



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

January 29, 2010

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

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-2009-2136508

Dear Secretary McNulty:

Enclosed please find an original and ten (10) copies of the Office of Trial Staff's
(OTS) **Comments** in the above-captioned proceeding.

Copies are being served on all active parties of record.

Sincerely,

Adeolu Bakare
Prosecutor
Office of Trial Staff
PA Attorney I.D. #208541

Enclosure
AAB/edc
cc: Parties of record

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

**THE OFFICE OF TRIAL STAFF'S
COMMENTS ON THE PROPOSED POLICY STATEMENT ON THE
APPLICATION OF THE CASH FLOW RATEMAKING METHOD
TO PHILDELPHIA GAS WORKS**

I. PROCEDURAL HISTORY

On October 16, 2009, Philadelphia Gas Works ("PGW" or "Company") filed a Petition with the Pennsylvania Public Utility Commission ("Commission") requesting that the Commission issue a Statement of Policy delineating its intended application of PGW's Cash Flow Ratemaking Method on a going forward basis. By Secretarial Letter dated October 21, 2009, notice of PGW's Petition was given and an invitation to submit Answers and Replies was afforded interested parties following publication in the *Pennsylvania Bulletin*. Notice of the Petition was published in the *Pennsylvania Bulletin* on October 31, 2009.¹ Answers to the Petition were filed by the Office of Trial Staff ("OTS"), the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), the Philadelphia Industrial and Commercial Gas Users Group

¹ 39 Pa.B 6341.

("PICGUG"), the Tenant Union Representative Network ("TURN") and the Action Alliance of Senior Citizens of Greater Philadelphia ("Action Alliance") (collectively TURN et al.). The Answers of OTS, OCA, OSBA and TURN et al. opposed PGW's Petition and proposed Policy Statement. Although varying reasons were presented in their respective Answers, each of the parties listed above requested that the Commission deny PGW's Petition. PGW filed a Reply to the Answers of OTS, OCA, OSBA and TURN et al. Despite overwhelming opposition, the Commission Entered an Order on December 30, 2009 granting the Petition in part and denying it in part. As the Statement of Policy put forth by the Commission differs from the Petition filed by PGW, and reviewed by the parties, the Commission issued a proposed statement thus allowing for notice and an opportunity for interested parties to be heard. The Commission's Order allowed for the submission of Comments to the proposed Policy Statement within thirty (30) days of the entry of the Order. OTS hereby files these timely Comments to the Proposed Statement of Policy on the Application of Philadelphia Gas Works' Cash Flow Ratemaking Method.

OTS maintains its position that the Commission and Commonwealth Court have provided clear and consistent guidance as to the ratemaking methodology to be applied to PGW through the Orders and Opinions issued in PGW's base rate cases while under Commission jurisdiction. In addition, the issuance of the proposed Statement of Policy would not override the Commonwealth Court Orders affirming the Commission's current interpretation and application of the appropriate ratemaking methodology to be applied to

PGW. As such, the application of Section 69.2703(a)(1) of the proposed Policy Statement is inadvisable as it contradicts the Commonwealth Court's affirmation of prior Commission determinations.

II. COMMENTS

a) Introduction

In order to fulfill the stated objectives of the Proposed Policy Statement, the Commission should modify Section 69.2703(a)(1) to eliminate consideration of PGW's projected future levels of non-borrowed yearend cash. As discussed in the Commission Order Entered December 30, 2009 ("December Order"), a policy statement announces an agency's tentative intentions for the future. The Commission stated that its purpose in issuing this proposed Policy Statement is to provide guidance on the information to be considered in determining just and reasonable rates for PGW and reduce the likelihood of future litigation on the specific elements of the Cash Flow Method.² Contrary to the enunciated goals, consideration of PGW's projected future levels of non-borrowed yearend cash introduces less reliable information into the ratemaking process and will lead to protracted litigation.³

b) The Proposed Policy Statement contradicts Commission Precedent

As acknowledged in previous Commission Orders, projected future levels of non-borrowed yearend cash provide less reliable information than test year data and therefore

² December Order at 10.

³ As described on page 5 of these Comments, calculation of the "projected future levels of non-borrowed yearend cash" would more than likely encompass substantially the same data as the "five-year forecast" proposed in PGW's 2007 base rate case.

cannot serve as a reliable check upon such test year data. In the December Order, the Commission opined that “the elements in PGW’s proposed ‘Statement of Policy’ are in fact drawn from Pennsylvania case law so that application of the policy statement in future proceedings will yield the same result as the application of established legal precedent.”⁴ However, in 2007, the Commission addressed the issue of considering forecasted data in establishing PGW’s rates under the Cash Flow Method.⁵ In that proceeding, PGW presented both test year data and financial projections for the five-year period from fiscal year 2008 through fiscal year 2012.⁶ PGW noted that it was not abandoning the test year concept but only “suggesting that the examination of the test year results be supplemented by the projected five-year period in evaluating its revenue requirement needs.”⁷ The Commission soundly rejected PGW’s proposal in the following manner:

[t]he 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. The Commonwealth Court stated the following:*

Necessity dictates that a rate proceeding must have some finality, and for this purpose a test

⁴ *Id.*
⁵ Order entered Sept. 28, 2007 at Docket No. R-00061931, pp. 17-18.
⁶ *Id.* at 14.
⁷ *Id.*

year is used and accepted as it may be adjusted by the commission for unusual changes.

...Moreover, we recognize that PGW is the only regulated gas utility to use the Cash Flow Method of presenting base rate filings. We believe, however, that this unique characteristic does not render our test year approach to ratemaking inapplicable.⁸

While the proposed Policy Statement does not specifically reference use of a five-year forecast, OTS submits that the proposal to consider projected future, i.e. outside the test year, levels of non-borrowed year cash could incorporate not only the five-year forecast but more expansive projections. As previously advocated by OTS and acknowledged by the Commission, future projections are speculative and unreliable.⁹ It is not in the public interest to consider less reliable data as a check upon actual test year data. The proposed Policy Statement permits consideration of data far beyond the confines of the test year or even the six month period permitted for known and measurable exceptions to the test year limitation. Therefore, OTS recommends modifying Section 69.2703(a)(1) to conform the proposed Policy Statement to Commission precedent.

c) The Proposed Policy Statement contradicts Commonwealth Court Case Law

The concept of considering PGW's projected financial data was comprehensively addressed and rejected by the Commonwealth Court. PGW appealed five Commission findings from the 2007 base rate case, including the rejection of PGW's proposal to

⁸ *Id.* at 18.

⁹ *Id.* at 15, 18.

“supplement” its test year data with a five-year forecast.¹⁰ The language of PGW’s argument mirrors that in Section 69.2703(a)(1) as the Company alleged that the “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...”¹¹ Similarly to the Commission, the Commonwealth Court rejected this argument as contrary to standard ratemaking principles and not otherwise authorized by the Section 2212 of the Natural Gas Choice and Competition Act (“Gas Choice Act”) or PGW’s Management Agreement Ordinance (“MAO”).¹² The relevant discussion from the Commonwealth Court’s Opinion is reproduced as follows:

[u]nder the test-year concept, revenues, expenses, and capital costs are to be simultaneously reviewed for the same period of time so that a utility may prove that its new rates are just and reasonable. Popowsky. This Court has held that standard ratemaking practice includes adjustments to eliminate the effect of unusual and nonrecurring items that might distort the value of the historic test-year data. Dauphin Consolidated Water Supply Co. v. Pennsylvania Public Utility Commission, 423 A.2d 1357, 1362 (Pa. Cmwlth. 1980).

PGW, the burdened party, has provided no authority for the use of the five-year forecast data in the establishment of a rate increase. Neither the Gas Choice Act nor the MAO requires the use of a five-year projected planning period to establish PGW’s revenue requirement. Section VII of the MAO itself refers to a single fiscal year. R.R. at 587a-590a. The MAO directs the regulatory authority to fix and regulate rates and charges for supplying gas to customers, which will in “each fiscal year” produce sufficient revenues to cover operation and maintenance costs and expense, interest and amortization due “in such fiscal year”. Id.

¹⁰ Philadelphia Gas Works v. Pa. PUC, No. 1914 C.D. 2007, at 9 (Pa. Commw. Ct. filed February 4, 2009).

¹¹ *Id.*

¹² *Id.* at 10.

PUC found that PGW's five-year forecast beyond the test year is based on major assumptions regarding future revenues and expenses as well as PGW's financial goals to be achieved during the time frame. PUC did consider one exception beyond the test-year period – the scheduled repayment in FY 2008 of a \$45 million loan. This post test-year expense however satisfied PUC's traditional "out of period adjustment" criteria because it was known and quantifiable. 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.¹³

As made clear by the Commonwealth Court's Opinion, nothing in the Gas Choice Act or the MAO requires or authorizes consideration of forecasts beyond the test year. In stark contrast to the Commission's observation that the proposed Policy Statement is drawn from Pennsylvania case law, Section 69.2703(a)(1) clearly revisits an issue that has been rejected on its merits by the Commission and upon appeal at Commonwealth Court.¹⁴ Therefore, OTS recommends modifying Section 69.2703(a)(1) to conform the proposed Policy Statement to Commonwealth Court case law.

d) The Proposed Policy Statement will Increase Litigation

The current form of the proposed Section 69.2703(a)(1) will increase litigation in this and other proceedings and should be modified in order to achieve the stated objective of the proposed Policy Statement. It is uncontestable that the test year is a foundational tenet of ratemaking in Pennsylvania. By permitting unrestricted consideration of projected future levels of non-borrowed yearend cash, the proposed Policy Statement

¹³ *Id.*

¹⁴ December Order, at 10.

invites PGW to develop all manner of projections with potential impacts upon its financial situation. Other parties will be obligated to engage in litigation as to the appropriateness of each new forecast in addition to the merits of such forecast. Rather than settle existing law, the current form of Section 69.2703(a)(1) creates a new arena for litigation at the Commission and beyond. As noted above, Section 69.2703(a)(1) of the proposed Policy Statement grants PGW the opportunity to raise an issue that was recently rejected by Commission and Commonwealth Court Orders. This contradiction alone will spur extensive litigation. Additionally, notwithstanding the limitation of the proposed Policy Statement to the Cash Flow Method, its impact on such a fundamental tenet of ratemaking may invite litigation by other jurisdictional utilities demanding similar treatment. To realize the stated goal of judicial efficiency and preserve a consistent record of case law, the Commission should modify the current form of Section 69.2703(a)(1) to eliminate consideration of PGW's projected future levels of non-borrowed yearend cash.

III. CONCLUSION

While OTS opposed PGW's originally proposed Policy Statement and continues to assert that no Policy Statement is necessary to adequately and efficiently apply the Cash Flow Method of Ratemaking, we acknowledge that the proposed Policy Statement conforms to established Commission precedent except for the significant departure within Section 69.2703(a)(1). The current form of Section 69.2703(a)(1) permits consideration of unreliable future projections in contrast with sound ratemaking principles. Its impact

on fundamental ratemaking principles will undoubtedly generate vigorous and protracted litigation in this proceeding and future PGW base rate cases. Furthermore, the consideration of data outside the test year within Cash Flow Method ratemaking could lead to litigation over the same issue in traditional rate base proceedings. OTS recommends that the Commission modify Section 69.2703(a)(1) by removing the provision for consideration of PGW's projected future levels of non-borrowed yearend cash, thereby preserving the reliability of PGW's data and avoiding extensive and burdensome litigation in this and other proceedings.

WHEREFORE, for the reasons state herein, the Office of Trial Staff respectfully requests that the Pennsylvania Public Utility Commission modify its Proposed Statement of Policy on the Application of Philadelphia Gas Works' Cash Flow Ratemaking Method to reflect the recommendation identified above.

Respectfully submitted,



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Dated: January 29, 2010

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Ratemaking Method :

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Comments** dated January 29, 2010, either personally, by first class mail, electronic mail, express mail and/or by fax upon the persons listed below, in accordance with the requirements of § 1.54 (relating to service by a party):

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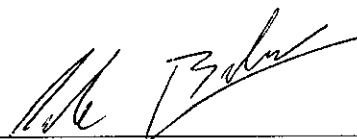
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