

COMMONWEALTH OF PENNSYLVANIA



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January 29, 2010

James J. McNulty
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

RE: Petition of Philadelphia Gas Works for a
Statement of Policy on the Application of
Philadelphia Gas Works' Cash Flow
Ratemaking Method
Docket No. P-2009-2316508

Dear Secretary McNulty:

Enclosed for filing are the Comments of the Office of Consumer Advocate, in the above-referenced proceeding.

Copies have been served as indicated on the enclosed Certificate of Service.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Darryl Lawrence".

Darryl Lawrence
Assistant Consumer Advocate
PA Attorney I.D. # 93682

Enclosures

cc: Stanley E. Brown, Law Bureau

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Philadelphia Gas Works for a	:	
Statement of Policy on the Application of	:	Docket No. P-2009-2136508
Philadelphia Gas Works' Cash Flow	:	
Ratemaking Method	:	

COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE

I. INTRODUCTION

On October 16, 2009, Philadelphia Gas Works (PGW or Company) filed a Petition requesting that the Pennsylvania Public Utility Commission (Commission) “issue a ‘Statement of Policy’ explaining how it intends to apply PGW’s Cash Flow Ratemaking Method on a going forward basis.” PGW Pet. at 1. On November 10, 2009, the Office of Consumer Advocate (OCA) filed an Answer to PGW’s Petition. The OCA opposed the issuance of a policy statement on numerous grounds. Among other things, the OCA argued that such a policy statement may run contrary to the recent Commonwealth Court decision as to the application of PGW’s Cash Flow method of ratemaking, and thus could violate the “law of the case” as to this issue. The OCA also argued that the issuance of a policy statement in this matter was procedurally in error, as the new policy would apply to only one company and the issues PGW wishes to “clarify” have already been addressed by this Commission and by the Commonwealth

Court. As such, through its Petition PGW is clearly seeking reconsideration of issues it has already argued and lost on several levels.

On December 17, 2009, the Commission agreed to issue a Policy Statement as PGW requested, with some modifications. In Re PGW Petition, Order and Proposed Policy Statement, Dock. No. P-2009-2136508 (entered December 30, 2009) (Order). The Order provided that comments to the Proposed Policy Statement would be due within 30 days of entry of the Order. The OCA provides these comments in continued opposition to the issuance of a Proposed Policy Statement in this matter. If the Commission determines to issue a policy statement, however, the OCA has provided a revised policy statement in Appendix A of this document in order to conform the statement to the law and sound ratemaking principles.

II. COMMENTS

The OCA submits that the Commission's Order should not be adopted in any form. As the OCA set forth in its Answer, there is no need to issue a policy statement as to how the Cash Flow method of ratemaking applies to PGW. No real confusion exists as to how this ratemaking methodology is applied to PGW. Rather, it is PGW's continued disagreement with how the Commission has interpreted and applied the Cash Flow method to PGW that is at the heart of this matter. PGW has had a full and fair opportunity to argue its case before this Commission and the Commonwealth Court. In all instances, PGW's interpretation of the Management Agreement Ordinance (MAO) and the correlating application of the Cash Flow method to PGW have been soundly rejected.

Moreover, the Proposed Policy Statement is contrary to recent decisions by this Commission and the Commonwealth Court and does not follow the MAO. In the OCA's view, the Proposed Policy Statement does not accurately reflect the holdings of recent decisions in

several important areas. Specifically, the references to certain phrases like “non-borrowed yearend cash” and “internally generated funds” in the Proposed Policy Statement will not “reduce the likelihood of future litigation” on these issues, but rather will likely force continued litigation on these same issues that were already finally decided by the Commonwealth Court. Phila. Gas Works v. Pa. PUC, Docket No. 1914 C.D. 2007, Memorandum Opinion (filed Feb. 4, 2009) (Commonwealth Court Order), Petition for Allocatur denied, Docket No. 259 EAL 2009, (Dec. 2, 2009).¹ If a Policy Statement is to be issued, however, certain alterations must be made in order to accurately reflect recent case law and the language of the MAO itself. In the following sections, the OCA will discuss the changes that should be made and will also provide a suggested policy statement revision in the event the Commission determines to go forward.

A. The Inclusion Of The Phrase “Internally Generated Funds” Only Serves To Rekindle Arguments That Have Already Been Finally Decided.

The Proposed Policy Statement provides the following:

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

Order at Annex A, Proposed Section 69.2702(b) (emphasis added). In the 2006 PGW base rate case,² the Company strenuously argued that PGW’s rates must be set at a level such that certain

¹ The Commonwealth Court Order (Order) is an unpublished opinion. Such an opinion should not ordinarily be cited for its decisional value. In this matter, however, the OCA’s use of the Order is appropriate as it is this appellate decision that establishes the “law of the case” as to the issues contained in PGW’s Petition. See 210 Pa. Code § 67.55. It should also be noted that PGW cited the Order in its Petition and subsequent Answer in this docket.

² Pa. PUC v. PGW, Opinion and Order, Dock No. R-00061931 (entered Sept. 28, 2007) (PGW 2006).

operating expenses and liabilities, namely capital improvements, prepayment of debt and working capital requirements could always be met with “internally generated funds” or “non-borrowed cash.” The OCA and others argued that such a definition was at odds with the very language of the MAO, which is the touchstone for the Cash Flow method as such method applies to PGW. To this end the MAO provides, in relevant part:

(ii) To provide appropriations, to the extent not otherwise provided, for prepayment of debt and for capital additions which have been determined by the Gas Commission to be reasonable and which have been approved by City Council; and

(iii) To provide cash, *or equivalent*, for working capital in such reasonable amounts as may be determined by Company to be necessary and as shall be approved by the Gas Commission.

Management Agreement Ordinance (MAO), City Ordinance No. 455, Section VII(b)(ii), (iii), December 29, 1972, as amended (emphasis added). As the MAO provides, PGW’s need for working capital can be met through cash or *equivalents* to cash. In its review of PGW 2006, the Commonwealth Court agreed with the OCA on the issue of non-borrowed cash, in relevant part as follows:

Contrary to PGW's contention that cash working requirements must be solely from non-borrowed cash, the MAO provides that PGW can fix rates to produce sufficient revenues to "provide cash, or *equivalent*, for working capital." R.R. at 589(a). We, therefore, conclude that PUC's determination that PGW needed only \$25 million in new revenues in order to satisfy all of the required elements of its mandated Cash Flow Method is supported by substantial evidence.

Commonwealth Court Order at 12.

The Commonwealth Court has decided this issue as to whether certain PGW operating expenses and liabilities must be funded through the use of *only* non-borrowed cash. It should be noted that after PGW filed its Petition in this matter, the Supreme Court of

Pennsylvania issued its Order denying PGW’s appeal on this issue. As the OCA explained in its Answer to PGW’s Petition, the Commonwealth Court Order is now the “law of the case” as to this issue.

The OCA submits that the use of “internally generated funds” within this section could suggest that the Commission now believes that PGW is correct as to the “non-borrowed cash” issue. Such a result is at odds with the Commonwealth Court Order and established case law.³ To remedy this inconsistency, the OCA continues to submit that no Policy Statement needs to be issued on these matters, but, alternatively, a revision to the Proposed Policy Statement is included herein as Appendix A, as follows:

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

In addition to these proposed revisions, Sections 69.2703(a)(1) and (2) in the Proposed Policy Statement also reference the terms “non-borrowed cash” and internally generated funds”, which must also be stricken as the OCA discusses in Sections B and C of this document. If a policy statement is issued, the OCA submits that the foregoing modifications must be made in order to ensure conformity with the law and the MAO.

³ Met-Ed Indus. Users Group v. Pa. P.U.C., 960 A.2d 189, 196 n.5 (Pa. Commw. Ct. 2008) (declaring that the PUC was “required” to follow the ratemaking methodologies adopted by the Commonwealth Court); City of Chester v. Pa. P.U.C., 773 A.2d 1280, 1286 (Pa. Commw. Ct. 2001) (“Because the PUC is a state administrative agency over which state courts have jurisdiction to determine what law it is to apply, . . . [the PUC] was required to apply the [Commonwealth Court’s] holding in *City of Philadelphia* to this case.”); and In Re Guy Heavener, Inc., 1982 Pa. PUC LEXIS 108, at *2, 56 Pa. PUC 46 (Apr. 30, 1982) (“Although Heavener's legal arguments may be persuasive as to why Makovsky was incorrectly decided by Commonwealth Court, the commission is legally bound to accept the decisions of the courts of Pennsylvania. It is not within the commission's powers to ignore, or attempt to administratively alter, court decisions and orders.”).

B. PGW's Future Financial Forecasts and Assumptions Are Not Appropriate Factors for Rate Setting Purposes.

The Proposed Policy Statement provides the following:

(a) In determining just and reasonable rate levels for PGW, the Commission will consider, among other relevant factors:

(1) PGW's test year end and (as a check) projected future levels of non-borrowed yearend cash;

Order at Annex A, Proposed Section 69.2703(a)(1). In PGW 2006, the Company argued that its five-year financial forecasts should be considered by the Commission as relevant factors in setting its rates. The Commission disagreed, in relevant part as follows:

The test year concept is a basic tenet of ratemaking that forms a sound and reasonable basis for establishing a representative level of prospective rates. It allows for a reasonable measure of predictability and semi-permanence in ratemaking. We are cognizant of the Company's current financial situation and goals; however, we do not find them to justify peering five years into the future on such uncertain circumstances. We agree with the opposing Parties that the use of a five-year forecast is too speculative and unreliable for the setting of rates.

PGW 2006 at 18. On appeal, the Commonwealth Court affirmed the Commission on this issue, as follows:

PGW contends that PUC committed an error of law and abused its discretion when it refused to consider projected financial data for five years after the test year, even though application of PUC's traditional "test-year" policy was inconsistent with the application of PGW's mandated "Cash Flow" ratemaking methodology, thereby significantly understating PGW's justified rate increase. We disagree.

...
We conclude that PUC did not err or abuse its discretion by using traditional test-year data and refusing to consider projected post-test-year data.

Commonwealth Court Order at 9, 10. The Commission held and the Commonwealth Court affirmed that PGW's rates are set using the traditional test year method. As Section 316 of the Public Utility Code provides:

Whenever the Commission shall make any rule, regulation, finding, determination or order, the same shall be prima facie evidence of the facts found and shall remain conclusive upon all parties affected thereby, unless set aside, annulled or modified on judicial review.

66 Pa.C.S. § 316. It could be inferred, however, and thus argued from the language of the Proposed Policy Statement that the Commission is now willing to consider PGW's future financial projections and assumptions to be "relevant factors" in setting PGW's rates – exactly what the Commission held it would not do in PGW 2006. Moreover, the proposed language continues the use of the "non-borrowed cash" terminology.

The OCA submits that using beyond the test year financial projections, even "as a check" is improper and at odds with the Commonwealth Court Order. As discussed above, the OCA is opposed to the issuance of any policy statement on this issue. If, however, the Commission chooses to proceed then the OCA has provided a revised policy statement as Appendix A to this document, in relevant part as follows:

§ 69.2703. Ratemaking procedures and considerations.

(a) In determining just and reasonable rate levels for PGW, the Commission will consider, among other relevant factors:

(1) PGW's test year end-financial data and ~~(as a check) projected future levels of non-borrowed yearend cash;~~

C. The Proposed Policy Statement Could Be Read To Introduce Benchmarking Into The Ratesetting Process For PGW Rather Than Applying The Just And Reasonable Standard.

The Proposed Policy Statement provides the following:

(a) In determining just and reasonable rate levels for PGW, the Commission will consider, among other relevant factors:

...

(3) Debt to equity ratios and financial performance of similarly situated utility enterprises;

(4) Level of operating and other expenses in comparison to similarly situated utility enterprises;

Order at Annex A, Proposed Section 69.2703(a)(3), (4). The OCA submits that any language relating to benchmarking activities to set rates for PGW should not be included in any policy statement. As an initial matter, PGW's rates are set in accord with the MAO provisions and the constitutionally-required just and reasonable standard. The just and reasonable standard, grounded in the United States Constitution, requires the Commission to balance the interests of the utility and its customers. See Pa. P.U.C. v. Philadelphia Gas Works, Dock. No. R-00061931 at 13 (order entered September 28, 2007); Pa. P.U.C. v. Philadelphia Gas Works, 2004 WL 1592809 at 9-10.⁴

There is no support in the Public Utility Code nor in PGW's prior ratemaking methodologies to suggest that the benchmarking information called for in the Proposed Policy Statement should, by policy, be a factor in setting rates for PGW. The Company is certainly free to include this type of information in its evidence to the Commission, but suggesting through a policy statement that this type of information is per se relevant to setting PGW's rates is

⁴ In the Proposed Policy Statement, the Commission has added Sections 69.2703(a)(6)-(8), which relate to PGW's quality of service, levels of management efficiency and universal service. If a policy statement is issued, the OCA agrees that these added sections are necessary to properly balance the interests of the utility and its customers.

improper. Accordingly, if a policy statement is issued, the OCA submits the revisions as found in Appendix A of this document, in relevant part here as follows:

§ 69.2703. Ratemaking procedures and considerations.

(a) In determining just and reasonable rate levels for PGW, the Commission will consider, among other relevant factors:

(1) PGW's test year end financial data and ~~(as a check) projected future levels of non-borrowed yearend 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 operating and other expenses ~~in comparison to similarly situated utility enterprises;~~

If a policy statement is issued, the OCA submits that the foregoing modifications must be made in order to ensure conformity with the law and the MAO.

D. Issuing A Policy Statement On These Issues Is Improper.

As the OCA set forth at length in its Answer, the Proposed Policy Statement will provide PGW with certain interpretations of the Cash Flow method that were expressly rejected by the Commonwealth Court and by this Commission in PGW's recent base rate cases. A Statement of Policy is defined in the Commonwealth Documents Law as:

any document, except an adjudication or a regulation, promulgated by an agency which sets forth substantive or procedural personal or property rights, privileges, immunities, duties, liabilities or obligations of the public or any part thereof, and includes, without limiting the generality of the foregoing, any document interpreting or implementing any statute enforced or administered by such agency.

45 Pa.C.S. § 501. The appellate courts of the Commonwealth have further defined a statement of policy as:

The distinction between a regulation and a statement of policy is that the former is an exercise of delegated power to make a law and as binding on a reviewing court as a statute while the latter is merely interpretive, not binding upon the reviewing court but persuasive if it tracks the meaning of the statute.

Pennsylvania Human Relations Comm. v. Norristown Area School Dist., 342 A.2d 464, 467 (Comm. Ct. 1976) (internal citations omitted). Regardless of the language of the Order that attempts to downplay the significance of the Proposed Policy Statement by assurances that no “binding norm”⁵ is being created, the effect will be much the same.

The Proposed Policy Statement, if issued, will create a persuasive interpretation of how the Commission intends to apply the Cash Flow method of ratemaking to PGW in the future. Such a presumption will almost certainly shift the burden of proof on those issues away from the Company and force the other parties to swim upstream on issues that have *already been finally decided by the Commonwealth Court*. To have those decisions swept away by a policy statement raises significant issues of due process and simple, basic fairness.

As stated, the OCA opposes the idea of publishing any policy statement on these issues for all the reasons discussed herein and in OCA’s Answer to PGW’s Petition on these matters. The OCA submits that rather than providing guidance to the parties on the application of PGW’s Cash Flow ratemaking methodology, the Proposed Policy Statement will only serve to create more confusion and lead to additional litigation as to issues which, as discussed above, have already been finally resolved. In the alternative, if the Commission chooses to issue a policy statement then the OCA submits that a modified version as found in the attached Appendix A should be considered.

⁵ Order at 9-10.

III. CONCLUSION

WHEREFORE, for the reasons set forth above, the Office of Consumer Advocate respectfully requests that the Commission not issue the Proposed Policy Statement as to Philadelphia Gas Works' Cash Flow Ratemaking Method. Alternatively, the OCA submits the attached revised Policy Statement for the Commission's consideration.

Respectfully Submitted,



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Dated: January 29, 2010
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APPENDIX A

APPLICATION OF PGW CASH FLOW RATEMAKING METHOD PROPOSED STATEMENT OF POLICY (OCA REVISED)

§ 69.2701. Definitions. The following words and terms, when used in §§ 69.2701-69.2703, have the following meanings, unless the context clearly indicates otherwise:

Act - The Natural Gas Choice and Competition Act (66 Pa.C.S. §§ 2201-2212).

PGW - Philadelphia Gas Works.

§ 69.2702. Background and ratemaking elements.

(a) The Act brought city owned natural gas operations, including PGW, under the Commission's jurisdiction. 66 Pa.C.S. § 2212(b) (relating to Commission jurisdiction).

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

§ 69.2703. Ratemaking procedures and considerations.

(a) In determining just and reasonable rate levels for PGW, the Commission will consider, among other relevant factors:

(1) PGW's test year end financial data ~~and (as a check) projected future levels of non-borrowed yearend 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 operating and other expenses ~~in comparison to similarly situated utility enterprises;~~

(5) Level of financial performance needed to maintain or improve PGW's bond rating;

(6) PGW's management quality, efficiency and effectiveness;

(7) Service quality and reliability; and

(8) Effect on universal service.

(b) The Commission is obligated to establish rate levels adequate to permit PGW to satisfy its bond ordinance covenants, consistent with the requirements of Section 2212(e) of the Act, 66 Pa.C.S. § 2212(e) (relating to securities of city natural gas distribution operations).

(c) These financial measures will be considered by the Commission in determining just and reasonable rates for PGW under the Public Utility Code and are consistent with the PGW Management Agreement Ordinance.

CERTIFICATE OF SERVICE

Petition of Philadelphia Gas Works for a :
Statement of Policy on the Application of : Docket No. P-2009-2136508
Philadelphia Gas Works' Cash Flow :
Ratemaking Method :

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

Dated this 29th day of January 2010.

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