

Appendix L

The Joint Petition

The *Joint Petition* sets forth a comprehensive list of issues that were resolved through the negotiation process. The following issues were of significance to the OSBA when it concluded that the *Joint Petition* was in the best interests of Peoples' small business customers.

Revenue Requirement – In the Company's original filing, Peoples requested a distribution revenue increase of \$70.2 million per year, with a requested return on equity ("ROE") of 11.50%. Peoples Statement No. 7, at 1. In regards to the Company's requested ROE, OSBA witness Brian Kalcic testified, as follows:

Counsel advises that the PPL Gas base rate case at Docket No. R-00061398 represents the most recent litigated proceeding. I am further advised that the Commission awarded PPL Gas an ROE of 10.40% in that proceeding, via its Opinion and Order entered February 8, 2007.

* * *

Approximately ten (10) months after the Commission issued its Opinion and Order in Docket No. R-00061398, the US economy entered a steep recession, from which it has yet to recover completely. In addition, capital markets experienced a financial crisis that intensified on and after approximately October 1, 2008. As a result, both interest rates and overall equity returns are lower today than when the Commission issued its PPL Gas Opinion and Order. For example, in February 2007, the prime lending rate (charged by banks to their most credit-worthy customers) was 8.25%. Today, the prime lending rate stands at 3.25%.

Logically, these facts suggest that the baseline 10.40% ROE awarded to PPL Gas in Docket No. R-00061398 should act as the cap or ceiling on the ROE awarded to the Company in this proceeding.

OSBA Statement No. 1, at 18-19 (footnote omitted). As a result, Mr. Kalcic concluded:

All else equal, a hypothetical increase of approximately \$63.334 million (per line 6 of Schedule BK-9) would result in Peoples realizing an ROE of 10.40% (line 18). Stated differently, a reduction in Peoples' requested ROE from 11.50% to 10.40%

would reduce the Company's requested increase by \$6.885 million (line 7), i.e., from \$70.219 million to \$63.334 million.

OSBA Statement No. 1, at 19.

The *Joint Petition* proposes to increase Peoples' distribution revenues by \$53 million. A \$53 million increase is below the maximum increase that would be consistent with Mr. Kalcic's critique of Peoples' requested ROE.

Customer Classes Revenue Allocation – Because the Company's requested increase is over \$1 million, Peoples submitted a cost of service study ("COSS") with its October 28th filing. *See generally* 52 Pa. Code § 53.53. Mr. Kalcic summarized the Company's filing, as follows:

The Company performed a fully allocated cost-of-service study ('COSS') for the purpose of assigning the Company's claimed base-rate revenue requirement to rate classes. More accurately, the Company completed two (2) COSSs utilizing different cost methodologies.

OSBA Statement No. 1, at 3.

Mr. Kalcic further explained the Company's decision to present two COSSs, as follows:

Company witness Russell A. Feingold states that the Design Day COSS incorporates his preferred cost-of-service methods. However, Mr. Feingold testifies that he 'decided to use two common demand cost allocation methods (the peak method and the peak and average method), with and without a customer component of distribution mains, to determine a range of rate of return values for purposes of evaluating class cost responsibility.'

OSBA Statement No. 1, at 5 (footnote omitted)

After examining the two COSSs presented by Peoples, Mr. Kalcic observed:

First, counsel advises that the Commission approved the Average and Excess ('A&E') demand cost methodology in at least two recent gas base rate proceedings in which cost of service methodology was litigated. Specifically, counsel advises that the Commission approved the A&E methodology in the base rate proceeding of PPL Gas (now UGI-Central Penn Gas) at Docket No. R-00061398 (Order entered February 8, 2007) and in the base

rate proceeding of Philadelphia Gas Works ('PGW') at Docket No. R-00061931 (Order entered September 28, 2007).

Second, Counsel further advises that the Commission ruled against classifying a portion of distribution mains as customer-related in the Philadelphia Gas Works rate proceeding at Docket No. R-00061931. As such, the Company's Design Day COSS is deficient on this count.

OSBA Statement No. 1, at 5-6.

However, Mr. Kalcic concluded that, with the elimination of the customer component, the Design Day methodology used in one of the Company's COSSs should produce substantially the same cost of service results as the Average and Excess methodology which is Commission precedent. Mr. Kalcic explained his conclusion, as follows:

They should produce essentially equivalent results because there are no off-peak rate classes on Peoples' system.

More specifically, the A&E and Design Day methodologies will tend to produce different results only in the case where one (or more) rate classes in a COSS takes service only in off-peak periods. In that instance, the A&E methodology *would* assign some costs to the off-peak class (via the average demand component), since the off-peak class does impose an average demand (i.e., usage) on the utility's system. However, the Design Day methodology would assign *no* demand related costs to the off-peak class, since such a class would exhibit zero demand during the Design Day or peak period.

* * *

I recommend that the Commission evaluate class revenue responsibility based upon a rerun of Peoples' Design Day COSS, with no customer component of distribution mains.

Id., at 7 (emphasis in original).

Peoples re-ran the Demand Day COSS as Mr. Kalcic recommended, *i.e.*, without a customer component. OSBA Statement No. 1, at 8. Mr. Kalcic then utilized the results of that revised COSS to present his recommendations for the class revenue allocation. *Id.*, at 8-11.

The *Joint Petition* represents a compromise of the revenue allocations presented in this proceeding. Set forth below is a table comparing the settlement revenue allocation to a scaleback of each party's litigation position.¹

Table 1
(Dollars in Thousands)

<u>Customer Class</u>	Peoples (Rebuttal) <u>Increase</u> 1	OSBA <u>Increase</u> 2	OCA <u>Increase</u> 3	OTS <u>Increase</u> 4	Settle- ment <u>Increase</u> 5
Residential	\$42,841	\$39,416	\$40,992	\$47,723	\$42,231
Small Commercial	\$1,239	\$1,379	\$1,176	\$1,106	\$1,379
Large Commercial	\$6,491	\$6,033	\$7,910	\$1,743	\$6,461
Industrial	<u>\$1,328</u>	<u>\$5,072</u>	<u>\$1,822</u>	<u>\$1,328</u>	<u>\$1,828</u>
Subtotal	\$51,900	\$51,900	\$51,900	\$51,900	\$51,900
Other Revenue	<u>\$1,100</u>	<u>\$1,100</u>	<u>\$1,100</u>	<u>\$1,100</u>	<u>\$1,100</u>
Total Company	\$53,000	\$53,000	\$53,000	\$53,000	\$53,000

The *Joint Petition* assigns an increase to the Small Commercial class that is virtually identical to what Mr. Kalcic had recommended in litigation. Furthermore, the Joint Petition assigns an increase to the Large Commercial Class that is only about 7% above Mr. Kalcic's recommendation. Consequently, the OSBA supports the *Joint Petition's* proposed revenue allocation as a just and reasonable outcome to a difficult and complex issue.

Gas on Gas Competition – Peoples is a natural gas distribution company (“NGDC”) that faces the potential loss of distribution customers to other NGDCs through so-called “gas-on-gas

¹ See OSBA Statement No. 2, Exhibit BK-1R. In Table 1, Exhibit BK-1R is simply scaled back to produce a total revenue increase of \$53 million. Note that Peoples revised its revenue allocation proposal in rebuttal.

competition.” To avoid the loss of customers, Peoples discounts the distribution rates paid by certain customers located in over-lapping NGDC service territories.

Determining how the lost revenues associated with these discounts should be recovered complicated the revenue allocation in this case. As the revised COSS demonstrated, the Company’s Industrial class should be allocated a larger revenue increase. *See* OSBA Statement No. 1, Exhibit BK-3. However, due, in part, to gas-on-gas competition, Peoples contends that its Industrial customers would not accept the significant distribution rate increases indicated by the revised COSS, and “they would leave the system.” Peoples Statement No. 16-R, at 5.

Mr. Kalcic summarized his views on gas-on-gas competition, as follows:

In a collective sense, the discounts arising from gas-on-gas competition represent a zero sum game. There are winners (customers that receive such discounts) and there are losers (customers that must pay for NGDC based discounts), but the gains and losses are exactly offsetting. Although there is a benefit to the business customers that receive these discounts, the cost of paying for the discounts is a burden to the business customers that do not have the good fortune of being located where service from another NGDC is an option. In short, there is no net benefit to the Commonwealth from allowing gas-on-gas competition.

OSBA Statement No. 3, at 2.

The impact of gas-on-gas competition was thoroughly demonstrated in this proceeding. By not requiring Industrial customers to pay their fully allocated cost of service, the *Joint Petition* requires other customer classes to heavily subsidize the Industrial class.

In an effort to resolve this issue for future cases, the *Joint Petition* requires that Peoples, the OSBA, and the other public advocates file with the Commission a request to initiate a generic investigation or rulemaking to determine whether gas-on-gas competition should be ended or significantly altered. *Joint Petition*, at Paragraph 29.

The OSBA fully supports this resolution, and will actively pursue this issue in a future proceeding before the Commission.

PES Program – Mr. Kalcic summarized the Company’s Production Enhancement Services (“PES”) program, as follows:

The Company’s PES Program encompasses a series of agreements entered into with Pennsylvania natural gas producers that were designed to enhance the flow of locally produced natural gas onto Peoples’ system. Beginning in 2002, an initial three-year agreement provided for improvements on Peoples’ gathering system (which lowered pressures on gathering lines so as to allow additional local gas supplies to flow). Per the 2002 agreement, participating producers agreed to pay the Company an Mcf based production fee that was based, in part, upon market prices.

In 2005, Peoples entered into a second agreement with producers that included a six-[year] term. As in the initial agreement, participating producers agreed to pay Peoples an Mcf based production fee tied to market prices.

In 2008, Peoples and local producers agreed to amend the 2005 agreement. As a result, the PES Program currently extends through March 2015. In general, the amended agreement requires Peoples to continue its investment in (and operation of) production enhancement projects, and requires participating producers to pay an Mcf based production fee for the term of the agreement.

OSBA Statement No. 1, at 12.

Peoples has not been using all of the PES revenue for production enhancement. In its original filing, the Company proposed to share the excess revenue generated by the PES Program on a 50%/50% basis between the Company and its customers. OSBA Statement No. 1, at 12-13.

Instead, Mr. Kalcic recommended:

Rather than share 50% of the excess revenues produced by the PES Program, Peoples should be required to apply the [Company’s share of] excess program revenues toward mitigating LUGF [lost

and unaccounted for gas] on its gathering system. Such mitigation would significantly benefit both ratepayers and local producers.

OSBA Statement No. 1, at 14.

The *Joint Petition* adopts the OSBA's recommendation. *Joint Petition*, at Paragraph 25.

POR Program – In its original filing, the Company proposed a purchase of receivables (“POR”) program. Such a program is typically strongly desired by natural gas suppliers (“NGSs”) on an NGDC's system. Mr. Kalcic summarized the proposed POR program in his direct testimony. See OSBA Statement No. 1, at 14-15.

However, the Company's POR program was silent in regards to permitting Peoples to recover from ratepayers the difference, if any, between the actual payments received from the customers of NGSs and the amount of receivables purchased from NGSs. *Id.*, at 15.

Mr. Kalcic testified that the OSBA did not object to the Company's proposed POR program “as long as Peoples would not be permitted to recover any NGS-related payment shortfalls from non-NGS customers.” *Id.*, at 16. Mr. Kalcic explained his reasoning, as follows:

First, OSBA counsel advises that the recovery of any such payment shortfalls from non-NGS customers would be unlawful. Second, Peoples had the opportunity to set appropriate (class based) discount rates when designing its proposed POR Program. Any risk that Peoples' proposed discount rates turn out to be too low should rest with the Company, not ratepayers.

OSBA Statement No. 1, at 15-16.

The *Joint Petition* adopts the OSBA's recommendation. *Joint Petition*, at Paragraph 43.

DSIC Mechanism – In its original filing, the Company proposed that a Distribution System Improvement Charge (“DSIC”) mechanism be pre-approved even though legislation allowing the implementation of said mechanism has not been enacted. Mr. Kalcic explained the operation of the DSIC, as follows:

Peoples' proposed DSIC (i.e., Rider G) would enable the Company to recover capital and depreciation costs associated with replacing certain natural gas infrastructure outside the context of a normal base rate case filing.

OSBA Statement No. 1, at 16.

The OSBA opposed the creation of a DSIC mechanism at this time. Mr. Kalcic explained, as follows:

Unless and until enabling legislation is passed, there is no way for the parties (or the Commission) to ascertain whether Rider G would, in fact, comply with the legislation. Thus, any consideration of Peoples' DSIC proposal is best deferred to a future proceeding, after (if) enabling legislation is adopted.

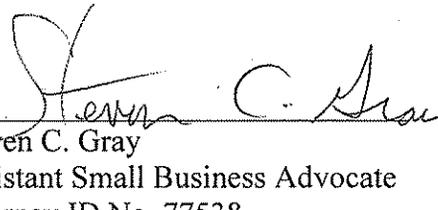
OSBA Statement No. 1, at 17.

In the *Joint Petition*, the Company agrees to withdraw the DSIC mechanism from this proceeding. *Joint Petition*, at Paragraph 30. The OSBA fully supports this result.

Conclusion

For the reasons set forth in the *Joint Petition*, as well as the additional factors that are enumerated in this statement, the OSBA supports the proposed *Joint Petition* and respectfully requests that the ALJ and the Commission approve the *Joint Petition* in its entirety.

Respectfully submitted,



Steven C. Gray
Assistant Small Business Advocate
Attorney ID No. 77538

For:

William R. Lloyd, Jr.
Small Business Advocate
Attorney ID No. 16452

Office of Small Business Advocate
300 North Second Street, Suite 1102
Harrisburg, PA 17101
(717) 783-2525

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