

ORIGINAL

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DOCUMENT
FOLDER

May 4, 2006

James McNulty
Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
2nd Fl., 400 North Street
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PA PUC
SECRETARY'S BUREAU

Re: Pa PUC v. Philadelphia Gas Works,
Docket No. R-00017034

Dear Secretary McNulty:

As part of the settlement of Philadelphia Gas Works' ("PGW" 2002 base rate proceeding (R-00017034), the Company was permitted to implement its proposed Weather Normalization Adjustment ("WNA") clause and, in addition, agreed to conduct a review of the costs and benefits of the WNA after three years. In addition, the Settlement stated that "[a] determination will be made at the end of the review as to whether the WNA will continue, with modifications." PGW conducted such a review at the conclusion of the three-year pilot period, the results of which are reflected in the attached Report on Weather Normalization Adjustment Clause (Appendix "A" to the Stipulation). The report incorporates the input and suggestions of the Office of Consumer Advocate ("OCA") and the Office of Trial Staff ("OTS") and contains data and analyses which, in PGW's view, support the continuation of the WNA for PGW. In addition, the OCA and the OTS have entered into a stipulation with PGW which accepts the continuation of the WNA clause for PGW on a permanent basis (with one contingency explained in the stipulation).

As the 2002 Rate Case Settlement did not specify how the WNA review was to occur, PGW, OCA and OTS have agreed that PGW shall submit the WNA Report to the Commission and request that the Commission review the report and issue a secretarial letter or other pronouncement of the Commission, as it determines to be most appropriate, which authorizes or acknowledges that the WNA will continue on a permanent basis. Accordingly,

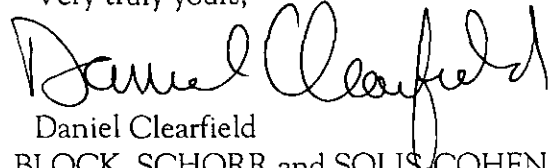
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James McNulty
May 4, 2006
Page 2

PGW is hereby submitting its WNA Report and Stipulation to the Commission for its review and any action it determines is appropriate.

Very truly yours,



Daniel Clearfield
For WOLF, BLOCK, SCHORR and SOLIS COHEN LLP

DC/lww

Attachments

cc: Robert Rosenthal, Director, FUS
Attached Service List

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

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:
:
:
:
:
:

Docket No. R-00017034

SECRETARY'S BUREAU
PA PUC

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STIPULATION

Philadelphia Gas Works ("PGW"), the Commission's Office of Trial Staff ("OTS") and the Office of Consumer Advocate ("OCA"), (collectively "the Stipulating Parties"), hereby stipulate and agree as follows:

WHEREAS, On February 25, 2002, PGW submitted Supplement No. 17 to Tariff Gas - Pa. P.U.C. No. 1 to become effective for service rendered on or after April 26, 2002, and proposed to increase PGW's base rates by \$60 million annually; and

WHEREAS, the proposed tariff contained a proposal to implement a weather normalization adjustment clause ("WNA") designed to adjust PGW's base rates on a monthly basis to account for colder or warmer than normal weather; and

WHEREAS, prior to completion of the public hearings on the base rate request, the parties were able to reach a Settlement which resolved all issues pertaining to PGW's base rate filing; and

WHEREAS, as part of that settlement, PGW was permitted to implement its proposed WNA as soon as necessary systems modifications were complete; and

WHEREAS, PGW actually began to implement the adjustment clause as of December 1, 2002; and

WHEREAS, the Settlement indicated that the WNA was being put in place for an initial three-year pilot period. At the conclusion of the three year period, the Company agreed to conduct a review of the costs and benefits of the WNA; and

WHEREAS, the Settlement stated that "[a] determination will be made at the end of the review as to whether the WNA will continue, continue with modifications;" and

WHEREAS, the Settlement was approved by the PUC in an order entered on August 2, 2002; and

WHEREAS, the three-year pilot period ended on August 9, 2005; and

WHEREAS, PGW has conducted the review of the costs and benefits of the WNA and has set forth its conclusions in the form of a Report, (hereinafter "the WNA Report") which is attached hereto as Appendix "A"; and

WHEREAS, the Report examined the performance of the WNA over the last three (3) years and its effect on reducing volatility of earnings and concluded that both the Company and its customers have benefited from the existence of the WNA over this period; and

WHEREAS, the Stipulating Parties were provided drafts of the WNA Report and made suggestions for inclusion, which were addressed in the body of the report.

NOW, THEREFORE, it is hereby stipulated and agreed as follows:

1. The other Stipulating Parties agree with PGW's conclusion that PGW's WNA tariff should continue on a permanent basis, subject to the conditions set forth in paragraphs 2 and 3 below.
2. PGW agrees that its internal audit department will annually audit the WNA by selecting a sample from invoices issued during the month in which the highest total monthly surcharge or credit was applied to customers' invoices. The surcharge or credit for the selected

invoices will be recalculated. All procedures will be documented and all data will be saved for a period of six months after the completion of the audit. The results of the annual audit will be provided to the Parties. The Parties will have the right to address any negative audit findings in the appropriate forum(s).

3. PGW agrees that if PGW is purchased by, or otherwise transferred to an investor owned utility, or should become an investor owned utility, PGW agrees that such successor entity may no longer utilize the WNA Clause unless the Commission upon petition by the purchasing IOU in the transfer application proceeding or otherwise authorizes the establishment of a WNA for the successor entity.

4. The Stipulating Parties agree to the following procedure to comply with the terms of the 2002 Rate Case Settlement:

a) PGW shall submit the WNA Report to the Commission and request that the Commission review the report and issue a secretarial letter or other pronouncement of the Commission, as it determines to be most appropriate, which authorizes or acknowledges that the WNA will continue on a permanent basis.

b) The Stipulating Parties, and any other interested person, may file comments to the Report and to PGW's conclusion that the WNA should continue on a permanent basis.

5. The Stipulating Parties specifically acknowledge and agree that PGW's WNA

shall continue unless and until the Commission issues a final order directing that it be terminated or modified.

Respectfully submitted,

Philadelphia Gas Works

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Counsel for PGW

Dated: May 3, 2006

Office of Trial Staff

By Johnnie E. Simms
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Date: May 4, 2006

Office of Consumer Advocate

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Counsel for Office of Consumer
Advocate

Office of Consumer Advocate
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Dated: May 3, 2006

PHILADELPHIA GAS WORKS

REPORT ON WEATHER NORMALIZATION ADJUSTMENT CLAUSE



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PA PUC
SECRETARY'S BUREAU

Prepared in Compliance with
Joint Petition For Settlement
Pa PUC v. PGW, R-00017034

PHILADELPHIA GAS WORKS
800 West Montgomery Avenue
Philadelphia, PA 19122

November 2005

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I. BACKGROUND

Traditionally, the base rates of natural gas distribution companies (NGDCs) are established on a "weather normalized" basis, i.e., rates are set to permit the Company to earn at levels determined to be reasonable assuming that sales and revenues are at the levels the utility would experience if the level of experienced "Heating Degree Days" ("HDD") were at "normal" levels. Accordingly, when a year is colder or warmer than some determined "normal" level the NGDC typically earns more or less than the normalized amount, all other things being equal.

One way in which to balance out the effects of "abnormal" weather is by implementing a Weather Normalization Adjustment ("WNA") mechanism. The typical WNA permits the NGDC to true-up its revenues when experienced HDDs in a given period are less than a determined "normal" level. Correspondingly, when experienced HDDs exceed normal levels the utility adjusts its charges to provide a credit to customers. Importantly, the WNA does not result in a utility being able to earn more or realizing an earnings short-fall; it merely permits the utility to recover its authorized level of earnings and, for a cash flow regulated utility, the company's authorized level of liquidity.

As a result of experiencing a number of winters in which abnormal weather caused severe shortfalls in earnings and liquidity, PGW determined that the establishment of a WNA was a crucial requirement if the Company was to return to financial health in the long term.

Accordingly, PGW included a request to establish a WNA clause as part of its 2002 general base rate proceeding. On February 25, 2002, PGW submitted Supplement No. 17 to Tariff Gas - Pa. P.U.C. No. 1 to become effective for service rendered on or after April 26, 2002. This base rate filing sought to increase PGW's base rates by \$60 million and to implement a weather normalization adjustment clause ("WNA"). Prior to completion of the public hearings on the base rate request, the parties were able to reach a Settlement which resolved all issues

pertaining to PGW's base rate filing. As part of that settlement, PGW was permitted to implement its proposed WNA as soon as necessary systems modifications were complete. PGW agreed that the WNA would be put in place after consulting with the settling parties. PGW actually began to implement the adjustment clause as of December 1, 2002. In compliance with its settlement agreement, PGW provided consumer education to its customers to assist them in understanding the workings of the WNA.

The Settlement indicated that the WNA was being put in place for an initial three-year pilot period. At the conclusion of the three year period, the Company agreed to conduct a review of the costs and benefits of the WNA. After that evaluation, a determination was to be made as to whether the WNA will continue, continue with modifications, or be eliminated.

The Settlement was approved by the PUC in an order entered on August 2, 2002.

In presenting its proposal for a WNA, PGW's Craig White explained that the establishment of the Clause would have a number of benefits:

- i. stabilizes cash flow from year-to-year
- ii. can reduce the need for short-term borrowing from year-to-year
- iii. positively affect PGW's credit rating
- iv. reduces the need for costly base rate proceedings¹

Mr. White also pointed out that a WNA-type clause was particularly appropriate for a municipally owned utility, such as PGW:

I believe that PGW's municipal status makes a WNA particularly appropriate. Under the cash flow method of ratemaking, ratepayers provide revenues to cover the entire costs of service -- but only the cost of service. Any revenue shortfalls or windfalls ultimately inure to the ratepayers. The WNA simply minimizes

¹ *Pa PUC v. PGW*, R-00017034, PGW BRP St. 2 at 3.

the degree to which such shortfalls or windfalls occur. For a municipal utility that utilizes a WNA, ratepayers are assigned the same responsibilities or obtain the same benefits that they would without a WNA.²

In response to the Company's presentation, the OTS agreed with the Company's WNA proposal in principle:

I cannot agree with the Company's proposed WNA as filed. ... However, I agree in concept that a WNA clause would be reasonable only because PGW's rates are established using the cash flow method of ratemaking.³

OTS's witness Mr. Metro recommended approval of the WNA clause if several conditions were adopted by the PUC.⁴

OCA witness Thomas Catlin also indicated that a WNA clause would make sense for the PUC to approve for a municipal utility such as PGW:

Generally, a WNA clause would not be appropriate for an investor-owned utility where the costs of capital, especially equity capital, embodies compensation for the very risk that a WNA clause would attenuate....PGW is unique among gas distribution companies in Pennsylvania. PGW is the only gas distribution utility in Pennsylvania regulated by the Commission that is a municipal utility. Moreover, PGW operates on a cash basis according to statute, and it has no source of equity financing in the sense of a traditional investor-owned utility. The Company represents that its ability to borrow short-term is largely exhausted and it has virtually no remaining flexibility to address short-term margin losses.⁵

² Id. at 3-4.

³ R-00017034, OTS St. 4 at 10.

⁴ The conditions Mr. Metro recommended were: 1) the WNA be approved for a 3 year "trial" basis; 2) the Company provide tariff language that describes how the individual customer charge and middle of the month monthly bills will be calculated; and 3) the Company will not file for a rate increase until after June 1, 2005. Id. at 10-12.

⁵ R-00017034, OCA St. 3 at 3-4. OCA witness Catlin also recommended several refinements to the Company's proposal, including the filing of periodic reports on the

Accordingly, in evaluating the performance of the clause three years after its initiation PGW has focused on whether the WNA has provided the benefits anticipated and whether PGW's implementation has been otherwise reasonable.

II. PERFORMANCE OF CLAUSE

In the three years in which the WNA clause has been in place, PGW has credited to customers, on net, approximately \$9.3 million.

Philadelphia Gas Works Weather Normalization Adjustment Clause

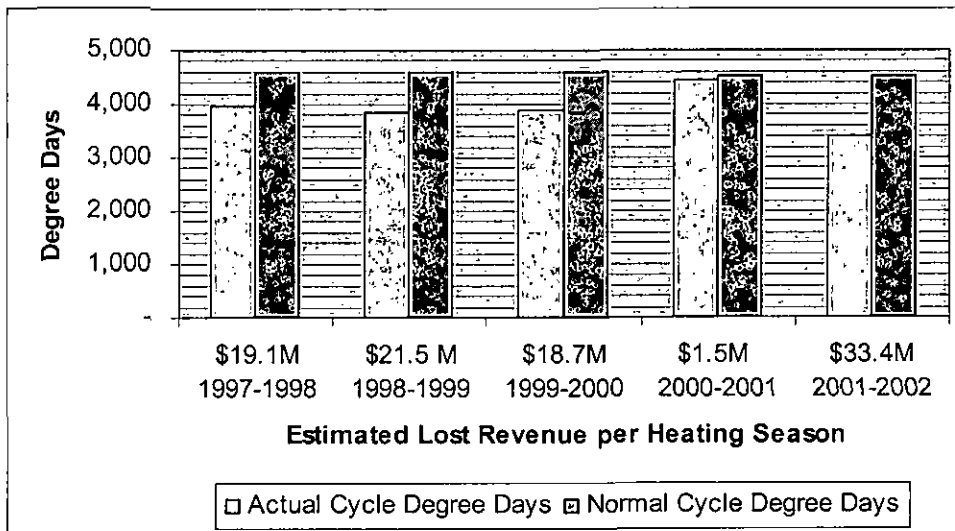
	<u>Fiscal Year</u> <u>2002-03</u>	<u>Fiscal Year</u> <u>2003-04</u>	<u>Fiscal Year</u> <u>2004-05</u>
SEP	-	\$ 5,837	\$ 1,093
OCT	-	(293,666)	(171,486)
NOV	-	1,744,403	(85,304)
DEC	(3,094,912)	249,694	1,456,550
JAN	183,378	(313,490)	2,349,557
FEB	(4,952,755)	(4,584,777)	(791,197)
MAR	(3,636,720)	2,384,882	(3,074,010)
APR	1,334,999	(111,428)	(9,860)
MAY	107,459	2,035,759	(462,910)
JUN	8,492	1,039,386	(568,422)
JUL	11,133	2,828	(11,583)
AUG	9,590	(50,881)	2,410
TOTAL	\$ (10,029,336)	\$ 2,108,547	\$ (1,365,162)

clause, the establishment of the clause on a 3 year pilot basis, consumer education on the clause and an evaluation of the appropriateness of the 1% plus or minus deadband after actual experience is obtained.

III. ASSESSMENT OF CLAUSE PERFORMANCE

A. Affect on PGW Financial Position

Notwithstanding the fact that, since its inception, the PGW has actually resulted in a net credit to customers, the existence of the WNA has had a very positive effect upon the way in which PGW has been viewed by the financial community. The principal reason for this is that the existence of the WNA has eliminated the effect of weather on earnings and cash flow. Prior to the establishment of PGW's WNA, the Company experienced substantial shortfalls in earnings and cash flow as a result of successive warmer than normal winters. The following chart illustrates PGW's historical experience:



These weather related reductions in earnings and cash flow decimated PGW's already precarious financial position and threatened the Company's ability successfully to issue additional long term debt, the firm's only available source of external capital. In fact, it is estimated that during the five fiscal years ending August 31, 2002, PGW experienced

approximately \$94 million in lost revenue due to higher than normal temperatures. As a result, PGW was downgraded to the lowest investment grade and was required to pay extremely high effective interest rates in order to obtain the long term financing on which it relies to maintain its capital improvement program. It was also forced to obtain a series of base rate increases (including a \$36 million emergency rate increase) in order to "weather" the storm.

With the implementation of the WNA, PGW has not filed any additional base rate cases and, while many other factors have continued to keep the Company in a challenging financial position, the investment community has recognized that PGW's earnings and cash flow are now uniquely insulated from the vagaries of weather. Both Standard & Poor's ("S & P") and Moody's continue to cite the WNA as a positive factor. In fact, both rating agencies have discussed the WNA in some of their most recently issued reports. In May 2005, S & P reiterated that "[a]nother indication of regulatory support involves the PUC's relatively recent approval of a weather normalization adjustment for PGW – the first such allowance to a gas utility in Pennsylvania. The WNA enables PGW to smooth out fluctuations in margin revenue due to abnormal weather in winter months."⁶ Again, on August 30, 2005, in a report in which S & P affirmed PGW's bond rating as the lowest investment grade rating and affirmed a negative outlook, S & P stated: "The current rating assumes that the company will continue to have access to its WNA. Although poor collections exacerbate liquidity problems in colder-than-normal years (as total customer bills increase), the WNA keeps distribution revenues from dropping precipitously in years with warmer-than-normal winters."⁷ Likewise, Moody's has clearly expressed that "[p]rior to the natural gas price spike in 2003 PGW has implemented several

⁶ Standard & Poor's Full Report (May 19, 2005).

⁷ Standard & Poor's Full Report (August 30, 2005).

changes that were to be key to improved financial performance. PGW ... was granted a Weather Normalization Adjustment, to normalize the impact of changes in weather on cash flow.”⁸ Additionally, Fitch Ratings favorably commented on the WNA after its approval. When discussing rating considerations, Fitch reported that the “rating considers management’s continued focus on cost control, steady albeit slow improvement in customer collections, and recent rate modifications that have provided some stability to cash flow...”⁹ The rate modifications were described later in the report as permanent base rate relief of \$70 million, as well as the ability to levy a WNA for warmer than normal years.”¹⁰

B. Effect on Customers

The WNA clause has been well accepted by PGW customers. Since its inception, PGW has had an extremely small number of complaints. The Clause has been calculated without any errors or revisions being necessary.

C. WNA Billing

PGW's WNA formula used to apply the clause works as it was intended. In order to demonstrate this, PGW sampled all rate classes to which the WNA was applied¹¹ for the month of March 2005. March 2005 was selected because it was the month during which the

⁸ Moody’s Report (September 28, 2004).

⁹ Fitch Ratings Report, p. 2 (December 18, 2002).

¹⁰ *Id.*

¹¹ GS, MS and PHA.

largest credit was issued during the 2004-2005 fiscal year. After selecting a sample size¹² from each rate class, the WNA applied to each selected invoice was recalculated and no exceptions were identified. PGW's conclusion is that algorithms and billing systems used to calculate the WNA are accurate and reliable.

IV. WORKSHOPS

PGW held two telephonic workshops with the Office of the Trial Staff (“OTS”), the Office of the Consumer Advocate (“OCA”), the Office of the Small Business Advocate (“OSBA”), and the Philadelphia Industrial and Commercial Users Group (“PICGUG”) (collectively the “Parties”) on August 30 and September 15, 2005 in order to discuss draft forms of this report and exchange information. PGW and the Parties discussed many issues, the more prominent of which follow.

A. WNA Deadband

At least one of the workshop participants asked that PGW provide an analysis of the pros and cons of modifying the existing deadband, currently set at 1%. Based upon total residential heating season sales (10/1 to 5/31) of 36 Bcf, each increase of the deadband by 1% shows a correlating decrease in the total heating season surcharge or credit of \$1.5M. For example, when 36 Bcf is used as baseline residential heating season sales which are then adjusted for 5% warmer or colder weather, the resulting surcharge/credit is \$6,050,000 using a 1% deadband. The increase of the deadband to 2%, 3%, 4% and 5% results in surcharges/credits of \$4,550,000, \$3,030,000, \$1,520,000 and \$0, respectively. The same incremental change of

¹² Three populations (i.e. March 2005 GS, MS and PHA invoices) were sampled based upon a 95% confidence level and a confidence interval of plus or minus 5%.

approximately \$1.5M per 1% occurs even if the temperature variance is less than 5% warmer/colder or greater than 5% warmer/colder.

The rating agencies have clearly indicated that they rely upon the WNA to be a risk mitigating tool, therefore, an increase of the deadband beyond 1% will diminish the effect of the WNA as a risk mitigating tool. After discussing PGW's analysis and the independent analyses prepared by another party, it was agreed that the deadband at 1% should be maintained.

B. WNA Audit

PGW and the parties agreed that it would be appropriate to conduct annual audits of the WNA. Accordingly, it was agreed that PGW's internal audit department will annually audit the WNA by selecting a sample from invoices issued during the month in which the highest total monthly surcharge or credit was applied to customers' invoices. The surcharge or credit for the selected invoices will be recalculated. All procedures will be documented and all data will be saved for a period of six months after the completion of the audit. The results of the annual audit will be provided to the Parties. The Parties will have the right to address any negative audit findings in the appropriate forum(s).

C. Change in Ownership of PGW

OTS wanted to address the question of the continuation of the clause in the event that PGW was sold to or transferred into an investor owned utility. Accordingly, it was agreed that if PGW is purchased by, or otherwise transferred to an investor owned utility or should become an investor owned utility, PGW agrees that such successor entity may no longer utilize the WNA Clause unless the Commission upon petition by the purchasing IOU in the transfer

application proceeding or otherwise authorizes the establishment of a WNA for the successor entity.

V. PGW CONCLUSIONS REGARDING THE WNA

While PGW continues to struggle under the weight of a variety of systemic (i.e. historically high natural gas prices) and idiosyncratic (high uncollectibles and low but improving cash receipts percentages) PGW's financial health would be far worse without the WNA Clause. There is no question that it can and must continue. PGW intends to continue the clause to obtain the needed benefits for the Company, its employees and, most importantly, its customers.

CERTIFICATE OF SERVICE

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

VIA FIRST CLASS MAIL

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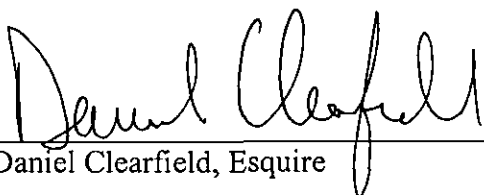
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Dated: May 4, 2006



Daniel Clearfield, Esquire



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May 24, 2006

HAND DELIVERED

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

**Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00017034**

Dear Secretary McNulty:

I am delivering for filing today the original plus three copies of the Answer of the Office of Small Business Advocate to Philadelphia Gas Works' Proposed Stipulation filed on May 4, 2006.

As evidenced by the enclosed Certificate of Service, two copies have been served on all parties in this proceeding.

Sincerely,

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

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Enclosures

cc: Parties of Record

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2006 MAY 24 PM 5:02
SECRETARY'S BUREAU

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

DOCKET NO. R-00017034

SECRETARY'S BUREAU

2006 MAY 24 PM 5:02

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CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Answer to Philadelphia Gas Works' Proposed Stipulation, on behalf of the Office of Small Business Advocate, by e-mail and first class mail (unless otherwise noted) upon the persons addressed below:

Hon. Cynthia Fordham
Administrative Law Judge
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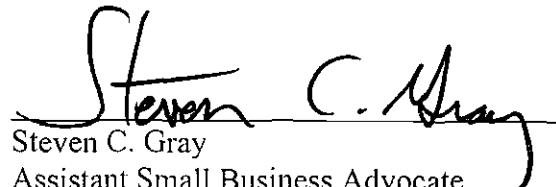
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Date: May 24, 2006

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PA. PUBLIC
UTILITY COMMISSION
SECRETARY'S BUREAU

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

DOCKET NO. R-00017034

PHILADELPHIA GAS WORKS

**OFFICE OF SMALL BUSINESS ADVOCATE'S
ANSWER TO PHILADELPHIA GAS WORKS'
PROPOSED STIPULATION**

SECRETARY'S OFFICE

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On May 2, 2006, Philadelphia Gas Works ("PGW" or the "Company") filed a Stipulation with the Pennsylvania Public Utility Commission ("Commission") that addresses the Company's weather normalization adjustment ("WNA") clause placed into operation as a "three-year pilot" by the Commission. See Docket No. R-00017034 (Order entered August 8, 2002), at Ordering Paragraph 5(c). The Stipulation proposes to place the WNA clause into permanent operation.

The Office of Small Business Advocate ("OSBA") submits this Answer in response to the Stipulation.

Responses to the Stipulation's Numbered Paragraphs

1. The averments of Paragraph 1 contain summaries of the Company's request for relief to which no response is required. By way of further response, the WNA clause went into effect on December 1, 2002. See *Stipulation*, at page 1. Consequently, the "three-year pilot" ended on November 30, 2005. The operation of the WNA clause should have terminated at that time. See also, *Statement in Support of the Office of Consumer Advocate*, Docket No. R-00017034 (Dated June 26, 2002), at page 3 ("The

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WNA is limited to a three year pilot period, at which time the Company will conduct a review of the costs and benefits of the WNA.”) Instead, the WNA clause continued to operate throughout the winter 2005-2006 season.¹

2. The averments of Paragraph 2 contain summaries of the Company’s request for relief to which no response is required. By way of further response, the OSBA respectfully requests that the Commission order PGW to provide the OSBA with a copy of the annual WNA audit, and grant the OSBA the opportunity to “address any negative audit findings in the appropriate forum(s).”

3. The averments of Paragraph 3 contain summaries of the Company’s request for relief to which no response is required.

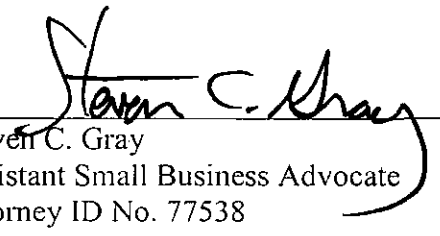
4a. The averments of Paragraph 4a contain summaries of the Company’s request for relief to which no response is required. By way of further response, the OSBA agrees that the Commission should review the Company’s *Report on Weather Normalization Adjustment Clause* once the Company has updated that *Report* for the winter 2005-2006 season. Specifically, the OSBA observes that Section II of the *Report* documents that the WNA clause has credited PGW’s customers two out of the three years of the WNA clause’s operation, and “since its inception, the [WNA] has actually resulted in a net credit to customers.” *Report*, at 6. If that trend continued in the winter 2005-2006 season, the OSBA is concerned that the WNA clause may not be properly designed for PGW’s purposes.

¹ The OSBA has not received any analysis of the operation of the WNA clause for the winter of 2005-2006 season from the Company. That analysis should be similar to what is set forth in Section II (entitled “Performance of the Clause”) of the Company’s *Report on Weather Normalization Adjustment Clause* that is attached to the Stipulation.

4b. The averments of Paragraph 4b contain summaries of the Company's request for relief to which no response is required. By way of further response, the OSBA respectfully submits that placing the WNA into permanent operation is not reasonable at this time. Instead, the OSBA recommends that the WNA clause be continued for an additional three-year trial period (which includes the winter 2005-2006 season), be subject to a full review by all interested parties at the conclusion of that additional three-year trial period, and be terminated at the end of that additional period unless there is a Commission Order continuing the operation of the WNA clause beyond the conclusion of the six-year trial period.

5. The averments of Paragraph 5 contain summaries of the Company's request for relief to which no response is required. By way of further response, the OSBA recommends that the WNA clause be continued for an additional three-year trial period (which includes the winter 2005-2006 season), be subject to a full review by all interested parties at the conclusion of that additional three-year trial period, and be terminated at the end of that additional period unless there is a Commission Order continuing the operation of the WNA clause beyond the conclusion of the six-year trial period. However, because the WNA clause should have ceased operation on November 30, 2005 (as required by the Commission's Order at Docket No. R-00017034), the OSBA respectfully requests that the Commission enter an Order granting a three-year extension for the operation of the WNA clause through the winter 2007-2008, at which time the WNA should be subject to a full review and further Commission Order.

Respectfully submitted,



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June 6, 2006

VIA FEDERAL EXPRESS

James McNulty
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JUN 06 2006

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Re: PA PUC v. Philadelphia Gas Works,
Docket No. R-00017034

Dear Secretary McNulty:

On behalf of Philadelphia Gas Works, enclosed for filing please find an original and three copies of its Response to the Office of Small Business Advocate's Answer to the Joint Stipulation with regard to the above-referenced matter. A copy has been served in accordance with the attached Certificate of Service.

Very truly yours,

Daniel Clearfield
Daniel Clearfield

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

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Enclosure

cc: Attached Cert. of Service w/enc.

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CERTIFICATE OF SERVICE

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

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PA PUBLIC UTILITY COMMISSION
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Dated: June 6, 2006


Daniel Clearfield, Esquire

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PENNSYLVANIA PUBLIC UTILITY COMMISSION

JUN 06 2006

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

v.

Docket No. R-00017034

PHILADELPHIA GAS WORKS

**PHILADELPHIA GAS WORKS' RESPONSE TO OFFICE OF SMALL
BUSINESS ADVOCATE'S ANSWER TO PHILADELPHIA GAS WORKS'
JOINT STIPULATION**

Philadelphia Gas Works ("PGW") hereby provides this response to the document filed by the Office of Small Business Advocate ("OSBA") which it characterized as an "Answer to Philadelphia Gas Works' Proposed Stipulation." While OSBA presents its position on the Joint Stipulation filed by Office of Trial Staff ("OTS"), the Office of Consumer Advocate ("OCA"), and PGW regarding the continuation of PGW's WNA tariff, it also makes several factual statements which require correction or clarification.

The joint stipulation was filed in accordance with the requirements of the settlement of the Company's 2002 rate case in which the parties agreed to permit the WNA to be placed into effect, but to study it after three years and make a determination whether it should continue or be modified, in whole or in part. Based upon a report prepared by PGW, with the input from the public parties, the Joint Stipulation endorsed the Clause and agreed that the WNA should continue as it is structured today, as a permanent part of PGW's rate structure.

While the OSBA joins with the other parties in agreeing that the PGW WNA clause should continue, it, unnecessarily and unreasonably, suggests that the clause should only be approved for an additional three years after which it should terminate unless the Commission issues an order to the contrary before that. As the clause is universally viewed as beneficial to PGW and its customers, and its termination would have profoundly negative consequences for

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PGW's financial circumstances, OSBA's suggestions should be rejected and, as the Joint Stipulation requests, the Commission should acknowledge that the WNA will continue in place, just as its present tariff states.

1. Preliminarily, the OSBA's document characterizes the joint filing as "PGW's proposed stipulation;" this is wrong on two counts. First, the document was filed jointly by PGW, OCA and OTS; it is not "PGW's" Stipulation. Second, the stipulation is not "proposed;" the Stipulation reflects the position of the majority of the public parties that the WNA should continue because it is good for the Company and fair to the customers.

2. OSBA requests that the report prepared by PGW detailing the Company's experience with the clause be updated to include results for the 2005-06 winter season. Attached (Attachment "A") is an Updated WNA Report which includes this information. This version is modified only to add the 2005-06 results and to remove any general characterizations of the actual WNA experience which were based on pre-2005-06 data.

3. Most importantly, OSBA incorrectly states that the original, 2002 rate Settlement had agreed that the WNA would be in place for three years and then terminated.¹ In addition, OSBA stated that "the WNA clause should have ceased operation on November 30, 2005 (as required by the Commission's Order at Docket No. R-00017034)."² These statements are completely untrue. The 2002 rate case Settlement states only that the clause would be in place for an initial three year pilot period, after which PGW was required to conduct a review of the clause and prepare a report which would inform a decision as to whether the clause should continue or be terminated (the relevant portions of the Settlement Agreement are attached as

¹ OSBA "Answer" at 1.

² OSBA "Answer" at 3.

Attachment "B"). The actual language from the Commission's order approving the settlement restates the settlement term:

the WNA will have a three-year pilot period. At the conclusion of the three year period, the Company will conduct a review of the costs and benefits of the WNA. A determination will be made at the end of the review as to whether the WNA will continue, continue with modifications, or be eliminated.³

4. As can be plainly observed, there is nothing in the Settlement or the Commission's Order approving the Settlement, which states that the WNA is to "terminate" after the three-year pilot period. Such a suggestion is not only inconsistent with the plain language in the Settlement but it is also inconsistent with permanent nature of the tariff provision implementing the WNA which was approved by the Commission when the 2002 Settlement was approved. That tariff provision was filed as part of PGW's compliance filing implementing the Settlement and was served upon all parties to the proceeding including OSBA. Neither OSBA nor any other party raised an objection to the tariff provision implementing the WNA, as per the Settlement and the Commission's Order. The tariff language states, in part, as follows:

The Weather Normalization Adjustment shall be applied to each Mcf (1,000 cubic feet) used for heating purposes under Rate Schedules GS, MS, and PHA ("heating" and "heating only" customers), except for Gas usage under the Special Provisions – Air Conditioning of those rates. The Weather Normalization Adjustment will be applied to customer usage during the period of October 1 through May 31 of each year for each billing cycle (except for the 2002-2003 heating season when the Weather Normalization Adjustment will be applied to customer invoices rendered during the period of December 1 through May 31 of each year for each billing cycle).

The full text of the WNA tariff provisions are attached hereto as Attachment "C." This tariff provision is permanent in every respect and does not state that it "terminates" or ends after three

³ *Pa PUC v. PGW*, R-00017034 (August 8, 2002) Ordering ¶ 5(c).

years. This is conclusive proof that the Commission did not order the clause to terminate at the end of the initial "pilot" but only that a review should occur at that time. If the OSBA was confused about the Settlement language or had a different interpretation than the Company, the Commission (as evidenced by the PUC's approval of the Company's permanent tariff provision) or all of the other parties, none of which have endorsed the OSBA view, it should have raised it in 2002.

5. Ironically, OSBA's substantive position does not challenge the appropriateness of the WNA (which makes its initial position even harder to understand), but suggests that the WNA be continued as an additional "trial" for another three years and that at the end of that second three year period, the clause should terminate, unless there is a PUC order prior to the end of the second trial which authorizes its continuation.⁴

6. PGW is not opposed to a second review and evaluation of the WNA after three years if the Commission, in its discretion, believes such a review would be prudent, but strongly opposes OSBA's suggestion that the clause should terminate after the 2007-08 winter unless the PUC issues an order continuing it. The WNA has been – and will continue to be – enormously important to PGW in providing a certain amount of financial stability for the Company. Creating a risk that the clause might not continue merely because of inadvertence or administrative error could create unnecessary and harmful uncertainty for PGW and its ratepayers.

7. In PGW's WNA Evaluation Report (attached), PGW documented how the WNA has insulated PGW's financial results from the vagaries of the weather and has had a positive impact on the way in which PGW is viewed by the bond rating agencies.⁵ Clearly, the

⁴ OSBA "Answer" at ¶ 5.

⁵ See, WNA Report at 6-8.

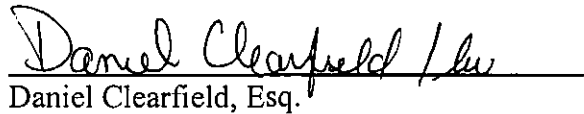
elimination of the WNA would have an extremely negative effect on the Company's bond rating and worsen its already precarious financial condition. Under the circumstances, putting in place a scheme in which the WNA clause would automatically go away unless the Commission took timely action is risky and inadvisable, especially since all parties, including OSBA endorse its continuation.

8. The OSBA does make a passing reference in its Answer to the fact that prior to the 2005-06 season, the WNA had resulted in a net credit to customers, and that "the OSBA is concerned that the WNA clause may not be properly designed for PGW's purposes."⁶ In light of the fact that the updated Report (including the 2005-06 data) shows that, over the last four years, the WNA has resulted in a small charge (\$3.9 million) to customers (which amounts to, on average, less than \$1 million a year), the OSBA should have no further concerns.

⁶ OSBA "Answer" at ¶ 4a.

WHEREFORE, PGW respectfully urges the Commission to reject both OSBA's incorrect factual assertions and its recommendations. PGW also requests that the Commission adopt the Joint Stipulation and indicate its approval of the continuation of the WNA for PGW. If the PUC believes that the WNA clause should be reviewed further, it should order such a review but make clear that the WNA clause will continue unless and until the Commission enters an order terminating or modifying the clause.

Respectfully submitted,



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Dated: June 6, 2006

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Attachment A

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

PHILADELPHIA GAS WORKS

REPORT ON WEATHER NORMALIZATION ADJUSTMENT CLAUSE



Prepared in Compliance with
Joint Petition For Settlement
Pa PUC v. PGW, R-00017034

PHILADELPHIA GAS WORKS
800 West Montgomery Avenue
Philadelphia, PA 19122

November 2005

Updated June 2006

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I. BACKGROUND

Traditionally, the base rates of natural gas distribution companies (NGDCs) are established on a "weather normalized" basis, i.e., rates are set to permit the Company to earn at levels determined to be reasonable assuming that sales and revenues are at the levels the utility would experience if the level of experienced "Heating Degree Days" ("HDD") were at "normal" levels. Accordingly, when a year is colder or warmer than some determined "normal" level the NGDC typically earns more or less than the normalized amount, all other things being equal.

One way in which to balance out the effects of "abnormal" weather is by implementing a Weather Normalization Adjustment ("WNA") mechanism. The typical WNA permits the NGDC to true-up its revenues when experienced HDDs in a given period are less than a determined "normal" level. Correspondingly, when experienced HDDs exceed normal levels the utility adjusts its charges to provide a credit to customers. Importantly, the WNA does not result in a utility being able to earn more or realizing an earnings short-fall; it merely permits the utility to recover its authorized level of earnings and, for a cash flow regulated utility, the company's authorized level of liquidity.

As a result of experiencing a number of winters in which abnormal weather caused severe shortfalls in earnings and liquidity, PGW determined that the establishment of a WNA was a crucial requirement if the Company was to return to financial health in the long term.

Accordingly, PGW included a request to establish a WNA clause as part of its 2002 general base rate proceeding. On February 25, 2002, PGW submitted Supplement No. 17 to Tariff Gas - Pa. P.U.C. No. 1 to become effective for service rendered on or after April 26, 2002. This base rate filing sought to increase PGW's base rates by \$60 million and to implement a weather normalization adjustment clause ("WNA"). Prior to completion of the public hearings on the base rate request, the parties were able to reach a Settlement which resolved all issues

pertaining to PGW's base rate filing. As part of that settlement, PGW was permitted to implement its proposed WNA as soon as necessary systems modifications were complete. PGW agreed that the WNA would be put in place after consulting with the settling parties. PGW actually began to implement the adjustment clause as of December 1, 2002. In compliance with its settlement agreement, PGW provided consumer education to its customers to assist them in understanding the workings of the WNA.

The Settlement indicated that the WNA was being put in place for an initial three-year pilot period. At the conclusion of the three year period, the Company agreed to conduct a review of the costs and benefits of the WNA. After that evaluation, a determination was to be made as to whether the WNA will continue, continue with modifications, or be eliminated.

The Settlement was approved by the PUC in an order entered on August 2, 2002.

In presenting its proposal for a WNA, PGW's Craig White explained that the establishment of the Clause would have a number of benefits:

- i. stabilizes cash flow from year-to-year
- ii. can reduce the need for short-term borrowing from year-to-year
- iii. positively affect PGW's credit rating
- iv. reduces the need for costly base rate proceedings¹

Mr. White also pointed out that a WNA-type clause was particularly appropriate for a municipally owned utility, such as PGW:

I believe that PGW's municipal status makes a WNA particularly appropriate. Under the cash flow method of ratemaking, ratepayers provide revenues to cover the entire costs of service -- but only the cost of service. Any revenue shortfalls or windfalls ultimately inure to the ratepayers. The WNA simply minimizes

¹ *Pa PUC v. PGW*, R-00017034, PGW BRP St. 2 at 3.

the degree to which such shortfalls or windfalls occur. For a municipal utility that utilizes a WNA, ratepayers are assigned the same responsibilities or obtain the same benefits that they would without a WNA.²

In response to the Company's presentation, the OTS agreed with the Company's WNA proposal in principle:

I cannot agree with the Company's proposed WNA as filed. ... However, I agree in concept that a WNA clause would be reasonable only because PGW's rates are established using the cash flow method of ratemaking.³

OTS's witness Mr. Metro recommended approval of the WNA clause if several conditions were adopted by the PUC.⁴

OCA witness Thomas Catlin also indicated that a WNA clause would make sense for the PUC to approve for a municipal utility such as PGW:

Generally, a WNA clause would not be appropriate for an investor-owned utility where the costs of capital, especially equity capital, embodies compensation for the very risk that a WNA clause would attenuate. ... PGW is unique among gas distribution companies in Pennsylvania. PGW is the only gas distribution utility in Pennsylvania regulated by the Commission that is a municipal utility. Moreover, PGW operates on a cash basis according to statute, and it has no source of equity financing in the sense of a traditional investor-owned utility. The Company represents that its ability to borrow short-term is largely exhausted and it has virtually no remaining flexibility to address short-term margin losses.⁵

² Id. at 3-4.

³ R-00017034, OTS St. 4 at 10.

⁴ The conditions Mr. Metro recommended were: 1) the WNA be approved for a 3 year "trial" basis; 2) the Company provide tariff language that describes how the individual customer charge and middle of the month monthly bills will be calculated; and 3) the Company will not file for a rate increase until after June 1, 2005. Id. at 10-12.

⁵ R-00017034, OCA St. 3 at 3-4. OCA witness Catlin also recommended several refinements to the Company's proposal, including the filing of periodic reports on the

Accordingly, in evaluating the performance of the clause three years after its initiation PGW has focused on whether the WNA has provided the benefits anticipated and whether PGW's implementation has been otherwise reasonable.

II. PERFORMANCE OF CLAUSE

In the three years in which the WNA clause has been in place, PGW customers have remitted to PGW on net, approximately \$3.9 million.

Philadelphia Gas Works
Weather Normalization Clause

	<u>Fiscal Year</u>	<u>Fiscal Year</u>	<u>Fiscal Year</u>	<u>Fiscal Year</u>	
	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>	
SEP	- \$	5,837	\$ 1,093	2,492	
OCT	-	(293,666)	(171,486)	657,761	
NOV	-	1,744,403	(85,304)	799,667	
DEC	(3,094,912)	249,694	1,456,550	(1,991,219)	
JAN	183,378	(313,490)	2,349,557	4,778,258	
FEB	(4,952,755)	(4,584,777)	(791,197)	5,695,014	
MAR	(3,636,720)	2,384,882	(3,074,010)	(61,095)	
APR	1,334,999	(111,428)	(9,860)	2,342,224	
MAY	107,459	2,035,759	(462,910)	1,024,782	MAY 2006 = ESTIMATE
JUN	8,492	1,039,386	(568,422)		
JUL	11,133	2,828	(11,583)		
AUG	9,590	(50,881)	2,410		
TOTAL	\$ (10,029,336)	\$ 2,108,547	\$ (1,365,162)	\$ 13,247,883	\$ 3,961,932

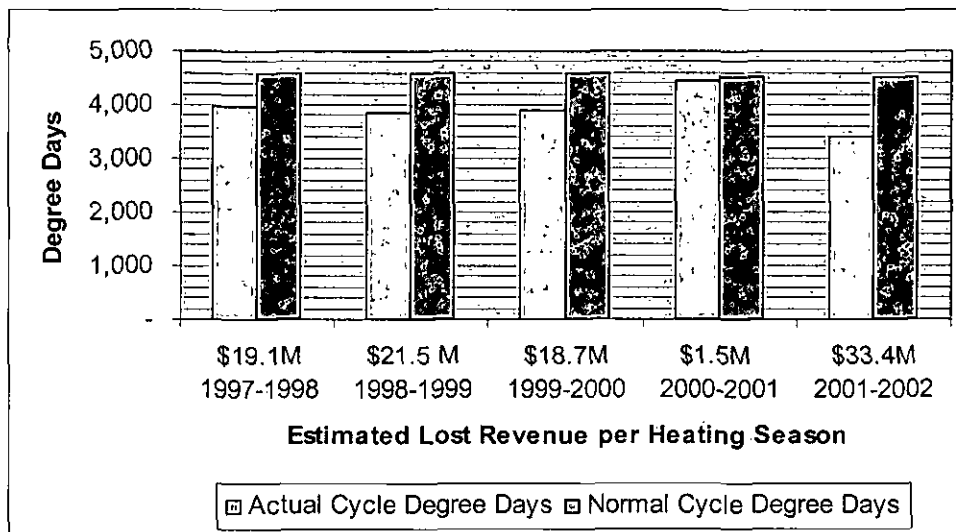
Updated June 2006

clause, the establishment of the clause on a 3 year pilot basis, consumer education on the clause and an evaluation of the appropriateness of the 1% plus or minus deadband after actual experience is obtained.

III. ASSESSMENT OF CLAUSE PERFORMANCE

A. Affect on PGW Financial Position

The WNA has had a very positive effect upon the way in which PGW has been viewed by the financial community. The principal reason for this is that the existence of the WNA has eliminated the effect of weather on earnings and cash flow. Prior to the establishment of PGW's WNA, the Company experienced substantial shortfalls in earnings and cash flow as a result of successive warmer than normal winters. The following chart illustrates PGW's historical experience:



These weather related reductions in earnings and cash flow decimated PGW's already precarious financial position and threatened the Company's ability successfully to issue additional long term debt, the firm's only available source of external capital. In fact, it is estimated that during the five fiscal years ending August 31, 2002, PGW experienced

approximately \$94 million in lost revenue due to higher than normal temperatures. As a result, PGW was downgraded to the lowest investment grade and was required to pay extremely high effective interest rates in order to obtain the long term financing on which it relies to maintain its capital improvement program. It was also forced to obtain a series of base rate increases (including a \$36 million emergency rate increase) in order to "weather" the storm.

With the implementation of the WNA, PGW has not filed any additional base rate cases and, while many other factors have continued to keep the Company in a challenging financial position, the investment community has recognized that PGW's earnings and cash flow are now uniquely insulated from the vagaries of weather. Both Standard & Poor's ("S & P") and Moody's continue to cite the WNA as a positive factor. In fact, both rating agencies have discussed the WNA in some of their most recently issued reports. In May 2005, S & P reiterated that "[a]nother indication of regulatory support involves the PUC's relatively recent approval of a weather normalization adjustment for PGW – the first such allowance to a gas utility in Pennsylvania. The WNA enables PGW to smooth out fluctuations in margin revenue due to abnormal weather in winter months."⁶ Again, on August 30, 2005, in a report in which S & P affirmed PGW's bond rating as the lowest investment grade rating and affirmed a negative outlook, S & P stated: "The current rating assumes that the company will continue to have access to its WNA. Although poor collections exacerbate liquidity problems in colder-than-normal years (as total customer bills increase), the WNA keeps distribution revenues from dropping precipitously in years with warmer-than-normal winters."⁷ Likewise, Moody's has clearly expressed that "[p]rior to the natural gas price spike in 2003 PGW has implemented several

⁶ Standard & Poor's Full Report (May 19, 2005).

⁷ Standard & Poor's Full Report (August 30, 2005).

changes that were to be key to improved financial performance. PGW ... was granted a Weather Normalization Adjustment, to normalize the impact of changes in weather on cash flow.”⁸

Additionally, Fitch Ratings favorably commented on the WNA after its approval. When discussing rating considerations, Fitch reported that the “rating considers management’s continued focus on cost control, steady albeit slow improvement in customer collections, and recent rate modifications that have provided some stability to cash flow...”⁹ The rate modifications were described later in the report as permanent base rate relief of \$70 million, as well as the ability to levy a WNA for warmer than normal years.”¹⁰

B. Effect on Customers

The WNA clause has been well accepted by PGW customers. Since its inception, PGW has had an extremely small number of complaints. The Clause has been calculated without any errors or revisions being necessary.

C. WNA Billing

PGW's WNA formula used to apply the clause works as it was intended. In order to demonstrate this, PGW sampled all rate classes to which the WNA was applied¹¹ for the month of March 2005. March 2005 was selected because it was the month during which the

⁸ Moody’s Report (September 28, 2004).

⁹ Fitch Ratings Report, p. 2 (December 18, 2002).

¹⁰ *Id.*

¹¹ GS, MS and PHA.

largest credit was issued during the 2004-2005 fiscal year. After selecting a sample size¹² from each rate class, the WNA applied to each selected invoice was recalculated and no exceptions were identified. PGW's conclusion is that algorithms and billing systems used to calculate the WNA are accurate and reliable.

IV. WORKSHOPS

PGW held two telephonic workshops with the Office of the Trial Staff (“OTS”), the Office of the Consumer Advocate (“OCA”), the Office of the Small Business Advocate (“OSBA”), and the Philadelphia Industrial and Commercial Users Group (“PICGUG”) (collectively the “Parties”) on August 30 and September 15, 2005 in order to discuss draft forms of this report and exchange information. PGW and the Parties discussed many issues, the more prominent of which follow.

A. WNA Deadband

At least one of the workshop participants asked that PGW provide an analysis of the pros and cons of modifying the existing deadband, currently set at 1%. Based upon total residential heating season sales (10/1 to 5/31) of 36 Bcf, each increase of the deadband by 1% shows a correlating decrease in the total heating season surcharge or credit of \$1.5M. For example, when 36 Bcf is used as baseline residential heating season sales which are then adjusted for 5% warmer or colder weather, the resulting surcharge/credit is \$6,050,000 using a 1% deadband. The increase of the deadband to 2%, 3%, 4% and 5% results in surcharges/credits of \$4,550,000, \$3,030,000, \$1,520,000 and \$0, respectively. The same incremental change of

¹² Three populations (i.e. March 2005 GS, MS and PHA invoices) were sampled based upon a 95% confidence level and a confidence interval of plus or minus 5%.

approximately \$1.5M per 1% occurs even if the temperature variance is less than 5% warmer/colder or greater than 5% warmer/colder.

The rating agencies have clearly indicated that they rely upon the WNA to be a risk mitigating tool, therefore, an increase of the deadband beyond 1% will diminish the effect of the WNA as a risk mitigating tool. After discussing PGW's analysis and the independent analyses prepared by another party, it was agreed that the deadband at 1% should be maintained.

B. WNA Audit

PGW and the parties agreed that it would be appropriate to conduct annual audits of the WNA. Accordingly, it was agreed that PGW's internal audit department will annually audit the WNA by selecting a sample from invoices issued during the month in which the highest total monthly surcharge or credit was applied to customers' invoices. The surcharge or credit for the selected invoices will be recalculated. All procedures will be documented and all data will be saved for a period of six months after the completion of the audit. The results of the annual audit will be provided to the Parties. The Parties will have the right to address any negative audit findings in the appropriate forum(s).

C. Change in Ownership of PGW

OTS wanted to address the question of the continuation of the clause in the event that PGW was sold to or transferred into an investor owned utility. Accordingly, it was agreed that if PGW is purchased by, or otherwise transferred to an investor owned utility or should become an investor owned utility, PGW agrees that such successor entity may no longer utilize the WNA Clause unless the Commission upon petition by the purchasing IOU in the transfer

application proceeding or otherwise authorizes the establishment of a WNA for the successor entity.

V. PGW CONCLUSIONS REGARDING THE WNA

While PGW continues to struggle under the weight of a variety of systemic (i.e. historically high natural gas prices) and idiosyncratic (high uncollectibles and low but improving cash receipts percentages) PGW's financial health would be far worse without the WNA Clause. There is no question that it can and must continue. PGW intends to continue the clause to obtain the needed benefits for the Company, its employees and, most importantly, its customers.

Attachment B

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00017034

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JOINT PETITION FOR SETTLEMENT OF
PHILADELPHIA GAS WORKS'
BASE RATE PROCEEDING

TO ADMINISTRATION LAW JUDGE CYNTHIA WILLIAMS FORDHAM:

I. INTRODUCTION

Philadelphia Gas Works ("PGW"), the Commission's Office of Trial Staff ("OTS"), the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), and the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG") (collectively "the Joint Petitioners"),¹ hereby submit this Joint Petition for Settlement of Philadelphia Gas Works' Base Rate Proceeding as captioned above and respectfully request the following:

1. That Administrative Law Judge ("ALJ") Cynthia Williams Fordham recommend and the Commission approve this Settlement and all of its terms and conditions.²

¹ The Consumers Education and Protective Association ("CEPA"), the Association of Community Organizations for Reform Now ("ACORN"), the Tenants Action Group ("TAG") and Action Alliance of Senior Citizens of Greater Philadelphia ("Action Alliance") (collectively "CEPA, et al."), who have participated jointly in this proceeding, the Service Employees International Union, Local 686, and PECO Energy Company are not participating in this Settlement, but have reviewed the Settlement and have informed the Joint Petitioners that they do not oppose the Settlement. Attached as Appendices "A" and "B," respectively, are letters of non-opposition executed by CEPA, et al, and the Service Employees International Union, Local 686.

² Attached hereto as Appendix "C" are Statements in Support submitted by OTS, OCA and PGW.

1. Base Rates. PGW shall be permitted an increase in rates equal to its existing \$36 million extraordinary rate award placed into effect in accordance with the PUC's Extraordinary Rate Order (entered April 12, 2002) on April 16, 2002.

2. The \$36 million settlement award is the result of a compromise and does not reflect or constitute the recovery of any individual expense claim or revenue assumption contained in PGW's pro forma test year filing.

3. PGW is specifically permitted to request recovery of all of the incremental costs for meter change out, gas leak survey, and safety training in its restructuring proceeding. The Joint Petitioners retain the right to argue that these costs are not incremental or that rates in effect are sufficient to cover these costs. The Joint Petitioners will not argue that these costs were specifically included in the \$36 million awarded pursuant to this Settlement or that these costs are not restructuring costs.

4. Rate Structure. The existing distribution of the extraordinary rate increase approved by the Commission in its April 12, 2002, Order will remain in effect.

5. Weather Normalization Adjustment Clause. In consideration of the agreements in this Settlement, PGW will be permitted to implement its proposed Weather Normalization Adjustment Clause (WNA) as soon as systems modifications are available.

(a) PGW will hold workshops in which all interested parties can participate where PGW will provide detailed information about systems modifications and where implementation procedures and consumer education plans will be developed. The final product of the workshop will be submitted to the Commission for review and approval. Any issues that cannot be resolved in the workshop will be submitted to the Commission for disposition.

Notwithstanding the above, the parties agree that PGW will be permitted to implement the WNA

for the 2002-03 winter heating season if systems modifications are available. Absent completion of the workshop and Commission approval by August 15, 2002, PGW will be permitted to implement the WNA as proposed with an effective date no sooner than October 1, 2002 and no later than December 1, 2002. Any subsequent changes required by the Commission will be implemented as soon as practicable.

(b) PGW will provide all consumer education materials and information and billing formats to the OCA, OTS, OSBA, all other interested parties, and the appropriate Commission staff for review and comment. Materials should be provided no less than two weeks before the Company anticipates that the materials must be in final form.

(c) The WNA will be put in place for an initial three-year pilot period. At the conclusion of the three year period, the Company will conduct a review of the costs and benefits of the WNA. A determination will be made at the end of the review as to whether the WNA will continue, continue with modifications, or be eliminated.

(d) PGW and the interested parties to the workshops will address tariff issues regarding the treatment of customers whose billing cycle falls outside of the October 1 to May 31 time frame as well the base load calculation for new customers.

6. Short Term Debt Paydowns. PGW will project the amount of annual short term debt pay down (commercial paper) that the agreed to revenue requirement will permit, will provide the basis for its projections, and will agree to meet those projections or explain why it cannot in a yearly report to the Joint Petitioners.

7. Withdrawal of Appeals. PGW will limit its appeal of the Commission's October 4, 2001 and December 6, 2001 Orders to the rate structure issue of PGW being required by the Commission to allocate a portion of its rate award to the municipal rate class, MUN/MS.

Attachment C

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

WEATHER NORMALIZATION ADJUSTMENT CLAUSEProvision For Adjustment

The Weather Normalization Adjustment shall be applied to each Mcf (1,000 cubic feet) used for heating purposes under Rate Schedules GS, MS, and PHA ("heating" and "heating only" customers), except for Gas usage under the Special Provisions – Air Conditioning of those rates. The Weather Normalization Adjustment will be applied to customer usage during the period of October 1 through May 31 of each year for each billing cycle (except for the 2002-2003 heating season when the Weather Normalization Adjustment will be applied to customer invoices rendered during the period of December 1 through May 31 of each year for each billing cycle).

Computation of Weather Normalization Adjustment

The Weather Normalization Adjustment surcharge or credit shall be computed to the nearest one-hundredth cent (0.01cent) in accordance with the formulas set forth below:

$$HL = TU - (BL * BC)$$

$$WNA = DC * [(HL * \frac{NHDD +/- (NHDD * 1\%)}{AHDD}) - HL]$$

Definitions

TU – Total Usage for the billing cycle. TU measured in Mcf.

BL – base load Mcf per billing day is the number of Mcf per Customer used per day for non-heating purposes based on usage by Customers to which this adjustment applies. It is determined separately for each individual customer and will be revised annually to reflect the non-temperature sensitive usage of Customers to which the adjustment applies reflected in the prior heating season's sales. If an individual customer base load is not available, the base load for the related customer class will be applied.

BC – billing cycle is the actual number of days shown on the bill that the Customer receives for service.

DC – Delivery Charge.

NHDD – normal heating degree days for any given calendar day within a month are based on the thirty year average for the given calendar day based on the thirty year period ended August 31, 2001. The NHDD provided for in the formula are the total number of NHDD for the billing cycle. The degree day data is provided by the National Weather Service and measured at the Philadelphia International Airport.

AHDD – actual experienced heating degree days for the billing cycle. The degree day data is provided by the National Weather Service and measured at the Philadelphia International Airport.

Operation of Weather Normalization Adjustment

The Weather Normalization Adjustment will be applied to a Customer's bill on a cents per Mcf basis when actual heating degree days vary from normal heating degree days during the period for which the Customer is billed. The Weather Normalization Adjustment will be applied to the Customer's space heating consumption except for air conditioning usage billed under the air conditioning rate. The Weather

Normalization Adjustment for a billing cycle will apply only if the actual heating degree days (AHDD) for the billing cycle are lower than 99 percent or higher than 101 percent of the normal heating degree days (NHDD) for the billing cycle and will only apply to the extent that the variation is lower than 99 percent or higher than 101 percent of the normal heating degree days for that billing cycle. A new weather adjustment will be calculated for each billing cycle.

Under the formulas, the Weather Normalization Adjustment surcharge or credit is calculated by:

- 1) Normal HDD are calculated for each day of the fiscal year based upon the thirty year average for the thirty year period ended August 31, 2001.
- 2) At the start of the fiscal year, an average daily base load (non-heating) usage is calculated for each individual customer based upon actual base load usage.
- 3) The average daily base load (non-heating) amount is multiplied by the number of days in the billing cycle.
- 4) The total billing cycle base load amount is subtracted from the actual cycle usage of the customer in order to derive the usage applicable to heating.
- 5) The WNA factor is multiplied times the heating usage in order to derive the normalized heating usage.
 - a) The WNA factor is calculated by first adjusting the Normal HDD (NHDD) for the billing cycle by the deadband percentage (1 %). The deadband percentage is multiplied by the NHDD and then added to NHDD for the billing period when the weather is colder than normal (i.e., AHDD > NHDD) or subtracted from NHDD for the billing period when the weather is warmer than normal (i.e., AHDD < NHDD).
 - b) The adjusted NHDD are then divided by the AHDD.
- 6) The actual heating usage is subtracted from the normalized heating usage and then multiplied by the delivery charge. The result is a surcharge or credit.

Reporting Requirements

The Company will file all Weather Normalization Adjustments with the Commission on an annual basis.