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March 2, 2021

Via Electronic Filing

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

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

Dear Secretary Chiavetta:

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

Very truly yours,

THOMAS, NIESEN & THOMAS, LLC

By

Thomas T. Niesen

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

**Before The
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

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

**REPLIES OF THE CITY OF BETHLEHEM TO THE EXCEPTIONS
OF THE OFFICE OF CONSUMER ADVOCATE**

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DATED: March 2, 2021

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. REPLIES TO OCA EXCEPTIONS	2
REPLY TO OCA EXCEPTION NO. 1 – APPROVAL OF PARTIAL SETTLEMENT	2
A. Economic Data Provides No Support for OCA’s Position	8
B. Case Law Does Not Support the OCA’s Position But, Rather, Supports the Recommended Decision	10
C. Principles of Public Utility Regulation Do Not Support the OCA’s Position But, Rather, Support the Recommended Decision	10
D. Projections in the City’s Rate Filing	10
E. The Recommended Decision and Partial Settlement Are Supported by the Evidence of Record	11
F. The Partial Settlement Is Reasonable	12
G. Conclusion	13
REPLY TO OCA EXCEPTION NO. 2 – WATER TREATMENT EMERGENCY GENERATOR	14
REPLY TO OCA EXCEPTION NO. 3 – UNION CONTRACT WAGES	15
REPLY TO OCA EXCEPTION NO. 4 – TOTAL RATE CASE EXPENSE	16
REPLY TO OCA EXCEPTION NO. 5 – RATE OF RETURN	16
A. DCF Growth Rate	18
B. OCA’s Critique of Mr. Walker’s DCF Growth Rate	19
C. Conclusion - Rate of Return	19
III. CONCLUSION	20

TABLE OF CITATIONS

<u>Cases</u>	<u>Page</u>
<i>Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia</i> , 262 U.S. 679 (1923)	4
<i>Dauphin Consol. Water Supply Co. v. Pa. P.U.C.</i> , 55 Pa. Cwlth. 624 (1980)	14
<i>Federal Power Commission v. Hope Natural Gas Co.</i> , 320 U.S. 591 (1944)	4
<i>Pa. P.U.C. v. City of Bethlehem (Water)</i> , 160 PUR 4 th 375 (Pa. P.U.C. 1995)	15
<i>Pa. P.U.C., et al. v. Columbia Gas of Pennsylvania</i> , Docket No. R-2020-3018835, Opinion and Order entered February 19, 2021	4, 7, 8, 10, 11
<i>Pa. P.U.C. v. Keystone Water Company</i> , 58 Pa. P.U.C. 437 (1984)	16
<i>Pa. P.U.C. v. Pennsylvania-American Water Company</i> , Docket Nos. R-2020-3019369 and R-2020-3019371, Opinion and Order entered February 25, 2021	2, 10, 12, 13
<i>Pa. P.U.C. v. Pennsylvania-American Water Company</i> , 68 Pa. P.U.C. 343 (1988)	14
<i>Pa. P.U.C., et al. v. Philadelphia Gas Works</i> , Docket No. R-2020-3017206, Opinion and Order entered November 19, 2020	2, 8, 10, 11
<i>Pa. P.U.C., et al. v. UGI</i> , Docket No. R-2019-30151623, Opinion and Order entered October 8, 2020	4, 10
 <u>Statutes and Regulations, Texts & Codes</u>	
52 Pa. Code § 5.535	2

I. INTRODUCTION

This proceeding concerns the City of Bethlehem – Water Department’s (“City”) 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.

By Recommended Decision dated February 11, 2021, Administrative Law Judge Haas recommended that the Public Utility Commission (“Commission”) approve, without modification, a Joint Petition for Approval of Partial Settlement of Rate Investigation (“Joint Petition” or “Partial Settlement”) submitted by the City and the Commission’s Bureau of Investigation and Enforcement (“I&E”).

The Joint Petition provides for a settlement increase of \$689,932, in lieu of the originally proposed increase of \$908,421, in annual revenue for Outside City Service. The City supports the Recommended Decision and Judge Haas’ recommended approval of the Partial Settlement.

While recommending approval of the Partial Settlement, Judge Haas also addressed the ratemaking adjustments proposed by the Office of Consumer Advocate (“OCA”) and the Office of Small Business Advocate (“OSBA”) but did so *only* in the event that the Commission wants to look past the Joint Petition and consider the adjustments proposed by OCA and OSBA.¹

¹ See Recommended Decision at 1. Thus, and in other words, if the Commission adopts the Recommended Decision and approves the Joint Petition, without modification, which the City submits it is reasonable and appropriate that the Commission do, further discussion of the ratemaking adjustments proposed by OCA and OSBA is not necessary. The City filed Exceptions to Judge Haas’ contingent ratemaking recommendations on February 24, 2021 to be considered only in the event the Commission determines that proposed adjustments to the City’s ratemaking claims are to be reviewed.

On February 24, 2021, OCA filed Exceptions in opposition to the Recommended Decision.² The City submits these Replies to the OCA Exceptions.³

II. REPLIES TO OCA EXCEPTIONS

REPLY TO OCA EXCEPTION NO. 1 - APPROVAL OF PARTIAL SETTLEMENT

Recommended Decision, Section V.B.2, City Main Brief, Section V.B.1, and Reply Brief, Section V.A.2.

OCA contends that Judge Haas erred by approving, without modification, the Partial Settlement submitted to the Commission by the City and I&E. The Commission encourages settlements and has approved partial settlements in the recently concluded PGW⁴ and PAWC⁵ rate proceedings. The City submits that the Commission should also approve the Partial Settlement in this proceeding.

The approval of the partial settlement in *PAWC* is noteworthy as OCA was not a participant in the partial settlement there just as it is not a participant in the partial settlement here. The Commission recognized the public benefit of settlement in *PAWC* and approved the partial settlement there noting as follows:⁶

While we acknowledge the rate increase amount was achieved under the terms of a “black box” Settlement, which does not necessarily attribute specific factors relied upon in the specified rate increase, we expressly find that the substantial evidence of the record supports the rate increase agreed upon under the terms of the Settlement. The stipulated rate increase is approximately 50% of PAWC’s original request, for which PAWC submitted supporting data and direct

² I&E and OSBA, the other parties to the proceeding, did not file Exceptions.

³ Pursuant to 52 Pa. Code Section 5.535, the City will incorporate into its Replies to Exceptions, by reference and citation, relevant pages of its previously filed Main and Reply Briefs.

⁴ *Pa. P.U.C., et al. v. Philadelphia Gas Works*, Docket No. R-2020-3017206, Opinion and Order entered November 19, 2020 (“*PGW*”).

⁵ *Pa. P.U.C. v. Pennsylvania-American Water Company*, Docket Nos. R-2020-3019369 and R-2020-3019371, Opinion and Order entered February 25, 2021 (“*PAWC*”).

⁶ *PAWC*, mimeo at 36-38

and rebuttal testimony to substantiate its request. We are further persuaded by I&E's endorsement of the Settlement rates, based upon I&E's thorough analysis of PAWC's ratemaking claims in its base rate filings, which included, *inter alia*, its operating and maintenance expenses, debt service coverage ratio, and rate structure and related information obtained through the discovery process to determine the amount of revenue PAWC needs to provide safe, effective, and reliable service to its customers. See I&E Statement in Support 4-19.

* * *

Viewed in its entirety, the Joint Settlement fairly and equitably resolves the issues impacting residential consumers, business customers, and the public interest at large and represents a fair balance of the interests of PAWC and its customers. We note that the Joint Settlement was non-unanimous, and therefore its provisions remained subject to litigation of the Non-Settling Parties. However, in the same respect that a "partial settlement" of issues benefits all Parties, here, the Joint Settlement served to focus the proceedings, and narrow the contested matters before the ALJ.

Additionally, we find that the Joint Settlement will result in significant savings of time and expenses for all Parties involved by reducing or avoiding the necessity of further administrative proceedings, as well as reducing or avoiding the need for possible appellate court proceedings, thereby conserving precious administrative resources. Further, the Joint Settlement provides regulatory certainty with respect to the disposition of issues which benefits all Parties. For the reasons stated herein and in the Joint Petitioners' Statements in Support, we concur with the ALJ's conclusion that the Joint Settlement is supported by substantial evidence and is in the public interest. Accordingly, we shall adopt the ALJ's Recommended Decision that grants the Joint Petition and approves the Settlement, as modified by this Opinion and Order.

The City submits that the Commission should, likewise, adopt the Recommended Decision of Judge Haas here which, after thorough analysis concludes that the Joint Petition submitted by I&E and the City is supported by substantial evidence and in the public interest.⁷ The settlement increase is an approximate 25% reduction of the City's original request and, as emphasized by Judge Haas falls near the midpoint between the City's original request of \$908,421 and I&E's litigation position of \$474,111, as well as OCA's alternate litigation position

⁷ Rec. Dec., Sections II, III and VI.

of \$443,666, representing a reasonable compromise.⁸

OCA relies on the circumstances of the COVID pandemic in support of its opposition to the partial settlement. The Commission, however, has approved rate increases during the COVID pandemic for PGW, PAWC and UGI⁹ and also for Columbia Gas.¹⁰ *Columbia* is especially noteworthy as the Commission there, as part of a fully litigated proceeding, addressed and rejected OCA's proposal that the Commission deny rate increases due to COVID pandemic concerns noting, in part, that the continued use of traditional ratemaking methodologies during the pandemic is consistent with the setting of just and reasonable rates and the constitutional standards established in *Bluefield*¹¹ and *Hope Natural Gas*,¹² and that the pandemic does not change the continued application of these standards.¹³

Additionally, in support of its opposition to any rate increase, the OCA suggests that the City can avoid the need for additional revenue by holding off on all but the absolute necessary system improvement projects.¹⁴ The OCA made this same argument in *PAWC* where the utility had capital projects planned throughout the Commonwealth.¹⁵ The argument has absolutely no

⁸ Rec. Dec. at 16 and 26, footnote 4.

⁹ *Pa. P.U.C., et al. v. UGI*, Docket No. R-2019-3015162, Opinion and Order entered October 8, 2020 (“*UGI*”).

¹⁰ *Pa. P.U.C., et al. v. Columbia Gas of Pennsylvania*, Docket No. R-2020-3018835, Opinion and Order entered February 19, 2021 (“*Columbia*”).

¹¹ *Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923).

¹² *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

¹³ *Columbia*, mimeo at 54.

¹⁴ OCA Exceptions at 2 and 12. At page 12 of its Exceptions, OCA contends that the City could preserve cash by deferring for several months certain construction projects, such as growth-related projects or longer-term system rehabilitation activities, which are not needed to ensure the current provision of safe and reliable service and that “other large utilities” have been taking advantage of the very low cost of debt and issuing 10-year notes or bonds. The City is *not* a large utility and it has no growth-related projects or longer-term system rehabilitation projects that could be deferred. OCA does not identify any projects that the City could defer.

¹⁵ See *PAWC*, Recommended Decision of Administrative Law Judge Conrad Johnson, mimeo at 108.

relevance here in the City's much smaller service area. The City included just five capital projects in its future test year claim and later withdrew three. The remaining two projects are necessary for continued service. The City has no unnecessary projects to delay.

In still further support of its opposition to a rate increase, the OCA claims that the City's return at present rates of 5.65% (with a capital structure of 52% equity and 48% debt) is "more than adequate" and represents a fair rate of return that balances the interests of consumers and shareholders and would be in the public interest.¹⁶ A return of 5.65% is, however, *less than* the City's embedded cost of long-term debt of 5.77%. A return of 5.65%, which is less than the embedded cost of debt of 5.77%, is not "fair" in any respect but is, rather, unfair in all respects demonstrating the need for immediate rate relief.

As a municipal provider of utility services, the City is aware of the difficulties faced by its City residents and outside City neighbors as a result of the COVID pandemic and has taken steps to assist customers.¹⁷ Significantly, 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-2020-3019244:¹⁸

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.

¹⁶ OCA Exceptions at 3, 17, 24 and 25. In making this further argument, the OCA confuses the City with a for-profit utility stating at page 24 of its Exceptions that "[w]hile perhaps not as much *profit* as Bethlehem would like, an overall rate of return of 5.65% is more than adequate in these times." The City's need for rate relief is not based on a profit motive but rather on the need to maintain a sufficient surplus and adequate debt coverage levels as explained in the City Main Brief, pages 13 and 14, and Reply Brief, page 6, footnote 17.

¹⁷ Although this proceeding is jurisdictional to outside city customers only, the City will apply the rates approved here for its service to inside city customers.

¹⁸ City of Bethlehem Hearing Exhibit No. 1.

2. The City shall continue to offer payment arrangements for customers who have difficulty making payments or who otherwise have significant overdue balances. This effort predates the Covid-19 pandemic and shall continue indefinitely.
3. The City shall waive all new late payment charges for all customers until March 31, 2021.

The elected City officials, in point of fact, weighed the impact of a rate increase on water customers while in the midst of the COVID-19 pandemic. The City officials determined that the need for a rate increase to adequately operate and maintain the City’s water system was justified and required even during this challenging period. The City’s elected officials would be the most qualified to make this decision as they are close to their constituents and the situation in Lehigh and Northampton Counties.¹⁹

Significantly, and in regard to OCA’s concern with increasing rates during “this financially challenging time,” the City emphasizes that it is one of the lowest cost providers of water service in the region, *even under proposed rates*, as demonstrated in the following chart:²⁰

Water Provider	Monthly Residential Bill
<i>Bethlehem – Proposed</i>	\$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

¹⁹ City of Bethlehem St. No. 1R at 3.

²⁰ City of Bethlehem St. No. 1R at 4. The City, moreover, is the recipient of awards for outstanding performance in filtration plant operations and forest management practices. Rec. Dec. at 3-4.

The partial settlement submitted by I&E and the City would increase the quarterly bill of a typical residential customer by \$6.19 or \$2.06 per month.²¹ OCA offers no explanation how the settlement increase of \$6.19 per quarter or \$2.06 per month presents a severe economic hardship to customers or is “substantial.”²² In *Columbia*, the Commission noted that rate affordability is an important ratemaking principle in the setting of just and reasonable rates.²³ With a proposed quarterly charge of \$82.13 to the typical residential customer or \$27.38 per month, the rates proposed in the Partial Settlement must be viewed as affordable as they will continue to be among the very lowest of rates for water service in the region.

Finally, the partial settlement is supported by the evidence of record and is within a zone of reasonableness. Judge Haas addressed the evidence of record in the Recommended Decision and observed as follows regarding a “reasonable compromise” of positions:²⁴

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.

The City submits that the Commission should adopt the Recommended Decision and approve the Partial Settlement without modification as it is supported by the evidence of record

²¹ The increase as originally proposed in Supplement No. 15 would have increased the quarterly bill to a typical residential customer by \$9.61 or \$3.20 per month.

²² OCA Exceptions at 3.

²³ *Columbia*, mimeo at 51.

²⁴ Rec. Dec. at 16. Judge Haas also emphasized in his analysis of, and support for, the Partial Settlement that 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. Rec. Dec. at 28, footnote 4.

and established Commission policy encouraging settlements. The Commission, moreover, recently approved partial settlements in *PGW* and *PAWC*. OCA’s claim that Judge Haas erred should be rejected and its Exception No. 1 should be denied.

In the following sections, the City supplements the foregoing in reply to the major subheadings in OCA Exception No. 1.

A. Economic Data Provides No Support for OCA’s Position

OCA contends that economic data, particularly unemployment rates, warrant rejection of the Recommended Decision and the Partial Settlement. Economic data and statistics are not a basis for denying the City’s rate increase or rejecting the Partial Settlement. The Commission in *Columbia* explained as follows:²⁵

Furthermore, we find the justifications set forth in the Recommended Decision to completely deny the Company’s requested rate increase are not supported by substantial evidence in this record. First, with regard to the pandemic’s impact on customers, the ALJ cited unemployment rates of 8.8% to 19.2% of the working population in Columbia’s service area. R.D. at 48. While we acknowledge the gravity of these unemployment statistics, it has not been demonstrated in this case with substantial evidence or explanation that the impact of *any* rate increase on unemployed customers will lead to harm that outweighs all other valid ratemaking concerns “especially the polestar – cost of providing service.” *Lloyd*, 904 A.2d at 1020. Furthermore, taking the approach of denying any rate relief due to rising unemployment numbers among residential customers is inconsistent with our prior rate orders issued during this pandemic: specifically, the *PGW Rate Order*, the *UGI Gas Rate Order*, and the *PWSA Rate Order*, where we granted rate increases despite rising unemployment numbers across the Commonwealth due to the pandemic. No party in this proceeding has offered a rational basis to justify a different treatment under the circumstances here. Indeed, we are not persuaded by the argument that the final rates in the other cases were the results of settlement agreements, as that fact alone does not change the reality that such settlements would not be effective unless approved under our ratemaking authority, and we clearly acknowledged the need for revenue increases during this pandemic for these companies by approving the settled-upon rate increases after we found that such settlements were in the public interest and resulted in just and reasonable rates. *See PGW Rate Order, UGI Gas Rate Order, PWSA Rate Order.*

²⁵ *Columbia*, mimeo at 51-52.

OCA's contention, in short, is contrary to prior Commission decisions approving rate increases during the pandemic. The suggestion that unemployment statistics are in some way extraordinary is also contrary to the evidence of record. The unemployment rates in Lehigh and Northampton Counties as of September 2020 were 8.1% and 7.4%, respectively. The unemployment rate during the 2010 financial crisis reached 10% in Lehigh County and 9.7% in Northampton County. Thus, while the pandemic circumstances are unique, the high unemployment rate is not an unprecedented economic crisis. In fact, the City filed a rate case in June 2011 and received approval for an increase totaling \$730,000 from the Commission during this period.²⁶

The unemployment rate, moreover, has improved since the March 2020 shut down, dropping from a high of 16.1% in April 2020 to the September 2020 rate of 8.1%. A recovery in employment appears to be swift. Additionally, while the Federal Reserve Bank Coincident Index for the Commonwealth of Pennsylvania, cited by the OCA, shows a precipitous decline in March 2020, the recovery trend shows a sharp V shape as the economy appears to be recovering, as was also demonstrated by the unemployment rate data.²⁷

Finally, and significantly, OCA's claim that the City, under present rates, has a sufficient surplus of \$1.5 million to meet its operating needs is inaccurate.²⁸ The City's Water Department requires a larger annual surplus than \$1.5 million to maintain a safe and reliable water system that serves over 36,000 customers, both inside and outside the City. The evidence of record demonstrates that the City's 2018 debt service coverage of 1.3 is very low. In comparison, the

²⁶ City of Bethlehem St. No. 1R at 2-3.

²⁷ City of Bethlehem St. No. 1R at 3.

²⁸ See OCA Exceptions at 11.

debt coverage levels between 2.5 and 3.4 are much higher for the Comparable Group. The City has an ongoing construction program and, without rate relief, the City's already below average debt coverage levels will be strained.

B. Case Law Does Not Support the OCA's Position But, Rather, Supports the Recommended Decision

OCA contends that case law from similar economic circumstances provides precedent for its proposed rejection of the Recommended Decision and Partial Settlement. This contention is contrary to recent decisions of this Commission in *UGI*, *PGW*, *Columbia* and *PAWC* as discussed above. In *PGW* and *PAWC*, the Commission approved partial settlements of rate proceedings during the pandemic, similar in all material respects to the Partial Settlement presented by I&E and the City here, and specifically rejected the OCA's contention that pandemic circumstances warrant rejection of rate relief.

C. Principles of Public Utility Regulation Do Not Support the OCA's Position But, Rather, Support the Recommended Decision

OCA contends that principles of public utility regulation support its proposed rejection of the Recommended Decision and Partial Settlement. The Commission, in *Columbia*, determined that the economic circumstances of the pandemic do not justify denial of rate relief and that doing so would be inconsistent with prior rate orders issued during the pandemic: specifically, the *PGW* Order, the *UGI* Order and the *PWSA* Order, where the Commission granted rate increases despite rising unemployment numbers across the Commonwealth due to the pandemic.

D. Projections in the City's Rate Filing

OCA contends that projections in the City's "early pandemic filing" are unreliable. This general criticism of ratemaking projections during the pandemic was rejected by the Commission in *Columbia* where the Commission concluded that the question of whether supporting data is

unreliable requires a claim-by-claim analysis based on the record evidence rather than a “broad brush” determination as proposed by OCA.²⁹ The City submits that the contention should also be rejected here.

E. The Recommended Decision and Partial Settlement Are Supported by the Evidence of Record

Citing a single sentence from the City’s Main Brief, OCA contends that Judge Haas agreed with a Bethlehem argument that the Commission does not have authority to deny the rate increase, even if the denial results in a just and reasonable return, and that the City is proposing a guaranteed rate increase. OCA’s paraphrasing of the City’s argument is wholly inaccurate.

The City’s argument in its Main Brief was that the Public Utility Code requires the Commission to address the merits of a rate filing by the end of the statutory suspension period and that the Code, therefore, does not support OCA’s proposed outright rejection of the City’s rate filing because of the COVID pandemic. The City’s argument is entirely consistent with the Commission’s recent decision in *Columbia* where the Commission concluded that, even in the midst of the COVID pandemic, traditional rate setting criteria apply.

OCA states that it has explained the legal framework in which the Commission addresses a rate increase. This statement is also inaccurate. OCA has failed to address the legal framework in which the Commission addresses a rate increase request during the COVID pandemic. The applicable legal framework, as presented in the Commission’s recent decisions in *PGW*, *Columbia* and *PAWC*, supports the Recommended Decision and final approval of the Partial Settlement. The framework does not support the OCA’s proposed denial of rate relief during the COVID pandemic.

Judge Haas presented a lengthy analysis of the Partial Settlement and the evidentiary

²⁹ *Columbia*, mimeo at 52.

support for the settlement increase in rates of \$689,932 in Sections II, III and VI of the Recommended Decision. He concluded, in pertinent part, as follows:³⁰

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.

The City submits, once again, that the Commission should adopt the Recommended Decision and approve the Joint Petition, without modification.

F. The Partial Settlement Is Reasonable

OCA contends that, even under a “business as usual” approach, the Recommended Decision is unreasonable. In effect, the OCA asks the Commission to ignore both the Partial Settlement and established Commission policy encouraging settlement and, instead, conduct a revenue requirement analysis based on OCA’s individual ratemaking adjustments. The Commission should decline to do so. We present, again, the following passage from the Commission’s approval of the Partial Settlement in *PAWC*:³¹

While we acknowledge the rate increase amount was achieved under the terms of a “black box” Settlement, which does not necessarily attribute specific factors relied upon in the specified rate increase, we expressly find that the substantial evidence of the record supports the rate increase agreed upon under the terms of the Settlement. The stipulated rate increase is approximately 50% of

³⁰ Rec. Dec. at 28.

³¹ *PAWC*, mimeo at 36-38.

PAWC's original request, for which PAWC submitted supporting data and direct and rebuttal testimony to substantiate its request. We are further persuaded by I&E's endorsement of the Settlement rates, based upon I&E's thorough analysis of PAWC's ratemaking claims in its base rate filings, which included, *inter alia*, its operating and maintenance expenses, debt service coverage ratio, and rate structure and related information obtained through the discovery process to determine the amount of revenue PAWC needs to provide safe, effective, and reliable service to its customers. *See* I&E Statement in Support 4-19.

* * *

Viewed in its entirety, the Joint Settlement fairly and equitably resolves the issues impacting residential consumers, business customers, and the public interest at large and represents a fair balance of the interests of PAWC and its customers. We note that the Joint Settlement was non-unanimous, and therefore its provisions remained subject to litigation of the Non-Settling Parties. However, in the same respect that a "partial settlement" of issues benefits all Parties, here, the Joint Settlement served to focus the proceedings, and narrow the contested matters before the ALJ.

Additionally, we find that the Joint Settlement will result in significant savings of time and expenses for all Parties involved by reducing or avoiding the necessity of further administrative proceedings, as well as reducing or avoiding the need for possible appellate court proceedings, thereby conserving precious administrative resources. Further, the Joint Settlement provides regulatory certainty with respect to the disposition of issues which benefits all Parties. For the reasons stated herein and in the Joint Petitioners' Statements in Support, we concur with the ALJ's conclusion that the Joint Settlement is supported by substantial evidence and is in the public interest. Accordingly, we shall adopt the ALJ's Recommended Decision that grants the Joint Petition and approves the Settlement, as modified by this Opinion and Order.

The City submits that, consistent with *PAWC*, the Commission should adopt the Recommended Decision and approve the Partial Settlement submitted by I&E and the City.

G. Conclusion

For all the reasons set forth above, OCA's Exception No. 1 should be denied.

REPLY TO OCA EXCEPTION NO. 2 - WATER TREATMENT EMERGENCY GENERATOR

Rec. Dec., Section V.B.2, City Main Brief, Section V.B.1, and Reply Brief, Section V.A.2.

Judge Haas explains that, in reaching the Settlement, I&E and the City did not agree to any individual plant in service claim and that, as such, no adjustment to plant in service is recommended. However, if the Commission determines that adjustments to the plant in service claim are to be considered, Judge Haas recommends that the Commission accept the City's claim for the Water Treatment Emergency Generator ("Generator"). OCA excepts to Judge Haas' contingent recommendation.

The Recommended Decision is supported by Commission precedent and past practice. As noted by Judge Haas, the Commission, in *Pa. P.U.C. v. Pennsylvania-American Water Company*, 68 Pa. P.U.C. 343, 351-352 (1988), explained, citing *Dauphin Consol. Water Supply Co. V. Pa. P.U.C.*, 55 Pa. Cwlth. 624 (1980) that it has "the discretion to allow in rate base expenses six months after the end of the test year."

The Generator is a necessary capital item for the City to continue to provide reasonable and adequate service. It is needed to ensure the water treatment plant remains operational during a power outage or failure in electronic components at the plant.³² The City has taken physical delivery of the Generator and the associated automatic transfer switch. Both were installed as of December 9, 2020. In Rejoinder Testimony served December 15, 2020, the City advised that scheduling the Generator for operation now would take less than six weeks.³³

³² City of Bethlehem St. No. 3R at 4.

³³ City of Bethlehem St. No. 3RJ at 1-2.

The evidence of record justifies the inclusion of the Generator in rate base. The evidence does not support OCA's contention that completion of the project is speculative. Vital component parts, including the Generator, have been received and installed. The rate base claim and related claim for depreciation expense for the Generator, accordingly, should be allowed.

OCA's Exception No. 2 should be denied.

REPLY TO OCA EXCEPTION NO. 3 - UNION CONTRACT WAGES

Rec. Dec., Section VII.A.4, City Main Brief, Section VII.A.4, and Reply Brief, Section VII.A.2.

Judge Haas explains that, in reaching the Settlement, I&E and the City did not agree to any individual expense claim and that, as such, no adjustment to union contract wage expense is recommended. However, if the Commission determines that adjustments to expense claims are to be considered, Judge Haas recommends that the Commission accept the City's claim for the increase in union contract wage expense effective January 1, 2021, one day after the end of the future test year. OCA excepts to Judge Haas' contingent recommendation.

The Recommended Decision is consistent with past Commission decisions. The Commission accepted, for ratemaking purposes, a similar union required wage increase occurring one day after the end of the future test year in the City's 1994 rate proceeding.³⁴ In *Pa. P.U.C. v. Keystone Water Company*, 58 Pa. P.U.C. 437, 454-456 (1984), the Commission explained that salary increases taking effect one day after the end of the future test year have been allowed for rate purposes in a number of Commission decisions. Significantly, the increase in union wage contract expense is known, measurable and certain to occur as it is required by union contract. The expense claim and related claim for social security expense, accordingly, should be allowed.

OCA's Exception No. 3 should be denied.

REPLY TO OCA EXCEPTION NO. 4 - TOTAL RATE CASE EXPENSE

Rec. Dec., Section VII.A.2, City Main Brief, Section VII.A.2, and Reply Brief, Section VII.A.1.

Judge Haas explains that, in reaching the Settlement, I&E and the City did not agree to any individual expense claim and that, as such, no adjustment to rate case expense is recommended. However, if the Commission determines that adjustments to expense claims are to be considered, Judge Haas recommends that the Commission accept the City's claim of \$414,560 for total rate case expense. OCA excepts to Judge Haas' contingent recommendation.

OCA's exception unreasonably seeks to limit the expense allowance to \$259,402, which was the expense actually incurred through early December 2020. The Recommended Decision properly recognizes that OCA's position fails to account for continued litigation "past early December 2020." Continued litigation since early December has included the preparation and submission of the Joint Petition with I&E, a stipulation of certain issues with OCA, preparation and submission of main and reply briefs, exceptions and replies to exceptions. In rejoinder testimony in early December 2020, the City continued to project total rate case expense of \$414,560, as it was continuing to litigate with OCA and OSBA.³⁵

OCA's Exception No. 4 should be denied.

REPLY TO OCA EXCEPTION NO. 5 - RATE OF RETURN

Rec. Dec., Section VIII, City Main Brief, Section VIII, and Reply Brief, Section VIII

Judge Haas explains that, in reaching the Settlement, I&E and the City did not agree to any particular rate of return. However, if the Commission determines that a rate of return is to be

³⁴ *Pa. P.U.C. v. City of Bethlehem (Water)*, 160 PUR 4th 375, 386 (Pa. P.U.C. 1995)

³⁵ City of Bethlehem St. No. 1RJ at 3.

considered as part of a revenue requirement calculation, Judge Haas recommends that the Commission accept the City's proposed rate of return. The City presented an overall rate of return claim of 8.21%.³⁶ Alternatively, 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 overall rate of return claim is 7.42%.³⁷ OCA excepts to Judge Haas' contingent recommendation.

OCA contends that the recommended return presented by its witness Garrett should be adopted.³⁸ Mr. Garrett's recommended overall return of 6.57% includes a common equity cost rate of 6.0% adjusted to 8.5% by an "add" of 250 basis points. The "add" is an extreme adjustment that is entirely subjective. If not absurd on its face, the magnitude of the add certainly calls into question Mr. Garrett's analysis and his application of the DCF and CAPM methodologies that produce common equity returns of 6.1% (DCF)³⁹ and 5.9% (CAPM).⁴⁰ Notably, the OCA fails to mention Mr. Garrett's "add" in its Exception.

OCA, however, contends that the City's common equity return of 10.20% includes multiple, unsupported adds (80 basis points for Bethlehem's small size, 20 and 10 basis points for Bethlehem's business risks) claiming that they are unsupported and unnecessary and should be "removed."⁴¹ This contention is simply incorrect and a misstatement of Mr. Walker's testimony. Mr. Walker applied a straight-forward 10-basis point adjustment to account for the

³⁶ City of Bethlehem St. No. 2, Exhibit HW-1, Schedule 2.

³⁷ City of Bethlehem St. No. 2 at 2. The City's Rate Study and calculation of revenue requirement are based on the tax adjusted rate of return of 7.42%. City of Bethlehem St. No. 1, Attachment 1 at 4 and Schedule 1, page 3 of 3.

³⁸ Without discussion, OCA presents a table on page 32 of its Exceptions that includes a column labelled "Capital Component" with Long Term Debt of 48% and Fund Equity of 52%. The appropriate capital structure ratios are 45% Debt and 55% Fund Equity as addressed by the City in its Main Brief, VIII.B and Reply Brief, Section VIII.B.

³⁹ OCA Main Brief at 56.

⁴⁰ OCA Main Brief at 58.

⁴¹ OCA Exceptions at 32-33.

risk difference between the City's Bureau of Water and the Comparable Water Group. Mr. Walker explained that 10-basis points is a conservative estimate of the risk differential. Adding the 0.10% risk adjustment to the various results of the three models employed by Mr. Walker for the Water Group shows a current range of common equity cost applicable to book value for the Bureau of Water of 10.20% (DCF), 9.90% (CAPM), and 10.50% (RP).⁴²

A. DCF Growth Rate

City witness Walker and I&E witness Spadaccio used projected growth in earnings per share in their DCF models with growth rates of 7.2% and 7.67%, respectively. OCA witness Garrett, however, took a different approach using a DCF growth rate of 3.9% based on a 30-year projected growth in Gross Domestic Product ("GDP").⁴³ The result is an unreasonably low rate of return value which Judge Haas found inappropriate:

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. Garrett's DCF calculation was the long-term growth rate. Thus, I do not find the DCF calculation appropriate.⁴⁴

A further criticism of Mr. Garrett's DCF growth estimate is that it is not used by investors. Investors' expectations are based on expected future growth for each comparison company, *not* Mr. Garrett's unique growth rate. Analysts' forecasts are relied upon by investors when they price utility stocks.⁴⁵ Value Line's projected earned returns on common equity for

⁴² City of Bethlehem St. No. 2 at 61 and Table 9.

⁴³ City of Bethlehem St. No. 2R at 15.

⁴⁴ Rec. Dec. at 49.

⁴⁵ Mr. Walker and the I&E witness both used published projected growth in earnings per share of their comparison companies in their DCF methods. City of Bethlehem St. No. 2 at 18.

Mr. Garrett's proxy group, upon which investors would rely, range from 9.5% to 14.0%. The end result of Mr. Garrett's analysis is a DCF common equity cost rate of 6.1%, which is clearly a significant undervaluation of the cost rate for common equity capital and outside the zone of reasonable results.

B. OCA's Critique of Mr. Walker's DCF Growth Rate

OCA states, incorrectly, that Mr. Walker assumed a growth rate of 9.2%, which is more than two and a half times as high as the projected long-term nominal U.S. GDP growth.⁴⁶ Mr. Walker addressed this error in his rebuttal testimony clearly stating that he used a 7.2% growth rate in his DCF model based on the average projected growth in earnings per share. Mr. Walker did not use a 9.2% growth rate in his DCF analysis. As it is inaccurate, the OCA's criticism of Mr. Walker's DCF analysis should be given no weight. Similar to Mr. Walker's 7.2% DCF growth rate, I&E witness Spadaccio also used published projected growth in earnings per share of his comparison companies and determined a 7.67% growth rate was appropriate for his DCF model.

C. Conclusion – Rate of Return

The City submits that its rate of return claim is just and reasonable. The evidence of record supports the Recommended Decision and Judge Haas' finding that the City's proposed rate of return is reasonable and in the public interest if the Commission determines a rate of return is necessary in calculating a revenue requirement.

OCA's Exception No. 5 should be denied.

⁴⁶ OCA Exception No. 6, Section B.

III. CONCLUSION

The Commission encourages settlement and the City submits that the Commission should adopt the Recommended Decision and approve the Joint Petition for Approval of Partial Settlement of Rate Investigation, *without modification*. The rates proposed in the Joint Petition are just and reasonable and consistent with Section 1301 of the Code. The Joint Petition provides for an increase in annual revenue for Outside City Service of \$689,932 in lieu of the originally proposed increase of \$908,421.

If the Commission determines that adjustments to the City's ratemaking claims should be considered (and the City agrees with Judge Haas that adjustments should not be considered) then the Commission should accept the City's claims and reject those adjustments proposed by the OCA as presented in the City's Exceptions and these Replies to Exceptions.

Respectfully submitted,

By 

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DATED: March 2, 2021

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

CERTIFICATE OF SERVICE

I hereby certify that I have this 2nd day of March 2021, served a true and correct copy of the foregoing Replies of the City of Bethlehem to the Exceptions of the Office of Consumer Advocate, upon the persons and in the manner indicated below:


VIA ELECTRONIC MAIL

The Honorable Steven K. Haas
Administrative Law Judge
Commonwealth of Pennsylvania
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sthaas@pa.gov

John M. Coogan, Prosecutor
Pennsylvania Public Utility Commission
Bureau of Investigation and Enforcement
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