**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17120**

Public Meeting held April 15, 2021

Commissioners Present:

Gladys Brown Dutrieuille, Chairman

David W. Sweet, Vice Chairman

John F. Coleman, Jr.

Ralph V. Yanora, Statement

Pennsylvania Public Utility Commission R-2020-3020256

Office of Consumer Advocate C-2020-3021583

Office of Small Business Advocate C-2020-3021576

v.

City of Bethlehem – Water Department

**OPINION AND ORDER**

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**BY THE COMMISSION:**

Before the Pennsylvania Public Utility Commission (Commission) for consideration and disposition is the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Steven K. Haas, issued on February 11, 2021, and the Exceptions and Reply Exceptions filed thereto, in the above-captioned proceeding.

Exceptions to the Recommended Decision were filed by the City of Bethlehem (City or Bethlehem) and the Office of Consumer Advocate (OCA) on February 24, 2021. Replies to Exceptions were filed by the City, the OCA, and the Commission’s Bureau of Investigation and Enforcement (I&E) on March 2, 2021.

Also, before the Commission is the Joint Petition for Approval of Partial Settlement of Rate Investigation (Joint Petition or Settlement) between the City and I&E (Joint Petitioners or Settling Parties), filed on December 28, 2020.[[1]](#footnote-2)

For the reasons stated, *infra*, we shall adopt the Settling Parties’ Joint Petition, and approve the Settlement, without modification, as in the public interest. Additionally, we shall: (1) deny the Exceptions of the OCA and the City; and (2) adopt the ALJ’s Recommended Decision, as modified, consistent with this Opinion and Order.

As discussed below, the genesis of this proceeding involved a general rate increase in which the City proposed base rate changes that would have increased its annual operating revenues by $2,691,114, which is comprised of an increase in water revenue for customers within the City limits (inside-City customers) of $1,782,693 and an increase in water revenue for customers residing outside of the City limits (jurisdictional or outside-City) customers of $908,421, or approximately 11.0%, based on a future test year (FTY) ending December 31, 2020.[[2]](#footnote-3), [[3]](#footnote-4)  City St. No. 1, Attachment 1 at 4; City Exh. CEH-1, Sch. A. In this Opinion and Order, we shall approve the Joint Petition, which embodies a “black box” settlement, permitting the City to file new tariff rates designed to provide a distribution base rate increase of $689,932, or approximately 8.4% over present revenues, from outside-City customers, approximately $218,000 less than what was requested by the City.[[4]](#footnote-5) Joint Petition at 3.

As discussed *infra*, under the terms of the Settlement, the approved increase to the City’s annual operating revenues from jurisdictional service is proposed to be $689,932, which reflects a substantial decrease from the City’s originally requested $908,421 rate increase for outside-City customers. Specifically, the Settlement increase of $689,932 is approximately the midpoint between the City’s request of $908,421 and both I&E’s litigated position of $474,161 and the OCA’s “business as usual” position of $446,173, which not only reflects a reasonable compromise, but mitigates a rate increase at a time in which many ratepayers are suffering economic hardship due to the 2019 Coronavirus (COVID-19) pandemic emergency, while providing the City with a level of revenue to earn a sufficient return to ensure the City’s continued provision of safe reliable water service within the Commonwealth. I&E St. No. 1-SR at 5; OCA M.B. at 8. Notably, no customer complaints were filed in opposition to the City’s proposed rate increase.

Therefore, based on our review of the record, we shall approve an increase in water base rates, as shown in Appendix B (Proof of Revenue) to the Joint Petition, designed to produce an increase in annual operating revenue from outside-City customers of $689,932, as reasonable and in the public interest.

# Background

The City is a municipal public utility water system, supplying drinking water for residential, commercial, industrial, institutional, resale, and public uses, as well as for fire protection purposes, that, as of December 31, 2019 provided water service to approximately 13,496 customers outside the City limits and 22,940 customers inside the City limits. City St. No. 1 at 6-7. Although the City operates and maintains the distribution systems that service the City and nearby communities, it does this in accordance with the terms of a Lease Agreement between itself and the Bethlehem Authority, who owns all water system assets including land, buildings, and infrastructure while serving as a financing authority for these systems. *Id.* at 3-4.

The City’s testimony provided three specific reasons for its requested $2,691,114 increase in annual operating water revenue of which $908,421 applies to Commission jurisdictional outside-City customers: (1) to provide sufficient revenues to enable it to continue to discharge, properly, its public duty to furnish adequate, safe, and reliable water service pursuant to the safe drinking water standards prescribed and enforced by the Pennsylvania Department of Environmental Protection and the Federal Environmental Protection Agency; (2) to provide the cash flow necessary to continue to operate, maintain and renew its facilities properly and meet its financial obligations; and (3) to afford the opportunity to achieve an adequate rate of return on the original cost invested in the water property. City St. No. 1 at 10. The City’s rate design proposal maintains the current monthly or quarterly customer charge for all classes and recovers its requested increase through volumetric usage rates. City Exh. CEH-1, Sch. 8. The Settlement simply scales back the City’s requested volumetric usage rates, in order to recover the base rate revenue increase under the Joint Petition. The increases to the consumption charges provided for under the Settlement are as follows: (1) the residential consumption charge will increase from $4.266 to $4.782 per thousand gallons; (2) the non-residential (commercial, industrial, and public) consumption charge will increase from $3.333 to $3.843 per thousand gallons; and (3) for other water utilities, the consumption charge will increase from $3.969 to $4.498 per thousand gallons. Joint Petition, Appendix B at 2. These increases to the City’s consumption charges, under the Settlement, produce increases in outside-City revenues ranging from 8.2% for the residential class to 12.6% for the industrial class, in lieu of the City’s request, which would have produced increases of 12.7% and 18.2% for those classes, respectively. Joint Petition, Appendix B at 1; City Exh. CEH-1, Sch. A.

# History of Proceeding

On July 31, 2020, the City filed Supplement No. 15 to Tariff Water – Pa. P.U.C. No. 6 (Supplement No. 15), with an effective date of September 29, 2020, with the Commission, containing proposed changes to base rates designed to produce an annual increase of $908,421, or approximately 11.0%, in water service revenue for jurisdictional customers based on a FTY ending December 31, 2020. [[5]](#footnote-6)

On August 14, 2020, I&E filed a Notice of Appearance. On August 27, 2020, the OSBA filed a Notice of Appearance, Public Statement and Formal Complaint at Docket No. C-2020-3021576. Also, on August 27, 2020, the OCA filed its Notice of Appearance, Public Statement, and Formal Complaint at Docket No. C‑2020‑3021583.

By Order entered September 17, 2020, the Commission suspended the implementation of Supplement No. 15 by operation of law, pursuant to 66 Pa. C.S. § 1308(d), until April 29, 2021, unless permitted by Commission Order to become effective at an earlier date, and instituted an investigation into the lawfulness, justness, and reasonableness of the rates, rules, and regulations proposed. Through this Order, the Commission assigned the matter to the Office of Administrative Law Judge for Alternative Dispute Resolution, if possible, and for scheduling of hearings as necessary for issuance of a Recommended Decision. On September 23, 2020, the City declined mediation and filed a suspension tariff (Supplement No. 16 to Tariff Water – Pa. P.U.C. No. 6 (Supplement No. 16)), suspending its proposed tariff to April 29, 2021.

On October 8, 2020, a telephonic Prehearing Conference was held before ALJ Haas, during which the Parties, upon approval of ALJ Hass, established modified rules for discovery as well as a litigation schedule, among other things. Present during this conference were counsel representing the following: The City, the OCA, the OSBA, and I&E. A Scheduling Order memorializing the litigation schedule was issued on October 8, 2020.

Pursuant to the litigation schedule, the City served direct, rebuttal, surrebuttal and rejoinder testimony in support of Supplement No. 15. I&E served direct and surrebuttal testimony, and the OCA and the OSBA served direct, rebuttal, and surrebuttal testimony in opposition to the proposed rate increase in whole or part. Discovery, which had been initiated prior to the Prehearing Conference remained ongoing.

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

An evidentiary hearing was held on December 17, 2020. Prior to the hearing, the Parties agreed to a mutual waiver of cross examination of all witness. The City, I&E, the OCA and the OSBA participated in the hearing. Testimony and exhibits were stipulated into the evidentiary record. Also, during the evidentiary hearing held on December 17, 2020, ALJ Haas set January 8, 2021 and January 12, 2021 as the respective due dates for Comments and Reply Comments on the Settlement.

The City, the OCA and the OSBA filed Main Briefs on December 30, 2020 and Reply Briefs on January 8, 2021.[[6]](#footnote-7) I&E did not file briefs.

The City and I&E filed their respective Reply Comments in response to the OCA’s Comments and in support of the Settlement on January 12, 2021. The record closed on January 12, 2021; the date Reply Comments were due.[[7]](#footnote-8)

In the Recommended Decision, issued on February 11, 2021, ALJ Haas recommended approval of the Settlement, without modification, finding that it was supported by substantial evidence and is in the public interest. R.D. at 1. While recommending approval of the Settlement, ALJ Haas also addressed the OCA’s and the OSBA’s recommended ratemaking adjustments, indicating that his recommendations on them were presented in the event that the Commission disagrees with the recommendation and ultimately determines that modifications to the Joint Petition are necessary. *Id*. The ALJ addressed the OCA’s and the OSBA’s adjustments to the City’s ratemaking claims on pages 22 through 57 of the Recommended Decision.

As previously noted, the City and the OCA filed Exceptions to the Recommended Decision on February 24, 2021. On March 2, 2021, the City, the OCA, and I&E filed their Replies to Exceptions.

# Legal Standards

## Justness and Reasonableness of Rates

In deciding this or any other general rate increase case brought under Section 1308(d) of the Public Utility Code (Code), 66 Pa. C.S. § 1308(d), certain general principles always apply. A public utility is entitled to an opportunity to earn a fair rate of return on the value of the property dedicated to public service. *Pa. PUC v.* *Pennsylvania Gas and Water Co.*, 341 A.2d 239, 251 (Pa. Cmwlth. 1975). In determining a fair rate of return, the Commission is guided by the criteria provided by the United States Supreme Court in the landmark cases of *Bluefield Water Works and Improvement Co. v. Public Service Comm’n of West Virginia*, 262 U.S. 679 (1923) *(Bluefield)* and *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) *(Hope Natural Gas)*. In *Bluefield*, the Court stated:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

*Bluefield*, 262 U.S. at 692-693.

Section 1301(a) of the Code mandates that “[e]very rate made, demanded, or received by any public utility ... shall be just and reasonable, and in conformity with [the] regulations or orders of the [C]ommission.” 66 Pa. C.S. § 1301(a). Pursuant to the just and reasonable standard, a utility may obtain “a rate that allows it to recover those expenses that are reasonably necessary to provide service to its customers [,] as well as a reasonable rate of return on its investment.” *City of Lancaster Sewer Fund v. Pa. PUC*, 793 A.2d 978, 982 (Pa. Cmwlth. 2002) (*City of Lancaster*). There is no single way to arrive at just and reasonable rates, and “[t]he [Commission] has broad discretion in determining whether rates are reasonable” and “is vested with discretion to decide what factors it will consider in setting or evaluating a utility’s rates.” *Popowsky v. Pa. PUC*, 683 A.2d 958, 961 (Pa. Cmwlth. 1996) (*Popowsky II*).

The burden of proof to establish the justness and reasonableness of every element of a public utility’s rate increase request rests solely upon the public utility in all proceedings filed under Section 1308(d) of the Code. The standard to be met by the public utility is set forth in Section 315(a) of the Code, 66 Pa. C.S. § 315(a), as follows:

**Reasonableness of rates.** – In any proceeding upon the motion of the commission, involving any proposed or existing rate of any public utility, or in any proceedings upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

In reviewing Section 315(a) of the Code, the Pennsylvania Commonwealth Court interpreted a public utility’s burden of proof in a rate proceeding as follows:

Section 315(a) of the Public Utility Code, 66 Pa. C.S. § 315(a), places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the public utility. *It is well-established that the evidence adduced by a utility to meet this burden must be substantial*.

*Lower Frederick Twp. Water Co. v. Pa. PUC*, 409 A.2d 505, 507 (Pa. Cmwlth. 1980) (emphasis added). *See also*, *Brockway Glass Co. v. Pa. PUC*, 437 A.2d 1067 (Pa. Cmwlth. 1981).

In general rate increase proceedings, it is well established that the burden of proof does not shift to parties challenging a requested rate increase. Rather, the utility’s burden of establishing the justness and reasonableness of every component of its rate request is an affirmative one, and that burden remains with the public utility throughout the course of the rate proceeding. There is no similar burden placed on parties to justify a proposed adjustment to the Company’s filing. The Pennsylvania Supreme Court has held:

[T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden is, by statute, on the utility to demonstrate the reasonable necessity and cost of the installations, and that is the burden which the utility patently failed to carry.

*Berner v. Pa. PUC*, 116 A.2d 738, 744 (Pa. 1955).

This does not mean, however, that in proving that its proposed rates are just and reasonable, a public utility must affirmatively defend every claim it has made in its filing, even those which no other party has questioned. As the Pennsylvania Commonwealth Court has held:

While it is axiomatic that a utility has the burden of proving the justness and reasonableness of its proposed rates, it cannot be called upon to account for every action absent prior notice that such action is to be challenged.

*Allegheny Center Assocs. v. Pa. PUC*, 570 A.2d 149, 153 (Pa. Cmwlth. 1990) (citation omitted). *See also, Pa. PUC v. Equitable Gas Co.*, 73 Pa. P.U.C. 310, 359-360 (1990).

Additionally, Section 315(a) of the Code, 66 Pa. C.S. § 315(a), cannot reasonably be read to place the burden of proof on the utility with respect to an issue the utility did not include in its general rate case filing and which, frequently, the utility would oppose. Inasmuch as the Legislature is not presumed to intend an absurd result in interpretation of its enactments,[[8]](#footnote-9) the burden of proof must be on the party who proposes a rate increase beyond that sought by the utility. The mere rejection of evidence contrary to that adduced by the public utility is not an impermissible shifting of the evidentiary burden. *United States Steel Corp. v. Pa. PUC*, 456 A.2d 686 (Pa. Cmwlth. 1983).

In analyzing a proposed general rate increase, the Commission determines a rate of return to be applied to a rate base measured by the aggregate value of all the utility’s property used and useful in the public service. The Commission determines a proper rate of return by calculating the utility’s capital structure and the cost of the different types of capital during the period in issue. The Commission is granted wide discretion, because of its administrative expertise, in determining the cost of capital. *Equitable Gas Co. v. Pa. PUC*, 405 A.2d 1055, 1059 (Pa. Cmwlth. 1979) (determination of cost of capital is basically a matter of judgment which should be left to the regulatory agency and not disturbed absent an abuse of discretion).

## Settlements Must Serve the Public Interest

The policy of the Commission is to encourage settlements, and the Commission has stated that settlement rates are often preferable to those achieved at the conclusion of a fully litigated proceeding. 52 Pa. Code §§ 5.231, 69.401. A full settlement of all the issues in a proceeding eliminates the time, effort, and expense that otherwise would have been used in litigating the proceeding, while a partial settlement may significantly reduce the time, effort, and expense of litigating a case. A settlement, whether whole or partial, benefits not only the named parties directly, but, indirectly, all customers of the public utility involved in the case.

The Settlement, in this case, is a “black box” settlement. This means that the Parties were not able to agree on each and every element of the revenue requirement calculation. The Commission has recognized that “black box” settlements can serve an important purpose in reaching consensus in rate cases:

We have historically permitted the use of “black box” settlements as a means of promoting settlement among the parties in contentious base rate proceedings. Settlement of rate cases saves a significant amount of time and expense for customers, companies, and the Commission and often results in alternatives that may not have been realized during the litigation process. Determining a company’s revenue requirement is a calculation involving many complex and interrelated adjustments that affect expenses, depreciation, rate base, taxes and the company’s cost of capital. Reaching an agreement between various parties on each component of a rate increase can be difficult and impractical in many cases.

*Pa.* *PUC v. Peoples TWP LLC*, Docket No. R-2013-2355886 (Order entered December 19, 2013) (*Peoples TWP*), at 28 (citations omitted).

Rate increase proceedings are expensive to litigate, and the reasonable cost of such litigation is an operating expense recovered in the rates approved by the Commission. Partial or full settlements allow the parties to avoid the substantial costs of preparing and serving testimony and the cross-examination of witnesses in lengthy hearings, the preparation and service of briefs, reply briefs, exceptions and replies to exceptions, together with the briefs and reply briefs necessitated by any appeal of the Commission’s decision, yielding significant expense savings for the company’s customers. For this and other sound reasons, settlements are encouraged by long-standing Commission policy.

Despite the policy favoring settlements, the Commission does not simply rubber stamp settlements without further inquiry. In order to accept a settlement such as those proposed here, the Commission must determine that the proposed terms and conditions are in the public interest. *Pa. PUC v. York Water Co.*, Docket No. R‑00049165 (Order entered October 4, 2004); *Pa. PUC v. C. S. Water and Sewer Assoc.*, 74 Pa. P.U.C. 767 (1991) (*CS Water and Sewer*). The focus of the inquiry for determining whether a proposed settlement should be approved by the Commission is whether the proposed terms and conditions foster, promote, and serve the public interest. *Pa. PUC, et al. v. City of Lancaster – Bureau of Water*, Docket Nos. R-2010-2179103, *et al*. (Order entered July 14, 2011), citing *Warner v. GTE North, Inc*., Docket No. C‑00902815 (Order entered April 1, 1996) and *CS Water and Sewer.* Because the Joint Petitioners request that the Commission enter an order in this proceeding approving the Settlement without modification, they share the burden of proof to show that the terms and conditions of the Settlement are in the public interest. *See* 66 Pa. C.S. § 332(a) (“Except as may be otherwise provided in section 315…or other provisions of this part . . . the proponent of a rule or order has the burden of proof.”)

As a preliminary matter, we note that any issue or exception that we do not specifically delineate shall be deemed to have been duly considered and denied without further discussion. We are not required to consider expressly or at length each contention or argument raised by the parties. *Consolidated Rail Corp. v. Pa. PUC*, 625 A.2d 741 (Pa. Cmwlth. 1993); *also see,* *generally*, *University of Pennsylvania v. Pa. PUC*, 485 A.2d 1217 (Pa. Cmwlth. 1984).

In his Recommended Decision, the ALJ reached seven Conclusions of Law. R.D. at 58-59. The Conclusions of Law are incorporated herein by reference and are adopted without comment unless they are either expressly or by necessary implication rejected or modified by this Opinion and Order.

# Joint Petition for Settlement

## Terms and Conditions of the Settlement

As previously indicated, the Settlement is a “black box” agreement, which means that it does not reflect a specific resolution of every element of the revenue requirement, including rate of return, but rather represents the Settling Parties’ agreed upon final revenue increase amount based on their respective individual analyses of the various revenue and expense items. The Settlement, if approved, will result in rates, presented in Appendix A to the Joint Petition, designed to produce additional annual water revenue from outside-City customers of $689,932, in lieu of the originally proposed revenue increase of $908,421. In addition to the agreement on an overall annual revenue increase, the City and I&E also agreed on several other provisions involving a tariff language change, unaccounted for water (UFW) commitments and the City’s Class Demand Study. Joint Petition at ¶ 16(b)-(d).

The Joint Petition consists of a seven-page document with the settlement rates in the form of a tariff supplement attached as Appendix A, a proof of revenue for the Appendix A settlement rates attached as Appendix B, and Appendices C and D, constituting Statements in Support of the Joint Petition submitted by the City and I&E, respectively. In support of their agreement, the City and I&E provided the following terms and conditions, excerpted in relevant part:

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

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

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

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

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

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

1. **(c) Unaccounted for Water (“UFW”)**

Going forward, and starting with the UFW calculation for calendar year 2020, the City will begin using the Commission Section 500 method for the purpose of assisting the Commission in its review of future rate cases. The City will take steps to maintain UFW below 20% and, in its next base rate case, if UFW is above 20%, provide a narrative explanation of possible reasons for it.[[9]](#footnote-10)

1. **(d) Customer Class Demand Study**

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

Joint Petition at ¶ 16(a)-(d).

In addition to the specific terms to which the Joint Petitioners have agreed, the Joint Settlement contains other general terms and conditions typically found in settlements submitted to the Commission. Specifically, the Joint Petitioners agreed that the Joint Settlement is conditioned upon the Commission’s approval of all of the terms and conditions contained therein without modification. The Joint Petition establishes the procedure by which any of the Joint Petitioners may withdraw from the Joint Settlement if the Commission should act to modify or reject the Joint Settlement. In addition, the Joint Petitioners asserted that although the Joint Settlement is proffered to settle the instant case, it may not be cited as precedent in any future proceeding, except to the extent required to implement any term specifically agreed to by the Joint Petitioners. Further, the Joint Petitioners submitted that the Settlement is made without any admission against, or prejudice to, any position which any of the Joint Petitioners might adopt in future proceedings, except to the extent necessary to effectuate or enforce any term specifically agreed to in the Joint Settlement before us. Joint Petition at 5-6.

The Joint Petitioners respectfully requested that the Commission: (1) approve the Joint Settlement; (2) grant the City permission to file a tariff supplement consistent with Appendix A; and (3) dismiss, with prejudice, the Formal Complaints of the OSBA and the OCA. Joint Petition at 7.

## Positions of the Parties

### Statements in Support of the Joint Petition

The Statements in Support from the City and I&E, included with the Joint Petition, address how the Settlement is consistent with Commission policy encouraging settlements as a means of reducing the time and expense that would otherwise be expended by the Parties in fully litigated proceedings. City Statement in Support at 2-4; I&E Statement in Support at 4-6 (citing, 52 Pa. Code § 5.231(a)). The Settling Parties submit that the Settlement reflects a compromise of positions, and therefore satisfies the public interest review, which as the City explained, is the lens through which the Commission is charged with evaluating partial settlements. City Statement in Support at 3-4 (citing, *Pa. PUC v. Philadelphia Gas Works*, Docket No. R-2020-3017206 (Order entered November 19, 2020) (*PGW*) at 66); I&E Statement in Support at 6-7, 12.

In its Main Brief the City asserted that approval of the Joint Petition would be consistent with the Commission’s approval of a partial settlement in *PGW*, and the Recommended Decision of ALJ Conrad A. Johnson recommending that the Commission approve a “non-unanimous” settlement in *Pa. PUC v. Pennsylvania-American Water Company*, Docket Nos. R-2020-3019369 and R-2020-3019371 (Order entered February 25, 2021) (*PAWC*). City M.B. at 10.

#### Bethlehem

As a signatory to the Joint Settlement, in its Statement of Support, the City asserted that, absent rate relief and given that its last base rate increase was in 2014, its overall rate of return on its FTY rate base would be an inadequate 5.57%, representing a financial position that would jeopardize the City’s ability to continue to operate, maintain and renew its facilities properly and meet its financial obligations, which, in turn, would compromise its ability to provide safe, reliable and adequate service to its customers. City Statement in Support at 4-5.

Although less than the $908,421 increase in annual operating revenue originally sought from outside-City service, which the City contended it has fully supported with financial data submitted in support of Supplement No. 15, the City explained that it accepts the reduced annual increase of $689,932 provided for in the Joint Petition, as it reflects a compromise of the positions of the City and I&E, which, consistent with Commission policy, fosters and promotes the public interest. *Id*. at 6-7. Specifically, the City, highlighting the reduction of monthly and quarterly customer bills that will result from approval of the Settlement rates versus those that would have been implemented under Supplement No. 15, contended that such a reduction from the City’s original filing is in the public interest. *Id*. at 5.

The City noted that the Settlement was reached after an extensive investigation of its filing and related information obtained through the discovery process, to determine the amount of revenue the City needs to provide safe, effective, and reliable service to its customers. The City added in its Statement of Support that such extensive investigation included, in addition to discovery, submission of multiple rounds of testimony by the Parties and extensive negotiations among the Joint Petitioners. *Id.* at 6.

As the increase to the City’s annual operating revenues from outside-City service was a matter of interest to all Parties in this proceeding, so was the accompanying rate design and distribution of any imposed revenue increase among the City’s customer classes. The City noted that, although the OSBA is not a Party to the Joint Petition, I&E and the City accepted the OSBA’s scale back as appropriate for settlement purposes.[[10]](#footnote-11) Therefore, the City submitted that the rate design and scale back reflected in the Settlement furthers the public interest, since “the settlement scale back resolves the competing positions in the allocation of revenue among outside-City customers and does so in a mutually acceptable way.” *Id*. at 7-8. It should be noted that in its Main Brief, the OCA determined that it would not oppose the scale back approach supported by the City and the OSBA if an increase approved by the Commission is less than the City’s initially proposed increase. OCA M.B. at 67. Furthermore, to recover the rate increase under the Settlement, the City and I&E agreed to increase the single block consumption rate for all customer classes while leaving the customer charge unchanged. City M.B. at 46.

The City contended that the other provisions (i.e., elimination of Lower Saucon Honor System Rate, unaccounted for water, and Demand Study), coupled with the Settling Parties’ agreement as to the amount of increase in the City’s annual water revenue for outside-City service, further provide an appropriate basis for resolution of the instant rate litigation. *Id*. at 8-9.

#### I&E

As a signatory to the Settlement, in its Statement in Support, I&E essentially concurred in all the reasons offered in support of the Joint Petition by the City, specifically asserting that the Settlement satisfies all applicable legal standards and results in terms that are preferable to those that may have been achieved at the end of a fully litigated proceeding. I&E Statement in Support at 5. According to I&E, the increase in revenue from jurisdictional outside-City customers is appropriate, as it balances the interests of the City and its customers in a fair and equitable manner, by allowing the City sufficient additional revenue to meet its operating and capital expenses and providing the opportunity to earn a reasonable return on its investment, and in turn, ensuring that customers will continue to receive safe and reliable service at just and reasonable rates. *Id.* at 7.

I&E also supported the cost allocation and the resulting scale back agreed upon in the Settlement, submitting that the settlement rates in Appendix A to the Joint Petition provide for reasonable progress in moving the applicable customer classes closer to their cost of service, consistent with the principles of gradualism. *Id.* at 7-8. In concurrence with the City, I&E also noted its support of the uncontested elimination of the Lower Saucon Honor System Rate, implemented in Appendix A to the Joint Petition, as well as the other uncontested provisions contained in the Settlement, expressing the City’s commitment to address and correct high levels of UFW and the Parties’ acceptance of the results of the City’s Demand Study used in its cost of service study presented in City Exhibit CEH-2R. I&E contended that its extensive analysis in this proceeding demonstrates a rate increase for the City is warranted, and although the increase under the Settlement is higher than I&E’s litigated position, it is a reasonable balance of positions.

### Comments in Opposition to the Joint Petition (Objections)

#### OCA

As previously indicated, the OCA provided a Statement in Opposition to the Joint Petition as part of its Reply Brief.[[11]](#footnote-12) The OCA asked the Commission to deny the City’s requested rate increase “due to current societal and economic conditions” as a result of the COVID-19 pandemic, as well as the uncertainties surrounding the City’s FTY projections.[[12]](#footnote-13) OCA R.B. at 9-10, 14. Regarding revenue requirement, the OCA disputed the evidence relied upon by the Joint Petitioners and proposed that the OCA’s witnesses and exhibits presented a more credible view of the City’s financial position, which did not demonstrate a need for a rate increase. Specifically, the OCA averred the City’s existing rates are adequate because they produce an overall rate of return of 5.65%, providing, according to the OCA, a reasonable return in these circumstances.[[13]](#footnote-14) *Id*. at 12 (citing, OCA M.B. at 9-24). Likewise, the OCA contended that increasing base rates for outside-City customers by $689,932, as provided for in the Settlement, “is not supported by the evidence of record in this case.” *Id*. at 12.

In support of its opposition to the Settlement, the OCA cited to ALJ Katrina L. Dunderdale’s Recommended Decision in *Pa. PUC v. Columbia Gas of Pennsylvania, Inc*., Docket No. R-2020-3018835 (Order entered February 19, 2021) (*Columbia Gas*), in which the ALJ recommended denial of the rate increase for reasons related to the COVID-19 pandemic. OCA R.B. at 11-12.

With regard to the pandemic’s impact on customers, the OCA cited unemployment rates, as of September 2020, of the working population in Lehigh and Northampton Counties, portions of which are served by the City, of 8.3% and 7.6%, respectively.[[14]](#footnote-15) OCA St. No. 1 at 11. In surrebuttal testimony, the OCA noted declining unemployment rates from September 2020 to October 2020, with unemployment rates in Lehigh County of 7.4% and Northampton County of 6.8%. OCA St. No. 1S at 2. Nevertheless, the OCA contended that the current economic situation justifies summarily denying the City’s request for rate relief.

Further, the OCA concluded that, assuming some of the City’s FTY projections are accurate and removing any consideration of the pandemic, the City has, at most, an additional revenue requirement of $443,666 for jurisdictional service to outside-City customers at an overall rate of return of 6.57%[[15]](#footnote-16) (OCA’s “business as usual” approach, including cost of equity and accounting adjustments). OCA St. No. 2S at 1-2; OCA R.B. at 10. However, the OCA submitted that an overall return of 5.65%, resulting from a denial of any rate increase at this time, although less than the “business as usual” approach, is sufficient for the City to cover its debt costs, operation and maintenance expense and provide safe, adequate, and reliable service in this time of a pandemic. OCA R.B. at 12; OCA M.B. at 15-22.

#### OSBA

Although the OSBA did not file Objections to the Joint Petition, the OSBA did argue in its Main Brief against approval of any rate increase to the City due to the impact of the COVID-19 pandemic. The OSBA’s argument is summarized on page five of its Main Brief, as it stated, “…our concern with increasing customer rates at this time is essentially two-fold: how many Commonwealth small businesses will be critically (and/or permanently) affected by the COVID-19 Pandemic; and how long will this Pandemic last?” OSBA M.B. at 5.

### Reply Comments to OCA’s Objections

#### Bethlehem

The City began its Reply Comments by highlighting the Commission’s standards for reviewing a nonunanimous settlement, with which the OCA concurred. Specifically, in *Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp*., Docket Nos. A‑2010‑2176520 and A-2010-2176732 (Order entered March 8, 2011) (*West Penn*), the Commission stated that “the Commission’s standards for reviewing a nonunanimous settlement, as proposed here, are the same as those for deciding a fully contested case. Accordingly, substantial evidence consistent with statutory requirements must support the proposed settlement.” City Reply Comments at 2-3. The City maintained that its originally proposed increase is supported by substantial evidence, satisfying this criterion, and consequently so does the revenue increase under the Settlement. *Id*. at 3. Likewise, the City maintained that the Settlement satisfies the public interest standard, under which partial settlements are to be evaluated, as indicated in *PGW*, since the settlement increase is at a level reduced from the City’s original filing, reflecting a compromise of the positions of the City and I&E. *Id*. at 3-5.

Contrary to the OCA’s reliance on the ALJ’s recommendation in the recent *Columbia Gas* proceeding, which neither involved a settlement nor had been decided upon by the Commission prior to the issuance of ALJ Haas’ Recommended Decision in the instant proceeding, the City maintained its contention that more pertinent to this proceeding is the Commission’s decision approving a partial settlement in *PGW*,[[16]](#footnote-17) and the Recommended Decision approving a “non-unanimous” settlement in *PAWC*,[[17]](#footnote-18) both of which took place during the COVID-19 pandemic, demonstrating that “[t]he Commission, clearly, is granting rate relief to utilities during the COVID pandemic.” As a municipal entity, similar, in that respect, to PGW, the City argued that the Settlement embodies a settlement similar to the resolution determined to be acceptable by the OCA and the OSBA in *PGW*, irrespective of the nature of their argument in that proceeding, recommending rejection of PGW’s rate increase due to the unprecedented and continuing COVID-19 pandemic. *Id*. at 4-5.

Regarding *PAWC*, where the OCA similarly sought to have the Commission reject a base rate filing because of COVID-19 concerns, the City noted the differences between a large publicly owned utility, such as PAWC, and a municipal entity with a much smaller service area and only 13,496 outside-City customers. Specifically, not only were there zero customer complaints filed in opposition to the City’s proposed rate increase, but even at the City’s original request, the total monthly bill for a 5/8-inch residential customer using 4,000 gallons per month would be $28.52, less than half the existing rates of PAWC at $64.37. *Id*. at 7. Additionally, in support of its position the OCA suggested, as it similarly did in *PAWC*, that the City can avoid the need for additional revenue by holding off on all but the absolute necessary system improvement projects.[[18]](#footnote-19) In response, the City contended that it is nota large utility and it has no growth-related projects or longer-term system rehabilitation projects that could be deferred. The City noted that it included just five capital projects in its FTY claim, later withdrawing three, and the OCA does not identify any projects that could be deferred. *See* City R.B. at 5-6.

Moreover, the City argued that the Commission has no authority under the Code to deny the City rate relief because of the COVID-19 pandemic, as proposed by the OCA and the OSBA. The City noted that the Commission addressed its statutory ratemaking authority in *PGW*, holding that it has no authority to alter a utility’s substantive right of a rate increase going into effect at the end of the seven-month statutory deadline. City Reply Comments at 8 (citing, *PGW* at 13). The City, therefore, contended that a Commission decision adopting the “no increase” proposal submitted by the OCA and the OSBA would violate the Code and the Commission’s statutory obligation to set just and reasonable rates. Specifically, the City submitted that, “if the Commission has no authority to postpone the implementation of a rate increase to after the seven-month statutory deadline, then it has no authority to reject an otherwise meritorious rate filing with the assumption that the utility can refile the case after the seven-month deadline.” City Reply Comments at 8.

In addressing the OCA’s concerns about recent and current unemployment rates, as a result of the COVID-19 pandemic, the City argued that, while the current unemployment rates cited by the OCA are certainly significant, they are not unprecedented. The City cited to 2010 unemployment rates in Lehigh and Northampton Counties of 10% and 9.7%, respectively, as a result of the financial crisis, noting that, while unique, the high unemployment rate is not an unprecedented economic crisis. The City noted that it filed a rate case in June 2011 and received approval for an increase totaling $730,000 from the Commission during this period. The City noted, moreover, that the unemployment rate 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%. City Reply Comments at 8 (citing, City M.B. at 12-13).

Furthermore, the City highlighted the steps it has taken to assist financially troubled customers during the COVID-19 pandemic. It noted first that it is not terminating service to customers. It is also continuing to offer payment arrangements to customers and waiving all new late payment charges. City Reply Comments at 7 (citing, City M.B. at 11-12; City R.B. at 6-7; City Statement in Support at 9-10).

#### I&E

As previously indicated, I&E also submitted Reply Comments in response to the OCA’s Comments and in support of the Settlement. I&E submitted that because the Settlement balances the interests of the City, its customers, and the regulated community as a whole, as I&E has determined after thorough investigation, the Settlement should be approved as in the public interest.[[19]](#footnote-20) I&E Reply Comments at 2. Specifically, I&E averred that the $689,932 annual increase in operating revenues from outside-City customers is reasonable for three reasons: (1) it benefits ratepayers by lowering the proposed rate increase by $218,489; (2) it satisfies the City’s claim for additional revenue to provide safe and reliable service; and (3) it is unrealistic to expect any party to win all their positions through litigation. Therefore, a settlement amount approximately halfway between revenue requirement positions is a reasonable compromise.[[20]](#footnote-21) *Id*. at 2-3.

I&E asserted that the Joint Petition’s revenue requirement provisions provide for Settlement rates that are consistent with the legal standards articulated in *Bluefield* and *Hope Natural Gas,* *supra*. I&E specifically noted that, although the Settlement is a “black box” settlement, as there has been no agreement upon individual issues regarding revenue requirement, it disputes the OCA’s contention that an overall rate of return of 5.65% under the City’s existing rates is adequate, since I&E’s DCF analysis demonstrated a rate of return of 6.75% is reasonable and the OCA’s own “business as usual” analysis reflected a rate of return of 6.57%. *Id*. at 3-5.

Similar to the City, I&E argued that contrary to the OCA’s contention, the Commission has continued to approve rate increases, notwithstanding similar arguments from the OCA regarding the impacts of the COVID-19 pandemic. I&E specifically noted that it “is unaware of the Commission denying a rate increase because of COVID.” *Id*. at 5.

## Recommended Decision

The ALJ recommended adoption of the Joint Petition, without modification. The ALJ’s analysis turned on: (1) a review of the substantial record evidence; (2) the positions of the Parties; (3) weighing, on balance, the Company’s interests in sufficient revenues for its continued provision of safe and reliable service and a reasonable rate of return; and (4) the interest of the City’s customers in safe and reliable service at affordable rates. In balancing these interests, the ALJ expressly considered that the Settlement contemplated, and sought to mitigate the serious economic hardship many may suffer due to the COVID-19 pandemic emergency. The ALJ reviewed the Joint Petition under the standards applicable for the granting of a rate increase under the *Bluefield* and *Hope* *Natural Gas* decisions, as well as the Commission guidance for consideration of whether to approve a Settlement, as set forth in *CS Water and Sewer*. Upon review, the ALJ concluded that the terms of the “black box” settlement were supported by substantial evidence and is in the public interest, and therefore, should be approved. R.D. at 5-7, 14-20, 27-28, 54, 56-58. Furthermore, the ALJ agreed with the City’s argument that the Commission has no current authority under the Code to deny the City a rate increase on the basis of the COVID-19 pandemic. *Id*. at 20.

While recommending approval of the Settlement, ALJ Haas also addressed the OCA’s and the OSBA’s proposed ratemaking adjustments but did so *only* in the event that the Commission wants to look past the Joint Petition and consider the adjustments proposed by the OCA and the OSBA. R.D. at 22-26, 29-51.

## Disposition

As set forth above and discussed in more detail, *infra*, in the Exceptions and Replies, having thoroughly reviewed the City’s rate filing, the supporting evidence of record, and the proposed rates in the Settlement, we conclude that it is in the best interest of the public to approve the Joint Petition. In taking this action, we concur with the Joint Petitioners and the ALJ that certain provisions of the Joint Petition directly benefit the impacted customers and help manage the cost of water utility service during this time of COVID-19 pandemic emergency. Among those provisions are: (1) the reduced revenue increase of $689,932, nearly 25% less than the City’s original request of $908,421; and (2) provisions to monitor the utility’s UFW to maintain a level below 20%, and document potential causes where the level exceeds 20%. R.D. at 14-16; City Statement in Support at 2-4; I&E Statement in Support at 4-7, 12.

We note our approval that the revenue increase under the terms of the Settlement acknowledges that, while the City may have a substantiated case for a rate increase, the COVID-19 pandemic is still ongoing, and therefore, it is appropriate, on balance, to consider factors which will mitigate the economic burden on ratepayers in this time of state-wide emergency. Under its terms, the Joint Petitioners achieved a settlement which reduces the City’s originally proposed rate increases to the City’s consumption charges in outside-City revenues ranging from 8.2% for the residential class to 12.6% for the industrial class, in lieu of the City’s request, which would have produced increases of 12.7% and 18.2% for those classes, respectively. The Settlement thereby mitigates the economic burden on ratepayers, while affording the City sufficient revenue necessary to maintain safe and reliable water service.

Furthermore, notwithstanding the Commission’s existing Chapter 56 Regulations, containing strong consumer protections, the Commission has been cognizant of the fact that there are customers who are experiencing financial problems as a result of the COVID-19 pandemic and remains committed to protecting consumers through proactive measures during this critical time, as demonstrated through the issuance of our Emergency Order on March 13, 2020 and through the measured approach of our Order entered on October 13, 2020, lifting the absolute ban on shut-offs effective November 9, 2020, and replacing it with specific limitations on affected utilities’ ability to terminate service.[[21]](#footnote-22) The next phase of our response to the COVID-19 pandemic, initiated by the *March 2020 Emergency Order*, acknowledges that the pandemic’s effect on the Commonwealth’s unemployment levels have changed, which was an area of concern to the OCA in the instant proceeding. Our Order, entered on March 18, 2021, takes additional steps toward returning to pre-COVID-19 pandemic procedures for collecting amounts due for utility service.[[22]](#footnote-23) As we noted in our *March 2021 Order*, the economy has improved since our *October 2020 Order* was entered and specifically, we stated that “Pennsylvania’s unemployment rate has improved from an astounding 16.2% in April 2020, to 10.2% in August 2020, to 7.1% in December 2020. This downward trajectory bodes well for Pennsylvania’s economy if this trend continues. February 2021 Pennsylvania statistics are not yet available, but the national unemployment rate for February at 6.2%, represents a continuing downward trend.” *March 2021 Order* at 2 (citations omitted). The *March 2021 Order* also noted that both Congress and the General Assembly have enacted legislation providing economic assistance during the pandemic, including utility assistance.[[23]](#footnote-24) In short, our *March 2021 Order* concluded, in view of the improving economic trend, “it is time to return to the regular collections process as set forth in the Public Utility Code and the Commission’s Regulations, with some additional protections.” *March 2021 Order* at 3.

We also note that our disposition of the settlement in this case requires our consideration whether a nonunanimous settlement is just and reasonable and in the public interest. As previously noted, in a prior case, deciding whether to approve a nonunanimous settlement involving a contested merger, the Commission has expressly stated that:

…[T]he Commission’s standards for reviewing a non-unanimous settlement, as proposed here, are the same as those for deciding a fully contested case. Accordingly, substantial evidence consistent with the statutory requirements must support the proposed settlement.

*West Penn* at 17 (citations omitted). Further, in our recent Opinion and Order in *PAWC*, we acknowledged that the standard for approval of settlement remains the same for a partial settlement, whether involving a partial settlement of issues, or a partial settlement of the parties involved (*i.e.*, nonunanimous). *PAWC* at 40.

It is understood that, per *Popowsky II,* in rate proceedings, the Commission has broad discretion to determine what factors are relevant to consider and what weight is to be given to those factors, when determining whether the proposed rate increase should be approved. Therefore, while the standard for approval of a partial or nonunanimous settlement remains whether the settlement is reasonable and in the public interest *per* *Pa. PUC v. Philadelphia Electric Company* and *CS Water and Sewer*, the Commission’s discretion continues to include consideration of whatever factors are deemed relevant in a given case per *Popowsky II*. Such factors may be weighed differently as the Commission deems appropriate in the given circumstances.

We underscore our discretion regarding what factors to consider and what weight they are to be afforded in all rate proceedings. We note a recent increase in the occurrence of nonunanimous settlements. As noted *supra*., the Commission has articulated its general policy favoring settlements. *See* *Peoples TWP*; 52 Pa. Code §§ 5.231, 69.401. While we do not find it necessary to disfavor or reject a settlement because it is nonunanimous, *per se*, we note there are sound policy reasons to ensure appropriate due process for non-settling parties that do not support the proposed settlement or wish to continue litigation.

For example, here the Joint Petitioners assert that our recent Opinion and Order in *PAWC*, approving a rate increase by adoption of a nonunanimous settlement, supports our approval of the nonunanimous settlement in the present case. The proponents of the nonunanimous settlement assert that, per *PGW*, the standard for approval of partial settlements is the “lens through which” the Commission is bound to review the terms of settlement. While accurate, the recitation of the standard for approval of partial settlements does not set forth all potentially relevant considerations for approval of a nonunanimous settlement.

In rate proceedings, the use of a nonunanimous settlement raises the obvious concern that the Commission continue to respect the non-settling parties’ right to notice and the opportunity to be heard. Therefore, where a nonunanimous settlement is proposed to resolve litigation, the agency’s review of the entire matter should ensure that evidence and argument presented by non-settling parties receives a full and fair consideration.

Considerations which may ensure fairness to all the parties include, inter alia, independent assessment by the Commission whether the nonunanimous settlement is reasonable and in the public interest; fact-finding hearings to determine whether the settlement is in the public interest and supported by substantial evidence; and the range of interests represented in the nonunanimous settlement. The Commission’s procedures already provide for many of these safeguards including, inter alia: (1) the Commission’s independent review and determination whether the settlement is reasonable and in the public interest; (2) the non-settling party’s opportunity to object to the settlement; (3) the non-settling party’s opportunity to fully litigate contested issues; and (4) the non-settling party’s opportunity for fact-finding hearings on the terms of settlement and contested issues.

For example, in *PAWC* the record reflected a fully contested, on the record proceeding, in which all the parties had fully litigated their positions and presented evidence at hearing. The nonunanimous settlement reached in *PAWC* was achieved at a point following the full litigation of the issues presented. In contrast, the procedural posture in the present case reflects that the City engaged in settlement negotiations with the Parties, the City and I&E and arrived at the agreed upon settlement terms, after which the ALJ provided the Non-Settling Parties the opportunity to fully litigate any contested issues. R.D. at 2-3.

We note that a proceeding’s procedural history is significant since it reveals whether and how all the parties were afforded due process. In *PAWC*, where the settlement was achieved after a fully contested, fully litigated rate proceeding, and where the non-settling parties could object to the settlement, there was no question that all the parties had been afforded full and fair notice and opportunity to be heard. Similarly, in the present case, where the Settlement was achieved prior to a fully contested and litigated proceeding by all the Parties, ALJ Haas ensured the Non-Settling Parties were afforded full and fair notice and opportunity to be heard, by both their opportunity to object to the Settlement and by affording them the subsequent opportunity to fully litigate any issue which remained contested. R.D. at 2-3,6.

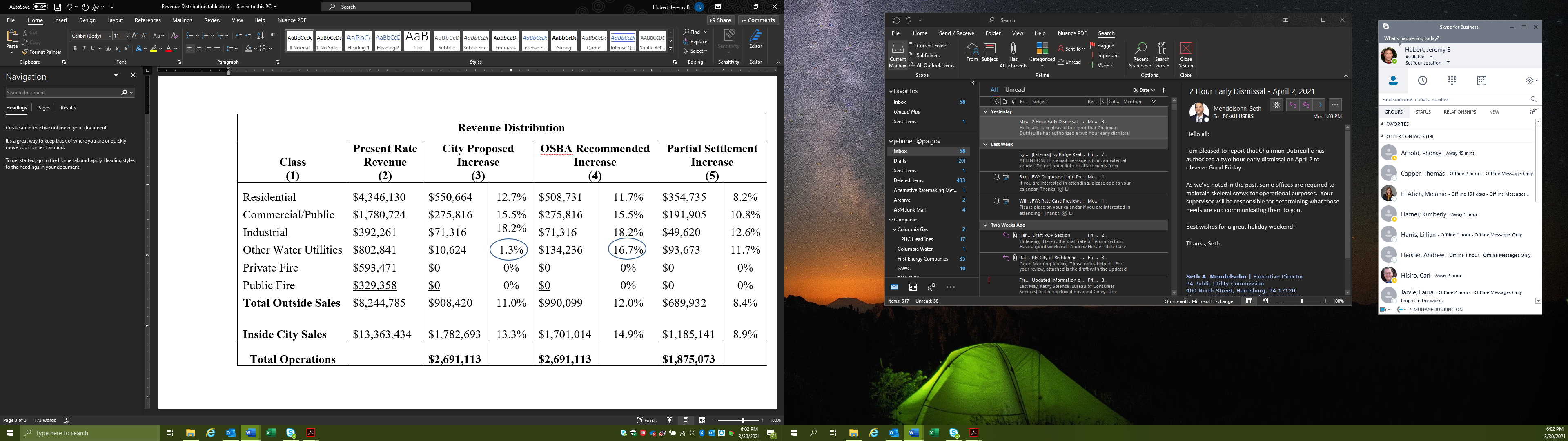
Turning now to the Settlement in the present case, upon review, we shall approve the Settlement. As discussed previously, we find that all the Parties were afforded due process in this proceeding, and that the matters in contention by the Non-Settling Parties did not assert a basis to undermine our finding that the Settlement was reasonable and in the public intertest. In the present case, the Settlement provides a benefit to the ratepayers, by a reduction in the overall rate increase originally sought by the City and limiting the rate increase to an amount necessary for the City to provide safe and reliable water service to its customers. R.D. at 6; City Statement in Support at 4-5; I&E Statement in Support at 5-7.

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 record supports the rate increase agreed to under the terms of the Settlement. The stipulated base rate increase of $689,932 is approximately a 25% reduction to the City’s original request, for which the City submitted supporting data and direct and rebuttal testimony to substantiate. We are further persuaded by I&E’s endorsement of the Settlement rates, based upon I&E’s thorough analysis of the City’s ratemaking claims in its base rate filing, and review of the evidence obtained through the discovery process to determine the amount of revenue the City needs to provide safe, effective, and reliable service to its customers. *See* I&E Statement in Support at 7.

We note that although the OCA filed an objection to the Settlement, it does not contest any specific provision concerning revenue allocation or rate design, which, consistent with the stipulated revenue increase and the other provisions contained in the Settlement, were achieved through compromise. As the Settling Parties concede, this is a “black box” settlement as to the revenue requirement. Likewise, the Settlement does not provide any indication as to how specific costs are allocated among the various customer classes served by the City. However, we agree with the ALJ’s finding that, considering the discussions presented by the Parties summarized on pages 52 through 57 of the ALJ’s Recommended Decision, the revenue allocation and rate design provided for under the Settlement is an appropriate resolution of the Parties’ positions, affording appropriate primary consideration to cost causation principles per *Lloyd v. Pa. PUC,* 904 A.2d 1010 (Pa. Cmwlth. 2006) (*Lloyd*) in tandem with secondary consideration for the value of service, gradualism, and conservation. *See* R.D. at 52-57. Based on the results of the OSBA’s changes to the City’s cost of service study, with which the City, I&E, and the OCA agree,[[24]](#footnote-25) the OSBA illustrated the effect the City’s proposed revenue allocation would have on the “subsidies” paid and received by each rate class, as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **OSBA Schedule BK-3**  **Subsidy Given (Received)** | | | |
| **Class** | **Under**  **Present Rates** | **Under**  **City Proposed Rates** | **Reduction in Subsidy** |
| Residential | ($75,778) | $47,417 | 37% |
| Commercial/Public | ($67,747) | $4,474 | 93% |
| Industrial | ($90,241) | ($74,411) | 18% |
| Other Water Utilities | ($35,459) | ($123,612) | (249%) |
| Private Fire | $199,387 | $146,132 | 27% |
| Public Fire | $69,838 | $0 | 100% |
| **Total** | **$0** | **$0** |  |

As noted by the OSBA, the proper yardstick for measuring the degree of movement toward cost of service is the change in the absolute level of class subsidies at present and proposed rates. OSBA St. No. 1 at 7. As seen in the table above, all outside-City customer classes are moving closer to cost of service under the City’s proposed revenue allocation, except for the Resale class (Other Water Utilities). As such, the OSBA recommended a revenue allocation of the City’s overall recommended increase of $2.691 million that would move the Resale class closer to cost of service as follows:



*See* OSBA Schs. BK-1, 4; Joint Petition, Appendix B at 1. The settlement rates in Appendix A to the Joint Petition are designed based on the approximate revenue allocation and proportional scale back of the target class increases shown in column 4 in the table above. Furthermore, the Settlement applies the OSBA’s scale back recommendation to the single block consumption rate for each customer class, following the widely accepted approach among the Parties of maintaining existing monthly customer charges while increasing volumetric rates. Accordingly, we find that the rate design and scale back reflected in the Settlement is consistent with *Lloyd* and in the public interest.

Viewed in its entirety, the Joint Petition 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 the City and its customers. We note that the Joint Petition was nonunanimous, 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 Petition served to focus the proceedings, and narrow the matters in contention before the ALJ.

Additionally, we find that the 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 administrative resources. Further, the 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 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.

# Issues Resolved Among the Parties

In addition to the Joint Petition entered into with I&E, the City has entered into a Stipulation with the OCA to address certain quality of service issues that were a concern of the OCA, including a valve exercising schedule, fire hydrant testing, pressure surveys, UFW measurement, customer complaints and customer meter age.[[25]](#footnote-26) In addition to our adoption of the Settlement and the ALJ’s Recommended Decision, we also adopt the terms of the Stipulation entered between the City and the OCA, discussed in more detail, *infra*,which provide for important terms and conditions in the interest of consumers. We commend the Parties for reaching mutual agreement on the issues addressed therein. While not contained in the Settlement, the agreement arose under the good faith negotiations between the Parties during this rate proceeding and serve an important benefit to the public interest. Finally, we note that the agreements reflect the City’s good faith negotiations with a Non-Settling Party and voluntary efforts to enhance benefits to its customers.

Specifically, the City agreed to take the following actions to comply fully with the Stipulation:

* 1. The City will exercise approximately 900 valves per year in the jurisdictional areas so that all valves are exercised at least once in a 5-year period.
  2. The City will establish and document an ongoing program and schedule for maintenance or replacement of inoperable valves identified as such in the annual valve exercise program, subject to availability of resources to affect such improvements.
  3. For the sixty-five (65) fire hydrants in its jurisdictional areas that cannot provide minimum flow of 500 gpm at 20 psig, the City will test these hydrants no later than October 31, 2021 to confirm capacity and will appropriately mark those that do not meet the minimum flow and pressure requirements as recommended.
  4. Regarding the City’s four small community well systems, the City will perform pressure surveys in accordance with regulatory requirements starting in calendar year 2021.
  5. Going forward, and starting with the UFW calculation for calendar year 2020, the City will begin using the Commission Section 500 method for the purpose of assisting the Commission in its review of future rate cases. The City will take steps to maintain UFW below 20% and, in its next base rate case, if UFW is above 20%, provide a narrative explanation of possible reasons for it.
  6. The City shall establish and maintain a single complaint log in live Excel format that satisfies 52 Pa. Code § 65.3. The following categories shall be part of the log so that the data can be sorted by date and location: dirty water, taste, odor, color, customer property damage, leaking meter, request for meter testing, request for water testing, incomplete surface restoration, and lead service lines.
  7. The City will submit a schedule to OCA and the Commission indicating the number and size of meters that need to be replaced or tested in order to comply with the requirements of 52 Pa. Code § 65.8. within seven years. The schedule will be submitted within 6 months of the entry of an order in this proceeding.[[26]](#footnote-27)

Attachment B to the City’s Main Brief.

Further, as noted by the City in its Main Brief, the following ratemaking adjustments, listed below, originally proposed by the OCA have been resolved or withdrawn:

**Rate Base**

Well Generator

Roof Replacement

Hecktown Road Bridge Main Replacement

**Expenses**

Uncollectible Account Expense

Professional Services Expense

East Allen Township Expense — Other Expense

Water Filtration Expense — Oil Expenses

Chemical Expense — Fluoride

Chemical Expense — Caustic Soda

City M.B. at 15. Additionally, the City noted that, as for revenue allocation, the Joint Petition adopts the revenue allocation and scale back of revenue proposed by the OSBA. *Id.*

Since no Party raised any objections or contested any issues subject to the Stipulation, the ALJ found it to be in the public interest and recommended approval of the Stipulation, explaining that the actions agreed upon by the City ensure that the City’s procedures more closely comply with the Commission’s Regulations. R.D. at 21, 57-58. Likewise, regarding the various issues identified above that have either been resolved among the Parties or withdrawn and are not the subject of any dispute or challenge, the ALJ recommended they be approved as part of the overall approval of the Joint Petition. R.D. at 22.

No Party filed Exceptions regarding the Stipulation. Finding the ALJ’s recommendation to be reasonable, we adopt it without further comment.

# Exceptions and Replies

Although we have determined to adopt the Settlement in this case, we have nevertheless conducted a full review of the issues presented on Exception, largely addressing matters which the ALJ treated “in the alternative” to the adoption of the Settlement. Under typical circumstances where a settlement is unanimous, once we have determined that adoption of the settlement is warranted, we may determine that matters raised “in the alternative” are moot, and therefore do not warrant our express review.

However, as discussed, *supra*., where, as here, a “black box” settlement of a rate proceeding is achieved *via* *nonunanimous* settlement, it is necessary to review the contested matters, to ensure, not only that the parties have had a full a fair opportunity to present their positions in opposition to the rate increase, but also that the exceptions raised do not assert any basis to undermine our ultimate finding that the settlement was supported by substantial evidence, reasonable and in the public interest, and that no other important basis asserted might warrant rejection of the settlement. Upon review of the Exceptions raised and the record of this proceeding, and as discussed more fully below, we will deny the Exceptions.

## Approval of Settlement

### Positions of the Parties

As discussed *supra*, in light of the ongoing COVID-19 pandemic and its purported impact upon the City’s customers, as well as the uncertainties that it imposes upon the City’s FTY projections, the OCA and the OSBA submitted that the City should not be awarded an increase in base rates at this time. OCA R.B. at 9-10, 14; OSBA M.B. at 3-5. Both the OCA and the OSBA asserted that the existence of an unprecedented public health emergency should override the traditional ratemaking principles and preclude the City from seeking a rate increase at this time. Naturally, the OSBA is advocating on behalf of the City’s small commercial and industrial customers, while the OCA has made an equally compelling argument on behalf of the City’s residential customers residing outside of the City. Furthermore, the OCA argued that denying rate relief is both a reasonable and temporary outcome in these extraordinary times, and that it will result in just and reasonable rates until such time when fewer customers are suffering financially, and the future is more ascertainable for ratemaking. Inasmuch as the OCA generally opposed any rate increase, the OCA disagreed with the increase to base rates provided for in the Settlement. The OCA contended that increasing base rates from outside-City customers by $689,932, as provided for in the Settlement, “is not supported by the evidence of record in this case.” OCA R.B. at 12.

The City argued that justification for denial of the Settlement or *any* rate increase were contrary to the long-standing ratemaking principles which have traditionally guided the Commission’s evaluation of a utility’s proposed rate increase. City M.B. at 10-12. The City submitted that the Commission has already established that the existence of the COVID-19 pandemic emergency is not a reason to, *per se*, reject a utility’s request for rate increase. The City maintained that, contrary to the position of the OCA and the OSBA, the Settlement properly weighed the ramifications of an unprecedented health emergency and the economic impact by achieving a reduced rate increase from the original proposal. City R.B. at 3-7. Furthermore, under the terms of the Settlement, the Settling Parties noted significant concessions, resulting in the mitigation of the economic impact of the rate increase. Specifically, I&E noted that, through the Settlement, the City’s proposed rate increase to outside-City customers was lowered by $218,489 to $689,932 (approximately the midpoint between the City’s request of $908,421 and both I&E’s litigated position of $474,161 and the OCA’s “business as usual” position of $446,173). I&E Reply Comments at 2-3.

### Recommended Decision

In the Recommended Decision, the ALJ agreed with the Joint Petitioners that the COVID-19 pandemic emergency did not preclude the adoption of the Settlement, and related rate increase in this rate proceeding. The ALJ reviewed the evidence of record developed by the Parties, and the rates, terms and conditions achieved under the proposed “black box” Settlement, albeit nonunanimous. The ALJ concluded that, in these circumstances, the terms of the Settlement achieve a just and reasonable rate increase which was supported by substantial evidence of record and is in the public interest. In reaching this conclusion, the ALJ applied the standards applicable to approving a settlement in rate proceedings. R.D. at 5-7, 14-20, 27-28, 54, 56-58 (*citing*, *CS Water and Sewer*).

### OCA Exception No. 1 and Replies

In its Exception No. 1, the OCA contends that the ALJ erred by approving, without modification, the Settlement submitted to the Commission by the City and I&E. The OCA maintains its objection to any rate increase and suggests that the COVID-19 pandemic is an unusual event causing unprecedented levels of economic devastation, thereby warranting denial of any rate increase. The OCA’s Exception No. 1 mainly reiterates its arguments from testimony and briefs, maintaining its belief that the Settlement is neither reasonable nor in the best interest of the public for the following reasons:

1. The ALJ did not give proper weight to the ratepayer concerns related to the COVID-19 pandemic, noting that economic data, particularly unemployment rates, warrant rejection of the Settlement. OCA Exc. at 3‑11, 16-17.
2. The evidence fails to establish it is necessary to increase rates for the City to earn a fair rate of return. Absent a rate increase, the City would still have enough revenue to provide safe and reliable service.[[27]](#footnote-28) OCA Exc. at 2, 11‑12, 23-25.
3. The Commission has the legal authority to reject a rate increase and given that case law from similar economic circumstances provides precedent for the Commission to deny a rate increase due to extreme customer hardships, it would be an appropriate and valid exercise of the Commission’s authority in this proceeding to do so. OCA Exc. at 4, 12-16, 19-23.
4. The City’s FTY projections in its “early pandemic filing” are unreliable. OCA Exc. at 18-19.
5. The OCA claims the record does not support a $689,932 increase.[[28]](#footnote-29) OCA Exc. at 26.

The OCA complains that, despite these conclusions supporting its overall position that no revenue increase is warranted at this time, which the OCA claims is supported by legal precedent, the ALJ went on to recommend the opposite.

In their Replies, both the City and I&E reject the OCA’s position that the ALJ erred by recommending approval of the Settlement, without modification, inclusive of a $689,932 rate increase for outside-City service, in the context of the ongoing COVID-19 pandemic, arguing that the ALJ’s recommendation is sound and should be upheld. City R. Exc. at 2-13; I&E R. Exc. at 3-8.

The City submits that the OCA’s proposal to summarily deny its rate relief request is not supported by substantial evidence. Conversely, the City contends that the evidence of record, as found by ALJ Haas, supports the rate increase agreed upon under the terms of the Settlement, which is an approximate 25% reduction of the City’s original request. City R. Exc. at 3. I&E notes that, although the base rate increase provided for under the Settlement does not entirely reflect I&E’s analysis, it agrees with the City and the ALJ’s conclusion that it is a reasonable compromise between positions. I&E R. Exc. at 4-6; City R. Exc. at 3-4, 7-8 (citing, R.D. at 16 and 28).

In addressing the OCA’s concerns regarding the economic impact on the City’s customers as a result of the COVID-19 pandemic, the City acknowledges the difficulties faced by its customers, and in weighing the impact of a rate increase on water customers, notes that it withdrew three of its five capital projects in its FTY claim, has taken steps to assist customers, and evaluated the unique but not unprecedented unemployment rates in its service territory, which appear to be quickly declining (from a high of 16.1% in April 2020 to the September 2020 rate of 8.1%). City R. Exc. at 5-6, 9. Furthermore, the City contends that the OCA offered no explanation of how the rate increase of $6.19 per quarter or $2.06 per month, under the Settlement, presents a severe economic hardship to customers or is “substantial,” especially taking note that the City is one of the lowest cost providers of water service in the region, even under proposed rates. *Id*. at 6-7 (citing, OCA Exc. at 3). The City, in essence, concurs with the assertion previously set forth by I&E that the additional base rate revenue that has been agreed upon in this proceeding in the context of a “black box” settlement adequately balances the interests of ratepayers and the City.

Furthermore, based on the current case law, both the City and I&E explain that there is nothing that would prevent a utility from implementing a base rate increase during a pandemic. The City maintains that its argument is consistent with the Commission’s recent decisions in *UGI*, *PGW*, *Columbia Gas*, *PAWC*, and *Pittsburgh Water and Sewer Authority*, Docket Nos. R‑2020-3017951, R-2020-3017970 (Order entered December 3, 2020) (*PWSA*), in which the applicable legal framework was presented, supporting the Commission’s decision that, even in the midst of the COVID‑19 pandemic, traditional rate setting criteria apply. City R. Exc. at 10-11. Specifically, I&E finds noteworthy two recent Commission’s decisions issued since the Recommended Decision in this proceeding was issued: (1) in *Columbia Gas*, the Commission rejected the OCA’s no rate increase position and confirmed reliance on traditional ratemaking methodologies as established in *Bluefield* and *Hope Natural Gas*; and (2) in *PAWC*, the Commission rejected the OCA’s no rate increase position, again confirming traditional ratemaking principles during the COVID-19 pandemic. I&E R. Exc. at 7. I&E adds that, in *Columbia Gas*, the Commission also rejected “broad brush” arguments that fully projected future test year projections are unreliable and rate of return positions unsupported by market-based equity cost analysis, which were similar to the arguments made by the OCA in this proceeding. I&E R. Exc. at 7 (citing, *Columbia Gas* at 52, 54). Therefore, consistent with the foregoing discussion, the City asserts that the Commission should adopt the Recommended Decision and approve the Settlement submitted by I&E and the City. City R. Exc. at 13.

### Disposition

Upon review, we shall deny the OCA’s Exception No. 1. As discussed *supra*, our approval of the Settlement is predicated upon our conclusion that the Settlement is reasonable and in the public interest and supported by substantial evidence. Further, the revenue increase under the terms of the Settlement acknowledges that, while the City may have a substantiated case for a rate increase, the COVID-19 pandemic is still ongoing, and therefore, it is appropriate, on balance, to consider factors which will mitigate the economic burden on ratepayers in this time of state-wide emergency. Under the terms of the Settlement, the Joint Petitioners achieved a settlement which reduces the City’s originally proposed rate increase to mitigate the economic burden on ratepayers by reducing the City’s originally proposed rate increases to the City’s consumption charges in outside-City revenues ranging from 8.2% for the residential class to 12.6% for the industrial class, in lieu of the City’s request, which would have produced increases of 12.7% and 18.2% for those classes, respectively, while affording the City revenue necessary to maintain safe and reliable water service.

Our disposition of this matter during the ongoing COVID-19 pandemic emergency, is guided by the ratemaking principles which established that the Commission must ensure that a public utility’s rates are just and reasonable and not unduly discriminatory. *See* 66 Pa. C.S. §§ 1301, 1304. “In determining just and reasonable rates, the PUC has discretion to determine the proper balance between interests of ratepayers and utilities…Further, the PUC is obliged to consider broad public interests in the rate-making process.” *Popowsky I*, 665 A.2d at 812 (citations omitted); *see also,* *Hope Natural Ga*s, 320 U.S. at 603 (the “…fixing of ‘just and reasonable’ rates, involves a balancing of the investor and the consumer interests…”).

Regarding our discretion in fixing just and reasonable rates, the Pennsylvania Supreme Court explained:

There is ample authority for the proposition that the power to fix “just and reasonable” rates imports a flexibility in the exercise of a complicated regulatory function by a specialized decision-making body and that the term “just and reasonable” was not intended to confine the ambit of regulatory discretion to an absolute or mathematical formulation but rather to confer upon the regulatory body the power to make and apply policy concerning the appropriate balance between prices charged to utility customers and returns on capital to utility investors consonant with constitutional protections applicable to both.

*Popowsky I*, 665 A.2d at 812 (citations omitted).

Here, as in *PAWC*, the main issue raised in the OCA’s Exception No. 1 is whether and how the ongoing COVID-19 global pandemic affects our authority and discretion in determining just and reasonable rates to be charged by the utility during the prospective period in which its rates will be in effect. As in *PAWC*, our present review relies upon ratemaking norms[[29]](#footnote-30) which have been developed over time and consistently utilized by parties in rate cases before the Commission to determine the appropriate level of a utility’s requested revenue increase in accordance with all applicable legal and constitutional standards.

Ratemaking norms and methodologies provide both structure and flexibility by which to determine a utility’s cost of providing service and to determine appropriate rate structure, among other things. We reject the notion that the existence of extraordinary circumstances, such as the COVID-19 pandemic emergency, inhibits our continued use of these traditional ratemaking methodologies to determine the utility’s cost of service, or limits our ability to consider and weigh important factors or principles in setting just and reasonable rates, such as quality of service, gradualism, and rate affordability, *albeit* during this pandemic. *PAWC* at 41-46. Contrary to the OCA’s position, that the existence of the extraordinary circumstances precludes our consideration of a utilities request for a rate increase, these ratemaking norms provide a flexible method for the Commission’s consideration and weighing of factors in setting just and reasonable rates, both in normal circumstances, and in extraordinary circumstances, such as a pandemic.

Here, our analysis of the Settlement is guided by these ratemaking norms, and consistent with the constitutional standards articulated in *Bluefield* and *Hope Natural Gas*, and in the exercise of our discretion, we are persuaded that the rates, terms and conditions of the Settlelment are just and reasonable, supported by substantial evidence of record, achieve a fair and equitable balance of the issues impacting the City, residential consumers, business customers, and the public interest at large. Accordingly, to the extent the OCA avers that the Settlement should be rejected due to the COVID-19 pandemic emergency, the OCA’s Exception No. 1 is denied.

To the extent the OCA asserts in its Exception No 1, that the evidence fails to establish it is necessary to increase rates for the City to earn a fair rate of return, we reject the OCA’s position. The OCA argues that absent a rate increase, the City would still have enough revenue to provide safe and reliable service, asserting, *inter alia*, that the City’s projections in its “early pandemic filing” are unreliable, and that the record does not support a $689,932 increase. OCA Exc. at 2, 11-12, 18-19, 23-26. Further, the OCA maintains that the City’s return at present rates of 5.65% is “more than adequate” and suggests that the City can avoid the need for additional revenue by holding off on all but the absolute necessary system improvement projects. OCA Exc. at 2-3, 12, 17, 24‑25. Finally, the OCA notes that it has presented testimony on revenue requirement, including cost of capital that establishes the revenue increase should be no more than $443,666 for outside-City customers. OCA Exc. at 26.

However, while the OCA has presented evidence to contradict the City’s claimed original requested rate increase and to oppose the City’s rate increase achieved per the Settlement, the OCA failed to demonstrate how the proffered conflicting evidence supports the conclusion that the base rates under the Settlement are either unreasonable or not in the public interest. We note that the “presence of conflicting evidence in the record does not mean that substantial evidence is lacking.” *Allied Mech. And Elec., Inc. v. Pa. Prevailing Wage Appeal Bd.*, 923 A.2d 1220, 1228 (Pa. Cmwlth. 2007) (citation omitted).

Because we conclude that the Settlement is supported by substantial credible evidence, and is reasonable and in the public interest, we find the OCA’s arguments premised on conflicting evidence in the record to be unpersuasive, and we shall, therefore, deny the OCA’s Exception No. 1.

## Rate Base

A utility’s rate base is essentially the company’s “prudent” capital investment, net of accumulated depreciation, plus other additions, such as cash working capital (CWC), and deductions that the Commission determines to be necessary in order to keep the utility operating and providing safe and reliable service to its customers. Stated differently, it is the net asset base from which the utility provides electric, natural gas, or, in this instance, water service, and upon which the utility is provided the opportunity to earn a rate of return. Thus, the rate base value is a key variable in the determination of a utility’s revenue requirement.

In this matter, the City originally claimed a total FTY rate base of $127,003,215, which includes a total FTY projected plant in service of $201,950,540, inclusive of $4,385,805 of plant additions projected to take place in the FTY (less $136,660 of retirements for a net change in plant in service for 2020 of $4,249,145). City M.B. at 16; City St. No. 1, Attachment 1 at 20; I&E Exh. 3, Sch. 3. The City allocated $49,031,825 of the total FTY rate base of $127,003,215 to outside-City service. City M.B. at 16; City St. No. 1, Attachment 1 at 13.

The OCA disagreed with the City’s level of plant in service projected for the FTY, identifying five projects that the OCA contended will not be in service until after December 31, 2020, and should therefore be removed from the City’s FTY plant in service. Specifically, these projects relate to: (1) a well generator under Account 312.13; (2) an emergency generator and (3) roof replacement at the water treatment plant under Account 312.30; (4) fire pump station engineering and construction under Account 316; and (5) the Hecktown Road Bridge main replacement project under Account 322. OCA St. No. 2 at 6-7.

After review of the OCA’s recommended adjustments to the projected plant in service, described above, the City, as discussed in its rebuttal testimony of John Spanos, withdrew its rate base claims for the well generator, the roof replacement at the water treatment plant, and the main replacement at the Hecktown Road Bridge, as those projects have been delayed beyond the end of the first quarter of 2021. City M.B. at 16‑17; City St. No. 3R at 4-5. The removal of these three projects from the City’s budgeted FTY plant additions resulted in a $185,981 reduction to the City’s FTY rate base.[[30]](#footnote-31) In order to reflect the City’s adjustments to operation and maintenance expenses, the City also included a $7,000 adjustment ($1,423,000 increased to $1,430,000) to its CWC claim. City St. No. 1R at 15; City Exh. No. CEH-1R. Therefore, in total, based on consideration of the OCA’s recommendations, the City reduced its original claimed FTY rate base by $178,981 to $126,824,234, reflecting a reduction in plant in service, an increase in accumulated depreciation, and an increase in CWC. However, due to cost allocation changes of the rate base claim apportioned to outside-City service, the jurisdictional allocation to outside-City service was increased by $254,255 to $49,286,080.[[31]](#footnote-32) City M.B. at 16; City St. No. 1R at 15. Two projected plant projects remain in controversy: (1) the emergency generator at the water treatment plant under Account 312.30 and (2) the fire pump station engineering and construction under Account 316.

### Plant in Service – Water Treatment Emergency Generator

#### Positions of the Parties

The City argued that the emergency generator is a necessary capital item for the City to continue to provide reasonable and adequate service, averring it is needed to ensure the water treatment plant remains operational during a power outage or failure in electronic components at the plant, and that scheduling 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. Further, the City argued, excluding the emergency generator from rate base would create an under recovery or a misaligned recovery until the next base rate case, creating an inaccurate level of rate base and depreciation expense going forward. *Id.*

The OCA challenged this capital project on the premise it was unclear from City witness Spanos’ rebuttal testimony that the Water Treatment Emergency Generator project would be completed by February 2021. OCA M.B. at 26-28. Additionally, the OCA averred that the City has not satisfied its burden of proving “that the property sought to be included in the rate base is used and useful in the public service” before it is entitled to a return from ratepayers for the investment. OCA R.B. at 18 (*citing, Pa. PUC v. Pennsylvania-American Water Company*, 68 Pa. P.U.C. 343 (1988)) (*1988 PAWC Order*).

In rejoinder testimony, Mr. Spanos provided a further update on the Water Treatment Emergency Generator project, explaining that the City has taken physical delivery of the emergency generator and the associated automatic transfer switch, both of which were installed as of December 9, 2020. Operation of the generator is expected by mid/late January 2021. City R.B. at 8. To support its position to include the emergency generator in the rate base, the City cited the *1988 PAWC Order*, for the principle that a utility is entitled to a return on investment in property which is essential to the continued operation of the utility in rendering service to its ratepayers. City M.B. at 18 (*citing, 1988 PAWC Order* at 343, 351-352). Mr. Spanos noted that the utility in that proceeding was allowed a claim for projects that would be operating and in service shortly after the end of the test year (approximately three months). *Id.* The City posited the same analysis supports its claim in the instant matter where the emergency generator will be operating and in service shortly after the end of the FTY (mid/late January 2021) and is essential for continued service. *Id.*

#### Recommended Decision

ALJ Haas noted that in reaching the Settlement, the Joint Petitioners did not agree to any individual plant in service claim and so he did not recommend an adjustment to plant in service. However, if the Commission determines that the adjustments to the plant in service are to be considered, the ALJ recommended that the Commission should accept the City’s claim regarding the Water Treatment Emergency Generator project. R.D. at 24-25. The ALJ agreed with the City’s position that the purported operational date of the emergency generator of mid/late January 2021, approximately six months after the end of the test year, is reasonable and that the emergency generator is essential for continued service to ensure the water treatment plant remains operational during a power outage or failure in electronic components at the plant. The ALJ reasoned 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, *1988 PAWC Order* at 343, *citing Dauphin Consol. Water Supply Co. v. Pa. PUC*, 55 Pa. Cmwlth. 624, 423 A.2d 1357 (1980)).

#### OCA Exception No. 2 and Replies

In its Exception No. 2, the OCA maintains its contention that the City has not shown that the emergency generator at the water treatment plant will be used and useful in the test year selected by the City (2020). The OCA contends that it would be unreasonable to include the project in the test year based on the City’s speculation as to when it will be completed and in service, considering that the reason it was delayed, COVID-19, continues to cast uncertainty over different aspects of everyday life. OCA Exc. at 27-28.

In response, the City argues that the ALJ’s recommendation is supported by Commission precedent and past practice. The City explained that the evidence does not support the OCA’s contention that completion of the project is speculative, since vital component parts, such as the generator and the associated automatic transfer switch, have already been installed. City R. Exc. at 14-15.

#### Disposition

As previously indicated, while recommending approval of the Settlement, ALJ Haas only addressed the OCA’s and the OSBA’s proposed ratemaking adjustments in the event that the Commission wants to look past the Joint Petition and consider the adjustments proposed by the OCA and the OSBA. Thus, in other words, if the Commission adopts the Recommended Decision and approves the Joint Petition, without modification, further discussion of the ratemaking adjustments proposed by the OCA and the OSBA is not necessary. *See* R.D. at 1. Therefore, because we previously denied the OCA’s Exception No. 1 and have adopted the Settlement, without modification, we find the OCA’s Exception No. 2 to be rendered immaterial with regard to this individual rate component.

However, for purposes of clarification, as the ALJ found, the Commission may allow claimed expenditures to undertake construction for plant that will not be completed, *i.e*., used and useful at the end of the FYT, in rate base. However, in those circumstances, construction of the specific project has been required to be “in progress” (construction work in progress) during the FTY, and “in service” shortly thereafter. In this instance, we agree with the ALJ that this is the case, which is strengthened by the fact that the emergency generator is essential during a power outage or failure in electric components at the water treatment plant. Nevertheless, the OCA’s Exception No. 2 has been rendered immaterial, as it challenges an individual rate component which is not determinative to our disposition above pertaining to the reasonableness of the Settlement, we therefore deny the OCA’s Exception No. 2.

### Plant in Service – Fire Pump Station

#### Positions of the Parties

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

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

#### Recommended Decision

Similar to the Water Treatment Emergency Generator project, while the ALJ did not recommend an adjustment to plant in service since the Joint Petitioners did not agree to any individual plant in service claim, the ALJ found that, contingent upon the Commission choosing not to approve the Settlement, without modification, the Fire Pump Station should be removed from rate base, reasoning that “the City [had] not provided sufficient evidence to indicate an operational date of the Fire Pump Station.” R.D. at 25-26.

#### City Exception No. 1 and Replies

In its Exception No. 1, the City opposes the ALJ’s alternative recommendation, maintaining its argument that the Fire Pump Station should be included in the plant in service figure because it is a necessary system improvement, and installation and construction will be completed once the City receives the remaining parts. City Exc. at 2-3. The City again cited to the *1988 PAWC Order*, arguing that the company in that case was allowed to claim projects that would be operating and in service shortly after the end of the FTY. City Exc. at 3.

In reply, the OCA supports the ALJ’s alternative finding that the City has not provided sufficient evidence to indicate an operational date of the Fire Pump Station, nor has the City provided any evidence as to when the Fire Pump Station will be in service. OCA R. Exc. at 2. The OCA contends that it would be unreasonable to include the project in the test year based on the City’s speculation as to when it will be completed and in service, considering that the reason why it was delayed, COVID-19 circumstances, continues to cast uncertainty over different aspects of everyday life. OCA R. Exc. at 3.

#### Disposition

Upon review, although we adopt the Settlement, for purposes of clarification, we agree with the rationale and the alternative recommendation of the ALJ to exclude the Fire Pump Station from rate base, which was provided as a contingency recommendation should the Commission choose not to approve the Settlement, without modification. The Fire Pump Station project included the initial engineering work, followed by the construction of the facility. The City’s only counter is that “installation and construction will be completed once the City receives the remaining component parts,” but does not state when it is expected to receive the remaining component parts. *See* City M.B. at 17-18. In matters such as this, where the completion date of the Fire Pump Station is shrouded in uncertainty, a utility’s projections are considered relative to supporting data that includes historic performance. In this instance, the City’s projections have a history of being unreliable. As I&E highlighted, the City’s actual plant additions have fallen short of those included in its capital budget for the past three historic periods. I&E St. No. 3-SR at 6-8. The uncertainty surrounding the completion date of the Fire Pump Station has been a notable concern of the OCA, recognized by the ALJ in the determination of his recommendation, and has been acknowledged by the City. Accordingly, although we adopt the Joint Petition, we also concur with the ALJ’s finding that the City has not provided sufficient evidence to indicate an operational date of the Fire Pump Station. Nonetheless, given our disposition denying the OCA’s Exception No. 1 challenging the reasonableness of the Settlement, the City’s Exception No. 1 is rendered immaterial, as it challenges an individual rate component which is not determinative to our disposition, and it is, therefore, denied.

### Cash Working Capital

#### Positions of the Parties

The City originally claimed an increase of $561,089 to its jurisdictional rate base for CWC. City M.B. at 20-21; City Exh. CEH-1 at 32. The City derived this CWC claim based upon 12.5%, or one-eighth, of the operations and maintenance (O&M) expenses and payment in lieu of taxes. City St. No. 1 at 8. In rebuttal testimony, the City revised its total CWC claim by $7,000 ($1,423,000 increased to $1,430,000) to reflect its adjustments to O&M expenses. As such, the jurisdictional claim for outside-City service was increased by $8,194 to $569,283.[[32]](#footnote-33) City St. No. 1R at 15.

The only disagreement that the OCA had with the City’s revised CWC claim is that it should be adjusted to reflect the OCA’s recommended adjustments to O&M expenses. OCA M.B. at 29. The City agreed, in theory, that the operating expenses included in the CWC calculation should reflect any changes to those expenses ultimately accepted by the Commission. OCA M.B. at 29; City M.B. at 20-22. Since the City disagrees with most of the OCA’s O&M expense adjustments, the City disagrees with the OCA’s CWC adjustment.

#### Recommended Decision

As previously indicated, the ALJ noted that the Joint Petitioners, in reaching the Settlement, did not agree to a rate base claim or, more specifically, a CWC claim, and therefore, recommended no adjustment to either rate base or CWC. R.D. at 26. However, the ALJ found that, contingent upon the Commission choosing not to approve the Settlement, without modification, and that if the Commission determines that adjustments should be made to the City’s O&M claims, an adjustment to the City’s CWC claim is necessary. Specifically, the ALJ stated that the Commission should “reduce or increase, as appropriate, the City’s CWC claim by the difference between the City’s CWC claim and 12.5% of the total adjusted O&M expenses, excluding bad debt expense.” R.D. at 26.

#### City Exception No. 2 and Replies

In its Exception No. 2, the City opposes the ALJ’s recommendation and instead stated that “if the Commission determines that adjustments to the City’s O&M expenses should be considered then the Commission should accept the City’s claim for O&M expenses and the related claim for CWC.” City Exc. at 4.

In reply, the OCA notes its recommended adjustments to O&M expenses, and therefore, expresses its agreement with the ALJ’s recommendation that the final CWC amount should be based on the final level of expenses. OCA R. Exc. at 3.

#### Disposition

As noted by the ALJ, the OCA did not oppose the one-eighth method proffered by the City for determining its claim for CWC. However, although the CWC calculation, known as an iteration, effectively prevents the determination of a precise calculation until such time as all proposed adjustments to the City’s expense claims have been considered by the Commission, the OCA proposed to reduce the City’s CWC claim to reflect its proposed O&M expense adjustments. Upon our review of the record, although we adopt the Settlement, for purposes of clarification, we note that we agree with the rationale behind the ALJ’s contingent recommendation to adjust the City’s CWC claim. However, given our disposition denying the OCA’s Exception No. 1 challenging the reasonableness of the Settlement, the City’s Exception No. 2 is rendered immaterial, as it challenges an individual rate component which is not determinative to our disposition, and it is therefore, denied.

## Rate Case Expense

### Positions of the Parties

The City stated that rate case expenses include: (1) legal fees; (2) professional consulting fees for revenue requirement, rate base, rate of return, and rate design exhibits, supporting data and testimony; and (3) customer notice expenses. The City presented an annual rate case expense of $138,187 based on a three-year, or 36-month, normalization of projected rate case expense totaling $414,560 through the conclusion of the instant proceeding. City M.B. at 25; City R.B. at 11-12.

The City offered that a three-year normalization period is reasonable because it acknowledges that rate case expense should be spread out over a period of years without penalization due to costs, previous case requirements and limited resources. The City explained that, historically, it filed its rate cases every two years; however, the City’s rate cases filed in 2007, 2011 and 2013 produced a period of extended, abnormal intervals due to its involvement in a long duration rate case dispute and a rate case in which the City took longer than two years to address the settlement terms. Further, the City emphasized that, although rate case expense is normalized for recovery over several months, the cash outlay occurs in real time during the rate case proceeding, resulting in a cash shortfall in relation to the expense. Moreover, the City noted that, if the rate case interval is shorter than the assumed normalization period, the effect of the shortfall is worsened by placing the City at risk for under recovery. City M.B. at 25-27; City R.B. at 11-12.

The OCA submitted that the City’s actual rate case expense is substantially less than its projection. The OCA witness, Ms. Stacy L. Sherwood, argued that, “the amount spent to date on rate case expense is $259,402.” OCA M.B. at 40 (citing, OCA St. No. 2S at 3-4). According to the OCA, the City’s projected total rate case expense of $414,560 is not supported by the record nor a reasonable estimate. The OCA further submitted that the City’s position, to normalize rate case expense over three years, does not accurately reflect the City’s filing history. The OCA asserted that, to ensure consistency with Commission precedent and based on the average time between the City’s three most recent rate filings, a 52-month normalization period should be applied to rate case expense, resulting in a proposed adjustment of $78,325. OCA M.B. at 40-41 (citing, OCA St. No. 2 at 10-11; OCA Exh. Sch. SLS-6S). The OCA cited several Commission cases to contend that rate case expenses are normal operating expenses and normalization, therefore, should be based on the historical frequency of the utility’s rate filings because it represents known and measurable data.[[33]](#footnote-34) OCA R.B. at 26-27; OCA M.B. at 38-39.

The OCA addressed the City’s speculation regarding the frequency of its rate increase cases going forward, arguing that it is contrary to the Commission’s precedent that the normalization period is determined “by examining the utility’s actual historical rate filings, not upon the utility’s intentions.” OCA R.B. at 27 (citing, *Popowsky*). The OCA also questioned the City’s reasoning as to why its recent rate cases were not filed on two-year intervals. Specifically, the OCA posited that the City did not explain how the same or other circumstances will not similarly prevent the City from filing for a rate increase more frequently than it has in the past. OCA R.B. at 27.

### Recommended Decision

The ALJ began by noting that a utility’s allowable claim for rate case expense is comprised of expenditures directly incurred to compile, present, and defend a utility’s request for a base rate increase before the Commission. R.D. at 32 (citing, I&E St. No. 1 at 6). The ALJ also cited three prior Commission cases to note that, although it is the Commission’s practice to recognize all prudently incurred rate case expense and determine a normalization period based upon the frequency of historic filings, the Commission has also recognized that there are exceptions to the general principle that the history of rate filings represents the best evidence for normalization.[[34]](#footnote-35) R.D. at 32-33.

Upon noting that the Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim, the ALJ recommended that no adjustment be made to rate case expense. However, the ALJ added that, if the Commission determines that adjustments to the individual expense claims are necessary, then he recommended that the Commission accept the OCA’s adjustment to normalize the rate case expense over a 52-month period. The ALJ explained that, although the City contended that the time gap between the filing of the present rate case and the last rate case was an anomaly, “[t]he City did not provide sufficient evidence to warrant deviation from the typical Commission practice to base the normalization period of the rate case expense on the historical frequency of the utility’s rate case filings.” R.D. at 33. The ALJ further elaborated that the City did not provide evidence sufficient to make a finding that a similar time gap between rate case filings will not occur again in the future. The ALJ also found that the City did provide evidence to support its claim that it will file another rate case within the next three years. The ALJ concluded that “there is a strong risk of over-recovery” if the City is permitted to normalize the expense over a three-year period. *Id.*

Regarding the amount of total rate case expense, the ALJ found that the City justified, with supporting evidence, its projected rate case expense of $414,560. The ALJ explained that the OCA’s total rate case expense of $259,402, as of early December 2020, does not account for the continued litigation of the present case past early December 2020. Accordingly, the ALJ concluded that, if the Commission determines that adjustments to the individual expense claims are necessary, then he recommended that the City’s rate case expense claim of $414,560 be normalized over a 52-month period. R.D. at 33.

### Exceptions and Replies

#### City Exception No. 3 and Replies

In its Exception No. 3, the City challenges the ALJ’s contingent recommendation that, if the Commission determines that adjustments to the City’s individual expense claims are necessary, then the Commission should accept the OCA’s proposal to normalize rate case expense over a 52-month period. The City contends that, if the Commission determines that adjustments to the City's individual expense claims should be considered, then the Commission should accept the City’s proposed normalization period of 36 months as a reasonable projection of historic rate case intervals. City Exc. at 4-5 (citing, R.D. at 33).

The City addresses the ALJ’s conclusion that the City did not present sufficient evidence to support its position that it will file another rate case within the next three years. City Exc. at 4-5 (citing, R.D. at 33). The City repeats its argument that the OCA’s proposal to increase the normalization period to 52 months is based on abnormal, extended intervals between the City's three most-recent base rate cases and, therefore, should not be relied upon for determining the appropriate normalization period. The City further notes that, although its normalization claim is presented for a 36-month period, the City’s rate case intervals prior to 2007 support a normalization period of 24 months. City Exc. at 5 (citing, City M.B. at 25-26; City R.B. at 11).

The City repeats its claim that, although rate case expense is normalized for recovery over several months, the actual cash outlay occurs in real time during the rate case proceeding, thereby creating a cash shortfall in relation to the expense. The City maintains that, if the rate case interval is shorter than the assumed normalization period, a 52-month normalization period would exacerbate the effect of the shortfall by placing the City at risk for under recovery. City Exc. at 5 (citing, City M.B. at 26; City R.B. at 11‑12).

In its Reply to the City’s Exception No. 3, the OCA counters that, the ALJ did not err in his recommendation that if the Settlement is adopted, then the Commission should normalize rate case expense over a 52-month period. The OCA contends that the City’s proposed three-year normalization period would be contrary to Commission precedent. The OCA notes that, the Recommended Decision acknowledged that while there are exceptions, there is Commission precedent to recognize all prudently incurred rate case expenses and determine a normalization period based upon the historical frequency of filings. OCA R. Exc. at 4 (citing, R.D. at 32-33). Further, the OCA repeats its argument that, the Commission has consistently held that rate case expenses are normal operating expenses and normalization, therefore, should be based on the historical frequency of rate filings and not the utility’s intentions. Moreover, the OCA maintains that basing the normalization period on historical filing frequency is reasonable because it represents known and measurable data. OCA R. Exc. at 4-5. In addition, the OCA repeats its argument that the City does not state how circumstances will not similarly prevent it from filing rate increase cases more frequently than it has previously, adding that, “the City does not present a coherent argument as to why the rare exceptions to this general rule should apply to them.” OCA R. Exc. at 5.

#### OCA Exception No. 4 and Replies

In its Exception No. 4, the OCA challenges the ALJ’s contingent recommendation that, if the Commission determines that adjustments to the City's individual expense claims are necessary, then the Commission should accept the City’s projected rate case expense of $414,560 because the OCA did not account for the expenses that the City had incurred and will incur after early December 2020. OCA Exc. at 29-30 (citing, R.D. at 33). The OCA repeats that, as of early December 2020, the actual amount of rate case expense spent was $259,402. OCA Exc. at 29 (citing, OCA M.B. at 40; OCA Sch. SLS-6S). Further, the OCA maintains that the City did not provide evidence to support a projected incurred expense of $155,158 from December 2020 through the resolution of the instant matter. Moreover, the OCA asserts that the City did not take the opportunity to update its projected rate case expense to reflect a more accurate amount of the expenses already incurred. OCA Exc. at 30.

In its Reply to the OCA’s Exception No. 4, the City counters that, the ALJ properly recognized that the OCA did not account for litigation expense actually incurred after early December 2020, including: (1) the preparation and submission of the Joint Petition with I&E; (2) the stipulation of certain issues with the OCA; and (3) the preparation and submission of main briefs, reply briefs, exceptions and replies to exceptions. The City notes that, in early December 2020, the City was continuing to litigate with the OCA and the OSBA, resulting in a total rate case expense of $414,560. City R. Exc. at 16.

### Disposition

As previously discussed, although he recommended approval of the Settlement, without modification, ALJ Haas addressed the OCA’s proposed adjustments to rate case expense in the event that the Commission determines that adjustments to the expense components are necessary. Therefore, if the Commission adopts the Recommended Decision and approves the Joint Petition, without modification, further discussion of the rate case expense adjustments proposed by the OCA is not necessary. *See* R.D. at 1.

The ALJ determined that the City did not provide sufficient evidence to justify an exception to the Commission’s guiding principle that utilization of the utility’s historical rate case filing frequency represents the best evidence for the normalization period of rate case expense. R.D. at 32-33. The City contended that the intervals between its rate cases filed after 2007 do not present a reliable basis for a normalization period due to abnormal circumstances stemming from its recent rate cases. City M.B. at 25-26. As noted by the ALJ, other than providing reasons for the intervals between its recent rate case filings, the City did not provide evidence sufficient to conclude that its recent pattern of rate filing frequency will not continue into the future.

The ALJ was persuaded, however, by the City’s justification, by evidence, of total rate case expense of $414,560. R.D. at 33. Although the OCA argued that the City had total rate case expense of $259,402 as of early December 2020, the ALJ noted that the City has continued to litigate this proceeding since early December 2020. OCA Exc. at 29; R.D. at 33. Given the continued litigation, the total rate case expense at the conclusion of this proceeding will be more than the accumulated total as of early December 2020; however, the City’s projected total rate case expense should be based on reliable evidence that supports its projection. Even so, as the City’s Exception No. 3 and the OCA’s Exception No. 4 have been rendered immaterial, as they challenge an individual expense component which is not determinative to our disposition above pertaining to the reasonableness of the Settlement, we therefore deny the City’s Exception No. 3 and the OCA’s Exception No. 4.

## Salaries and Wage Expenses / Social Security Expense

### Positions of the Parties

The City’s original requests for salaries, wages and social security expenses for its water employees were subsequently adjusted during this proceeding to include a 2.0% increase in union contract wages that had been negotiated and approved by the City effective January 1, 2021, one day after the end of the FTY relied upon by the City in this rate case. With the pro forma adjustments, the City presented a claim of $4,064,528 for its salaries and wage expenses. City St. No. 1 at 6; City St. No. 1, Attachment 1 at 32 (Adjustment E-10). Similarly, the City submitted a claim of $310,936 for social security expenses, which includes the pro forma adjustment resulting from the increase in union contract wages effective January 1, 2021. City Exh. CEH-1R at 23 (Adjustment E-10-REB).

The City stated that the post-test year salary and wage adjustment and related increase in social security expenses effective January 1, 2021, are known, measurable and certain to occur as they are required by union contract, and, as such, are fair to include in the present rate case. The City argued that this Commission has accepted salary increases required by union contract taking effect one day after the end of the FTY in a number of ratemaking cases in the past, citing *Pa. PUC v. City of Bethlehem (Water)*,160 PUR 4th 375, 386 (Pa. PUC 1995), and *Pa. PUC v. Keystone Water Co.*,58 Pa. PUC 437, 454 (1984), as authority. The City, therefore, asserted that the OCA’s proposed changes to the City’s salary, wage, and social security expenses to remove the adjustments necessitated by the union contract should be rejected. City M.B. at 27-28.

The OCA argued that the City’s water department should not be allowed to use the pro forma salary and wage rates (and corresponding adjustments to social security expenses) it is now seeking arising from the union contract that went into effective on January 1, 2021, because the claimed expenses fall outside the City’s FTY that ended December 31, 2020. The OCA stated that the City affirmatively chose to use the selected test period, and it should not now be allowed to have it both ways by reaching beyond the FTY to further adjust salaries, wages, and social security expenses.

The OCA contended that such pro forma adjustments are improper as they violate the “matching principle,” which requires revenues and expenses to be from the same time period. The OCA cited to *Pa. PUC v. City of Lancaster – Sewer Fund*, Docket No. R-00049862 (Order entered August 26, 2005), *aff’d* in relevant part, *rev’d* in part 2006 Pa. Commw Unpub. LEXIS 2 (Pa. Cmwlth. 2006), in which the Commission excluded a post-test year debt service payment that fell outside of the test year. The OCA contended that any exception to the matching principle should not be used to justify the requested adjustment during the COVID-19 pandemic given the negative effects that the additional cost will have on ratepayers. The OCA, therefore, concluded that the City’s salaries and wages need an overall reduction of $79,697 ($30,913 of which should be allocated to outside-City customers) and a similar corresponding reduction to social security expenses of $6,096 ($2,365 of which should be allocated to outside-City customers). OCA M.B. 32-34 (citing, OCA St. No. 2 at 8; OCA St. No. 2S at 4; OCA Schs. SLS-4 and SLS-5S; and App. A.2, Table II); OCA R.B. at 22-24 (citing, OCA St. No. 1 at 26).

### Recommended Decision

The ALJ found that no adjustment to salaries and wages or social security expenses are necessary if the Settlement is approved as the Joint Petitioners did not agree to any individual expense claim. However, if the Commission finds that a determination must be made as to whether adjustments to these individual expense claims are necessary, the ALJ recommended that the City’s position should be adopted and that no adjustment be made to the salaries and wages or social security expense claims. According to the ALJ, an exception should be made to the “matching principle” for the union contract expense because the expense is known, measurable and certain to occur. The ALJ found that this conclusion is consistent with prior Commission rate proceedings permitting salary increases to take effect one day after the end of the FTY when based on a union contract, and that applying the “business-as-usual” approach further supports this result despite the existence of the COVID-19 pandemic. R.D. at 36-37.

### OCA Exception No. 3 and Replies

In its Exception No. 3, the OCA asserts that the ALJ improperly applied an exception to the matching principle in this case, which requires revenues and expenses to be from the same test period, by allowing the City to include an increase in union contract wages and related social security costs in the FTY (2020) that was not scheduled to go into effect until January 1, 2021. The OCA argues that the City should not benefit from its decision to use a test period that did not include the effective date of the new union contract. Further, while the ALJ relies on a “business-as-usual” approach as the justification for not taking the COVID-19 pandemic into account when deciding whether to grant the exception, the OCA argues that denying the exception and applying a “business-as-usual” approach are not mutually exclusive. The OCA concludes that the City’s customers are facing real financial hardship because of this pandemic; and, therefore, the Commission should not apply the exception to the matching principle given the negative effects that applying the new union contract rates will have on ratepayers. OCA Exc. at 28-29 (citing, OCA St. No. 1 at 26; OCA M.B. at 32-34; OCA R.B. at 22‑23).

In its Reply, the City submits that the ALJ was correct to accept the City’s claim for the increase in union contract wage and social security expenses effective January 1, 2021, one day after the end of the 2020 calendar year test period. The City states that the Recommended Decision is consistent with past Commission decisions on this issue since the increases are known, measurable and certain to occur as they are required by union contract. City R. Exc. at 15 (citing, R.D. at 34-37).

### Disposition

We agree with the ALJ’s recommendation that no adjustments to the salaries and wage or social security expense claims are necessary. As the ALJ found, there are a number of Commission decisions that have allowed salary and wage increases, as well as the corresponding social security increases, after the end of the FTY when the increases are the result of a union contract. The Commission has regularly allowed such post-test year union contract increases because they are known and measurable and will be in effect during the period that rates established in the proceeding are in force. However, where the proposed post-test year increase is based on anticipatory or estimated expense changes, the Commission has routinely disallowed those increases under the matching principle. Furthermore, as it challenges an individual rate component, which is not determinative to our disposition approving the Settlement, the OCA’s Exception No. 3 is rendered immaterial, and therefore denied.

## East Allen Township Equipment Maintenance Expense

### Positions of the Parties

The City made a claim of $225,171 for the East Allen Township expense of which there are several subcategories. City Exh. CEH-1R at 7; I&E Exh. 1, Sch. 6 at 6. Only one of the subcategories, the “equipment maintenance expense” totaling $34,605, remains in dispute. The City’s claim for the equipment maintenance expense is based on the expense actually incurred during 2019. The City stated that the equipment maintenance expense incurred in 2019 was the result of emergency repairs performed by the City. While admitting that the expense incurred in 2019 was higher than the previous two years, the City argued that it experiences emergency equipment repairs every year in order to maintain its aging infrastructure. The City asserted, therefore, that the emergency maintenance expenses actually incurred in 2019 are just and reasonable and should be accepted on a going-forward basis. City M.B. at 29.

In regard to the disputed East Allen Township equipment maintenance expense, the OCA disagreed with the City’s position that the expense should be adjusted based on the 2019 expense level alone, arguing that the City presented no evidence to support its assertion that the 2019 level is representative of the expense on a going-forward basis. Rather, the OCA argued that the ratemaking technique of “normalization” is appropriate here to smooth out the effects of a regularly occurring expense but at differing amounts so that the expense can be fairly recovered on an annual basis, citing *Pa. PUC v. Total Environmental Solutions, Inc.,* 2008 Pa. PUC. LEXIS 42, \*98 (2008) and James H. Cawley & Norman J. Kennard, *A Guide to Utility Ratemaking* at 86 (2018 ed.), in support of its position. OCA M.B. at 35-36.

As such, the OCA’s expert, Ms. Sherwood, recommended that the FTY be adjusted to reflect the normalized expense over a three-year period, 2017 through 2019. Ms. Sherwood used the actual expense levels for the three years ($4,048, $11,648, and $34,605, respectively) and normalized them to account for any fluctuations, including one-time expenses in the equipment maintenance expense. As a result, Ms. Sherwood adjusted this expense in the amount of $17,838, of which $6,586 is allocated to outside-City customers. *Id.* (citing, OCA St. No. 2S at 6; OCA Sch. SLS-3S).

### Recommended Decision

The ALJ found that no adjustment to the East Allen Township expense is recommended if the Settlement is approved as the Joint Petitioners did not agree to any individual expense claim. However, if the Commission finds that a determination must be made as to whether adjustments to this individual expense claim is necessary, the ALJ recommended that the OCA’s position should be adopted on this issue. The ALJ determined that the City did not present sufficient evidence to support its conclusion that the equipment maintenance expense incurred in 2019 will be the same on a going-forward basis. The ALJ agreed with the OCA that this expense for the FTY should be calculated through normalizing the past three years to smooth out any irregularities and to prevent overcollection. In so finding, the ALJ recommended that the East Allen Township expense claim be adjusted by $6,586 allocated to the City’s Outside-City service. R.D. at 39.

### City Exception No. 4 and Replies

In its Exception No. 4, the City argues that it experiences emergency equipment repairs every year in order to maintain its aging plant and infrastructure. The City claims that the level of expenses incurred in 2019 for equipment maintenance was reasonably incurred and should, therefore, be accepted as reasonable and just on a going-forward basis. City Exc. at 6-7.

In its Reply, the OCA asserts that the ALJ correctly used the normalization technique to adjust the equipment maintenance expense over a three-year period (2017‑2019) to account for fluctuations and one-time expenses that may occur over time. The OCA states that the evidence shows that the actual expense levels incurred for the three years varies widely, ranging from a low of $4,048 in 2017 to a high of $34,605 in 2019. The OCA concludes that with such variance in expense levels, it is unreasonable to expect that the annual equipment maintenance expense will remain at the 2019 level in FTY given the historical expense levels in prior years. The OCA submits that the ALJ properly adopted the OCA’s three-year normalization adjustment as reasonable and appropriate in order to account for routine fluctuations and one-time expenses. OCA Exc. at 5-6 (citing, R.D. at 38-39; OCA St. No. 2S at 5-6).

### Disposition

Upon review, although we adopt the Settlement, we also agree with the ALJ’s alternative recommendation to adopt the OCA’s position that the East Allen Township equipment maintenance expense for the FTY should be calculated by normalizing the past three years, 2017 through 2019, to smooth out any fluctuations and one-time charges in order to prevent overcollection. Our examination of the record in this proceeding does not support a finding that the City met its burden of proof that relying only on the 2019 level of spending for this expense was reasonable or justified. Based on the foregoing, we accept the ALJ’s alternative recommendation that the East Allen Township equipment maintenance expense claim should be adjusted by $6,586 and allocated to the City’s jurisdictional outside-City customers, noting that this does not change our disposition above pertaining to the reasonableness of the Settlement on this matter.

## Water Filtration Related Expenses

The OCA cited the City’s response to I&E’s interrogatories to note that the City identified department contracts expense, heating oil expense and equipment maintenance expense as being under the water filtration heading that include either one‑time expenses or fluctuating expenses. The OCA recommended that, to account for the fluctuations and one-time expenses over the three-year period of 2017 through 2019, the FTY expense levels be adjusted by $3,677, $13,442, and $23,458, to reflect normalized expenses for department contracts expense, heating oil expense and equipment maintenance expense, respectively. OCA M.B. at 36-37 (citing, OCA St. No. 2 at 9-10).

### Positions of the Parties

#### Department Contracts Expense

The City submitted that its department contracts expense claim of $196,413, of which $79,272 is allocated to jurisdictional outside-City service, is reasonable and appropriate. The City disagreed with the OCA’s proposed normalization to department contracts expense and noted that the OCA used incorrect values in its proposed normalization adjustment. City M.B. at 29-30.

Consequently, the OCA updated its normalization adjustment of department contracts expense to $1,270 over a three-year period, of which $469 is allocated to jurisdictional outside-City service. OCA St. No. 2S at 7; OCA Exh. Sch. SLS-4S. However, the OCA contended that the City did not explain why department contracts expense should not be normalized. OCA R.B. at 25.

#### Heating Oil Expense

The City contended that its claim for heating oil expense is not based on a fluctuation, but rather an increase in the historic test year expense between 2017 and 2019. The OCA accepted the City’s argument regarding heating oil expense and, therefore, this issue was resolved. City M.B. at 30; OCA M.B. at 37 (citing, OCA St. No. 2S at 7).

#### Equipment Maintenance Expense

The City explained that its claim for equipment maintenance expense is based on actual expenses incurred during 2019 due to necessary emergency repairs. The City noted that, although equipment maintenance expense is higher in 2019 than the previous two years, necessary and emergency equipment repairs are experienced every year in order to operate and maintain an aging plant and infrastructure as well as meet regulatory requirements. The City further noted that equipment maintenance expense was reasonably incurred in 2019 and should be accepted as the reasonable and appropriate level of expense going forward. City M.B. at 30-31; City R.B. at 14.

The OCA maintained that equipment maintenance expense should be normalized by an adjustment of $23,458, of which $8,661 is allocated to jurisdictional outside-City service. Further, the OCA contended that, although the City claims that necessary and emergency repairs occur every year, the City did not explain why equipment maintenance expense should not be normalized. OCA R.B. at 25-26; OCA Sch. SLS-4S.

### Recommended Decision

#### Department Contracts Expense

Upon noting that the Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim, the ALJ recommended that no adjustment be made to department contracts expense. However, the ALJ added that, if the Commission determines that adjustments to the individual expense claims are necessary, then he recommended that the Commission accept the OCA’s adjustment to department contracts expense of $1,270, including $469 allocated to jurisdictional outside-City service. The ALJ explained that, “[t]he City did not provide sufficient evidence to show that the department contracts expense is a normally occurring prudent expense, but in fact admitted in its response to I&E’s interrogatories that its department contracts expense contains fluctuating expenses.” R.D. at 40-41. Accordingly, in his alternative recommendation, the ALJ agreed with the OCA’s position to normalize the expense over a three-year period. *Id.*

#### Heating Oil Expense

The ALJ noted that the City proved, and the OCA agreed, that heating oil expense is not a fluctuating expense but has been increasing each year. Accordingly, the ALJ concluded that normalization of heating oil expense is not necessary and, therefore, recommended that no adjustment be made to heating oil expense. R.D. at 42.

#### Equipment Maintenance Expense

Upon noting that the Joint Petitioners, in reaching the Settlement, did not agree to any individual expense claim the ALJ recommended that no adjustment be made to equipment maintenance expense. However, the ALJ noted that, if the Commission determines that adjustments to the individual expense claims are necessary, then he recommended that the Commission accept the OCA’s proposed adjustment to equipment maintenance expense of $23,458, including $8,661 allocated to jurisdictional outside-City service. The ALJ explained that, “[t]he City did not provide sufficient evidence to show that the 2019 equipment maintenance expense is representative of the expense moving forward.” R.D. at 43. Accordingly, the ALJ, in his alternative recommendation, agreed with the OCA’s position to account for the irregular level of expense in 2019 by normalizing the expense over a three-year period. *Id.*

### City Exception No. 5 and Replies

We begin by noting that, with regard to the issues concerning department contracts expense and heating oil expense under water filtration, no Parties filed exceptions.

In its Exception No. 5, the City challenges the ALJ’s contingent recommendation that, if the Commission determines that adjustments to the City's individual expense claims are necessary, then the Commission should accept the OCA’s proposal to normalize water filtration equipment maintenance expense based on a three-year average. The City contends that, if the Commission determines that adjustments to the City's individual expense claims should be considered, then the Commission should accept the City's claim for water filtration equipment maintenance expense. City Exc. at 7 (citing, R.D. at 43).

The City addresses the ALJ’s conclusion that the City did not present sufficient evidence to support its claim that equipment maintenance expense incurred in 2019 represents the level of expense going forward. The City repeats its argument that the equipment maintenance expense incurred in 2019 was based on the actual expense incurred during 2019 and was due to necessary and emergency repairs, which the City experiences every year in order to operate and maintain an aging plant and infrastructure and meet all regulatory requirements. Further, the City maintains that, although the expense incurred in 2019 is higher than the previous two years, equipment maintenance expense was reasonably incurred in 2019 and should be accepted as the reasonable and appropriate level of the expense going forward. City Exc. at 7-8 (citing, R.D. at 43, City M.B. at 30-31; City R.B. at 14).

In its Reply to the City’s Exception No. 5, the OCA counters that, the ALJ’s recommendation that if the Settlement is not adopted then the Commission should normalize water filtration equipment expense based on a three-year average, is reasonable and appropriate. The OCA contends that, the ALJ’s determination that the City did not provide sufficient evidence to prove that all of the expenses associated with water filtration equipment maintenance are normally occurring and prudent, is consistent with the evidence in this case. Further, the OCA notes that, the City admitted in its response to I&E’s interrogatories that “one of these expenses contains fluctuating expenses.” OCA R. Exc. at 7 (citing R.D. at 41). Moreover, the OCA repeats its position that the City failed to “articulate” why normalizing water filtration equipment maintenance expense is not suitable if necessary and emergency repairs occur each year. OCA R. Exc. at 7.

### Disposition

As previously discussed, although he recommended approval of the Settlement, ALJ Haas addressed the OCA’s proposed adjustments to water filtration expenses in the event that the Commission determines that adjustments to the expense claims are necessary. Therefore, if the Commission adopts the Recommended Decision and approves the Joint Petition, without modification, further discussion of the water filtration equipment maintenance expense adjustments proposed by the OCA is not necessary. *See* R.D. at 1.

In his alternative recommendation, the ALJ determined that the City did not provide “sufficient evidence” to support its claim that the 2019 amount of equipment maintenance expense represents the level of expense moving forward. R.D. at 43. The City claimed that its 2019 level of equipment maintenance expense, while larger than the previous two years, includes expenses for necessary and emergency repairs that occur each year. City Exc. at 7; City R.B. at 14. Beyond arguing that its 2019 equipment maintenance expense includes expenses for yearly repairs and maintenance, the City did not specify why this category of expenses should not be based on normalization going forward. Nevertheless, the City’s Exception No. 5 has been rendered immaterial, as it challenges an individual expense component which is not determinative to our disposition above pertaining to the reasonableness of the Settlement, we therefore deny the City’s Exception No. 5.

## Depreciation Expense

### Positions of the Parties

The City originally claimed a total pro forma depreciation expense of $2,675,569 for the FTY. City Exh. CEH-1 at 11. Of this $2,675,569, $1,036,879, or 38.75%, was allocated to outside-City customers. City St. No. 1, Attachment 1 at 13. As discussed previously, based on the removal of three specific projects from the City’s budgeted FTY plant additions discussed in the rebuttal testimony of Mr. Spanos,[[35]](#footnote-36) the City reduced its total FTY depreciation expense claim by $3,387 to $2,672,182. City St. No. 1R at 13-14; City Exh. CEH-1R at 2. However, as a result of changes to allocation factors,[[36]](#footnote-37) the amount allocated to jurisdictional outside-City customers increased by $6,596 to $1,043,475. City Exh. CEH-1R at 4.

As previously noted, two forecasted plant projects remain contested by the OCA: (1) the emergency generator at the water treatment plant under Account 312.30 and (2) the fire pump station engineering and construction under Account 316. In surrebuttal testimony, the OCA noted that the depreciation expense for the remaining two contested projects was $24,049, of which $9,892 was allocated to outside-City customers. OCA Sch. SLS-8S. The OCA averred the outside-City values for the emergency generator and the fire pump station are $5,668 and $4,224, respectively, and, like the rate base claims for these projects, the related claims for depreciation expense, accordingly, should be removed. *Id*.

### Recommended Decision

Consistent with his alternative recommendation to exclude the Fire Pump Station project from the City’s rate base, which is contingent upon the Commission choosing not to approve the Settlement, without modification, the ALJ recommended that the Commission adopt the OCA’s associated adjustment to depreciation expense for the Fire Pump Station. The ALJ referenced his discussion concerning the plant in service claims, noting his alternative recommendation that the OCA’s arguments regarding the emergency generator should be rejected. Accordingly, the ALJ’s alternative recommendation did not include an associated adjustment to the City’s depreciation expense, regarding the emergency generator. R.D. at 46.

### City Exception No. 6 and Replies

In its Exception No. 6, the City maintains that its claim for depreciation expense is just and reasonable and supported by the evidence of record. Therefore, the City submits that its rate base claim for the Fire Pump Station and the related claim for depreciation expense should be accepted. City Exc. at 8.

The OCA’s Replies maintain that the ALJ appropriately recommended a downward adjustment to the City’s depreciation expense claim, related to the ALJ’s recommendation to adopt the OCA’s adjustment to exclude the Fire Pump Station from rate base, as discussed in the OCA’s Reply to the City’s Exception No. 1. OCA R. Exc. at 8. However, consistent with the OCA’s Exception No. 2, the OCA, accordingly, maintains that the related depreciation expense adjustment for the emergency generator should be accepted.

### Disposition

For the reasons set forth in our dispositions of the issues pertaining to the OCA’s recommended adjustments to plant in service, reflective of its position that both the Emergency Generator and Fire Pump Station projects should be excluded from the City’s FTY rate base claim, discussed *supra*, while we adopt the Settlement, we also find that the ALJ, in his alternative recommendation, properly excluded the Fire Pump Station from the City’s forecasted FTY plant in service, and accordingly correctly recommended reduction to the City’s depreciation expense claim. However, given our disposition denying the OCA’s Exception No. 1 challenging the reasonableness of the Settlement, the City’s Exception No. 6, as well as the OCA’s Exception No. 2, discussed *supra*, are rendered immaterial, as they challenge an individual rate component which is not determinative to our disposition, and they are therefore, denied.

## Fair Rate of Return

### Positions of the Parties

The City claimed an overall rate of return of 8.21%, utilizing a 10.20% return on equity. City St. No. 2; Exh. HW-1, Sch. 2; City M.B. at 33. It requested that if the Commission decides to adjust the City’s common equity cost rate to reflect the income tax status of the City’s “investors,” the City’s cost rate for common equity capital is 8.77% with an overall rate of return of 7.42%. City St. No. 2 at 2.

The OCA recommended an overall rate of return of 6.57%, utilizing a tax adjusted 7.31% return on equity. The “black box” Settlement only specifies a revenue requirement of $689,932 and does not stipulate any of the rate of return components. The OCA submitted the revenue requirement should be no higher than $443,666. OCA M.B. at 4.

OCA Witness Garrett used the DCF model and the CAPM in determining a market-based cost of equity of 6.0%. OCA St. No. 3 at 6. Mr. Garrett recommended a “business as usual” cost of equity of 8.50%. OCA M.B. at 49. The primary difference between Mr. Garrett’s analysis and that of City witness Harold Walker was the long-term growth inputs. Specifically, Mr. Garrett stated 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, as measured by the Gross Domestic Product (GDP). OCA M.B. at 54-55.

The City noted that OCA Witness Garrett recommended a market value DCF of 6.1% for his proxy group, 355-basis points less than the market value DCF of the I&E witness and below any zone of reasonableness. According to the City, Mr. Garrett’s market value DCF of 6.1% is a result of his sole reliance on an inappropriate, short term, 30-day yield measurement component, and an inappropriate growth component based on a 30-year measure of growth for the overall national economy as measured by GDP. Mr. Walker stated the growth in GDP does not provide a reasonable measure for the growth of the comparison companies, noting over the past 30 years (1989-2019), nominal GDP increased by 280% while the comparison companies’ revenues increased 510%, or 82% more than GDP. City M.B. at 39-40.

### Recommended Decision

The ALJ found it unreasonable for the OCA to use a GDP forecast as a long-term growth rate, given that the revenues of the comparison companies outgrew GDP by 82% over the last 30 years. Noting the primary difference between the City’s and the OCA’s DCF calculation was the long-term growth rate, the ALJ did not make any other decisions regarding the OCA’s DCF calculation. Therefore, the ALJ did not find the OCA’s DCF calculation to be appropriate. R.D. at 49. The ALJ did not examine the CAPM calculations since he found the OCA’s DCF calculation to be inappropriate. Additionally, the ALJ did not make a specific return on equity recommendation and therefore deemed it unnecessary to recommend a capital structure. R.D. at 50.

The ALJ noted the Settlement did not agree to a specific rate of return. However, if a rate of return must be calculated, the ALJ found the City’s proposed rate of return to be reasonable and in the public interest. R.D. at 51.

### OCA Exception No. 5 and Replies

In its Exception No. 5, the OCA asserts the 3.9% DCF growth rate used by Mr. Garrett is reasonable and produces a reasonable DCF result. Additionally, the OCA reiterates the City’s proposed rate of return is overstated and should not be used in determining the revenue requirement. The OCA avers its recommended rate of return should be adopted as it uses an appropriate capital structure and a reasonable return on equity based on its DCF calculation. OCA Exc. at 30-37.

In its Replies, the City pointed out the DCF growth rates of the City and I&E of 7.2% and 7.67%, respectively, compared to the OCA’s 3.9% GDP based DCF growth rate. The City argues the ALJ appropriately found Mr. Garrett’s DCF calculation to be inappropriate. The City states the evidentiary record supports the ALJ’s finding that the City’s rate of return is reasonable and in the public interest if the Commission determines a rate of return. City R. Exc. at 16-19.

### Disposition

While we adopt the Settlement, we also agree with the ALJ’s rationale and recommendation on this issue, which was provided as a contingency recommendation should the Commission choose not to approve the Settlement, without modification. We expressly agree with the ALJ’s findings, favoring the City’s application of traditional ROE models and its analysis of current market conditions. We conclude that the ALJ’s alternative recommendation is supported by substantial evidence. Therefore, we shall deny the OCA’s Exception No. 5.

# Conclusion

Based upon our review, evaluation, and analysis of the record and the positions of the Parties, we shall adopt the Settling Parties’ Joint Petition and approve the Settlement as in the public interest. Additionally, we shall: (1) deny, the Exceptions of the OCA and the City; and (2) adopt the ALJ’s Recommended Decision, as modified, consistent with this Opinion and Order; **THEREFORE,**

**IT IS ORDERED:**

1. That the Exceptions of the City of Bethlehem – Water Department, filed on February 24, 2021, to the Recommended Decision of Administrative Law Judge Steven K. Haas, issued on February 11, 2021, are denied, consistent with this Opinion and Order.

2. That the Exceptions of the Office of Consumer Advocate, filed on February 24, 2021, to the Recommended Decision of Administrative Law Judge Steven K. Haas, issued on February 11, 2021, are denied, consistent with this Opinion and Order.

3. That the Recommended Decision of Administrative Law Judge Steven K. Haas, issued on February 11, 2021, is adopted, as modified by this Opinion and Order.

4. That the Joint Petition for Approval of Partial Settlement of Rate Investigation of the City of Bethlehem – Water Department and the Commission’s Bureau of Investigation and Enforcement filed at Docket No. R-2020-3020256, including all terms and conditions stated therein, is granted and the Joint Petition is thereby approved, without modification, consistent with this Opinion and Order.

5. That the City of Bethlehem – Water Department is authorized to file tariffs, tariff supplement or tariff revisions containing the rates, rules and regulations, consistent with the findings herein, and Appendix A attached to the Joint Petition for Approval of Partial Settlement of Rate Investigation, consistent with this Opinion and Order, so as to produce annual sales revenue not in excess of $8,934,717 from customers residing outside of the City limits, which is an increase over present base rate revenues of $689,932 for jurisdictional customers.

6. That the City of Bethlehem – Water Department’s tariffs, tariff supplement and/or tariff revisions as set forth in Ordering Paragraph No. 5, above, may be filed on at least one (1) days’ notice after the entry date of this Opinion and Order, for service rendered on and after April 29, 2021.

7. That the City of Bethlehem – Water Department and the Office of Consumer Advocate shall comply with the terms of the Stipulations submitted in this proceeding as though each term therein were the subject of an individual ordering paragraph.

8. That the Formal Complaint filed by the Office of Small Business Advocate in this proceeding at Docket No. C-2020-3021576 be dismissed and marked closed.

9. That the Formal Complaint filed by the Office of Consumer Advocate in this proceeding at Docket No. C-2020-3021583 be dismissed and marked closed.

10. That upon acceptance and approval by the Commission of the appropriate compliance filings, tariffs, tariff supplements or tariff revisions filed by the City of Bethlehem – Water Department consistent with this Opinion and Order, this proceeding at Docket No. R-2020-3020256 shall be marked closed.

**BY THE COMMISSION,**

Rosemary Chiavetta

Secretary

(SEAL)

ORDER ADOPTED: April 15, 2021

ORDER ENTERED:April 15, 2021

1. We note that the Joint Petition resolves the entire rate proceeding and reflects a *nonunanimous* settlement initiated by some, but not all, of the parties to the proceeding. For clarity, future reference to a “nonunanimous settlement” refers to a settlement of the issues by a less than total number of the parties to the proceeding. Reference to a “partial settlement” shall refer to a settlement of less than the total number of issues in the rate case. Further, in this case, stipulations were achieved regarding tangential matters with non-settling parties, which were independent of the Settlement. Specifically, the OCA and the Office of Small Business Advocate (OSBA) (Non-Settling Parties) are Parties to this proceeding but are not signatories to the Joint Petition. [↑](#footnote-ref-2)
2. The City provides water service in the City of Bethlehem and all or parts of eleven other municipalities: (a) in Lehigh County – portions of Salisbury Township, portions of Upper Saucon Township, portions of Hanover Township, and the Borough of Fountain Hill; (b) in Northampton County – portions of Lower Saucon Township, portions of Bethlehem Township, portions of Hanover Township, East Allen Township, portions of Allen Township, portions of Lower Nazareth Township, and the Borough of Freemansburg. [↑](#footnote-ref-3)
3. Although the City subsequently made adjustments to revenue requirement, rate base and the cost allocation changes, the City did not make any revisions to its proposed revenue increase or proposed rates as a result of those adjustments. Despite its revisions to a variety of rate case claimed amounts, its requested increase remained at $908,421 for outside-City customers, by adjusting the requested overall rate of return for outside the City from 7.42% to 7.17%. City St. No. 1R at 17; City Exh. CEH-1R, Sch. 1‑R at 1-3. As discussed *infra*, although the City claimed an overall rate of return of 8.21%, the City’s calculation of revenue requirement is based on the tax adjusted rate of return of 7.42%. [↑](#footnote-ref-4)
4. It should be noted that customer charges for all classes, as well as Private and Public Fire Protection rates, were excluded from any rate increase, as no increase in those rates was requested by the City in this proceeding. Additionally, since the City is currently charging the same rate inside and outside the City, and will continue this practice, the increases to inside-City customers are identical to the increases for outside-City customers. [↑](#footnote-ref-5)
5. Originally, the City expected to file this base rate request on or before June 26, 2020, required by 52 Pa. Code § 53.52(b)(2) given the use of its historic test year (HTY) ending December 31, 2019. However, beginning on March 16, 2020, pursuant to an Executive Order issued by the Pennsylvania Deputy Secretary for Human Resources and Management due to the COVID-19 disaster emergency declaration of the Governor, the Commission’s physical offices were closed. As of the entry date of this Opinion and Order, the Commission’s office buildings remain closed due to the COVID‑19 disaster emergency; however, the Commission remains fully operational with its staff teleworking. All business was conducted via electronic mail and/or telephonically. On June 5, 2020, the City requested to postpone the initial filing until on or before August 31, 2020. The Commission granted the City’s request by Secretarial Letter issued on June 9, 2020. [↑](#footnote-ref-6)
6. The OCA filed its Comments in opposition to the Settlement as part of its Reply Brief filed on January 8, 2021. The OSBA did not file Comments or specifically mention the Settlement in its Reply Brief. [↑](#footnote-ref-7)
7. On February 23, 2021 the ALJ issued an errata, noting that the record closed on January 12, 2021, not January 8, 2021, as the initial Recommended Decision stated. [↑](#footnote-ref-8)
8. 1 Pa. C.S. § 1922(1), *PA Financial Responsibility Assigned Claims Plan v. English*, 541 Pa. 424, 430-431, 64 A.2d 84, 87 (1995). [↑](#footnote-ref-9)
9. We note the City’s commitment to submitting a Section 500 form as part of its Annual Report to the Commission. As indicated, the City is unsure of the reasons that UFW has recently increased. *See* I&E Statement in Support at 10. Therefore, we encourage the City to explore the use of the water audit methodology established by the International Water Association (IWA) and the American Water Works Association (AWWA) to determine sources of water loss within its system, in addition to its current efforts to reduce UFW. We note that the Commission just recently entered an Advance Notice of Proposed Rulemaking Order on September 17, 2020 at Docket No. L‑2020‑3021932 regarding the replacement of the policy statement at 52 Pa. Code § 65.20 with a Commission Regulation to implement the IWA/AWWA water audit methodology as a best management practice in water loss control in Pennsylvania. Therefore, it is possible that issues related to the City’s UFW may be subject to new regulations by the time of the City’s next base rate proceeding. Nonetheless, this settlement term reflects consideration of the Commission’s current policy statement on UFW. [↑](#footnote-ref-10)
10. In rebuttal testimony, the City agreed with the scale back that reflects the change in the Sales for Resale class demand factors, modifying the increases by customer class based on the cost of service presented on page 3 of City Exhibit CEH-3, as proposed by the OSBA. City St. No. 1R at 17-18. In surrebuttal testimony, I&E confirmed its agreement with the OSBA’s recommendations because they reflected the corrections to the Sales for Resale class and otherwise reflected the same proposal I&E made in direct testimony. I&E St. No. 3-SR at 18. [↑](#footnote-ref-11)
11. OCA R.B. at 9-15, Section III.B – OCA Opposition to Settlement. The OSBA did not comment on the Joint Petition in its Reply Brief. [↑](#footnote-ref-12)
12. The OCA’s position to the Settlement, as a result of the COVID-19 pandemic is essentially the same as its opposition to the rate increase generally. [↑](#footnote-ref-13)
13. The OCA noted that should no rate increase be imposed at this time, as a result of the ongoing COVID-19 pandemic and the related economic impact on the City’s customers, the resulting overall rate of return (with a capital structure of 52.0% cost of common equity and 48.0% cost of debt) and reflecting the tax factor adjustment would be 5.65%. OCA M.B., App. A.1, OCA Table A.1. [↑](#footnote-ref-14)
14. For comparison, the OCA noted that the unemployment rate in both counties one year earlier was 4.6%, and the unemployment rate in both counties peaked in April 2020 at 16.9% and 16.3%, respectively. OCA St. No. 1 at 11. Additionally, the OCA noted that, according to the Household Pulse Survey conducted by the U.S. Census Bureau, through the two-week period ending October 13, 2020, 47% of households in Pennsylvania have lost at least some of their employment income. The most recent data, through the two-week period ending November 23, 2020, showed the percentage remaining fairly constant at about 46% of households. OCA St. No. 1S at 2. [↑](#footnote-ref-15)
15. OCA witness David J. Garrett, using a Discounted Cash Flow (DCF) analysis and a Capital Asset Pricing Model (CAPM), demonstrated that under a “business as usual” approach for the City, the market-derived cost of common equity is 8.50%, (7.31% after the tax factor adjustment) and an overall rate of return of 6.57%, based upon a capital structure of 48.0% debt and 52.0% common equity. OCA St. No. 3 at 6; OCA M.B., App. A.2, OCA Table A.2. [↑](#footnote-ref-16)
16. The City noted that, notwithstanding the OCA’s argument in *PGW* that PGW’s current rates are sufficient to not only adequately cover annual debt but also to provide excess cash flow, the Commission approved the partial settlement in that proceeding, inclusive of a $35 million rate increase. City Reply Comments at 6. The City further noted that the Commission, in October 2020, approved a settlement and $20 million rate increase for UGI Utilities, Inc. – Gas Division, although UGI had an overall return at existing rates of 5.95%. *Id*. at 6 (*citing, Pa. PUC v. UGI Utilities, Inc. – Gas Division*, Docket No. R-2019-3015162 (Order entered October 8, 2020) (*UGI*), Recommended Decision, issued August 29, 2020, at 42. [↑](#footnote-ref-17)
17. The City noted, specifically, that the Recommended Decision of ALJ Conrad A. Johnson in PAWC, approving a “non-unanimous” settlement, is inclusive of a proposed “phase in” rate increase of $70.5 million with a net increase of $40 million taking effect on January 28, 2021. City Reply Comments at 7. [↑](#footnote-ref-18)
18. OCA M.B. at 10, 17 and 23. The OCA contended 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. [↑](#footnote-ref-19)
19. The Commission has recognized that “[t]he prime determinant in the consideration of a proposed Settlement is whether or not it is in the public interest.” *Pa. PUC v. Philadelphia Electric Company*, 60 Pa. P.U.C. 1 (1985). Additionally, the Settlement promotes the public interest because it reflects a compromise of I&E’s and the City’s positions. *See CS Water and Sewer* (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.”). I&E Reply Comments at 2. [↑](#footnote-ref-20)
20. The settlement increase of $689,932 is approximately the midpoint between the City’s request of $908,421 and both I&E’s litigated position of $474,161 and the OCA’s “business as usual” position of $446,173. [↑](#footnote-ref-21)
21. On March 6, 2020, Governor Tom Wolf issued a Proclamation of Disaster Emergency (Proclamation) that identified the COVID-19 pandemic as a disaster emergency affecting the entire Commonwealth. On March 13, 2020, relying on both the Proclamation and the Commission’s authority under the provisions of Section 1501 of the Public Utility Code, the Commission issued an Emergency Order establishing a prohibition on the termination of public utility service and directing the reconnection of service to customers previously terminated, to the extent it could be done safely, for the duration of the Proclamation, or until a time otherwise established by the Commission. *See* *Public Utility Service Termination Moratorium*, Docket No. M-2020-3019244 (Order entered March 13, 2020) (*March 2020 Emergency Order*); *Public Utility Service Termination Moratorium – Modification of the March 13th Emergency Order*, Docket M‑2020-3019244 (Order entered October 13, 2020) (*October 2020 Order*). [↑](#footnote-ref-22)
22. As of April 1, 2021, existing Commission-ordered restrictions on service terminations will be lifted in favor of modified rules for payment arrangements that allow customers to pay their arrearages over extended periods. These Commission-ordered modifications will remain in effect through December 31, 2021, when they will expire and pre-pandemic procedures will once again control the collection process. *See* *Public Utility Service Termination Moratorium*, Docket No. M-2020-3019244 (Order entered March 18, 2021) (*March 2021 Order*). [↑](#footnote-ref-23)
23. Specifically, the *March 2021 Order* indicated that the American Rescue Plan Act (ARPA) of 2021, passed by Congress on March 10, 2021, contains extended unemployment compensation, stimulus checks, monthly payments for families with children, and assistance for low-income water and wastewater customers. [↑](#footnote-ref-24)
24. *See* City St. No. 1R at 17-18; I&E St. No. 3-SR at 18. The OCA’s Main Brief cited from the cost of service testimony of Mr. Jerome D. Mierzwa explaining that he generally agreed with the City’s cost of service study; that he was not proposing to modify it; and that, in rebuttal, he indicated his agreement with OSBA witness Brian Kalcic’s adjustment to reflect the appropriate maximum day and maximum hour factors for wholesale customers. OCA M.B. at 63-65. [↑](#footnote-ref-25)
25. The Stipulation terms addressing UFW are identical to the term presented by the City and I&E in the Joint Petition. [↑](#footnote-ref-26)
26. Meter replacement and accuracy was a matter of importance to the OCA in this proceeding, as it is for the Commission. The ages of meters within the City limits and those beyond the City limits should be reasonably close to reflect accurate readings for similar usage. Therefore, we note that through this Opinion and Order we are not approving any waiver of 52 Pa. Code § 65.8 at this time. Any plan to come into compliance with Section 65.8 of our Regulations should be provided as part of a petition for waiver of Commission Regulations. This petition should detail the waivers requested, the requested length of time for the waiver, and how the City will prioritize meter replacement and/or testing activities on an interim basis until it is able to comply with 52 Pa. Code § 65.8 (*i.e*, similar to Pittsburgh Water Authority’s Compliance Plan filed in accordance with the Commission’s *Final Implementation Order*, at Docket Nos. M‑2018‑2640802 and M-2018-2640803 (Order entered March 15, 2018)). [↑](#footnote-ref-27)
27. The OCA maintains that the City’s return at present rates of 5.65% is “more than adequate” and suggests that the City can avoid the need for additional revenue by holding off on all but the absolute necessary system improvement projects. OCA Exc. at 2-3, 12, 17, 24-25. [↑](#footnote-ref-28)
28. The OCA notes that it has presented testimony on revenue requirement, including cost of capital that establishes the revenue increase should be no more than $443,666 for outside-City customers. OCA Exc. at 26. [↑](#footnote-ref-29)
29. *Popowsky II*, 683 A.2d at 961 (“[t]he PUC has broad discretion in determining whether rates are reasonable” and “is vested with discretion to decide what factors it will consider in setting or evaluating a utility’s rates.”). [↑](#footnote-ref-30)
30. The City noted that this $185,981 reduction to rate base included a reduction to plant in service of $181,278 and an associated increase to accumulated depreciation of $4,703. Additionally, depreciation expense was reduced by $3,387 from the as-filed position. City St. No. 3R at 5. [↑](#footnote-ref-31)
31. As previously indicated, while the City has revised a variety of rate case claimed amounts in rebuttal testimony, the requested increase remained the same by the City’s adjustment to its requested rate of return. City St. No. 1R at 17; City Exh. CEH‑1R, Sch. 1-R at 1-3. [↑](#footnote-ref-32)
32. The City noted that the CWC calculation increased because operation and maintenance expenses increased to $4,650,083 and the allocation to outside-City service also increased due to the change in the cost allocation in City Exhibit CEH-2R. City M.B. at 21-22. [↑](#footnote-ref-33)
33. *Popowsky v. Pa. PUC*, 674 A.2d 1149, 1154 (Pa. Cmwlth. 1996) (*Popowsky*); *Pa. PUC v. Columbia Water Company*, 2009 Pa. PUC LEXIS 1423 (2009); *City of Lancaster (Sewer Fund) v. Pa. PUC*, 793 A.2d 979 (Pa. Cmwlth. 2002) (*Lancaster 2002*); *Pa. PUC v. Roaring Creek Water Company*, 73 Pa. PUC 373, 400 (1990); *Pa. PUC v. West Penn Power Company*, 119 PUR4th 110, 149 (1990); *Pa. PUC v. City of Lancaster*, 2011 Pa. PUC LEXIS 1685 (2011) (*Lancaster 2011*); *Pa. PUC v. Metropolitan Edison Company*, 2007 Pa. PUC LEXIS 5 (2007); *Pa. PUC v. City of Dubois – Bureau of Water*, Docket No. R-2016-2554150 slip op. at 65 (Order entered May 18, 2017) (*City of Dubois*). [↑](#footnote-ref-34)
34. *City of Lancaster v. Pa. PUC*, 793 A.2d 978 (Pa. Cmwlth. 2002); *Pa. PUC v. PPL Electric Utilities Corporation,* Docket No. R-2012-2290597 (Order entered December 28, 2012) (*PPL 2012*); *Pa. PUC v. UGI Utilities Inc. – Electric Division,* Docket No. R-2017-2640058 (Order entered October 25, 2018) (*UGI 2018*). [↑](#footnote-ref-35)
35. *See* City St. No. 3R at 4-5. [↑](#footnote-ref-36)
36. *See* City Exh. CEH-2R at 6. [↑](#footnote-ref-37)