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March 9, 2010

Via Electronic FilingJames McNulty, Secretary
PA Public Utility Commission
PO Box 3265
Harrisburg, PA 17105-3265Re: 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:

On behalf of Philadelphia Gas Works enclosed please find its Reply Comments with regard to the above-referenced matter along with the electronic filing confirmation. Copies have been served in accordance with the attached Certificate of Service.

Very truly yours,



Carl Shultz

CS/lww
Enclosure

cc: Cert. of Service w/enc.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of PGW's Reply Comments upon the participants listed below in accordance with the requirements of § 1.54 (relating to service by a participant).

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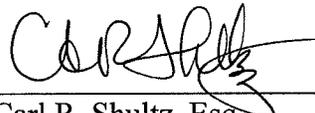
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Carl R. Shultz, Esq.

Dated: March 9, 2010

**BEFORE THE
PENNSYLVANIA UTILITY COMMISSION**

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

**REPLY COMMENTS OF
PHILADELPHIA GAS WORKS**

I. INTRODUCTION

Philadelphia Gas Works (“PGW”) respectfully submits these Reply Comments to the Pennsylvania Public Utility Commission (“PUC” or “Commission”) in response to the Comments submitted by the Office of Trial Staff (“OTS”), the Office of Consumer Advocate (“OCA”), and Tenant Union Representative Network (“TURN”) and Action Alliance of Senior Citizens of Greater Philadelphia (“Action Alliance”) (TURN and Action Alliance are collectively referred to as “TURN, et al.”).

II. REPLY COMMENTS BY PGW

A. OCA demands that references to “non-borrowed cash” and “internally generated funds” should be eliminated are contrary to law and would be bad policy.

1. Non-Borrowed Cash.

The Commission should reject OCA’s contention that the references to “non-borrowed cash” in § 69.2703(a)(1) of the Policy Statement should be deleted. *See* OCA Comments, at pp. 3-5.

In making this contention, OCA fails to acknowledge the terms of the Management Agreement. Specifically, the Management Agreement provides that PGW

must have rates sufficient “[t]o provide cash, or equivalent, for working capital in such reasonable amounts as may be determined ...”¹ This means that the Commission must consider PGW’s non-borrowed year end cash and other liquid investments (*i.e.*, cash equivalents) as well as its other short term borrowing capability, for purposes of determining a “reasonable” level of working capital for PGW. The exact levels of cash, cash equivalents and borrowing capability are determined by the PUC in each base rate proceeding on the basis of substantial evidence submitted in the record. Therefore, it is not only appropriate but legally necessary to retain references to “non-borrowed cash” in the Policy Statement. *See* Policy Statement, at § 69.2703(a)(1). As noted, it will be left to the Commission to determine the “reasonable” level of this item as well as other items that make up PGW’s cash working capital.

In making this contention, OCA also misreads that 2009 Commonwealth Court Opinion² as foreclosing consideration of “free” (or non-borrowed) cash in rate making for PGW. *See* OCA Comments, at pp. 3-5. Nothing could be further from the truth. In that Opinion, the Commonwealth Court found³ that there was substantial evidence to support

¹ Management Agreement, Section VII.1(b)(iii) (working capital). As noted by the Commonwealth Court, Section VII of the Management Agreement requires, in pertinent part, Philadelphia Gas Commission [and, now the PUC] 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 expenses, interest and amortization due, debt service coverage, cash, or its equivalent, for working capital, and reasonable amounts to fund construction and retire debt. *City of Philadelphia v. PUC*, Docket No. 1914 C.D. 2007, Memorandum Opinion, at p. 7 (filed February 4, 2009) (“2009 Commonwealth Court Opinion”).

² 2009 Commonwealth Court Opinion, *supra*.

³ 2009 Commonwealth Court Opinion, p. 12 (“We, therefore, conclude that the PUC determination that PGW needed only \$25 million in new revenues in order to satisfy all of the required elements of the mandated Cash Flow Method is supported by substantial evidence.”).

the PUC's determination in that case that PGW's cash working capital needs should not be solely determined on the basis of non-borrowed cash.⁴ Indeed, the section of the Court opinion relied upon by the OCA specifically states that the record supported the conclusion that PGW's cash working capital requirement did not need to be met solely by non-borrowed cash and that, therefore, the PUC's revenue requirement determination was "supported by substantial evidence."⁵ The essence of a finding supported by substantial evidence is that it is a question of fact that may be reexamined in each case. That is precisely what the PUC has mandated in the Policy Statement by indicating that, in determining a reasonable level of cash working capital for PGW, it will review the level of non-borrowed cash as well PGW's available short term borrowing capability.⁶

OCA then tries to buttress its argument by creating a "law of the case" preclusion against the consideration of non-borrowed cash in future rate proceedings. *See* OCA Comments, p. 5. But the "law of the case" doctrine does not apply here because it does not apply to future proceedings.⁷ The prior findings were in a prior, now closed, case,

⁴ *PUC v PGW*, PUC Docket No. R-00061931, *et al.*, 2007 Pa. PUC LEXIS 45, (Order entered September 28, 2007) ("2007 PGW Base Rate Order"), which was affirmed by, the 2009 Commonwealth Court Opinion, *supra*.

⁵ 2009 Commonwealth Court Opinion, at p. 12, quoted in OCA Comments at p. 4.

⁶ Moreover, while the Commission found otherwise in the 2007 rate case, "cash equivalents" are not additional borrowing – a "cash equivalent" is a short term investment that can be turned into cash, such as a treasury bill. *PUC v. PGW*, PUC Docket No. R-00061931, *et al.*, 2007 Pa. PUC LEXIS 46, at p. *95 (Recommended Decision, July 24, 2007), adopted as modified by, the 2007 PGW Base Rate Order, *supra*. The Commission will be able to review this evidence in future proceedings and correct its mistaken finding.

⁷ The "law of the case" doctrine refers to a family of rules which embody the concept that a court involved in the later phases of a litigated matter should not reopen questions decided by another judge of that same court or by a higher court in the earlier phases of the matter. *Commonwealth v. Starr*, 541 Pa. 564, 664 A.2d 1326, 1331 (Pa. 1995).

based on a record developed in that proceeding. As noted, the Commonwealth Court found that there was substantial evidence to uphold that Commission's determination that the PUC's revenue requirement determination was sufficient.⁸ That is not a legal determination – it's a factual one and is not legally binding in future cases.⁹

2. Internally Generated Funds.

There is even less justification for OCA's contention that reference to "internally generated funds" (§ 69.2702(b), and § 69.2703(a)(2)) should be deleted from the Policy Statement. The Management Agreement specifically states that PGW's rates must reflect an amount permitting it to finance its construction expenditures and to pre-pay previously issued long-term debt.¹⁰ Funds from rates to finance construction are called internally generated funds. This section of the Management Agreement has no reference to "cash equivalents," regardless of how this term is interpreted based on the evidence.¹¹ Thus, the PUC correctly determined that it was not only appropriate to consider the level of

⁸ See footnote 3, *supra*.

⁹ A fact can be binding in a future case if it satisfies the requirements of *res judicata* or collateral estoppel. See, e.g., *Philadelphia Electric Co. v. PUC*, 433 A.2d 620 (Pa. Cmwlth. 1981) (reviewing cases and holding that ordinarily *res judicata* does not apply to rate making, but that *res judicata* may be a bar to the relitigation of an issue based on immutable facts and circumstances decided in a prior rate case.); *Keystone Water Company v. PUC*, 474 A.2d 368, 372-73 (Pa. Cmwlth. 1984) (utility could "relitigate" issue of whether investment in filtration plant could properly be included in rate base because collateral estoppel does not preclude litigation when there is a factual or legal change). The ultimate issue in a rate case is the justness and reasonableness of the proposed rates based on test year circumstances. Different rate cases involve different test years. Therefore, the facts on which ratemaking determinations are made are, by their nature, different from case to case and normally *res judicata*/collateral estoppel are not applicable. *Id.*

¹⁰ Management Agreement, Section VII.1(b)(ii) (debt reduction and capital additions).

¹¹ *Id.*

“internally-generated funds” in setting rates for PGW under the Management Agreement it is required to do so pursuant to the Management Agreement.

Additionally, it must be remembered that the 2008 Extraordinary Rate Order recognized that PGW will have to improve its cash flow position as well as its internally generated funds so that PGW’s financial statistics improve.¹² Simply put, PGW needs strong financial operating ratios to support its ability to continue to access the capital markets.¹³ But, if the OCA’s demands were granted, PGW would be placed in the position of being forced to rely exclusively on external borrowing to fund capital. Exclusive reliance on borrowing would increase PGW’s cost of service enormously¹⁴ and would expose PGW (and its ratepayers) to the risk of a financial crisis of mammoth proportions if it found itself unable to raise capital externally.¹⁵ It is for this precise

¹² *PUC v. PGW*, Docket No. R-2008-2073938, 2008 Pa. PUC LEXIS 32 (Order entered December 19, 2008) (“2008 Extraordinary Rate Order”).

¹³ *Id.* at pp. *48-*49 (“We must ensure that PGW continues to provide reliable service at reasonable rates. It is therefore critical that PGW have adequate funds to continue its approximately \$ 70 million annual capital investment program to replace deteriorating gas mains and other projects. This will require additional funding that can only be acquired cost effectively if PGW has strong financial operating ratios to support lower cost debt.”).

¹⁴ *Id.* at pp. *37 (“PGW will have to improve its cash flow position so that PGW can eventually produce internally generated funds with which to fund at least a portion of its capital improvement program”), *45-*46 (“The recent turmoil in the financial markets, resultant complications in negotiations of financial instruments, and overall struggles in the local, regional, and national economy warrant decisive action by this Commission to ensure that PGW’s financial position remains strong through these difficult times.”).

¹⁵ *Id.* 2008 Extraordinary Rate Order, at pp. *46-*47 (“PGW’s interest rate swap with JPMorgan Chase Bank demonstrates the uncertainties of the present market and the magnitude of PGW’s potential revenue needs. PGW originally projected its expenses related to terminating the swap transaction at between \$ 15 million and \$ 30 million as a one-time expense. Based upon that dollar range, PGW advanced \$ 25 million in support of its requested rate relief. At the evidentiary hearing on December 4, 2008, however, PGW revised that figure upward to \$ 54 million. The simple explanation is that the amount of money needed to operate the Company in this economic environment is

reason that the Management Agreement mandates that PGW's rates must provide for a "reasonable" amount of financing of capital additions and debt pre-payment from PGW's own rates – i.e., from internally generated funds.¹⁶ OCA's claims are not only wrong legally, if adopted, they would be enormously harmful to the Company and its customers.

Finally, it should be remembered that OCA (and others) can always challenge the application of Policy Statement in future proceedings. The levels of "non-borrowed cash" and "internally generated funds" may be disputed in future proceedings. It would, however, be illegal, and bad policy to delete references to these items for consideration merely because the future amounts for them may be challenged on the basis of the record in a future proceeding.

B. The use of projections "as a check" is reasonable.

OTS and OCA seek to delete the reference to "projections" in § 69.703(a)(1) of the Policy Statement. *See* OTS Comment, pp. 1-10; OCA Comments, pp. 6-7. They contend that the use of projections violates the test year approach. *Id.*

But, the Policy Statement plainly states that future projections would not be the primary basis for a determination of revenue requirements – but would be used only as a check. The future test year is used as the basis for setting rates. But, the future test year is not a mere collection of historic costs. Rather, the future test year is basically projections of expected costs based on those costs experienced in the historic test year.

dynamic and based upon a formula that depends upon specific market data which fluctuates by the minute.") (citations omitted).

¹⁶ Management Agreement, Section VII.1(b)(ii) (debt reduction and capital additions).

Commission precedent allows adjustments to eliminate the effect of unusual and nonrecurring items that might distort the value of the test-year data.¹⁷ In fact, the use of projections “as a check” on the future test year is not prohibited.¹⁸ The Policy Statement merely indicates a willingness to consider other projections “as a check” on the test year data.¹⁹ It is hard to imagine how the mere consideration of such data could be inappropriate.

The claims of OCA and the OTS derive from a mischaracterization of the PUC’s prior base rate case. There PGW asked that its revenue requirement be determined by examining both its future test year data and its five year financial projections.²⁰ The PUC rejected that approach. But the approach adopted in the Policy Statement is different and does not contemplate that PGW’s revenue requirement will be determined in the first instance by reference to financial projections outside the test year. Only that any determination made by the PUC based on test year data could be checked by reference to future projections.

¹⁷ *Dauphin Consolidated Water Supply Co. v. PUC*, 423 A.2d 1357, 1362 (Pa. Cmwlth. 1980).

¹⁸ *See, e.g., PA PUC v. Pennsylvania-American Water Company*, Docket Nos. R-00943231, *et seq.*, 1995 Pa. PUC LEXIS 173, at p. *44 (Order entered May 22, 1995) (“Frequently, a test year is adjusted by looking at other years, especially when a particular variable is unstable.”).

¹⁹ The Public Utility Code requires a utility to submit whatever data the Commission specifies in its final rate order as appropriate to demonstrate the accuracy of its future test year estimates. *See* 66 Pa. C.S. §315(e); 52 Pa. Code § 53.56. This subsection merely allows, but does not require, the Commission to specify such data.

²⁰ *See* 2007 PGW Base Rate Order, at p. *20 (“PGW stated that all of its financial presentations in this proceeding have included the financial results for its test year, FYE 2007, as well as the five-year period FY 2008 through FY 2012.”).

C. The use of “benchmark” standards is reasonable.

The use of comparisons in ratemaking is not a new concept in Pennsylvania. Long-established Commission precedent allows the examination of relevant comparable statistics for barometer groups for investor owned utilities.²¹ The Commonwealth Court has even held that Commission may use the cost of capital statistics of comparable utilities to reach a fair calculation of a utility's cost of capital.²²

Despite such precedent, the OCA seeks the removal of “benchmark” type-standards in § 69.2703(a)(3) (financial performance of similarly situated utility enterprises) and § 69.27803(a)(4)(comparison to similarly situated utility enterprises) of the Policy Statement. See OCA Comments, at pp. 8-9. Specifically, OCA contends that the inclusion of such references would make such information “*per se* relevant.” See OCA Comments, at p. 8.

This is not true. While the PUC’s Policy Statement would plainly establish that referring to benchmark financial data would be a relevant consideration , as explained by

²¹ See, e.g., *Pa. PUC v. Media Borough*, Docket No. R-00912150, 1992 Pa. PUC LEXIS 116, (Order entered November 25, 1992) (Commission approved a capital structure of 55% debt and 45% equity, although the utility’s actual capital structure was 82.66% long-term debt and 17.34% equity); *Pa. PUC v. Clean Treatment Sewage Company*, Docket Nos. R-911918 (Order entered January 23, 1992) (Commission approved a capital structure of 55% debt and 45% equity, although the utility’s actual capital structure was 87.08% debt and 12.92% equity); *Application of Lake Latonka Water Company and Western Utilities, Inc.*, Docket No. A-210017, 74 Pa. P.U.C. 647 (1991), 1991 Pa. PUC LEXIS 87 (Commission approved a capital structure of 55% debt and 45% equity, while the utility’s actual capital structure consisted of 89.62% debt and 10.38% equity; Commission also used estimate of overtime hours based on direct experience with similarly situated utilities was used as a beginning point.).

²² See, e.g., *Blue Mountain Consolidated Water Co. v. PUC*, 57 Pa. Cmwlth. 363, 426 A.2d 724 (1981) (explaining why the PUC may use cost of capital statistics of comparable utilities to reach a fair calculation of a utility's cost of capital); *Wall v. PUC*, 182 Pa. Superior Ct. 35, 125 A.2d 630 (1956) (It may be appropriate to look at the capital structure and costs of comparable public utilities).

PGW in its Comments, the Policy Statement would not be creating filing requirements for PGW (or any other party). PGW could choose whether (or not) to present comparisons. The Commission would still have authority to determine whether the benchmarking data considered should be given weight, and if so, the degree to which such evidence should be considered relevant.²³

D. There is no need to refer to the Constitutional standard of ratemaking.

Turn, *et al.* seeks to add a reference to the Constitutional “just and reasonable” standard in a new subsection to § 69.2702(c). *See* Turn, *et al.*, Comments, at pp. 1-7. This is not necessary.

Since the Policy Statement already makes numerous references to the “just and reasonable” standard, there is no practical reason to create a separate and specific reference to the Constitutional standard. Constitutional issues are to be reached only if a case cannot be decided on other grounds.²⁴ In 2001, the Commission determined that the “just and reasonable” standard in Section 1301 of the Public Utility Code is coextensive with the federal constitutional standard for determining utility rates.²⁵ It follows that a specific reference to the constitutional standard would not add any clarity to the Policy Statement as to the application of the Cash Flow Method to PGW.

E. There is a continuing need for the Policy Statement.

OTS and OCA continue to contend that a Policy Statement is not necessary. *See* OTS Comments, pp. 2-3; OCA Comments, pp. 9-10. In doing so, they are essentially

²³ *See, e.g.*, 66 Pa. C.S. § 1308; 52 Pa. Code § 5.536.

²⁴ *Barasch v. Bell Telephone Co. of Pa.*, 529 Pa. 523, 605 A.2d 1198 (1992).

²⁵ *See, PUC v. PGW*, R-00006042, *et seq.*, 2001 Pa. PUC LEXIS 109, at p. *39 (Order entered October 4, 2001).

requesting that the Commission reconsider the December Order, which adopted the Proposed Policy Statement. *See* December Order, at p. 16, at ¶ 2.

However, the comments by OTS and OCA merely rely on the reasons previously submitted to the Commission.²⁶ *See* OTS Comments, pp. 2-3; OCA Comments, pp. 9-10. These comments do not raise novel arguments, not previously heard, or considerations which appear to have been overlooked or not addressed by the Commission.²⁷ Therefore, these requests for reconsideration should be denied.

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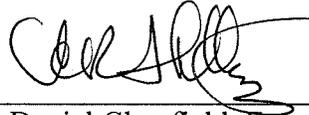
²⁶ To the extent deemed necessary, PGW incorporates its Reply to the Answers filed by OTS and OCA. PGW's Reply addresses the need for the Policy Statement.

²⁷ *See, e.g.*, 66 Pa. C.S. § 703(g); *Duick v. Pennsylvania Gas and Water Company*, 56 Pa. P.U.C. 553, 558-559 (1982).

III. CONCLUSION

PGW appreciates the opportunity to present Reply Comments to the proposed Policy Statement from the December Order. PGW's Reply Comments have been provided with the objective of maintaining the purposes of enhanced and succinct guidance on the application of the Cash Flow Methodology to PGW.

Respectfully submitted,



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