021 and could continue to delay the completion” of this project. OCA M.B. at 26–28; OCA St. 2S at 8–10. There is no guarantee that this project will be completed by January and thus, considering the uncertainty that the COVID-19 pandemic continues to cast over different aspects of everyday life, it would be unreasonable to include the project in the test year based on the City’s speculation as to when it will be complete and in service. Accordingly, the OCA further recommends that the related depreciation expense adjustment for the emergency generator be accepted.

Exception #3: The Recommended Decision’s Determination Regarding the Union Contract Should Be Rejected. R.D. at 34-36; OCA M.B. at 32-34; OCA R.B. at 23.

The City adjusted the salaries and wages for Water Supply and Treatment and Water Maintenance by a collective \$378,527 and made a corresponding adjustment for Social Security. OCA R.B. at 22. The City proposed pro forma adjustments to the HTY for 2019 and to the FTY for 2020. OCA R.B. at 22. The City included an increase in union contract wages in the FTY (2020) that was not slated to go into effect until January 1, 2021. OCA R.B. at 22.

The OCA argued that “[t]he expense falls outside the test period as the raises will not go into effect until January 1, 2021[, which] violates the matching principal which requires revenues and expenses to be from the same period.” OCA M.B. at 33. The OCA also argued 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. 32–34 (citing OCA St. 2S at 4). The OCA further argued that the City “could have chosen a fiscal year for the FTY period or utilized a fully projected FTY to include the Salaries and Wages Expense and the associated Social Security Expense increases that are anticipated to occur on January 1, 2021,” but chose not to.

OCA M.B. 32–34 (citing OCA St. 2S at 4). The OCA also cited economic concerns over the effects of the COVID-19 pandemic. OCA R.B. at 23.

The ALJ recommends that an exception be made to the matching principle in this case arguing 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.” R.D. at 36. The OCA respectfully disagrees with this recommendation. The Recommended Decision fails to address why the City’s decision to not choose a fiscal year for the FTY period or utilize a fully projected FTY to include the Salaries and Wages Expense and the associated Social Security Expense increases that are anticipated to occur on January 1, 2021 is without consequence. Further, while the Recommended Decision cites recommending a business-as-usual approach as the reason for not taking the COVID-19 pandemic into consideration when deciding whether to grant the exception, denying the exception and a business-as-usual approach are not mutually exclusive. The City’s customers are facing real financial hardship because of this global pandemic and thus, the OCA reiterated its recommendation that if the Commission finds a rate increase necessary at this time, the Commission should not apply the exception to the matching principle given the negative effects that the additional cost will have on ratepayers. See OCA St. 1 at 26. The OCA further recommends that the corresponding social security expense should be adjusted accordingly.

Exception #4: The Recommended Decision’s Determination Regarding the Rate Case Expense Is Not Supported by the Evidentiary Record. R.D. at 30-33; OCA M.B. at 40.

The City projected a \$414,560 rate case expense. OCA M.B.at 38. However, the OCA recommended a total rate case expense figure of \$259,402, which was the actual amount spent up to early December, 2020. OCA M.B. at 40; Sch. SLS-6S. The Recommended Decision recommends accepting the City’s projected rate case expense of \$414,560 because the OCA’s expense does not account for the expenses that the City has incurred and will incur post early

December, 2020. R.D. at 33. However, as of December, 2020, the City was nowhere near its projected expense of \$414,560. OCA St. 2S, Sch. SLS-6S. Further, as the present matter approaches its resolution, the City did not provide any evidence to support a projected incurred expense of \$155,158 from December, 2020 until the resolution of the matter. The City had the opportunity to update its projected rate case expense to a more accurate amount reflecting the expenses already incurred, but has not done so. Thus, the OCA respectfully disagrees with the recommendation that the City's projected rate case expense of \$414,560.

Exception #5: The ALJ Erred By Recommending The City's Proposed Rate of Return. R.D. at 46-51; OCA M.B. at 42-61; OCA R.B at 28-36

The ALJ found that “the City’s proposed rate of return⁹ to be reasonable and in the public interest” and recommended that it be approved by the Commission “if the Commission determines that a rate of return is necessary in calculating a revenue requirement.” R.D. at 51. In reaching that recommendation, the ALJ rejected OCA witness Garrett’s long-term growth rate and as a result did not find Mr. Garrett’s Discounted Cash Flow (DCF) calculation “appropriate”. R.D. at 49. As discussed below, the growth rate used in Mr. Garrett’s DCF calculation is reasonable and produces a reasonable DCF result. See OCA M.B. at 55-57; OCA R.B. at 34-35. In addition, the City’s proposed rate of return is overstated and should not be used in determining the revenue requirement in this case. OCA M.B. at 42-61; OCA R.B. at 28-36. The OCA’s recommended “business as usual” cost of equity of 8.5% (7.31% after the tax factor adjustment) and overall

⁹ The ALJ does not explain whether he is recommending the City’s proposed overall rate of return that results after the tax factor adjustment. For purposes of this Exception, the OCA is treating the proposed rate of return recommended by the ALJ as the tax factor adjusted overall return of 7.42% because there is no discussion in the Recommended Decision that the ALJ has recommended overturning Commission determinations that the municipal return on equity should be adjusted by a tax factor adjustment. See Pa. P.U.C v. City of Dubois – Bureau of Water, Docket No. R-2016-2554150 (Order entered May 18, 2017) (City of Dubois).

return of 6.57% (after the tax factor adjustment) should be used in determining a revenue requirement if the Commission does not accept OCA’s primary position of no increase.

The City used a tax-adjusted overall return of 7.42% in calculating its proposed rate increase. City M.B. at 33, footnote 60. The City’s argument (City M.B. at 33–44) that it is entitled to a return on equity of 10.20% are without merit under a “business as usual” approach and are wholly without merit in the midst of the COVID-19 pandemic. OCA M.B. at 42–61; OCA R.B. at 28-36. As set forth in the testimony of David J. Garrett, the market-based return on equity is no more than 8.50%, (7.31% after the tax factor adjustment) resulting in an overall rate of return of 6.57%, based upon a capital structure of 48.00% debt and 52.0% common equity, under a “business as usual” approach. OCA St. 3 at 6, Fig. 1; Exh. DJG-17. As discussed *supra*, the OCA’s primary position is that no increase is necessary given the ongoing COVID-19 pandemic and its related, ongoing impact on Bethlehem’s customers and economy. The market-derived cost of equity is only the starting point for fair rate of return. See OCA St. 3 at 12–13. The OCA submits that the resulting overall rate of return of 5.65% at current rates (using the same capital structure of 52% equity and 48% debt), represents a fair rate of return that balances the interests of consumers and shareholders and would be in the public interest. See, Exc. # 1, *supra*; OCA Hearing Exh. #1; OCA M.B. App. A.1, Table I and I(A).

Under the “business as usual” approach recommended by the ALJ, the following table shows the resulting return recommended by OCA under the “business as usual” scenario:

Capital Component	Proposed Ratio	Cost Rate	14% 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 St. 3 at 6; Figure 1; Exh. DJG-17.

As explained in the OCA’s testimony and Briefs, the City’s proposed 10.2% return on equity on a capital structure that contains too high a proportion of equity should be rejected. In addition to the flaws and inconsistencies with basic financial principles contained in the City’s rate of return analysis, the City’s 10.2% return on common equity includes multiple, unsupported adders (80 basis points for Bethlehem’s small size, 20 and 10 basis points for Bethlehem’s business risks) that add 110 basis points to the City’s overall return on equity and that should be rejected. OCA St. 3 at 64–67; OCA M.B. at 59; OCA R.B. at 35. The Commission rejected a similar size adjustment and other adjustments to the return on equity in a recent municipal rate case finding that a size adjustment, along with other adjustments made by the City of DuBois’ witness, were “simply unnecessary and are contrary to the public interest.” See City of DuBois, slip op. at 105.

The Commission should similarly reject Bethlehem’s attempt to unreasonably increase its return on equity claim in this case for the reasons set forth in Mr. Garrett’s testimony. OCA St. 3 at 11, 47-49, 60-71. Adjusting the City’s return on equity to remove the 110 basis points of unsupported adders would reduce the City’s return on equity position to 9.0% (before the tax factor adjustment). At a minimum, the City’s return on equity, before the tax factor adjustment, should

be no more than 9.0%. If the unnecessary adders are removed, there is only 50 basis points separating City witness Walker's DCF result from Mr. Garrett's recommended cost of equity.

A. DCF Growth Rate

The ALJ rejected Mr. Garrett's DCF growth rate because it did "not appear appropriate". R.D. at 49. He specifically noted that, "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." Id. The City's arguments regarding Mr. Garrett's DCF growth rate are without merit and should be rejected.

The DCF model used in this case is the constant growth valuation model. OCA St. 3 at 34-46. That model assumes that the growth rate will stay at a constant rate forever. This is reasonable when used to determine the cost of equity for low-growth firms such as utilities. Id. at 34.

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). Id. The "long-term forecast for nominal U.S. GDP growth is about 4%, which includes an inflation rate of 2%." OCA St. 3 at 39. Mr. Garrett explained that the risk-free rate is sometimes used for the terminal growth rate in the DCF model because the risk-free rate "will converge on the growth rate of the economy". Id. at 40. For companies like utilities, the terminal growth rate, according to Mr. Garrett, "will likely fall between the expected rate of inflation and the expected rate of nominal GDP growth." OCA

St. 3 at 39-40. For Bethlehem, that means a terminal growth rate between 2% and 4%. Id. at 40. Mr. Garrett also explained that a qualitative analysis needs to be undertaken to determine the growth rate to be used in the model. OCA St. 3 at 41-45.

Mr. Garrett examined various qualitative determinants and maximum growth rates under basic principles of finance and economics to arrive at a terminal growth rates ranging from 1.5% to 3.9%. OCA St. 3 at 46; Exh. DJG-5. He selected the maximum growth rate of 3.9% which means “my model assumes that Bethlehem’s qualitative growth in earnings will qualitatively match the nominal growth rate of the entire U.S. economy over the long run – a charitable assumption.” Id. When that growth rate is used in the DCF model, along with the stock and dividend figures determined above, the resulting cost of equity estimate for Bethlehem is 6.1%. OCA St. 3 at 47; Exh. DJG-6.

In rebuttal, City witness Walker criticized Mr. Garrett for the long-term growth rate that Mr. Garrett used in his DCF analysis. Mr. Garrett noted that qualitatively, using the projected annual U.S. GDP as the long-term growth rate for each utility overstates the growth rate because it is unlikely that utilities’ growth rate would be higher than the GDP.¹⁰ OCA St. 3S at 4. In addition, even if a specific utility’s historical earnings growth outpaces GDP growth over some period of time, its earnings would not outpace GDP growth over the long run and it would be unreasonable to assume such growth rates to infinity, as is required in the DCF model. Id. at 4-5. Also, it is inappropriate to assume a utility’s historical earning growth would exceed GDP in the

¹⁰ As Mr. Garrett noted, by using the average U.S. GDP growth rate, there are companies that will have higher than average growth rate and those that will have lower than average growth rate. OCA St. 3S at 4. Typically, the younger, high growth firms reinvest earnings into growth opportunities rather than paying dividends, while low-growth stocks have higher dividend yields.

DCF model because they are not “qualitative” growth rates (i.e., based on a new product, or market, for example) and contribute to the circular reference problem. OCA St. 3S at 5; OCA St. 3 at 44-45, 70-71.

B. Critique Of City Witness Walker’s DCF Growth Rate

The ALJ relied on the DCF result, adopting the City’s proposed cost of equity and overall return. R.D. at 50-51. In rejecting the growth rate proposed by OCA witness Garrett, the ALJ erroneously adopted the overstated growth rate and overstated return on equity used by the City’s witness. City witness Walker’s DCF Model results are overstated because of a fundamental error in his growth rate inputs. OCA St. 3 at 47-48. First, Mr. Walker’s assumed growth rate is 9.2% which is more than two and a half times as high as the projected long-term nominal U.S. GDP growth. OCA St. 3 at 47; City St. 2 at 40-41. As Mr. Garrett explained, this violates the basic finance principal that no company can grow at a rate greater than the economy in which it operates. Id. Another flaw in City witness Walker’s growth rate determination is his reliance on analysts’ short-term quantitative growth estimates. OCA St. 3 at 47-48. Analysts at Zacks, Value Line, and Bloomberg publish estimated projections of earnings growth for utilities. OCA St. 3 at 45. The estimates are short-term growth rate projections that range from 3-10 years. Id. Mr. Walker admits that his growth rate projections are short term, 5-year estimated projections. OCA St. 3 at 48; City St. 2 at 40. Short term growth rate projections are not appropriate to use in the DCF model which requires long-term growth rates. Not only is that use in the DCF model fundamentally different than the analysts’ short-term projections, it is an unrealistic assumption. OCA St. 3 at 44-45. Mr. Garrett provided an example of why an estimated short-term growth projection, used as a long-term growth projection, is not realistic:

Mr. Walker assumes a long-term growth rate estimate of 9% for York Water Co. This means that an analyst at Value Line apparently thinks that York Water’s

earnings will quantitatively increase by 9% each year over the next several years (*i.e.*, the short-term). However, it is Mr. Walker, not the commercial analyst, who is suggesting to the Commission that York Water's earnings will more than double U.S. GDP growth each year, every year, for many decades into the future (*i.e.*, long-term growth). Again, Mr. Walker is extrapolating the analyst's conclusions well beyond what the analyst actually said. Furthermore, this assumption is simply not realistic, and it contradicts fundamental concepts of long-term growth. Many of Mr. Walker's other short-term growth rate estimates also exceed projected U.S. GDP growth.

OCA St. 3 at 48 (footnote omitted).

Using the projected annual U.S. GDP as the long-term growth rate, as used by City witness Walker, for each utility overstates the growth rate because it is unlikely that utilities' growth rate would be higher than the GDP.¹¹ OCA St. 3S at 4. In addition, even if a specific utility's historical earnings growth outpaces GDP growth over some period of time, its earnings would not outpace GDP growth over the long run and it would be unreasonable to assume such growth rates to infinity, as is required in the DCF model. *Id.* at 4–5. Also, it is inappropriate to assume a utility's historical earning growth would exceed GDP in the DCF model because they are not “qualitative” growth rates (*i.e.*, based on a new product, or market, for example) and contribute to the circular reference problem. OCA St. 3S at 5; OCA St. 3 at 44–45, 70–71.

In no event should City witness Walker's proposed 10.2% cost of equity determination be adopted as it is overstated due to violations of fundamental, widely accepted tenets in finance and valuation. The problems associated with Mr. Walker's analyses, and his unsupported adders, result in a return on equity that is more than 400 basis points above the market-based cost of equity.

¹¹ As Mr. Garrett noted, by using the average U.S. GDP growth rate, there are companies that will have higher than average growth rate and those that will have lower than average growth rate. OCA St. 3S at 4. Typically, the younger, high growth firms reinvest earnings into growth opportunities rather than paying dividends, while low-growth stocks have higher dividend yields.

Under a business as usual approach, the OCA's recommended overall return should be adopted as it uses an appropriate capital structure, a reasonable return on equity based on proper application of the DCF, and results in an appropriate cost of capital.

III. CONCLUSION

Based on the foregoing and for the reasons articulated in the OCA's Main and Reply Briefs, the OCA respectfully requests that the Commission grant the OCA's Exceptions and adopt the OCA's positions as discussed above.

Respectfully Submitted,

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