

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

REBUTTAL TESTIMONY OF

JAMES H. CAWLEY

ON BEHALF OF
PHILADELPHIA GAS WORKS

Docket No. R-2020-3017206

Philadelphia Gas Works

General Rate Increase Request

Topics:

Responses to: Mr. Rubin, Mr. Knecht and Dr. Hausman

July 13, 2020

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1 **I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND CURRENT POSITION.**

3 A. My name is James H. Cawley. My consulting business address is 1020 Kent Drive,
4 Mechanicsburg, PA 17050.

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. I am an independent consultant and an attorney. It is in that role that my testimony is
7 presented. As an attorney, I am also Of Counsel to the law firm of SkarlatosZonarich
8 LLC, 320 Market Street, Suite 600W, Harrisburg, PA 17101.

9 **Q. PLEASE DESCRIBE THE NATURE OF YOUR CONSULTING PRACTICE AS**
10 **OPPOSED TO YOUR LAW PRACTICE.**

11 A. My consulting practice is limited to matters affecting the public utility industry. My law
12 practice with SkarlatosZonarich LLC, is confined to legal representation. My consulting
13 services include advice to investment management firms concerning matters important to
14 them that are pending before the Pennsylvania Public Utility Commission
15 (“Commission”), and some government relations activity at the Commission and the
16 General Assembly on matters affecting the public utility industry. I am a registered
17 lobbyist.

18 **Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.**

19 A. Before my appointment to the Commission in 1979, I served as majority counsel to the
20 Pennsylvania Senate Consumer Affairs Committee where I was a major draftsman of
21 substantial amendments to Pennsylvania’s public utility laws as a part of the two-year
22 effort of that committee under the chairmanship of Senator Franklin L. Kury to reform
23 Pennsylvania’s public utility laws for the first time since their enactment in 1937. During
24 that effort, I spent a great deal of time studying the history of public utility regulation and

1 public utility ratemaking in the United States. The Kury Committee's work culminated
2 in passage of Acts 215 and 216 of 1976. I then worked with the Pennsylvania Joint State
3 Government Commission to codify those laws into the Pennsylvania Public Utility Code.
4 In 1977, I was appointed chief counsel to the Senate Democratic Floor Leader.

5 I then served two terms as a member of the Pennsylvania Public Utility
6 Commission, the first from 1979 to 1985 during which time I co-authored with Norman
7 James Kennard a guide to ratemaking before the Commission. My second term was from
8 2005 to 2015. I was Chairman of the Commission from 2008 to 2011.

9 Between my two terms, I primarily represented clients before the Commission
10 while serving as the managing partner of the Harrisburg office of the New York City law
11 firm of LeBoeuf, Lamb, Greene & MacRae LLP (1988-1996) and then as a partner of the
12 Harrisburg law firm of Rhoads & Sinon LLP (1996-2005).

13 From 1998 to 2003, I served on the Board of Directors of Pennsylvania-American
14 Water Company, and from 1991 to 1999 on the Pennsylvania Energy Development
15 Authority. Since 2016, I have served on the Board of Directors of The York Water
16 Company. From 1994 until 2014, I was an adjunct professor of federal administrative
17 law and appellate advocacy at Widener University Commonwealth Law School in
18 Harrisburg.

19 **Q. PLEASE DESCRIBE THE PURPOSE OF YOUR REBUTTAL TESTIMONY.**

20 A. I have been asked by Philadelphia Gas Works ("PGW" or "the Company") to provide my
21 expert opinion regarding the direct testimony of Scott J. Rubin filed on behalf of the
22 Pennsylvania Office of Consumer Advocate on June 15, 2020, which recommends that,
23 given the economic effects of the current pandemic over a four month period, the
24 Commission completely deny PGW's requested rate increase based on a theory of public

1 utility ratemaking that rejects cash flow ratemaking principles and substitutes an ad hoc,
2 overly broad, asymmetric, and essentially undefined customer affordability standard for
3 ratemaking.

4 I also have been asked by the Company to provide my expert opinion regarding
5 the direct testimonies of Robert D. Knecht (OSBA St. No. 1) who generally advocates
6 against the rate increase proposed by PGW based upon the occurrence of the COVID-19
7 pandemic, and Dr. Ezra Hausman (SC St. No. 1), who urges denial of PGW's rate
8 increase request because of the Company's alleged failure to properly account for the
9 claimed adverse environmental effects of PGW's operations. My testimony can be
10 understood to generally respond to the policy-based arguments of these witnesses.

11 **Q. DO YOU HAVE ANY OTHER PRELIMINARY MATTERS TO ADDRESS?**

12 A. Yes. I express the same disclaimers as Mr. Rubin does at page 3 of his testimony. My
13 testimony deals with regulatory policy issues. Given the nature of public utility
14 regulation, much of the public policy in this field is constrained by and contained in
15 decisions by regulatory agencies and courts; or in statutes, ordinances, or regulations. I
16 cite to these types of sources, not as a legal opinion (although I am qualified to provide
17 expert testimony as a regulatory attorney in Pennsylvania), but rather as sources
18 supporting my expert opinion concerning appropriate public policy and regulatory
19 practice.

20 My references to a "utility" (singular or plural) refer to PGW. My references to
21 "investors" refer, as Mr. Rubin does at page 3 of his testimony, to the City of
22 Philadelphia (as well as its citizens) and to the bondholders of the City's outstanding
23 revenue bonds.

1 **II. SUMMARY**

2 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

3 A. Mr. Rubin recommends that the Commission “should deny PGW’s request in its entirety
4 and keep PGW’s existing rates (and all other tariff provisions) in effect,”¹ “unless it finds
5 that an increase is required for PGW to meet its 1.5 times interest coverage
6 requirement.”²

7 Mr. Rubin abandons well-established and long-standing Cash Flow Method and
8 normalized test year ratemaking in favor of a ratemaking method that forsakes the
9 required balancing of investors’ and customers’ interests by giving exclusive
10 consideration to customers’ interests when prevailing economic conditions (such as the
11 current pandemic) make it difficult for an increased number of them to pay their utility
12 bills. Solely focusing on customers’ interests to the exclusion of investors’ interests is
13 contrary to the appropriate lawful and constitutional standard for setting PGW’s rates and
14 to Pennsylvania ratemaking that has been in place for over 100 years.

15 Mr. Rubin’s proposed method of conducting a general rate case short circuits the
16 traditional and required process before it begins and imposes a preordained result, giving
17 PGW no opportunity to prove its case. It is regulation by surveys, polls, and selective
18 reference to economic data to determine PGW’s revenue requirement. Fundamental
19 ratemaking principles require that a utility’s revenue requirement be determined principally
20 by an examination of the utility’s financial data and the determination of an appropriate
21 return on the utility’s used and useful property in service to the public. Customer interests
22 should be considered but cannot be completely overriding or exclusively determinative.

¹ OCA St. No. 1, p. 21.

² *Id.*

1 Importantly, I emphasize that I do *not* advocate that the effects of the pandemic or
 2 customer interests generally should not be considered in this proceeding. I describe below³
 3 some of the non-financial considerations that the Commission takes into account when it
 4 balances customers’ and investors’ interests to determine PGW’s just and reasonable rates.

5 Mr. Rubin’s recommendation that, in times of economic distress, just and
 6 reasonable rates may be set within a “null” zone (reflecting the value and affordability of
 7 service to customers) that is below—instead of *within*—the traditionally regarded zone of
 8 reasonableness simply invites the Commission to confiscate PGW’s property.

- 9 • Most seriously, Mr. Rubin’s “bare bones” recommendation of rates that
 10 only meet PGW’s interest coverage requirement would create a real risk of
 11 default that would have disastrous consequences for the Company and its
 12 customers, the very persons that Mr. Rubin seeks to protect with his
 13 proposed ratemaking method.
- 14 • His method is overly broad because all customers, including the vast
 15 majority of customers who remain employed and even the wealthy would
 16 pay little or no rate increase.
- 17 • His method is an arbitrary and an ad hoc method of setting rates that is not
 18 predictable because it lacks adequate standards. It therefore would be
 19 unacceptable to investors that have historically provided capital to PGW
 20 and other Pennsylvania utilities with the result that capital will become
 21 more expensive and potentially not available in difficult economic
 22 conditions.

³ See *infra* note 30 and accompanying text.

- 1 • His proposal is fundamentally asymmetric because it would produce rates
2 below the traditional zone of reasonableness during an economic
3 disruption, but it undoubtedly would not produce rates above the zone of
4 reasonableness in good economic times.
- 5 • His method contravenes the Legislature’s intent in enacting Act 11 of
6 2012—to ensure that Commission-determined rates provide as nearly as
7 possible the utility’s needed revenues and return on capital at the time that
8 the rates are put into effect, for it to make desired infrastructure
9 investments and to increase employment opportunities in the
10 Commonwealth.
- 11 • He fails to recognize the important programs the Company maintains for
12 those ratepayers who experience ability to pay situations, and he
13 essentially ignores substantial government aid provided in response to the
14 COVID-19 pandemic in determining whether the increase requested is
15 affordable or not.

16 Rather than adopting Mr. Rubin’s ratemaking solution to assist customers in times
17 of pandemic or other serious economic dislocation, the Commission should (1) apply
18 lawful and constitutional ratemaking principles designed to protect everyone’s interests,
19 and (2) continue to ensure that PGW’s customers in financial need receive all possible
20 help from PGW and from state and federal COVID-19 relief funding. For participating
21 low-income customers, the Company’s universal service programs will significantly
22 reduce or eliminate the effect of the rate increase altogether.

1 To that part of Mr. Knecht's testimony which urges denial of any rate increase
 2 until "the economy has had a chance to recover from and/or adapt to the pandemic," I
 3 reply that PGW's obligation to provide reliable service at reasonable rates, and the need
 4 for borrowed capital and additional cash to provide such service, continues whatever the
 5 condition of our national economy. Municipal entities providing a vital, essential service
 6 do not have the luxury of suspending operations until the economy improves.

7 To that part of Dr. Hausman's testimony which also urges denial of any rate
 8 increase until a "Climate Business Plan" (detailing energy efficiency efforts to supplant
 9 the Company's distribution of natural gas, thereby avoiding further investments in natural
 10 gas infrastructure that will become stranded because of climate changes) is submitted to
 11 the Commission and completely adopted by the Company, I reply that the Commission
 12 lacks jurisdiction to adopt his recommendations, and must determine PGW's just and
 13 reasonable rates in accordance with Section 2212 of the Public Utility Code.

14 **III. MR. RUBIN'S AFFORDABILITY RATEMAKING METHOD**

15 **Q. PLEASE DESCRIBE MR. RUBIN'S RATEMAKING METHOD FOR**
 16 **DETERMINING JUST AND REASONABLE RATES UNDER THE PUBLIC**
 17 **UTILITY CODE.**

18 A. Section 1301 of the Public Utility Code⁴ requires that "[e]very rate made, demanded, or
 19 received by any public utility ... shall be just and reasonable, and in conformity with
 20 regulations or orders of the commission." In Mr. Rubin's view, however, economic
 21 circumstances and affordability determine the justness and reasonableness of rates,
 22 viewed solely from the customers' perspective.⁵

⁴ 66 Pa.C.S. § 1301.

⁵ OCA St. No. 1, pp. 5-10, 21.

1 He contends that public utility rates should depend, in substantial part if not
 2 entirely, on the wealth and income status of PGW’s customers, especially if their ability
 3 to pay their utility bills is adversely affected by the economic conditions of the moment,
 4 even if those conditions significantly affect only a minority of PGW’s customers and may
 5 be of limited duration.

6 Mr. Rubin believes that PGW’s filed case assumes “business as usual” but that
 7 life and business because of the pandemic is anything but normal. Therefore, he believes
 8 that the Commission cannot lend any credence to PGW’s projections for the fully
 9 projected future test year (“FPFTY”)—and “essentially every aspect of PGW’s
 10 projections”—because there is too much uncertainty.⁶

11 Further, he believes that, in extraordinary circumstances like the current COVID-
 12 19 pandemic, “the Commission must attempt to determine whose needs are being met
 13 and whose are not,” which he claims is not usually done in the traditional ratemaking
 14 process where investors’ interests are the central focus and there is not “as much
 15 emphasis on attempting to define the consumers’ interest.”⁷

16 He therefore substitutes arbitrary “value of service” or affordability (“ability to
 17 pay”) ratemaking (for the long-established Cash Flow Method of ratemaking—described
 18 below—adopted by the Commission under the Public Utility Code to determine just and
 19 reasonable rates for PGW’s customers) based on a “slice of time” that does not appear to
 20 be indicative of conditions during the time when rates established in this proceeding will
 21 become effective in December of this year or January of next year.

22 **Q. IN MR. RUBIN’S VIEW, HOW SHOULD PGW’S RATE CASE PROCEED?**

⁶ *Id.* at pp. 23, 24.

⁷ *Id.* at p. 8.

1 A. He proposes that PGW's rate case should consist of:

2 (1) a determination of whether an economic dislocation exists, such as the
3 COVID-19 pandemic;

4 (2) an assessment of the severity and effects of the economic dislocation on
5 PGW's customers by means of various extraneous sources (such as unemployment data
6 in PGW's service area, Federal Reserve System surveys on household finances, Federal
7 Reserve Bank of Philadelphia surveys of the business community, U.S. Census Bureau
8 estimates of job losses, Electric Power Research Institute surveys of customer concerns
9 about paying their utility bills, and examples of whether utility regulatory bodies in
10 Canada and the United States are granting or denying rate increase requests);⁸ and

11 (3) a conclusion from this accumulated information as to whether PGW's
12 customers can afford to pay PGW's proposed increase in rates.⁹

13 If these subjective criteria lead to such a conclusion, Mr. Rubin proposes that the
14 Commission is prevented from treating the case as "business as usual,"¹⁰ lending any
15 credence to any aspect of the utility's fully forecasted future test year projections because
16 of the prevailing economic uncertainty,¹¹ or from assuming that the rates based on such
17 data will be just and reasonable.¹² The rate case would end there, without giving PGW
18 an opportunity to present or prove its case. Rather, based on the extrinsic data regarding
19 adverse economic conditions affecting some of PGW's customers, the Commission

⁸ *Id.* at pp. 10-21.

⁹ *Id.* at pp. 5, 9.

¹⁰ *Id.* at p. 9, 19.

¹¹ *Id.* at p. 23, 24.

¹² *Id.* at p. 19.

would then be required to deny PGW's rate increase request entirely "unless it finds that an increase is required for PGW to meet its 1.5 times interest coverage requirement."¹³

Q. WHAT IF MR. RUBIN ACTUALLY INTENDS THAT THE COMPANY BE GIVEN THE OPPORTUNITY TO PROVE ITS CASE?

A. I do not interpret his testimony as intending that, but if it does express that intention the proceeding would be a pointless exercise because the result would be preordained. His ratemaking method would make it impossible for the Company to carry its burden of proof under Section 315(a)¹⁴ no matter what evidence it introduced into the record.

IV. PGW'S UNIQUENESS AND WHY IT MATTERS

Q. WHAT IS YOUR OPINION OF MR. RUBIN'S PROPOSED "AFFORDABILITY" RATEMAKING PROPOSAL?

A. It demonstrates a fundamental misunderstanding of PGW's uniqueness and of the Cash Flow Method of ratemaking.

Q. HOW IS PGW UNIQUE AND WHY DOES IT MATTER?

A. PGW is the only entity regulated by the Commission that is (1) a municipal utility (2) regulated by the Commission as a "city natural gas distribution operation,"¹⁵ that is (3) the subject of a Commission policy statement that "articulate[s] a comprehensive explanation of the elements and supporting information that should be examined in applying the Cash Flow Method to PGW and determining PGW's revenue requirement."¹⁶

¹³ *Id.* at p. 21 (adding that "[t]he Commission should deny PGW's request in its entirety and keep PGW's existing rates (and all other tariff provisions) in effect."); *see also* p. 4 ("unless it finds that an increase is needed for PGW to comply with its bond indentures").

¹⁴ 66 Pa.C.S. § 315(a).

¹⁵ *See* 66 Pa.C.S. §§ 102 (definitions; "city natural gas distribution operation") & 2212.

¹⁶ *Application of PGW Cash Flow Ratemaking Method—Final Statement of Policy*, 40 Pa.B. 2668 (2010), 52 Pa. Code §§ 69.2701-2703.

1 Consequently, unlike the way the Commission sets rates for investor-owned
2 public utilities (a rate base-rate of return, cost-of-service approach), PGW's rates are
3 determined by the Cash Flow Method (which I describe shortly) according to a very
4 specific section of the Public Utility Code¹⁷ and a Commission issued policy statement
5 announcing the ratemaking elements, procedures, and considerations it will use in setting
6 just and reasonable rates for PGW.

7 PGW's uniqueness matters because, unlike public utilities that are owned by their
8 shareholders who provide equity capital to supplement the company's other sources of
9 financing for operations and infrastructure, PGW's only source of revenue is its customer
10 base supplemented by borrowing and other credit facilities requiring the payment of
11 interest and principal by those same customers.

12 What Mr. Rubin's "just allow rates that cover the 1.5 times interest coverage"
13 recommendation fails to appreciate is that substantial additional cash is needed for a host
14 of other expenses over and above the revenue needed to cover the Company's bond
15 coverage requirements.¹⁸ Without rates that produce this extra revenue, PGW simply
16 cannot pay its bills. If that were to occur, the Company's credit rating would fall (raising
17 the cost to borrow) and the Company's ability to provide safe, adequate, and reliable
18 service at reasonable rates would decline.

19 Thus, perhaps unwittingly, Mr. Rubin has suggested a perfect way for those he
20 professes to protect to instead suffer harm. If the Commission were to adopt his
21 recommendation, the opposite of what he intends would occur—those having difficulty
22 paying their bills would have even more difficulty doing so as the Company paid more to

¹⁷ See 66 Pa.C.S. § 2212.

¹⁸ See *infra* notes 24, 28, and 34 and accompanying emphasized text.

1 borrow needed revenue to provide safe, adequate, and reliable service and those costs
2 were passed on to customers, as they must be.

3 PGW's uniqueness also matters because, if consistently reasonable, rational, and
4 carefully balanced (between ratepayers and investors) ratemaking is abandoned by, for
5 example, adopting one-sided measures like Mr. Rubin's "bare bones" approach, the result
6 for a vulnerable municipal utility like PGW will be (1) a loss of confidence by the
7 investment community in the Commission's willingness to provide PGW with the
8 financial wherewithal to persevere with its betterment efforts; (2) a perception that
9 investing in PGW is riskier; and (3) therefore a demand for a greater yield on any
10 investments made in PGW's bonds and credit facilities, which inexorably must be passed
11 onto to PGW's customers in higher rates. Instead of seeing progression and hard-fought
12 momentum maintained, investors would see regression and backsliding.

13 PGW's customers should not be forced to pay much more for such
14 shortsightedness. They expect that the Company's managers and the Commission will
15 protect them from the entirely avoidable costs of myopic ratemaking however well
16 intentioned.

17 **V. PROPER STATUTORY RATEMAKING**

18 **Q. WHAT ARE THE FUNDAMENTAL PRINCIPLES OF THE CASH FLOW**
19 **METHOD OF UTILITY RATEMAKING?**

20 A. PGW came under Commission regulation on July 1, 2000, pursuant to the Natural Gas
21 Choice and Competition Act ("Gas Choice Act") and is "subject to regulation and control
22 by the commission with the same force as if the service were rendered by a public

1 utility”¹⁹ as defined by Section 102 of the Public Utility Code (designating the Company
2 as a “City Natural Gas Distribution Operation”).²⁰

3 Rather than impose traditional rate base/rate of return regulation on PGW, the Gas
4 Choice Act specifies that “the commission shall follow the same ratemaking
5 methodology and requirements that were applicable to the city natural gas distribution
6 operation prior to the assumption of jurisdiction by the commission, and such obligation
7 shall continue until the date on which all approved bonds have been retired redeemed,
8 advance refunded or otherwise defeased.”²¹ The Management Agreement between PGW
9 and the Philadelphia Facilities Management Corporation (“PFMC”) (“PGW/PFMC
10 Agreement”) defines the ratemaking methodology for the city’s gas utility.²²

11 In PGW’s first base rate case, the Commission decided that the statute required a
12 debt service coverage (or “cash flow”) form of ratemaking.²³

13 Section 2212(e) of the Act obligates the Commission not to take an action that
14 would adversely affect the debt service coverage of PGW’s bonds. This
15 requirement has the effect of imposing a statutory floor that the Commission has
16 carefully considered in adjudicating this matter. *In order to determine the*
17 *appropriate rate increase, the Commission is required to ensure that PGW is able*
18 *to maintain an adequate level of financial health required to fund operations and*
19 *meet debt service requirements.*²⁴

20 At the same time, Public Utility Code § 1301 standards of “just and reasonable” rates

¹⁹ 66 Pa.C.S. §2212(b).

²⁰ 66 Pa.C.S. § 102 (definitions).

²¹ 66 Pa.C.S. § 2212(e).

²² See generally Cawley & Kennard Guide, pp. 157-160.

²³ “While the PGW/PFMC Agreement, and now the PUC, label it as a ‘cash flow method’ of ratemaking, this is actually a misnomer. It is a debt service coverage-based ratemaking methodology.” *Id.* at p. 158 n.376.

²⁴ *Pennsylvania Public Utility Commission v. Philadelphia Gas Works*, Docket No. R-00006042, Opinion and Order (Oct. 4, 2001) at 43 (emphasis added) (hereinafter “PGW I”), *aff’d*, *City of Philadelphia v. Pa. PUC*, 829 A.2d 1241 (Pa. Cmwlth. 2003) (“We hold that the approach described above satisfies the Gas Choice Act directive to follow the same ratemaking methodology and requirements. The PUC committed no clear error when it adopted this approach.”).

1 apply:

2 Since the General Assembly was clear in placing PGW squarely under the
3 jurisdiction of this Commission, the additional legislative mandates set forth in
4 the Code, i.e., Section 1301, also apply to PGW.²⁵

5 This conclusion followed an earlier affirmation of the just and reasonable standard in the
6 Commission's decision:

7 Accordingly, this Commission must, and intends to, exercise its discretion to
8 determine a just and reasonable level of rates for PGW while balancing the
9 interests of PGW's customers, as it does in all other rate cases before us. Only
10 through the exercise of this authority is the Commission in conformity with all the
11 provisions of the Code, namely Sections 1301 and 2212, and sound ratemaking
12 principles.²⁶

13 In 2010, when I was chairman, the Commission issued a policy statement more fully
14 setting forth the criteria and the financial and other considerations that are to be examined
15 in setting PGW's base rates at just and reasonable levels.²⁷ In its Policy Statement, the
16 Commission described the requirements of the Cash Flow Method as follows:

17 The Commission is obligated under law to use the cash flow methodology to
18 determine PGW's just and reasonable rates. Included in that requirement is the
19 subsidiary obligation *to provide revenue allowances from rates adequate to cover*
20 *its reasonable and prudent operating expenses, depreciation allowances and debt*
21 *service, as well as sufficient margins to meet bond coverage requirements and*
22 *other internally generated funds over and above its bond coverage requirements,*
23 as the Commission deems appropriate and in the public interest for purposes such
24 as capital improvements, retirement of debt and working capital.²⁸

25 In addition to debt service coverage, the Commission also stated in its policy statement
26 that it would consider in determining just and reasonable rate levels for PGW the

²⁵ *PGW I* at 24 (footnote omitted).

²⁶ *Id.* at pp. 15-16.

²⁷ *Application of PGW Cash Flow Ratemaking Method—Final Statement of Policy*, 40 Pa.B. 2668 (2010), 52 Pa. Code §§ 69.2701-2703.

²⁸ 40 Pa.B. at 2672; 52 Pa. Code § 69.2702(b) (emphasis added).

following *financial* factors:²⁹

1. PGW's test year-end and (as a check) projected future levels of non- borrowed year-end cash.
2. Available short-term borrowing capacity and internal generation of funds to fund construction.
3. Debt-to-equity ratios and financial performance of similarly situated utility enterprises.
4. Level of financial performance needed to maintain or improve PGW's bond rating, thereby permitting PGW to access the capital markets at the lowest reasonable costs to customers over time.

And the following *non-financial* factors:

1. Level of operating and other expenses in comparison to similarly situated utility enterprises.
2. PGW's management quality, efficiency and effectiveness.
3. Service quality and reliability.
4. Effect on universal service.³⁰

The Commission is obligated to establish rate levels adequate to permit PGW to satisfy its bond ordinance covenants, the most important of which is the debt service coverage covenant.³¹ Debt service coverage ratio is a financial metric used to determine a company's ability to generate enough income in its operations to cover annual debt expenses (interest and principal). The formula (generally) is net operating income divided by debt service. PGW's debt is financed through bonds issued by the City. The City's General Ordinances require that PGW maintain a minimum debt service coverage ratio of 1.5 times on debt issuances.³²

²⁹ 52 Pa. Code §§ 69.2703(a).

³⁰ *Id.*

³¹ Public Utility Code § 2212(e), 66 Pa.C.S. § 2212(e); 52 Pa. Code § 69.2703(b). *See also Pennsylvania Public Utility Commission v. Philadelphia Gas Works*, Docket No. R-00006042, Opinion and Order (October 4, 2001) at 43, *aff'd*, *City of Philadelphia v. Pa. PUC*, 829 A.2d 1241 (Pa. Cmwlth. 2003) ("[T]he Commission is required to ensure that PGW is able to maintain an adequate level of financial health required to fund operations and meet debt service requirements.").

³² "So, if PGW's net income were set at \$196 million and its total debt service were \$107 million, the resulting coverage ratio would be 1.82x and sufficient to meet its debt covenants." Cawley & Kennard Guide, p. 160.

PGW's revenue requirement is determined using the methods of a traditional rate base/rate of return case, including a test year and various *pro forma* adjustments. No depreciation expense is included in rates because both principal and interest are included in the debt service portion. The principal payment is the *return of* the cost of the asset (depreciation expense), and interest is the *return on* the asset (or rate of return under normal rate base/rate of return treatment). There is, however, no calculation of rate base or a rate of return. Interest paid on the outstanding debt is treated as an expense. So, too, is the \$18 million paid to the City annually as a lease payment (or, alternatively, as an equity dividend).³³

Net expense is set to meet the minimum coverage requirements plus an additional "reasonable" amount to ensure sufficient cash flow and to maintain or improve PGW's bond rating.³⁴ In other words, it is not sufficient, as Mr. Rubin suggests, to establish a revenue requirement that produces the minimum coverage levels mandated by PGW's bond ordinances. The net income over and above debt service obligations becomes internally generated capital that is used for construction, to pay cash items that are not included in the debt service coverage calculation, and to provide a cushion to address contingencies.

Q. DOES MR. RUBIN'S RATEMAKING METHOD COMPLY WITH THESE REQUIREMENTS FOR DETERMINING JUST AND REASONABLE RATES?

A. No, it does not, with my opinion based on my experience as a member of the Commission and on advice of the Company's counsel, because it departs completely from Public Utility Code Section 2212 (especially subsection (e)), Commission case law,

³³ 66 Pa.C.S. § 2212(f).

³⁴ See 52 Pa. Code § 69.2703(a)(5) & (b).

1 and the Commission's policy statement. In short, his method is unlawful and contrary to
 2 Commission precedents. Also on the advice of counsel, his method is also
 3 unconstitutional, as I shall explain shortly.

4 Section 1301 of the Public Utility Code requires the Commission to regulate
 5 utilities within its jurisdiction to ensure that the rates it establishes are just and reasonable
 6 for PGW and all other utilities and their customers. As the Commission's Policy
 7 Statement states:

8 The Commission is obligated under law to use the cash flow methodology
 9 to determine PGW's just and reasonable rates. Included in that
 10 requirement is the subsidiary obligation to provide revenue allowances
 11 from rates adequate to cover its reasonable and prudent operating
 12 expenses, depreciation allowances and debt service, *as well as* sufficient
 13 margins to meet bond coverage requirements and other internally
 14 generated funds over and above its bond coverage requirements, as the
 15 Commission deems appropriate and in the public interest for purposes
 16 such as capital improvements, retirement of debt and working capital.³⁵
 17

18 A Commission order that only allowed a rate increase permitting the Company
 19 "to comply with its bond indentures" (as Mr. Rubin recommends), would ignore the other
 20 listed financial needs to fund capital improvements, retirement of debt, and working
 21 capital. Such a miserly "bare bones" approach is not consistent with the Commission's
 22 requirements for just and reasonable rates.

23 **Q. WHAT OCCURS ONCE THE REVENUE REQUIREMENT HAS BEEN**
 24 **DETERMINED?**

25 A. Once the revenue requirement of PGW has been determined, the final step is the
 26 translation of the overall increase into tariffs (replacing those initially filed to produce the
 27 proposed rate increase), a process called "rate design" or determining the "rate structure."
 28 Once the size of the "pie" is determined in the revenue requirement process, it is then

³⁵ 40 Pa.B. at 2672; 52 Pa. Code § 69.2702(b) (emphasis added).

1 parsed into “slices”—groupings of customers with similar usage patterns. There are two
 2 steps: the allocation of revenue responsibility between the rate classes and the distribution
 3 of that portion into individual rate elements (e.g., \$ per Mcf, \$ per month).

4 Like investor-owned utilities, PGW provides a cost of service study in rate cases
 5 that allocates plant in service, depreciation expense, return dollars, and net income by
 6 class so that the Commission can determine if the revenue received from each class is
 7 more or less than the cost of providing service to that class.

8 Beyond the basic concern of allowing PGW the opportunity to recover the
 9 allowed revenue increase, there are a variety of other factors to be considered: the cost of
 10 service by rate class, value of service, gradualism (meaning rates should not be raised too
 11 abruptly), policy objectives (e.g., conservation), and social welfare considerations.³⁶ But
 12 these factors go to how the “pie” is to be sliced; not the size of the pie in the first place.

13 Other examples of relevant factors include the utility’s recent and past rate history
 14 and rate programs of the utility, the sales characteristics of the various classes of
 15 consumers, the practicability of administering the schedules, the value of the service to
 16 the various consumers, the promotional aspects of the rates, and the competition in
 17 certain areas by other fuels.³⁷

18 More pertinent to our present economic circumstances, rate structures may be
 19 modified from time to time in response to changes in economic conditions, whether
 20 general changes or changes especially affecting particular classes of customers.³⁸

21 Adjustments should not be made for temporary economic fluctuations.³⁹

³⁶ See Cawley & Kennard Guide, pp. 138-155.

³⁷ *City of Pittsburgh v. Pa. Pub. Util. Comm’n*, 126 A.2d 777, 785-86 (Pa. Super. 1956).

³⁸ *U.S. Steel Corp. v. Pa. Pub. Util. Comm’n*, 390 A.2d 865, 871 (Pa. Cmwlth. 1978).

³⁹ *City of Pittsburgh v. Pa. Pub. Util. Comm’n*, 144 A.2d 648, 660 (1958).

1 **Q. ARE YOU SUGGESTING THAT THE COVID-19 PANDEMIC IS A**
2 **TEMPORARY ECONOMIC FLUCTUATION THAT THE COMMISSION MAY**
3 **IGNORE IN THE RATE STRUCTURE PHASE OF THIS RATE CASE?**

4 A. Not necessarily. No one knows how long the current pandemic will persist. As of this
5 writing, the virus has caused economic disruption in varying forms to a number of
6 PGW's customers for about four months; some of its customers are now seeing an easing
7 of this disruption. Whether it remains serious for certain customers when PGW's
8 proposed rates are scheduled to go into effect in late December of this year or early
9 January of next year remains to be seen, but that will be reflected in the level of the
10 Company's arrearages, uncollectible accounts expense, and most importantly,
11 participation rates in the Company's universal service programs and initiatives that may
12 become the subject of future proceedings. Meanwhile, the parties to this case should
13 focus on the reasonableness of the Company's FPFTY projections.

14 **Q. WHY DO YOU SUGGEST SUCH A FOCUS?**

15 A. Sound and accepted utility ratemaking should not be deterred by unsettling economic
16 circumstances. Equally, PGW's obligation to provide safe, adequate, and reliable service
17 at reasonable rates is not suspended during such times. Nor does PGW's need to recover
18 its operating expenses and attract capital disappear during difficult economic straits.
19 Mr. Rubin's advocacy urging complete regulatory distrust and rejection of PGW's claims
20 because of the uncertainty of existing or anticipated economic conditions is not sound
21 public policy. No one has a crystal ball, but ratemaking is prospective and must occur
22 somehow because PGW provides an essential public service. That "somehow" is
23 facilitated using test year data and projections of revenue and expenses as reasonably as

1 they can be determined, which is a process authorized by Pennsylvania's General
2 Assembly.⁴⁰

3 Because PGW's service is essential to the public's health, welfare, and safety in
4 good times and in bad, the Commission and its counterparts across the nation use the test
5 year method to provide reasonable rate certainty during the period when the rates will be
6 in effect.⁴¹ The use of a test year is a sound and reasonable basis for establishing a
7 representative level of prospective rates. It allows for a reasonable measure of
8 predictability and semi-permanence in ratemaking.

9 The test year concept is such a basic tenet of ratemaking that the use of a fully
10 projected future test year ("the twelve month period beginning with the first month that
11 the new rates will be placed in effect after application of the full suspension period") was
12 recognized by the General Assembly under Act 11 of 2012 and is now embodied in
13 Section 315(e) of the Public Utility Code.

14 **Q. HOW DOES THIS BEAR ON THE PROPRIETY OF MR. RUBIN'S PROPOSED**
15 **METHOD OF RATEMAKING?**

16 A. His method is the antithesis of accepted ratemaking principles because it is based on
17 abnormal, extraordinary conditions, while the test year concept rejects abnormal
18 distortions and reflects typical conditions (which guards against, at any given time, the
19 utility either receiving too much or too little, and customers either paying too much or too
20 little).

21 **Q. MR. RUBIN SUGGESTS, HOWEVER, THAT A UTILITY'S RATE INCREASE**
22 **IS ALWAYS CONTINGENT ON NON-ECONOMIC CIRCUMSTANCES,**
23 **SPECIFICALLY THE UTILITY'S PROVISION OF SAFE, ADEQUATE AND**
24 **REASONABLE SERVICE AND THAT COMMISSIONS IN THE PAST HAVE**

⁴⁰ See Public Utility Code Section 315(e) (relating to burden of proof; use of future test year), 66 Pa.C.S. § 315(e).

⁴¹ See Cawley & Kennard Guide, pp. 85-88.

DENIED RATE INCREASES FOR FAILURE TO MEET THIS “SAFE AND ADEQUATE” STANDARD. CAN YOU COMMENT?

A. Mr. Rubin may be correct that a (perhaps implicit) “quid pro quo” for a utility rate increase is a determination that the company is in fact meeting its obligations to provide safe, adequate and reasonable service as required by Public Utility Code Section 1501.⁴² From my experience as a member of the Commission for many years, in rate cases of a utility that exhibits severe service quality deficiencies, the Commission accounts for them in a variety of ways. In its rate order it may be more skeptical of the Company’s expense prudence claims, disallowing some or all of them. It may deny inclusion of items in the company’s rate base. It may award a rate of return on that rate base at a lower end of the zone of reasonableness. It invariably will require the company to correct the deficiencies, and it will monitor the company to ensure compliance.

Notably, however, service quality problems do not justify a confiscatory rate order that arbitrarily denies otherwise legitimate and prudent expenses, rate base additions, or a return on plant investments that falls below the zone of reasonableness.

In my experience, significant service quality problems usually plague very small companies, and the Commission has little choice but to grant rate relief to enable the utility to make the necessary improvements, subject to Commission monitoring. Denying most or all the rate increase request would be counterproductive and only worsen service quality.

⁴² 66 Pa.C.S. § 1501 (“Every public utility shall furnish and maintain adequate, efficient, safe, and reasonable service and facilities, and shall make all such repairs, changes, alterations, substitutions, extensions, and improvements in or to such service and facilities as shall be necessary or proper for the accommodation, convenience, and safety of its patrons, employees, and the public.”).

1 I recall only one complete denial of a large public utility's rate increase request
2 based on service inadequacies. It involved a rate case filed by Pennsylvania Gas and
3 Water Company, whose divisions have long since been sold to other utilities. The denial
4 was based on what the Commission perceived as a very grave systemic failure by the
5 company to construct adequate water filtration facilities that resulted in widespread
6 intestinal sickness among the company's customers from a giardia infestation in the
7 company's reservoirs. The infestation was likely caused by overly lax local regulation of
8 residential housing development near some of the company's reservoirs, but the
9 Commission faulted the company for not preventing the sickness with adequate water
10 filtration. The Commission's refusal to grant any rate relief until the utility constructed
11 eight new water filtration plants over a period of years nearly bankrupted the company
12 and caused it to defend opportunistic lawsuits that were unsuccessful but very costly to
13 defend. For lack of adequate revenues, the company struggled to maintain service quality
14 until all eight new plants were completed. I know all this because I represented the
15 company throughout the rate case and meritless lawsuits. The case involved extreme
16 circumstances that certainly do not exist in PGW's service territory.

17 Here, Mr. Rubin does not claim (nor could he) that PGW's service is inadequate
18 as a basis for adopting his "bare bones" "1.5 times interest coverage requirement"
19 ratemaking method.⁴³ He therefore is precluded on service quality grounds from
20 justifying rates falling in a "null" (i.e., below the) zone of reasonableness any more than

⁴³ I acknowledge that other OCA witnesses (Mr. Colton and Mr. Geller) do testify that PGW is providing inadequate customer service and that its efforts to assist low income customers are inadequate. These contentions are forcefully refuted in PGW's rebuttal testimony. See PGW witnesses Adamucci (PGW St. No. 9-R), Cummings (St. 10-R) and Peach (St. 11-R).

he can do so based on a subjective and standardless determination that PGW's customers cannot afford a rate increase beyond that necessary to meet the Company's interest coverage requirements.

VI. PROPER CONSTITUTIONAL RATEMAKING

Q. DOES MR. RUBIN'S RATEMAKING METHOD COMPLY WITH CONSTITUTIONAL PRINCIPLES FOR DETERMINING JUST AND REASONABLE RATES?

A. No, it does not, with my opinion again based on my experience as a member of the Commission and on advice of the Company's counsel. Mr. Rubin acknowledges that the constitutionally-required zone of reasonableness within which rates must fall is the "traditional" or "normal" zone, but believes that it must give way to a "null" zone if there is a divergence of investors' and customers' interests. In such case, "still attempt[ing] to fairly balance the interests of all parties to the extent possible," "rate regulators may have to set rates which fall outside of the normal zone of reasonableness."⁴⁴ That is, below the lowest rate within the normal zone of reasonableness.

Contrary to Mr. Rubin's view, there is no such thing as a "null" zone of reasonableness. As long understood in the field of utility regulation, any rate below the traditional or normal zone of reasonableness is by definition confiscatory.

The total revenues to be earned by PGW from its gas distribution services pursuant to Commission-established rate levels are permissible if such revenues fall within a "zone of reasonableness" bounded at the lower end by the constitutional

⁴⁴ OCA St. No. 1, pp. 7-8.

1 prohibition against confiscation and at the upper end by the statutory prohibition against
 2 the exploitation of utility customers through the exercise of monopoly pricing powers.

3 It is not possible, as Mr. Rubin suggests, “to fairly balance the interests of all
 4 parties to the extent possible” by setting rates in a “null” zone below the “zone of
 5 reasonableness.” After a balancing of investors’ and customers’ interests, the
 6 Commission must set the rate *within* the zone to be “just and reasonable.”⁴⁵

7 Indeed, the U.S. Supreme Court subsequently stated that “any rate selected ...
 8 *from* the broad zone of reasonableness ... cannot be attacked as confiscatory.”⁴⁶ The just
 9 and reasonable standard has been found by the Supreme Court of Pennsylvania to satisfy
 10 the constitutional requirement precluding the Commission from exercising its ratemaking
 11 authority in a manner that confiscates utility assets without just compensation. Rates
 12 found to be “just and reasonable” for statutory purposes do not constitute a taking under
 13 the Pennsylvania or United States Constitutions. As the Court stated, the requirement of
 14 just and reasonable rates “confer[s] upon the regulatory body [the Commission] the
 15 power to make and apply policy concerning the appropriate *balance* between prices
 16 charged to utility customers and returns on capital to utility investors *consonant with*
 17 *constitutional protections* applicable to both.”⁴⁷ Therefore, in determining whether a rate
 18 increase is “just and reasonable,” the Commission has the duty and the discretion to
 19 determine the proper balance between the interests of ratepayers and the utility’s
 20 investors.

⁴⁵ See *FPC v. Conway*, 426 U.S. 271, 278 (1976) (“there is no single cost-recovering rate, but a zone of reasonableness”).

⁴⁶ *Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968) (emphasis added).

⁴⁷ *Pennsylvania Electric Co. v. Pa. Pub. Util. Comm’n*, 502 A.2d 130, 133 (Pa. 1985) (quoting *Pa. Pub. Util. Comm’n v. Pennsylvania Gas and Water Co.*, 424 A.2d 1213, 1219 (1980) (emphasis original), *cert. denied*, 454 U.S. 824 (1981)).

Thus, Mr. Rubin’s suggestion that, in times of economic distress, just and reasonable rates may be set within a “null” zone below—instead of *within*—a zone of reasonableness simply invites the Commission to practice confiscation and is therefore unconstitutional.

VII. THE CONFISCATORY RISK OF CHANGING RATEMAKING METHODOLOGIES

Q. IS THERE A RISK OF CONFISCATION BY ADOPTING MR. RUBIN’S AFFORDABILITY MODEL?

A. Yes, there is a significant risk of confiscation which Mr. Rubin acknowledges but then ignores with his affordability model. He correctly acknowledges that “[i]n protecting consumers, regulators cannot confiscate the property of the utility’s investors. That is, regulators cannot tilt the scale so far in favor of consumers ... that the utility’s investors are deprived of an opportunity to earn a reasonable return on their investment.”⁴⁸

Mr. Rubin stands on this point with Justice Holmes who penned the now famous phrase, “while property may be regulated to a certain extent, if regulation goes too far, it will be recognized as a taking.”⁴⁹

In the U.S. Supreme Court’s most recent decision regarding public utility ratemaking,⁵⁰ the Court recognized another way that ratemaking can be confiscatory—an arbitrary change in methodology.

As described by the Court, “a State’s decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad

⁴⁸ OCA St. No. 1, p. 5.

⁴⁹ *Pennsylvania Coal v. Mahon*, 260 U.S. 393, 415 (1922) (Holmes, J.).

⁵⁰ *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

1 investments at some times while denying them the benefit of good investments at others
2 would raise serious constitutional questions.”⁵¹

3 Mr. Rubin’s suggested switch from traditional to “affordability” ratemaking is
4 just such an arbitrary change of ratemaking methodology. In fact, his proposal is even
5 more arbitrary. Rather than making investors bear only the risks of bad investments
6 while denying them the benefit of good ones, his method that gives PGW no opportunity
7 to prove its case beyond a “bare bones,” minimum-coverage result could deny PGW the
8 revenues it needs not only to continue to maintain adequate financial metrics but to
9 operate in the FPFTY. That is playing a regulatory game of heads-the-consumer-wins,
10 tails-the-company-loses.

11 **VIII. OTHER SPECIFIC INFIRMITIES IN MR. RUBIN’S PROPOSED METHOD**

12 **Q. ARE THERE OTHER SPECIFIC INFIRMITIES IN MR. RUBIN’S PROPOSED** 13 **METHOD?**

14 A. Yes, there are at least four. *First*, Mr. Rubin’s remedy is overly broad. Under his
15 method, all customers, including the vast majority of customers who remain employed
16 and even the wealthy, would pay little or no rate increase. Unless Mr. Rubin’s goal is to
17 attempt to mitigate the psychic trauma that all of us have experienced as a result of the
18 pandemic, this result makes no sense and demonstrates that his relief is too broad.
19 Although some portion of the affected portion of Pennsylvania’s labor force appears to be
20 preparing to return to work, Mr. Rubin does not explain why the vast majority of the
21 Company’s customers should be absolved of a rate increase when they have not lost their
22 income. Mr. Rubin has not demonstrated that the government and Company assistance

⁵¹ *Id.*, 488 U.S. at 315.

1 provided to those who have lost some or all their income is insufficient to pay the
2 increase that the Company is requesting. Moreover, if it is insufficient, the appropriate
3 remedy is for the Commonwealth and the Company to adjust such programs, not to deny
4 an increase to customers that can afford to pay it.

5 Neither does Mr. Rubin provide any analysis of the actual impact of the proposed
6 rate increase on the customers whom he claims are too harmed by the pandemic to pay
7 any increase in PGW's rates and, where some may be harmed, how the Company's
8 universal service programs don't resolve those issues.

9 *Second*, he essentially ignores substantial government aid provided in response to
10 the COVID-19 pandemic in determining whether the increase requested is affordable or
11 not.

12 *Third*, Mr. Rubin's approach presents a problem of adequate standards. How
13 large must the proposed rate increase be before it becomes unaffordable? For what
14 percentage of the customer base? When and to what extent are economic conditions
15 sufficiently debilitating as to justify restricting rate increases? Under what conditions is
16 normalcy restored? Mr. Rubin's testimony provides no standards to decide these and
17 other pertinent questions. It would lead to an ad hoc method of setting rates that is not
18 predictable. What is predictable is that such a system will be unacceptable to the
19 investors that have historically provided capital to Pennsylvania utilities with the result
20 that capital will become more expensive and potentially not available in difficult
21 economic conditions.

22 *Finally*, his proposal is fundamentally asymmetric. Mr. Rubin proposes a
23 ratemaking method that would produce rates below the traditional zone of reasonableness

1 during an economic disruption, but it undoubtedly would not produce rates above the
2 zone of reasonableness in good economic times.

3 Unregulated businesses' earnings, during good financial times, are not
4 constrained. Regulated businesses, such a PGW, are fundamentally different in this
5 respect. Utility profits are constrained at both ends of the equation—they may not be too
6 high or too low.

7 Furthermore, unregulated businesses can generally enter and exit markets at their
8 discretion and seek to serve markets where they can earn higher profits and refuse to
9 serve low profit markets altogether. PGW cannot do this. It must serve all customers in
10 its service territory, and it must provide safe and reliable service throughout its service
11 area. For these reasons, its rates are regulated and its earnings protected on the low end
12 by confiscation standards and constrained on the high end by its regulators.

13 **IX. BEST MEANS OF ASSISTING PGW'S CUSTOMERS**

14 **Q. WHAT ARE THE BEST MEANS OF ASSISTING PGW'S CUSTOMERS WHO**
15 **ARE HAVING DIFFICULTY PAYING THEIR UTILITY BILLS?**

16 A. Mr. Rubin fails to recognize the important programs the Company maintains for those
17 ratepayers who do experience ability to pay situations. These safety net programs have
18 not gone away or been idled by the pandemic, but rather stand ready to support ratepayers
19 who are affected to a greater degree by the pandemic situation. PGW has implemented a
20 host of major customer assistance programs, many of which are identified in the rebuttal
21 testimony of Ms. Adamucci (PGW St. No. 9-R) who specifically notes PGW's efforts to
22 provide additional relief in response to the COVID-19 pandemic.

23 These programs supplement the Company's existing Customer Assistance and
24 Referral Evaluation Services ("CARES" or the "CARES Program"), Hardship Fund,

Customer Assistance Program (“CAP”), and Low Income Usage Reduction Program (“LIURP”), which are existing Company-run programs designed to assist low-income customers. These programs are provided by PGW in addition to its active encouragement of low-income customers to apply for grants from the Low-Income Home Energy Assistance Program (“LIHEAP”).

Contrary to Mr. Rubin’s assertions, denying PGW’s rate increase request or severely limiting it to allow only minimum bond indenture coverages, is not the best way to assist PGW’s customers. They already have substantial options available to receive economic aid should they need it.

X. MR. RUBIN’S RECOMMENDED STOPGAP MEASURES

Q. DO YOU AGREE WITH MR. RUBIN’S TWO RECOMMENDATIONS FOR PGW TO DO “IF THE ECONOMIC SITUATION WORSENS SIGNIFICANTLY AND CASH FLOW BECOMES A CONCERN FOR PGW”?

A. No, I do not agree with his suggestions that PGW can defer construction projects such as “growth-related projects [of which, I am informed, there is not one] or system rehabilitation activities that are not needed to ensure current levels of service within the next six to 12 months,” and that PGW can “work with the City to temporarily reduce or eliminate the cash dividend PGW pays to the City.”⁵²

Mr. Rubin’s first stopgap measure contravenes what I believe was the Legislature’s intent in enacting Act 11 of 2012—to ensure that Commission-determined rates provide as nearly as possible the utility’s needed revenues and return on capital in the period in which rates will be in effect for it to make desired infrastructure investments and to increase employment opportunities in the Commonwealth.

⁵² OCA St. No. 1, p. 24.

1 It is well-established that many electric, gas and water companies in Pennsylvania
2 have aging infrastructure and must undertake substantial capital investments to continue
3 to provide safe and reliable service to customers. PGW is among those utilities facing
4 this issue. As PGW's Statement of Reasons for requesting a rate increase explains,
5 "Since PGW's last base rate case in 2017, the Company has continued a number of
6 initiatives to modernize its infrastructure, make its system safer and more efficient and
7 improve customer service. While some of those efforts have been financed through
8 surcharges (i.e., the acceleration of PGW's main replacement program), PGW has
9 undertaken numerous other efforts that have been financed through base rates or
10 additional borrowing."⁵³

11 Thus, Mr. Rubin fails to consider that most of the rate increase in this case is
12 designed to fund PGW's Commission-approved replacement and betterment programs,
13 which will produce hundreds of millions of dollars in economic benefits and thousands of
14 jobs in PGW's service territory alone as explained in the direct and rebuttal testimony of
15 PGW witness Mr. Moser (PGW St. Nos. 7, 7-R).

16 As to Mr. Rubin's second stopgap measure, PGW is legally obligated to make the
17 annual \$18 million payment to the City⁵⁴ and while the City could voluntarily reduce or
18 eliminate it, this would deprive it of vital revenues when it most needs to receive them to
19 counter the negative economic effects of the pandemic. In fact, such an action would
20 deprive the City of funds to assist the same group of individuals, the citizens of

⁵³ PGW Statement of Reasons, Responses to Filing Requirements, vol. 1, Docket No. R-2020-3017206 (Feb. 2020).

⁵⁴ 66 Pa.C.S. § 2212(f).

Philadelphia many of whom are also PGW customers, who Mr. Rubin acknowledges need help with paying their bills.

Overall, Mr. Rubin tries to have it both ways—by assuring us that he is not “suggesting that PGW should have rates that are inadequate to ensure the provision of safe and reliable service to its customers”⁵⁵—while simultaneously ensuring with his “bare bones” ratemaking proposal that PGW will not receive reasonable and necessary revenues to fulfill its statutory and Commission-ordered obligations.

XI. RESPONSES TO MR. KNECHT’S TESTIMONY

Q. WHAT DOES MR. KNECHT RECOMMEND REGARDING PGW’S RATE INCREASE REQUEST?

A. Conceding at least that “rate increases will likely be necessary within the next few years,” he recommends that, “[i]n the middle of a pandemic exacerbated by urban unrest,”⁵⁶ the Commission “should seriously consider whether PGW’s proposed base rate increase should be deferred, until (a) the economy has had a chance to recover from and/or adapt to the pandemic, and (b) the rate implications of the ‘pilot program’ have been absorbed by ratepayers.”⁵⁷

Q. WHAT IS YOUR REACTION TO HIS RECOMMENDATION?

A. As I have stated previously, PGW’s obligation to provide reliable service at reasonable rates, and the need for borrowed capital and additional cash to provide such service, continues whatever the condition of our national economy. Municipal entities providing

⁵⁵ OCA St. No. 1, p. 23.

⁵⁶ OSBA St. No. 1, p. 9.

⁵⁷ *Id.* at p. 3. The “pilot program” to which he refers is described in the testimony of PGW witness Adamucci (PGW St. No. 9-R).

1 a vital, essential service do not have the luxury of suspending operations until the
2 economy improves.

3 There is a mutually beneficial symbiotic relationship between PGW's customers
4 and the investment community. They need each other (one to ensure provision of their
5 utility service, the other to make money), but the price charged by investors and the
6 resultant cost to customers is highly dependent on the risk perceived by the former who
7 have many other places to invest their money.

8 If Mr. Knecht's recommendation to delay rate relief were adopted by the
9 Commission, investors would perceive increased risk because they are informed enough
10 to know that such a delay would have negative effects on the Company's operations. The
11 price (the yield demanded) of ongoing borrowings would inevitably rise, which
12 customers would bear. The projects delayed will cost more when finally undertaken,
13 perhaps due to inflation, but certainly because of higher financing costs.

14 Also, from my experience, the Commission (whose members and staff fully
15 understand what I have just described) much prefers to address regularly-timed requests
16 for gradual rate relief than overly-delayed requests asking for heartburn-inducing
17 percentage increases based on avoidably inflated costs.

18 **Q. PERTINENT TO YOUR EXPERTISE AND EXPERIENCE, DID MR. KNECHT**
19 **GIVE ANY OTHER REASONS WHY PGW'S FILING SHOULD BE DELAYED**
20 **OR MINIMIZED?**

21 A. Yes. He states that "potential future benefits [to the Company] are contingent on PGW
22 being able to use the rate increase to reduce debt (or other liabilities)."⁵⁸ He continues:

23 Unfortunately, if PGW's income begins to rise, it is likely to face
24 increased pressure from a variety of stakeholders who want "a piece
25 of the action." These stakeholders could potentially include labor

⁵⁸ *Id.* at p. 6.

unions (seeking above market employee benefits), management (seeking higher compensation), the City of Philadelphia (seeking fees in lieu of taxes), suppliers, attorneys, economic and DSM consultants, etc. Raising rates will provide zero future economic benefits to ratepayers if the increased rates simply inure to the benefit of other stakeholders.⁵⁹

Q. WHAT DOES MR. KNECHT RECOMMEND THAT THE COMMISSION DO TO PREVENT THIS PERCEIVED PROBLEM?

A. He recommended this extraordinary remedy:

The Commission should focus on ensuring that contributions by ratepayers benefit ratepayers and not other parties. The power of PGW's stakeholders to extract additional rents from PGW can be minimized *by keeping rate increases to the bare minimum necessary to avoid a financial crisis*. By keeping rates as low as possible, the Commission keeps PGW in a heightened state of alert with respect to controlling costs. *In my view, this has generally been the approach taken by the Commission (and ratepayer advocates) for rate regulation of PGW for much of the past two decades.*⁶⁰

Q. DO YOU AGREE WITH HIM?

A. Absolutely not. I strongly disagree with him based on my experience as a commissioner.

I cannot speak for the “ratepayer advocates,” but I can speak for myself and my

Commission colleagues from 2005 to 2015. We never consciously intended to keep

PGW’s rate increases “to the bare minimum necessary to avoid a financial crisis.” We

chafed at times with regulating PGW, principally at the actions of the Philadelphia Gas

Commission and our inability to penalize the Company for any noncompliance with our

orders (because innocent customers rather than shareholders would pay any fine), but we

were well aware of the uniqueness of the Company as a municipal entity and its ongoing

need to borrow money to maintain its operations. Consequently, and especially because

⁵⁹ *Id.*

⁶⁰ *Id.* (emphasis added).

1 of the need for the Company to replace its cast iron and bare steel gas mains, we always
 2 sought to *avoid* putting the Company in a financial crisis.

3 The Commission should reject Mr. Knecht's recommendation to delay or
 4 minimize the requested rate relief. Instead, for the good of the Company and its
 5 customers, it should continue to provide gradual rate increases to the Company on a
 6 timely basis.

7 **XII. RESPONSES TO DR. HAUSMAN'S TESTIMONY**

8 **Q. WHAT DOES DR. HAUSMAN RECOMMEND IN HIS TESTIMONY?**

9 A. Dr. Hausman generally contends (or intimates) that PGW, as a natural gas distribution
 10 company, is operating unreasonably because it allegedly has not recognized that its
 11 continued operation is contributing to global warming and the emission of greenhouse
 12 gases. He concludes that PGW is acting imprudently to the extent that it continues to
 13 modernize its natural gas distribution facilities over the next several decades, as is its
 14 present plan. Instead, he contends that PGW should be examining more "cost effective"
 15 approaches, and therefore the Commission should find that the Company has failed to
 16 demonstrate that its proposed investments are necessary, reasonable, or prudent."⁶¹

17 Dr. Hausman recommends that, "[t]o redress these deficiencies, and *to provide the*
 18 *Commission with the necessary information to determine whether or not the Company's*
 19 *proposed rate increase is just and reasonable*, the Commission should direct the
 20 Company to produce a Climate Business Plan ("CBP") ... which should include

⁶¹ SC St. No. 1, p. 3.

1 consideration of potentially cost-effective alternatives to maintaining or expanding the
 2 Company's gas infrastructure, such as energy efficiency."⁶²

3 The CBP would not include continuation of PGW's cast-iron and bare steel
 4 pipeline replacement program (a major driver of PGW's rate request) because such
 5 modernized infrastructure "will have no use by the time the project is complete [about
 6 2055], and, therefore, further spending on it is a "wasteful endeavor."⁶³

7 Until such CBP is completed and PGW is found by the Commission to be
 8 compliant with it, all rate relief should be denied.

9 **Q. WHAT AUTHORITY DOES DR. HAUSMAN CITE AS AUTHORITY FOR**
 10 **REQUIRING A CBP TO BE FILED AS A PREREQUISITE TO COMMISSION**
 11 **APPROVAL OF A RATE INCREASE?**

12 A. He first cites Gov. Wolf's Executive Order Number 2019-01 which sets out aspirational
 13 targets to reduce greenhouse emissions by 26% on or before 2025 and 80% by 2050.⁶⁴ He
 14 also cites the Philadelphia City Council's Resolution No. 190728 which sets a goal to
 15 reduce the City's carbon footprint by 80% before the year 2050.⁶⁵ This non-binding
 16 resolution aims to have the City served by "100% clean renewable energy" by 2050.

17 **Q. ARE MR. HAUSMAN'S ASSERTIONS WELL GROUNDED?**

18 A. No. They are fatally flawed in many ways. His entire testimony presupposes that the
 19 continued operation of PGW as a natural gas distribution company is or will be
 20 unreasonable and should be ended because it unreasonably contributes to global
 21 warming. But no such legislative directive to that effect has been made by the

⁶² *Id.* at pp. 3-4 (emphasis added).

⁶³ *Id.* p. 10.

⁶⁴ *Id.* at p. 8.

⁶⁵ *Id.* at p. 8-9.

1 Pennsylvania General Assembly or any other agency of Pennsylvania Government. Yet,
 2 Dr. Hausman asks the Commission to deny rate relief based on those conclusions.

3 I am informed by counsel that the Commission does not have the authority to
 4 make such determinations about whether a natural gas distribution company's operations
 5 unreasonably contribute to global warming, or to mandate greenhouse gas emission
 6 reductions, and neither the Governor's executive order nor City Council's resolution
 7 provides that authority.

8 The Commission simply lacks jurisdiction to base its decision on such
 9 determinations that are foreign not only to its governing statute but to its expertise as
 10 well.

11 Upon advice of PGW's counsel, there is nothing in the Public Utility Code that
 12 authorizes the Commission to make rate case determinations based on the perceived
 13 effects of greenhouse gases or global warming. The Commission would act ultra vires if
 14 it made such determinations, and it would usurp the authority of the Pennsylvania
 15 Department of Environmental Protection ("DEP") by doing so.

16 To illustrate the point, Governor Wolf issued Executive Order No. 2019-07, as
 17 amended, on June 22, 2020, directing DEP "[b]y no later than September 15, 2020, [to]
 18 develop and present to the Environmental Quality Board a proposed rulemaking to abate,
 19 control or limit carbon dioxide emissions from fossil-fuel-fired electric power
 20 generators."⁶⁶ The proposed rulemaking directs DEP "working with the Public Utility
 21 Commission" to engage with PJM Interconnection to minimize emissions leakage.⁶⁷

⁶⁶ See Executive Order No. 2019-07 as amended, *Commonwealth Leadership in Addressing Climate Change through Electric Sector Emissions Reductions* (June 22, 2020), 50 Pa.B. 3406, 3407 (July 11, 2020).

⁶⁷ *Id.* at 3408.

1 Thus, the Commission may assist other Commonwealth agencies on matters that
 2 are ancillary or tangential to the Commission’s jurisdiction but do not fall directly within
 3 it, but nothing in its enabling statute authorizes it to take the actions recommended by Dr.
 4 Hausman. At the least, requiring the Commission to make ratemaking (or other)
 5 determinations in response to climate change would create the real possibility of disparate
 6 and potentially inconsistent regulation.

7 Finally, I am further advised by PGW’s counsel that the Commonwealth Court of
 8 Pennsylvania recently held in *Funk v. Wolf*⁶⁸ that the Commission cannot make (or be
 9 made to make) decisions based upon environmental considerations or implement
 10 regulations addressing climate change.

11 **Q. Have you reviewed City Council Resolution No. 190728?**

12 A. Yes. The resolution states: “RESOLVED, That the City of Philadelphia shall take
 13 measures to achieve a fair and equitable transition to the use of 100% clean renewable
 14 energy for electricity in municipal operations by 2030, for electricity City-wide by 2035,
 15 and for all energy (including heat and transportation) city-wide by 2050 or sooner.” The
 16 measures to be undertaken are not specifically identified in the Resolution. Rather, it
 17 refers generally to the Office of Sustainability’s “Clean Energy Vision Plan” (and
 18 apparently the same document by reference to that Office’s “Powering Our Future: A
 19 Clean Energy Vision for Philadelphia”), that Office’s “Municipal Energy Master Plan,”
 20 and the 2018 International Building Code for commercial construction. Further, the
 21 Resolution resolves to appoint members to the Philadelphia Gas Commission “who
 22 support and advocate for clean renewable energy in PGW’s operations.”

⁶⁸ *Funk v. Wolf*, 144 A.3d 228 (Pa. Cmwlth. 2016).

1 I have not read the referenced documents, but I am confident without reading
 2 them that they are responsible and sensible enough *not* to include Dr. Hausman's
 3 suggested denial of PGW rate relief (only excepting rate relief "narrowly tailored ... for
 4 safety-related distribution system maintenance and addressing major gas leakage.")⁶⁹

5 Finally, I am advised by counsel for the Company that, whatever the City or the
 6 City Council ultimately determines to do in furtherance of the Resolution, it would not be
 7 binding on the Commission. Any determinations that would affect PGW's provision of
 8 safe and reliable natural gas service to current and prospective customers would have to
 9 be consistent with the Public Utility Code and approved by the Pennsylvania Public
 10 Utility Commission.

11 **Q. WHAT DO YOU CONCLUDE ABOUT DR. HAUSMAN'S TESTIMONY?**

12 A. The Commission is powerless to adopt Dr. Hausman's recommendations, even if every
 13 member of the Commission agreed fervently with everything stated in his testimony.

14 Indeed, as I have already testified, the PUC must determine PGW's just and
 15 reasonable rates in accordance with the provisions of Section 2212, not in accordance
 16 with or in furtherance of a CBP which term or concept is not found in the Public Utility
 17 Code.

18 Even if the Commission possessed the requisite jurisdiction, and even if Dr.
 19 Hausman's recommendations were adopted, they would take considerable time to
 20 implement. Meanwhile, the Company's financial condition would need to be maintained
 21 to continue operations and ongoing infrastructure improvements. Denying the current
 22 rate increase (and necessary future ones) would not only cripple the Company but prevent

⁶⁹ SC St. No. 1, p. 4.

1 it from financing the “energy efficiency” or other methane reducing efforts that Dr.
2 Hausman recommends.

3 **XIII. CONCLUSION**

4 **Q. DOES THAT COMPLETE YOUR REBUTTAL TESTIMONY?**

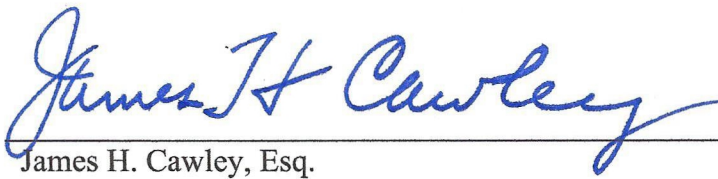
5 A. Yes.

VERIFICATION

I, James H. Cawley, hereby state that: (1) I am an independent consultant and attorney;
(2) I have been retained by Philadelphia Gas Works for purposes of this proceeding; (3) the facts set forth in my testimony are true and correct to the best of my knowledge, information and belief; and (4) I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

July 13, 2020

Dated



James H. Cawley, Esq.