

COMMONWEALTH OF PENNSYLVANIA



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James J. McNulty, Secretary  
PA Public Utility Commission  
Room B-20, North Office Bldg.  
P.O. Box 3265  
Harrisburg, PA 17105-3265

Re: Pa. Public Utility Commission  
v.  
Philadelphia Gas Works  
Docket No. R-00005654

Dear Secretary McNulty:

Enclosed for filing please find an original and 9 (nine) copies of the Main Brief of the Office of Consumer Advocate in the above-referenced proceeding.

Copies of this document have been served upon all parties as evidenced by the attached Certificate of Service.

Sincerely yours,

Stephen J. Keene  
Assistant Consumer Advocate

Enclosure

cc: All parties of record  
Hon. Marlane Chestnut, Administrative Law Judge

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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PENNSYLVANIA PUBLIC UTILITY  
COMMISSION :

v. :

Docket No. R-00005654

PHILADELPHIA GAS WORKS :  
(Interm Base Rate Proceeding) :

OFFICE OF CONSUMER ADVOCATE'S  
MAIN BRIEF

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## I. INTRODUCTION

This is the first proceeding before the Pennsylvania Public Utility Commission ("Commission") involving the Philadelphia Gas Works ("PGW" or "Company"). On July 1, 2000, pursuant to The Natural Gas Choice and Competition Act ("Act"), the Commission assumed jurisdiction over the public utility service being offered by PGW within the City of Philadelphia. 66 Pa.C.S. §2212. Prior to passage of the Act, PGW's rates, terms and conditions of service were exempt from the jurisdiction, regulation and control of the Commission. Instead, PGW was regulated by the Philadelphia Gas Commission, a local agency of the City provided for by the Philadelphia Home Rule Charter. 351 Pa.Code §§3.3-100, 3.3-909, 5.5-902.

On August 8, 2000, PGW filed a Petition with the Commission for Establishment of Interim Rates Procedures and for a Declaratory Order ("PGW Petition for Interim Rates Procedures"). In its Petition, PGW requested that the Commission establish an expedited hearing schedule on PGW's request for an interim rate increase of \$52 million. The Petition requested a Commission decision no later than the November 8, 2000 Public Meeting so that the new rates could go into effect no later than November 15, 2000. PGW Petition for Interim Rates Procedure ¶1. The Petition also sought a declaratory order limiting the scope of the expedited proceeding. On August 17, 2000, the Commission entered an Order ("August 17 Order") which granted PGW's request for an expedited proceeding to establish interim rates subject to certain conditions. However, the Commission rejected PGW's request for a declaratory order limiting the scope of the expedited proceeding and stated that it would allow the parties to present all relevant

issues to the Commission for consideration during the expedited review process. August 17 Order at 10.

The OCA filed a Formal Complaint on August 22, 2000. On August 24, 2000, PGW submitted testimony and information in support of its request for an interim rate increase of \$52 million. A Prehearing Conference was held before Administrative Law Judge Marlane R. Chestnut in Philadelphia on August 25, 2000. Pursuant to the procedural schedule established at the Prehearing Conference, the OCA submitted the Direct Testimony of Richard W. LeLash on September 18, 2000. The Company submitted the Rebuttal Testimony of Thomas E. Knudsen on September 25, 2000. Public Input Hearings were held in Philadelphia on September 26 and 29, 2000. Evidentiary Hearings were held on September 27-28, 2000.

Although this is the first case PGW has filed at the Commission, it comes to the Commission in an unusual manner – a request for expedited, interim rate relief. In other words, the Company has brought an emergency request to avoid a financial crisis to the Commission within six weeks of the Commission assuming jurisdiction. The emergency that PGW confronts is substantially of the Company's own making. PGW has had years to address base rate concerns that it now requests the Commission and parties in this proceeding to address in less than three months. This is a crisis long in the making. It comes after three successive warmer than normal winters which impacted the Company's revenues. It comes after lengthy problems with the Company's billing system which resulted in customers going months without being billed. And it comes at a time of unprecedented increases in natural gas costs.

PGW has not filed for a base rate increase since 1992, despite its own claim that the financial condition of the Company has eroded significantly since then, due to inflation, three consecutive warm winters and a dramatic increase in the level of long-term debt. Petition for Interim Rates Procedures ¶16. As Chairman Quain noted in his Statement approving the establishment of interim rate proceedings:

It is important to point out, however, that the Natural Gas Choice and Competition Act was passed in June 1999, conferring jurisdiction of PGW to the Public Utility Commission on July 1, 2000. During the interim year, PGW had the opportunity to take the necessary steps before the Philadelphia Gas Commission to ensure a healthy financial condition for the year 2000-2001, but chose not to do so.

Statement of Chairman John M. Quain of August 17, 2000. In fact, the Company admitted that if it had filed a base rate case in 1999, it would have had more cash on hand at the end of the fiscal year ending August 31, 2000, would have more flexibility with its finances, and would not be facing the financial crisis that it faces today. Tr. at 138, 156.

Instead, the Company waited until June 19, 2000, only 11 days before the change in jurisdiction, to bring a request for rate relief to the Philadelphia Gas Commission, which then effectively transferred the case to the Pennsylvania Public Utility Commission. The OCA submits that ratepayers should not be caused to suffer a dramatic increase in base rates at the same time they are confronted with unprecedented increases in the Gas Cost Rate ("GCR") due to increases in the cost of gas supplies, particularly with such limited time for review of the Company and the pending completion of the Commission's management audit. The \$52 million interim rate

increase which PGW seeks, along with the \$97 million increase in the Company's GCR, would place an extraordinary burden on the Company's ratepayers. The interim rate increase represents an increase in base rates of approximately 10% in addition to the requested 20% increase in the GCR, or a total increase in rates of 30%. It is also important to note that the \$97 million GCR increase may grow larger due to increasing prices of natural gas supply since the Company made its initial GCR filing. The Company presented updated gas cost projections in its rebuttal case in the GCR proceeding which suggest that it might request a potential additional increase in the GCR of up to \$75 million. Thus, the \$97 million GCR increase currently requested could rise as high as \$172 million. The OCA submits that a large interim base rate increase at a time of soaring GCR rates will result in rate shock and rates which are unaffordable for many of PGW's ratepayers.

The real task at hand given these extraordinary circumstances is to reach a proper balance where all stakeholders contribute to addressing the immediate and most urgent needs of the Company. The OCA has reviewed the Company's claims and the applicable legal standards and has developed a recommendation that strikes such a balance. Given the circumstances, the OCA recommends that the Company be allowed to increase base rates by up to \$25 million subject to certain conditions. The OCA's proposal would provide enough revenue for the Company to meet its bond coverages, go forward with scheduled capital projects, and allow for necessary financing in Spring 2000. Additionally, if the City, as owner of the utility, contributes to the Company as well, the Company would be provided sufficient cash as a backstop to meet any

unexpected needs and to be in a position to resolve its long-term financial problems following its full base rate review.

The interim rate relief granted in this proceeding does *not* have to be at a level which would allow the Company to have a year-end cash balance at the end of August 2001 of \$35-40 million as suggested by the Company. The Commission should not allow cash flow and working capital to be the basis for base rate relief in this interim proceeding. Moreover, the interim rate relief granted must not ignore the need for the City to contribute to resolving this fiscal crisis. Instead, the interim base rate increase should only be enough to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season. August 17 Order at 7. If PGW has additional cash requirements to meet, it should seek assistance from the City through either a loan or temporary advance from the City or a waiver of the \$18 million payment from PGW. If the City does not waive the payment, then it should return the \$18 million to PGW as a grant of project revenues if the Company wishes to improve its debt coverage and cash position.

Under these circumstances, and with certain conditions, the OCA submits that a maximum interim base rate increase of \$25 million at this time would fully satisfy PGW's needs until a full base rate case and the Commission's management audit can be completed. Importantly, the OCA's recommendation in this proceeding recognizes and requires all stakeholders to contribute to managing the current financial crisis.

Any interim rate relief granted must be subject to certain conditions so that basic protections are afforded ratepayers as a result of this interim rate procedure. The first set of conditions are set forth in the Commission's August 17 Order:

- PGW must file a full base rate case with the Commission on or before January 1, 2001;
- any interim rates ultimately granted are subject to refund at the conclusion of a full base rate case if the Commission determines that a lower level of rates is just and reasonable;
- PGW will not seek to recoup additional revenues from ratepayers if the Commission ultimately determines that a higher level of rates is just and reasonable;
- PGW will commit to its "Transition to Excellence" plan for improvement and a demonstration throughout the interim rate period that it is providing safe and adequate service.

August 17 Order at 11.

In addition, the OCA submits that as a prerequisite to any interim rate increase certain other conditions should be satisfied to ensure that the Company provides safe and adequate service during the interim period. The OCA would note that through the public input process, and from a review of evaluations conducted on behalf of PGW, it is clear that the quality of PGW's service must be improved. Under the Public Utility Code, the Commission has full authority and indeed must consider quality of service when considering rates. This Commission has often addressed the need for service quality improvements when determining whether base rate relief should be granted.

Based on the record in this proceeding, the OCA submits that additional conditions are necessary if any interim base rate relief is granted. First, the Company should be required to achieve a 1% replacement rate in its mains replacement program as provided for in the Company's base case capital budget. Second, the Company should

commit to correcting the problems with its Billing, Collection and Customer Service System ("BCCS") and provide periodic reports to the Commission's Bureau of Consumer Services ("BCS") of the progress it is making in correcting the BCCS problems. Special efforts must be made to ensure that customers are able to exercise a budget billing option during this period of rapid gas cost increases. Third, the Company should proceed with its Liquefied Natural Gas ("LNG") Liquefaction Replacement Program to ensure that PGW's system supply and reliability are maintained. Finally, PGW must show improvement in its customer service functions and file periodic reports with BCS of its progress.

The OCA submits that its recommendation of interim base rate relief of up to \$25 million, subject to certain conditions set forth herein, strikes a reasonable balance. It requires all stakeholders to meaningfully contribute to the management of this financial crisis until such time as full base rate review and the Commission's management audit are completed. Most important, it seeks to minimize the burden on ratepayers during this time of skyrocketing natural gas costs.

## II. LEGAL STANDARD

### A. The Current Interim Proceeding Is Made Possible By Section 2212(d), But Is More Akin To Extraordinary Rate Relief Under Section 1308(e).

#### 1. Introduction.

In its Petition dated August 8, 2000, the Company proposed that the "Commission utilize the authority provided by Section 2212 of the Code to consider the establishment of 'interim rates' for the Company. See PGW Petition for Interim Rates Procedures ¶27. There is no reference to "interim rates" in Chapter 22 of the Public Utility Code. Nor is there any specific provision of Chapter 13 that allows the type of interim rate relief requested by PGW in this proceeding. The relevant portion of Section 2212 reads as follows:

Nothing contained in this section shall prevent a city natural gas distribution operation from requesting or, if so requested, the commission from approving modifications to the prior tariff at any time prior to the effective date of the final order approving the restructuring plan and new tariff.

66 Pa.C.S. §2212(d).

In this case, the Company requests a unique procedure from the Commission to modify the rates contained in its Tariff. In granting the City's request for an expedited hearing schedule to establish interim rates, the Commission recognized this unique procedure and set forth certain standards for the consideration of this request. The Commission stated:

While it would clearly be inappropriate for the Commission to comment at this time on the merits of PGW's request for interim rate relief, suffice it to say that PGW must present substantial evidence to support its assertion that an interim

rate increase is necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season until the Commission can conduct and rule on a full base rate proceeding. In particular, PGW must present substantial evidence to support its assertion that an interim rate increase is necessary for PGW to comply with its covenants to the holders of any approved bonds.

August 17 Order at 7. The Commission continued:

... our approval of an expedited interim rate "process" in no way lessens PGW's obligations to meet the requisite burden of proof to substantiate the need for an increase of any dollar amount ... our approval is conditioned upon the Company's commitment to its "Transitioning to Excellence" plan for improvement and a demonstration throughout the interim rate period that it is providing safe and adequate service.

Id. at 8.

The OCA submits that the requirements set forth above by the Commission are more similar to those set forth in Section 1308(e) of the Public Utility Code, than to any other ratemaking provisions. Section 1308(e) of the Public Utility Code addresses extraordinary rate relief. Specifically, the pertinent provision reads:

... any public utility may seek extraordinary rate relief of such portion of the total rate relief requested as can be shown to be *immediately necessary for the maintenance of financial stability in order to enable the utility to continue providing normal services to its customers, avoid reductions in its normal maintenance programs, avoid substantially reducing its employment*, and which will provide no more than the rate of return on the utility's common equity established by the commission in consideration of the utility's preceding rate filing ...

66 Pa.C.S. §1308(e) (emphasis added). As can be seen, the Commission's August 17 Order reflects some of the requirements of Section 1308(e). That is, the Commission has tied the granting of the PGW interim rate increase to a showing that such an increase is "necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season ..."

August 17 Order at 7. Lacking any other relevant precedent for the "interim" rate increase requested by PGW, the OCA submits that, in reviewing the record of this proceeding, the Commission should carefully consider the nature of this proceeding and should be guided by the key principles that have been employed in reviewing requests for extraordinary rate relief. Although not directly applicable, the OCA submits that these principles are instructive and provide relevant guidance in this unusual proceeding.

2. The Commission's Cases On Extraordinary Rate Relief Are Instructive When Considering The Company's Request For Interim Rate Relief.

As noted above, the OCA submits that the Commission's cases addressing extraordinary rate relief under Section 1308(e) provide relevant and instructive guidance in the consideration of the Company's interim request. The award of emergency rate relief under Section 1308(e) requires the utility to meet a stringent burden as to need, cannot be based on speculation or conjecture, and is carefully tailored based on the underlying facts.

After the accident at Three Mile Island, Metropolitan Edison ("Met-Ed") sought an increase of \$76.5 million in its retail base rates. Pa.P.U.C. v. Metropolitan

Edison Co., P-80070235 (Order entered August 28, 1980)(Met-Ed). As to \$35 million of the \$76.5 million, Met-Ed sought expedited implementation under Section 1308(e), *i.e.*, base rates would be increased by this amount prior to the Commission's final determination on the overall \$76.5 million. Id. at 1. In setting forth the purpose of Section 1308(e), the Commission in Met-Ed stated:

In our opinion, the purpose of Section 1308(e) is to assure adequate and continuous service to utility customers and to prevent interruptions thereof due to the financial instability of the utility.

Id. at 5. As to the burden of proof, the Commission held that Met-Ed bore a heavy burden and had to provide strong evidence that the financial stability of the Company was in jeopardy. Id. at 6. The Commission further held that it could not grant an award for such relief on speculation or conjecture. Id. Based on the evidence before it, the Commission denied Met-Ed's request for extraordinary rate relief on the premise that Met-Ed had not satisfied the requirements of Sections 1308(e). Met-Ed at 7.

As previously set forth, in its August 17 Order in the present case, the Commission stated that "PGW must present substantial evidence to support its assertion that an interim rate increase is necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season". August 17 Order at 7. This burden imposed by the Commission is quite similar to that of Section 1308(e) as expounded upon in Met-Ed. Prior to awarding any relief to PGW in the instant proceeding, the Commission must ensure that this burden has been met.

The Commission's decision in Met-Ed also stated that extraordinary rate relief cannot be based on speculation or conjecture. Met-Ed at 6. Therefore, PGW's speculations regarding potential future events, without more, should not be relied upon to form the basis of interim rate relief.

As to utilization of any funds awarded by the Commission as extraordinary rate relief, the Commission in the Met-Ed case made it clear that it will not write a "blank check." Met-Ed at 16. The Commission stated that the Company witnesses in Met-Ed were "unable or reluctant to identify the specific needs for, or the intended use of, the requested \$35 million interim rate increase." Id. For purposes of this proceeding, if the Commission determines that PGW is in need of interim relief, the Commission must ensure that specific needs have been established and plans have been identified for the use of the awarded revenues.

Finally, in the Met-Ed case the Commission made it clear that it expected all "involved" parties to share the burden in rehabilitating the company. Met-Ed at 6. Although the Commission denied extraordinary rate relief to Met-Ed, it made the point that in a prior order, it had provided Met-Ed with sufficient revenues to "rehabilitate itself" in the eyes of its bank creditors. Id. Therefore, if the Commission is to award PGW any extraordinary interim rate relief, it should be assumed that other involved parties, including the City of Philadelphia as PGW's owner, will assist in this rehabilitation.

Based on the above, the OCA submits that the following principles should form the basis of any award for interim relief: (1) Commission satisfaction that PGW has

met its burden in establishing that the Company requires relief to maintain financial stability, (2) Commission refusal to consider speculation and conjecture, (3) Commission satisfaction that the Company has identified specific needs for revenue and concise plans for use of the funds and (4) consideration of the ability of other involved parties to take part in assisting the Company through the upcoming winter.

Additionally, in determining whether the interim rates are just and reasonable, the Commission must consider whether safe and adequate service is being provided by PGW.

**III. THE OCA'S RECOMMENDATION SATISFIES THE STANDARDS FOR INTERIM RATE RELIEF SET FORTH IN THE COMMISSION'S AUGUST 17 ORDER AND STRIKES A REASONABLE BALANCE.**

A. Introduction.

The OCA submits that it is important not to lose sight of the fact that the need for interim rate relief is substantially of the Company's own making. In contrast to PGW's recent GCR filing, which was primarily the result of unanticipated spikes in natural gas prices on a national basis, PGW has had years to address the base rate concerns that it is now giving the Commission less than three months to resolve. PGW has not sought a base rate increase since 1992, even though the Company states that "the financial condition of the Company [has] eroded very significantly since then because of inflation, three consecutive warm winters and a dramatic increase in the level of long-term debt." See PGW Petition for Interim Rates Procedures ¶16. Although PGW's current management team only took control in March of 2000, PGW itself has been on

notice for more than a year -- since the passage of the Natural Gas Choice and Competition Act on June 22, 1999 -- that it would become subject to the Commission's jurisdiction on July 1, 2000. Nevertheless, the Company waited until June 19, 2000, only 11 days before the change in jurisdiction, to bring its request for rate relief to the Philadelphia Gas Commission. Even after the change to Commission jurisdiction, the Company waited nearly six weeks before filing its Petition for an expedited proceeding. The Company then sought a base rate increase of \$52 million which would provide it debt service coverages of 2.73x on 1975 bonds and 2.76x on 1998 bonds, and a cash reserve of \$35-40 million at the end of the fiscal year ending August 31, 2001.

In reviewing the Company's request, the OCA sought to determine the level of interim rate relief needed to maintain the Company's financial health, meet debt service requirements, and provide safe and adequate service. The OCA has not sought to resolve all of the Company's financial problems in this interim proceeding. The OCA's proposal, however, will better position the Company to address long term financial problems in the context of a full base rate review. Importantly, the OCA's proposal refrains from placing the burden of correcting all of the problems caused by past failure solely on PGW's customers.

After a review of the discovery and testimony, OCA witness Richard LeLash recommended that PGW be permitted to increase its base rates by up to \$25 million, subject to certain conditions, on an interim basis.<sup>1</sup> This level of interim base rate

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<sup>1</sup> Mr. LeLash is an independent financial and regulatory consultant. Prior to becoming an independent consultant, he was a principal with the Georgetown Consulting Group for twenty years. He has testified on cost of service, rate of return, and regulatory

increase would allow the Company to meet its debt service coverage with coverages of 2.01x on its 1975 bonds and 1.50x on its 1998 bonds. Additionally, the Company would end the fiscal year with \$11.2 million in cash. If the Company wishes additional cash prior to full base rate review, it should seek support from its owner, the City of Philadelphia.

B. The OCA Recommends That The Company Be Permitted An Interim Base Rate Increase Of No More Than \$25 Million.

1. The OCA's Recommendation Provides PGW With Adequate Debt Service Coverage And Positive Year-Ending Cash Balances On A Going-Forward Basis.

Starting from the Company's base case, the OCA conducted an analysis to determine the level of rate increase required by the Company to meet its debt service coverage requirements. In his Direct Testimony, OCA witness LeLash determined that an interim base rate increase of \$7.5 million would allow the Company, under normal weather conditions, to meet its coverage requirements. OCA St. 1 at 33-34. After reviewing the Company's Rebuttal Testimony and recognizing the upward pressure on uncollectible expense caused by increasing natural gas prices and recognizing the aggressive nature of the Company's productivity savings projections, OCA witness

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policy issues in more than 200 regulatory proceedings before the Philadelphia Gas Commission, the Federal Energy Regulatory Commission, the Pennsylvania Public Utility Commission and the commissions in numerous other states. Mr. LeLash has also participated and provided testimony on behalf of the Philadelphia Public Advocate in all of PGW's Gas Cost Rate (GCR) proceedings and in other related matters since 1990. A complete description of Mr. LeLash's background and experience can be found on pages 1-5 of his Direct Testimony and the Appendix attached thereto. OCA St. 1.

LeLash concluded that the Company would need up to \$25 million in interim base rate relief. Tr. at 230. With an interim rate increase of up to \$25 million, the Company's debt service coverage would be 2.01x on its 1975 bonds and 1.50x on its 1998 bonds and it would have a year end cash balance of \$11.2 million. OCA Sch. 2.1. If the City contributes to resolving the Company's financial problems with a return of the \$18 million City payment to PGW in the form of a grant of project revenues, the debt service coverage would be 2.36x on its 1975 bonds and 2.11x on its 1998 bonds and the Company would end the year with \$29.4 million in cash. OCA Sch. 3.1. The OCA's proposal recognizes a temporary advance from the City of \$20 million and recovery of the \$97 million increase in the Company's GCR which it has requested.

As the OCA stated at the outset, the current financial crisis PGW faces is largely of its own making. The Company and its owner's failure to recognize the deteriorating financial condition of the Company has left it in this position. Now that the Company claims it is on the brink of financial disaster -- and in its first rate proceeding before the Public Utility Commission -- the Company seeks an interim base rate increase of \$52 million through this expedited process and without full base rate review.

Throughout this expedited proceeding, it has been difficult to determine exactly what good the Company is seeking to achieve through this interim rate relief. It appears as though the Company's requested \$52 million interim rate increase is designed to allow the Company to meet its bond covenants for fiscal year 2001 and allow the Company to have between \$35-40 million in cash at the end of fiscal year 2001. Tr. at 141. The Company's base case does not include or consider any financial assistance from

the City. Rather, the Company seeks to reserve all possibility of financial assistance from the City to meet unexpected contingencies for use only if it absolutely needs it.

The Commission's August 17, 2000 Order held that the Company must establish that "an interim rate increase is necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season until the Commission can conduct and rule on a full base rate proceeding." August 17 Order at 7. The Commission Order *does not* require that the interim rate increase put PGW in the position of having \$35-40 million in cash on hand at the end of the fiscal year ending August 2001.

The OCA submits that the emphasis in this proceeding should not be to build up enough cash in the interim period to ensure financial liquidity in the longer term. Rather, the emphasis should be on what rates the Company absolutely requires to get through its present financial situation. OCA St. 1 at 25. That is, the interim rate increase should only be an amount that is necessary for the Company to meet its expenses through the winter heating season and meet its debt obligations. This is especially true since ratepayers are also facing a GCR increase of at least \$97 million, and probably more, this winter. Additional base rate increases, if any, can be determined after the Company files its full base rate case and a full investigation is conducted. To the extent the Company needs the cushion of a \$35-40 million cash position at the end of the fiscal year, that cushion should be provided by the City, not ratepayers. This can be done if the City either waives the \$18 million payment from PGW or grants it back to PGW as project

revenues.<sup>2</sup> Another option, as noted in PGW witness Knudsen's Rebuttal Testimony, is an additional loan from the City. PGW-IR St. 1.1 at 4-5. The OCA submits that any interim rate increase approved as part of this proceeding should be limited to that amount necessary for the Company to fund its operations through the winter heating season and meet its bond obligations. Any additional cash requirements that PGW is seeking for this interim period should come from the City, particularly while customers are facing a 20% increase in rates related to gas costs, if not more.

As set forth in more detail below, the OCA's recommendation of an interim base rate increase of up to \$25 million results in PGW satisfying its bond covenants and having enough cash on hand to fund operations throughout the interim period. In the Schedules accompanying the OCA testimony, the OCA has also demonstrated the impact of its recommendation when combined with assistance from the City through the return of the \$18 million payment in the form of a grant of project revenues that would not have to be repaid.<sup>3</sup> See OCA Sch. 2.1; OCA Sch. 3.1.<sup>4</sup>

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<sup>2</sup> Project revenues represent funds supplied by the City, in this case the return of the \$18 million payment, that qualifies for inclusion as above-the-line operating revenue in the coverage calculation.

<sup>3</sup> The OCA's analysis assumes the Company will receive the \$20 million temporary advance from the City which it is permitted under the Management Agreement. Management Agreement Section IV(3). PGW witness Knudsen has indicated that the City is now considering an advance of \$45 million. The incremental \$25 million is not reflected in the OCA's analysis but would provide additional cushion and backstop for the Company.

<sup>4</sup> A copy of OCA Schedule 2.1 is attached hereto and marked "Appendix B." A copy of OCA Schedule 3.1 is attached hereto and marked "Appendix C."

2. The OCA's Recommended Revenue Requirement Adjustments To PGW's Base Case Are Reasonable And Should Be Accepted.

a. Introduction.

OCA witness LeLash utilized PGW's monthly FY2001 Budget of Cash Receipts and Disbursements schedule. PGW-IR St. 1.0, App. B at 4. OCA witness LeLash then made three adjustments to the Company's revenue requirement projections. First, Mr. LeLash adjusted the Company's base case to reflect normal weather rather than warmer than normal weather as the Company had assumed. Second, Mr. LeLash reflected the continuation of the Senior Citizen Discount rather than the elimination of this discount. Third, OCA witness LeLash reduced the Company's projected productivity and personnel savings due to concerns that the savings would not be fully realized in the interim period. The OCA submits that these adjustments are reasonable and should be accepted.

b. Weather Normalization Adjustment.

In developing his recommendation, OCA witness LeLash made three adjustments to the Company's base case to reflect more reasonable assumptions. First, Mr. LeLash reversed the Company's \$4 million downward adjustment to revenues based upon the possibility of warmer than normal winter weather. OCA St. 1 at 31, 34, 38. In its base case, PGW sought to reduce its projected revenues based upon the traditional 4600 heating degree days ("HDD") due to recent warm winters. OCA St. 1 at 38. This resulted in an adjustment of \$4 million, or approximately 2.7% (125 HDD), downward for marginal revenue loss due to weather. Id. The OCA submits that the Company has

not presented any evidence to support that such an adjustment meets the regulatory "known and measurable" standard. As OCA witness LeLash presented in his Direct Testimony, the Company's proposed 125 HDD or 2.7% adjustment is not supported by the average HDD history in the Company's service territory. OCA St. 1 at 38. Over the past 40 years, the average HDD history in PGW's service territory is as follows:

<u>Time Period</u>	<u>Degree Days</u>	<u>% Variation</u>
40 years	4,628	0.6
30 years	4,569	(0.7)
20 years	4,521	(1.7)
10 years	4,418	(4.0)

OCA St. 1 at 39.

Thus, only over the past 10 years has degree day variation even approached the Company's proposed 125 degree day or 2.7% adjustment, and this was driven primarily by the abnormally warm winters of the past three years. OCA witness LeLash testified that it is not appropriate to present such an adjustment based upon such a short time period. OCA St. 1 at 39. For example, the National Weather Service (NWS) utilizes a 30-year time period to determine normal temperatures and degree days. This methodology is utilized so that short-term fluctuations in weather will be averaged out over time. It is not more probable that weather this year will be warmer than normal just because degree days over the past three years have been warmer than the 30-year standard. The OCA submits that revenue projections should be based upon the norm, not

upon the abnormal, especially as here, when any rate relief granted is only applicable for the interim period. Id.

c. Senior Citizen Discount Adjustment.

Mr. LeLash's analysis also reflects a reduction in revenues of \$1.5 million attributable to the senior citizen discount. OCA St. 1 at 41. In its forecast, PGW included an upward adjustment to revenues of \$1.5 million, representing the elimination of the Senior Citizen Discount for any PGW customer who was not already receiving it, or who turned 65 after June 30, 2000. However, as OCA witness LeLash noted, there is no evidence that the Senior Citizen Discount will be amended or eliminated during this interim period. Additionally, the \$1.5 million is an annualized figure, and does not reflect the fact that the increased revenues from such an elimination would be realized progressively from month to month throughout the year. Id. Therefore, even if one assumes that PGW is correct concerning the number of seniors who might be precluded from obtaining the discount by the end of FY2001 (5,000-6000), the additional revenues derived from this tariff change in FY2001 would have been only \$750,000. Id.

The OCA submits, however, that base case revenues should be decreased by \$1.5 million because there is no basis to believe that the Senior Citizen Discount will be amended for the interim period. In the absence of an amendment to the existing Tariff, it is not appropriate to reflect the elimination of the discount. Thus, a downward adjustment to the Company's revenue projection is necessary. OCA St. 1 at 41.

d. Personnel And Productivity Impacts Adjustment.

PGW has also included a \$2.5 million adjustment for personnel cost reductions and a \$10 million adjustment for cost savings and productivity improvements which it expects to achieve in the next year. OCA St. 1 at 42. However, as OCA witness LeLash noted, while there are undoubtedly ample opportunities for cost savings and productivity increases within PGW, these adjustments may also be considered speculative. Id. PGW has a long history of "business as usual" and new management will be challenged to achieve this magnitude of cost savings during the interim period. Furthermore, the level of savings will also be uncertain until the union negotiations, which will take place in the spring of 2001, are completed. Id. Even if the identified level of savings can be achieved, there is some question as to whether these savings will be fully achieved within the interim period. Id.

In his original analysis, OCA witness LeLash included the level of cost savings PGW set forth in its base case. OCA St. 1 at 42. Mr. LeLash did so for several reasons. First, since PGW's ratepayers are being asked to make contributions to address the current financial problems, and with the OCA's recommendation that the City also make a contribution, it would be reasonable to require the Company itself to make some contribution. Accordingly, OCA witness LeLash assumed that the projected cost savings would have the effect of formalizing a commitment by the Company and its employees to make a contribution as well. Id.

Second, there are several areas of potential cost reductions and underspending of budgeted items which were not directly factored into the revenue

requirement analyses since this is not a full base case review. With the Company's forecasted cash position, it is quite likely that there will be on-going constraints even in the case of budgeted expenditures. Therefore, on balance, Mr. LeLash concluded that the total cost savings can be achieved, even though they may be realized from a variety of different cost control initiatives. OCA St. 1 at 43.

The OCA does realize that it is difficult, if not impossible in an expedited proceeding such as this, for someone outside the Company to fully assess how the forecasted savings can be achieved and to quantify their precise level. Therefore, OCA witness LeLash recommended in his Direct Testimony that the Company's estimate be utilized unless the Company itself proposes and documents an alternative quantification. OCA St. 1 at 43.

On cross-examination, PGW witness Knudsen once again committed to achieve the level of cost savings set forth in the Company's base case. Tr. at 157. However, Mr. Knudsen also testified that the Company's projected revenue requirement may be understated due to an aggressive forecast of potential cost savings and due to the fact that some of the savings will not be captured until later in the fiscal year. PGW-IR St. 1-1 at 9.

In recognition of the uncertainties associated with the Company's projected costs savings, and the fact that some savings may not be realized in the interim period, OCA witness LeLash revised his recommendation to reflect \$5 million less in cost savings than contained in the Company's base case. Tr. at 230, 233; OCA Sch. 2.1 at 1;

OCA 3.1 at 1. This modification to the productivity savings more accurately reflects realistic cost savings which the Company can achieve in the interim period.

3. Results Of The OCA's Analysis.

With these factors in mind, OCA witness LeLash performed an analysis to determine a level of rates that would allow the Company to maintain its financial health and meet its debt service coverage. As OCA witness LeLash's analysis demonstrates, PGW does not have to receive the full amount of its requested \$52 million interim rate increase to meet the 1.50x coverage required by its bond covenants for both series of bonds and to provide funds for necessary capital projects during the interim period. OCA St. 1 at 30. In fact, the OCA submits that an increase far less than the requested \$52 million is reasonable for the interim period.

Initially, the OCA would note that its witness concluded that without base rate relief, the Company would end the fiscal year with a cash balance of negative \$25.1 million. The Company would also have other months when cash balances are negative. OCA Sch. 1 at 2. This base case, as developed by the Company, also results in a coverage of 1.87x on 1975 bonds and 1.25x on 1998 bonds. OCA Sch. 1 at 3. This base case also includes allowances for planned capital expenditures such as the mains replacement program. It does not, however, include any loan from the City or any return of the \$18 million payment by the City to the Company. OCA Schedule 1 attached to OCA witness LeLash's Direct Testimony simply replicates the Company's base case and calculates the bond coverages for use as the starting point to consider further alternatives.

Starting with that base case, OCA witness LeLash analyzed the necessary level of revenues which would allow the Company to meet its debt coverage on both the 1975 and 1998 bonds and finish the fiscal year with a positive cash balance.<sup>5</sup> OCA St. 1 at 33. Mr. LeLash assumed in his analysis, however, that the Company would take advantage of the \$20 million temporary advance from the City that is available under the terms of the Management Agreement.<sup>6</sup> OCA St. 1 at 33-34.

From his analysis, Mr. LeLash originally determined that with a \$7.5 million interim rate increase, the Company could have a the fiscal year-end cash balance of \$3.0 million. Unlike the Company's base case scenario, in no month during the fiscal year does PGW have a negative cash balance if it receives an interim increase of \$7.5 million in base rates as well as the \$20 million temporary advance from the City. OCA St. 1 at 34; OCA Sch. 2 at 2. This level of increase also produced bond coverages of 2.01x on the 1975 bonds and 1.50x on the 1998 bonds. OCA St. 1 at 34; OCA Sch. 1 at 3. This satisfies the minimum bond coverage requirement of 1.50x for each type of bond. This is true even though under this analysis PGW makes the \$18 million cash payment to the City and receives no grant of project revenues back from the City.

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<sup>5</sup> In recognition of the unexpected increase in natural gas costs throughout the country, the OCA has accepted the City's requested \$97 million GCR increase, and this increase is reflected in Mr. LeLash's analysis. OCA St. 1 at 31; OCA Sch. 2.1 at 1; OCA Sch. 3.1 at 1.

<sup>6</sup> OCA witness LeLash's recommendation assumes the Company receives a \$20 million temporary advance from the City. The City has now indicated to the Company that it is willing to make available a loan of \$45 million. PGW-IR St. 1.1 at 4-5.

Thus, with only a \$7.5 million interim rate increase, and even with no granting of project revenues by the City, the Company's bond coverages are met and it finishes the fiscal year with a positive cash position.

After reviewing the Company's rebuttal case, OCA witness LeLash revised certain assumptions used in developing the necessary level of revenues. First, Mr. LeLash determined to reflect increased uncollectible expense as a result of rising gas costs. As a result, Mr. LeLash included an additional \$12.5 million of uncollectible expense in his analysis. Tr. at 229-30. Second, Mr. LeLash reduced the level of productivity savings contained in the Company's base case by \$5 million to reflect the fact that the savings projections were aggressive and may not be realized during the interim period. Based on these adjustments, Mr. LeLash recommended an interim increase in base rates of up to \$25 million.

With a \$25 million interim base rate increase, the Company would realize a fiscal year-end cash balance of \$11.2 million, if it receives a \$20 million temporary advance from the City. OCA Sch. 2.1 at 2. This recommendation would also yield bond coverages of 2.01x on 1975 bonds and 1.50x on 1998 bonds. OCA Sch. 2.1 at 3. Thus, with a \$25 million increase and the \$20 million temporary advance from the City, the Company would meet its bond covenants and finish the fiscal year with a cash balance of \$11.2 million. OCA Sch. 2.1 at 2, 3. The OCA submits that this revised OCA recommendation, as presented in Schedule 2.1, satisfies the standard for interim rate relief set forth in the Commission's August 17 Order and is one scenario which could be used to address PGW's interim financial concerns.

4. The Company's Financial Position Could Be Further Improved If The City, As Owner, Made A Contribution Toward The Company's Financial Problems.

It is important to note that these cash balances and bond coverages continue to assume that the \$18 million payment is made to the City and the City does not return it to PGW as a grant of project revenues and that the City does not provide any additional financial assistance to PGW beyond the \$20 million temporary advance. The OCA submits, however, that the City, as owner of this utility, should contribute to resolving these financial problems during the interim period. To contribute, the City could return the \$18 million to PGW in the form of project revenues or it could waive the \$18 million payment for this year. OCA witness LeLash explained the importance of the City contributing to resolve these financial problems as follows:

Janice Davis, the City Finance Director and a member of the PFMC Board, has stated that the City is committed to grant PGW revenue to assure that it meets debt service coverage for FY2000. As the major stockholder of PGW, the City should likewise stand behind the Company during this interim period to address the financial problems. It can do so by pledging back to PGW part or all of the \$18.0 million payment in order to stabilize PGW's cash position in lieu of trying to make ratepayers have to address what should be an owner's responsibility.

The Commission should also note Ms. Davis' acknowledgment in the hearings before the Philadelphia Gas Commission that an additional 24,000 families would fall behind in their payments if the requested rate increase were to be granted (PGC FY 2001 Transcript, page 489) and that the cost of providing social services to these families could approach, if not exceed, the amount of the City payment (PGC FY 2001 Transcript, pages 552-553).

OCA St. 1 at 28.<sup>7</sup>

In light of the importance of the City in assisting PGW during this interim period, Mr. LeLash presented an analysis that utilized the same assumptions, but includes an \$18 million grant of project revenues from the City. OCA St. 1 at 35; OCA Sch. 3. Under this analysis, the \$18 million payment is made to the City in June and then granted back to the Company as project revenues. If the City returns the \$18 million payment to PGW as project revenues, and ratepayers contribute through an interim base rate increase of up to \$25 million, PGW would have a fiscal year-end cash balance of \$29.4 million. OCA Sch. 3.1 at 2. The Company would also have bond coverages of 2.36x on 1975 bonds and 2.11x on 1998 bonds. OCA Sch. 3.1 at 3. Thus, under the OCA's recommendation and with assistance from the City in the form of an \$18 million grant in project revenues, the Company would meet its bond covenants and finish the fiscal year with a cash balance of \$29.4 million. OCA Sch. 3.1 at 2, 3. The OCA submits that this analysis demonstrates that the \$25 million interim base rate increase, with assistance from the City, satisfies the standard for interim rate relief set forth in the Commission's August 17 Order.

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<sup>7</sup> The potential social service costs which would be incurred were increased by PGW witness Knudsen during his cross-examination. In light of the envisioned interim rate and GCR rate increases, Mr. Knudsen stated that there probably will be an additional 40,000 delinquent customers as opposed to the 24,000 estimate used by Ms. Davis. Tr. at 196.

C. The OCA's Recommendation Provides The Company With Adequate Bond Coverage And Cash On Hand At The End Of Fiscal Year 2001 To Sustain Operations.

Under the OCA's recommendation the Company will meet its bond coverages and have cash on hand at the end of fiscal year 2001. It is important to note that the calculation of cash and coverages assumes only a \$20 million temporary loan from the City. However, in his Rebuttal Testimony, PGW witness Knudsen stated that the Administration has asked the City Council to approve a \$45 million loan to PGW. PGW St. 1.1 at 4-5. This is far in excess of the \$20 million advance from the City used in the assumptions underlying the OCA's recommendation.

The incremental loan of \$25 million could provide the Company with any necessary cash if it seeks a more liquid cash position or encounters unexpected circumstances. In other words, even under the OCA's recommendation, the Company still retains the ability to fall back on the incremental loan of approximately \$25 million from the City.

The OCA submits that its recommendation provides viable, meaningful rate relief to PGW on an interim basis. The OCA's recommendation will allow the Company to meet its debt service obligations and sustain operations throughout fiscal year 2001, until a full base rate case review can be completed. The OCA submits that it is crucial that the Commission keep any interim rate increase to the bare minimum so as to cushion the rate impact which will be felt by ratepayers during this period of spiraling gas costs. It is also critical that all relevant stakeholders, including the City, participate in resolving this financial crisis. The OCA's recommendation reflects contributions from

the relevant stakeholders by reflecting productivity improvements by the Company, an interim rate increase from ratepayers, and a grant of project revenues and extension of credit from the City. The OCA submits that only through contributions from all stakeholders and by limiting the interim rate increase to only that which is necessary for PGW to meet its bond coverages and cover its expenses through the winter heating season will PGW customers be able to continue to receive affordable service this winter.

**IV. PGW'S REQUESTED \$52 MILLION INTERIM RATE INCREASE SEEKS TO PROVIDE TOO LARGE A CUSHION FOR PURPOSES OF INTERIM RATE RELIEF.**

A. The Purpose Of The Instant Proceeding Is Not To Provide The Company With A "Cushion" Of Revenues Totaling Between \$35-40 Million.

As noted above, the Company's case is predicated on its position that it needs a \$35-40 million cushion of cash at the end of the fiscal year. Company witness Knudsen states that "it is crucial that PGW go into the 2001-02 fiscal year with a total of \$35-40 million in liquidity". PGW-IR St. 1 at 10. Since PGW's fiscal year runs from September to August, the Company is proposing that the Commission award the Company interim revenues enabling the Company to have \$35-40 million of cash on September 1, 2001. The OCA submits, however, that it is unreasonable and inconsistent with the Commission's August 17 Order to attempt to provide the Company with a substantial cushion of cash through this proceeding. This is particularly true given that the Commission's management audit has not been completed and a full base rate review which examines all items of expenditures has been conducted. Furthermore, the

Company's attempt to saddle ratepayers with the obligation to provide such a "cushion" without fervently calling upon the owner of the system – the City of Philadelphia – to assist PGW in its time of need should not be accepted. The City, as owner of the utility, must contribute to restoring this Company to financial health.

The OCA's recommendation, in contrast to the Company's, attempts to serve the dual purpose of providing the Company with the means of maintaining its financial health and providing safe and adequate service through the winter heating season, while protecting PGW customers from the burden of a substantial base rate increase. Towards this end, the OCA has utilized the Company's base case with recognition of reduced revenues due to continuation of the Senior Citizen Discount and the likely increase in uncollectibles as a result of skyrocketing gas costs. OCA St. 1 at 41; Tr. at 230. The OCA has also recognized that the Company's productivity improvements contained in its base case are aggressive and has reduced the Company's projected cost savings. Tr. at 230. Such efforts by the OCA seek to shepherd the Company through the winter, while avoiding a situation where ratepayers are compelled to provide the Company with a cushion stretching into late summer of 2001. As described above, in the OCA's initial Direct Testimony, OCA witness LeLash concluded that the Company could meet the financial standards established in the Commission's August 17 Order with an interim rate increase of \$7.5 million. OCA St. 1 at 33-34. After consideration of the Company's Rebuttal Testimony, and recognizing a possible \$12.5 million increase in uncollectible expenses and a \$5 million reduction in productivity savings, Mr. LeLash

concluded that the Company should nevertheless be granted no more than \$25 million in increased base rate revenues on an interim basis. Tr. at 230.

The OCA submits that the underlying premise of this proceeding is recognition that PGW ratepayers should not solely be saddled with financially rescuing PGW from its current predicament. In the case In re Petition of City of Philadelphia, 340 Pa. 17, 16 A.2d 32 (1940), the Supreme Court stated that the construction, operation or maintenance of gas systems by a municipal corporation is in the nature of a private enterprise. In re Petition of City of Philadelphia 340 Pa. at 20, 16 A.2d at 34.

Considering PGW is a private enterprise, which is owned by the City of Philadelphia, it is quite reasonable to expect the City to assist PGW in righting itself until a full base rate review and Commission management audit are complete. As witness Knudsen admitted, had PGW filed before the Philadelphia Gas Commission during the fall of 1999, PGW could have averted at least a portion of its current financial crisis. Tr. at 156. Therefore, since the City is the owner of PGW and the Company readily admits that quicker action would have placed the Company in a better position than it currently occupies, the OCA submits that the burden to PGW ratepayers should be minimized and the City should provide assistance to the Company to help it get through its current financial crisis.

B. PGW's Interim Request Will Leave The Company In A Better Year-End Position Than It Has Been In Any Of The Past Eight Years

The Company's requested \$52 million interim rate increase would place the Company in a better position with respect to debt service coverage and net earnings than at any time in the last eight years. OCA St. 1 at 21-22. The Company has not had a

base rate increase since 1992. During that time, the Company's net earnings were never greater than \$17 million and in FY1998 and FY1999 net earnings were actually negative. OCA St. 1 at 21. In this proceeding, if the Company's \$52 million interim rate increase is granted, its net earnings will rise to \$26 million in FY2001. Id.

Also, in the past eight years, the Company's debt service coverage was never higher than 1.67x, and in several cases approached the bond covenant minimum of 1.50x. OCA St. 1 at 21. If the Company's \$52 million interim rate increase is approved, the bond coverages are projected to be 2.73x on the 1975 bonds and 2.76x on the 1998 bonds. The OCA submits that such coverage ratios are much higher than what is necessary coming out of this interim rate case before a full base rate review has been conducted.

The Company considers cash flow to be the focus of this proceeding and seeks an interim rate increase which would provide it with \$35-40 million at the end of the fiscal year ending August 31, 2000. In fact, during informal discovery, the Company indicated that one of its goals is to have a year-end cash balance of approximately \$50 million. OCA St. 1 at 23. As OCA witness LeLash noted, however, since FY1992, the Company has only exceeded \$50 million in year-end cash twice, in FY1994 and FY1995. OCA St. 1 at 23. While the OCA understands that PGW's major focus must be on cash requirements, the OCA submits that cash flow and working capital should not be the only basis for rate relief in this interim proceeding. Id.

As can be seen by the above comparisons, there is nothing unusual about the financial measures PGW is forecasting in this proceeding which would justify an

interim rate increase of \$52 million. This is especially true at a time when ratepayers are facing an increase in the GCR of at least 20%. The proposed interim rate request is driven more by the fact that the Company has reached its maximum short-term borrowing limit, and the City, as of the time of this filing, had not offered to provide necessary working capital or permanent capital to cover the financial shortfall. OCA St. 1 at 23. The OCA submits that if the City will loan PGW \$45 million, the Company's cash position is substantially enhanced. As demonstrated in OCA Schedule 3.1, an interim rate increase of no more than \$25 million, along with assistance from the City in the form of a \$20 million loan and a grant of project revenues of \$18 million, is sufficient to provide adequate bond coverages and provide the Company with sufficient cash resources to continue operations until a full base rate investigation can be completed.

C. The Company's Application Of The Cash Flow Method Of Rate Setting Should Not Be Adopted.

The Company has taken the position that the Act requires the cash flow method of rate setting to be used, even in this extraordinary interim rate proceeding. Under the Company's application of the cash flow method, ratepayers are required to provide PGW's capital as well as meet revenue requirements. OCA St. 1 at 27. The OCA submits that from a regulatory perspective, this interpretation of the Act and the cash flow method is fundamentally unreasonable. OCA witness LeLash explained the fundamental flaw with PGW's application of the cash flow method:

If it is followed, it would have the effect of absolving the City from any of its ownership responsibilities. In effect,

the City would always be able to say that any PGW deficiencies were the result of insufficient revenues for costs and capital. Failure to rectify Billing, Collections and Customer Service System (BCCS) problems, lack of adequate mains replacement, unreasonable levels of customer service could always be explained away by inadequate rate allowances. In effect, the cash flow method of setting rates as espoused by the Company would allow service to follow rates. I do not recommend that the Company's application of the cash flow method be adopted.

OCA St. 1 at 27.

The use of the Company's application of the cash flow method in this expedited, interim rate proceeding is especially inappropriate. Due to the expedited nature of this proceeding, a full investigation of the Company's projected expenditures to determine if they are necessary, prudent and reasonable cannot be done. The OCA submits that absent a full review of the Company's expenses and capital costs, using the Company's cash flow method cannot result in rates that are just and reasonable.

By progressive steps the cash flow method would have this Commission set rates to ensure the fulfillment of PGW's bond covenants, underwrite a dividend payment to its owner, the City, and finally, relieve its owner of any responsibility to ensure the adequate financing of the operation. The Commission should not accept the Company's reliance on the cash flow method of rate setting in this interim proceeding, but rather, it should consider the interests of PGW's ratepayers, the owner's inability to effectively manage the operation for many years, and the current level of service being provided when it determines the level, if any, of rate relief.

The OCA submits that the Company's application of the cash flow method in this proceeding is fundamentally flawed and would result in rates which are unjust and unreasonable. Therefore, the Commission should not adopt the Company's cash flow method for purposes of this extraordinary interim rate proceeding.

D. It Is Not Certain That PGW's Bond Rating Will Be Downgraded If It Does Not Receive A \$52 Million Interim Rate Increase.

The Company has argued throughout this proceeding that if it does not obtain adequate interim rate relief from the Commission it could face a downgrade in its bond rating. PGW witness Bisgaier testified that "[i]f PGW is not granted increases in both its GCR and base rates, there is a substantial probability that PGW will be in default of one or more of its bond covenants." PGW-IR St. 2 at 4-5. Ms. Bisgaier testified that failure by PGW to generate revenues to pay all of its expenses or to meet the 1.50x debt service coverage test, *even if debt service payments are made on a timely basis*, could result in a technical default under the bond resolutions. Id. at 5. Ms. Bisgaier opines that if such a technical default occurs, PGW bonds would be downgraded to junk bond status. Id. However, PGW witness Bisgaier's opinion is based on a worse case scenario – one in which PGW receives no interim rate relief and no assistance at all from the City. Tr. at 211-212.

The OCA submits that it has presented a recommendation for interim rate relief which allows the Company to meet all of its operating expenses and its bond coverages and therefore avoid a technical default on its bonds. Furthermore, even if

PGW were to go into technical default on its bond covenants, it is simply uncertain at this time whether this would automatically trigger a downgrade of PGW's bonds to junk bond status.

The OCA's recommendation provides adequate bond coverages as well as sufficient cash to sustain operations throughout the fiscal year. Even without any assistance from the City in the form of an \$18 million grant of project revenues, the OCA's recommendation results in bond coverages of 2.01x on 1975 bonds and 1.50x on 1998 bonds, and permits the Company to end the fiscal year with a cash balance of \$11.2 million. OCA Sch. 2.1 at 2, 3. If the City returns the \$18 million as project revenues, PGW would realize bond coverages of 2.36x on 1975 bonds and 2.11x on 1998 bonds, and the Company would end the fiscal year with a cash balance of \$29.4 million. OCA Sch. 3.1 at 2, 3. Thus, the Company is able to meet its expenses and bond coverages and no technical default would occur. Therefore, the scenario that PGW witness Bisgaier speculates could result in a downgrade would not occur.

Moreover, as PICGUG witness Baudino testified no one can be certain what the bond community's reaction would be if PGW did not obtain the level of interim rate relief that PGW requested. PICGUG St. 1 at 10. Mr. Baudino testified that bond rating agencies look at both present and expected future circumstances of a company in determining ratings. Id. While the Standard & Poor's evaluation of PGW indicates that the agency believes the Company needs some form of rate relief, that relief could come now in the form of an interim increase or later in the form of a permanent base rate increase. Id. In fact, Mr. Baudino testified that even under the Company's base case,

which results in bond coverages of only 1.26x, the Company's bonds might not be downgraded. PICGUG St. 1 at 11. As Mr. Baudino explained on cross-examination:

It has been my experience in 17 years of regulatory practice that companies can and sometimes do fail to meet the quantitative standards with respect to coverages and still maintain a bond rating if – if – there is the possibility in the future for additional rate relief or something that would improve coverages in the future ...

... This Commission has required – this Commission is looking at the gas cost recovery mechanism. Assuming that the Commission grants – finds a level of gas cost that is prudent, I have every reason to expect that the Commission will grant that in full. Then looking at 2001, the Commission has requested that the company come in for a permanent base rate increase. I am assuming that the company is going to comply with that and do that. And my point is that Standard & Poor's, Moody's, any agency you want to look at, again, not only looks at current data, it looks at prospects for improvement in the future. And I think one positive thing is if the company files a base rate case it has got at least on the table an opportunity to address through permanent rates an increase and improvement in its coverages that way.

Tr. at 308-311.

As can be seen, it is uncertain how the investment community will respond. The OCA's recommendation for up to a \$25 million interim rate increase, however, provides the Company the opportunity to meet its debt service coverage and to end the year with a positive cash balance.

E. An Interim Rate Increase Of \$52 Million Imposed Upon Customers At The Same Time As A Gas Cost Rate Increase Of \$97 Million Will Result In Rate Shock And Rates Which Are Unaffordable For Many Of PGW's Customers.

The Company's \$52 million interim rate request represents a 10% increase in revenues. Furthermore, PGW's \$97 million gas cost rate request represents an increase of 20%. Therefore, PGW is requesting that the Commission increase the rates the Company charges to its customers by at least 30% for this winter. A total increase of this magnitude certainly raises concerns as to rate shock and affordability. Since PGW's service territory includes a significant number of low-income consumers, the Commission must be cognizant of the ability of PGW's customers to afford such significant increases.

As was made abundantly clear in the testimony given by customers at the public input hearings, a significant increase in rates would present a financial hardship to many customers of PGW. In asserting a need for constant rates, customer Maria Dirkson testified that: "We can only pay what we have now. Some of us have to pay gas and some don't eat a little in order to keep the payments going. So we cannot afford this 30 percent rate." Tr. at 56. Customer Sid Karp continued: "I live on a fixed income and I know that I can barely get by with what I have ... I think that this is [a] terrible mistake on your part to try to raise the rates on PGW customers because we can barely afford it." Tr. at 68. Ms. Anna Marrero touched upon the possibility of increased criminal conduct should a significant increase be awarded as she testified that: "I am so afraid you are going to take good people and turn them into thieves that got to go around stealing gas and might blow us all up." Tr. at 75. As these testimonials illustrate, the Commission must strike a

careful balance between what PGW customers can feasibly afford and what level of revenues are needed to shepherd the Company through the upcoming winter.

Due to the delay by PGW in seeking rate relief, PGW claims it is faced with higher capital costs, increasing cash flow deficiencies and possible downgrades to the Company's bonds. These possibilities, coupled with increasing gas costs, have placed PGW in a difficult position entirely of its own making. In testifying that the City could have sought to address its ever-worsening position sooner, witness Baudino stated: "It could have been addressed two to three years ago by management. It could have been addressed earlier in the year." Tr. at 295-296. In light of such, the Commission must consider the ability of PGW's customers to pay any increase and the Company's own role in arriving at the current financial predicament.

**V. IN DETERMINING WHETHER TO GRANT PGW'S REQUEST FOR AN INTERIM RATE INCREASE, THE COMMISSION SHOULD CONSIDER WHETHER PGW IS OFFERING SAFE AND ADEQUATE SERVICE.**

A. Introduction.

In considering whether any rate increase request is just and reasonable, the Commission must consider the quality of service being provided by the utility. As OCA witness LeLash explained, the regulatory process has consistently followed the principle that a utility operation is only entitled to rate increases if its service is adequate and reasonable. OCA St. 1 at 14. Pennsylvania law is clear that the Commission has the discretion to withhold, limit or condition rate relief on the quality of service. Section 526(a) of the Public Utility Code states that:

[t]he Commission may reject in whole or in part, a public utility's request to increase its rates where the Commission concludes, after a hearing, that the service rendered by the public utility is inadequate in that it fails to meet quantity or quality for the type of service provided.

66 Pa.C.S. § 526(c).

In the instant case, the Commission has already conditioned the grant of an expedited interim rate proceeding upon PGW's commitment to its "Transition to Excellence" plan for improvements in service and has required that such improvements in service be demonstrated throughout the interim rate period. August 17 Order at 8. The OCA submits, however, that the evidence of record in this proceeding demonstrates that further action by the Commission may be necessary.

The public input testimony in this proceeding has raised a number of concerns about the level of PGW's service. Moreover, the studies that underlie PGW's own "Transition to Excellence" plan have identified several significant concerns about the state of PGW's billing system ("BCCS"), PGW's call center and PGW's Human Resources functions. OCA St. 1 at 49. The OCA is also concerned that PGW's mains replacement program has become a discretionary item as its financial condition deteriorated, thus raising safety concerns. Id. It is imperative from a public safety standpoint that PGW be required to maintain a mains replacement rate of approximately 1% per year and address the deficiencies as required by the Commission in Gas Safety Plan for Philadelphia Gas Works, Docket No. A-125042 (Order entered September 13, 2000). OCA St. 1 at 44. The costs to achieve a 1% replacement rate are already provided for in the Company's base capital budget and in the OCA's recommendation. Id. at 46.

B. Public Input Testimony Regarding Quality of Service

The public input testimony demonstrates that PGW's quality of service must be improved. Many individuals expressed concern about PGW's billing system. For example, customer Mae Beasley testified at the September 29, 2000 public input hearing that she has not received a gas bill since September 30, 1999. Tr. at 366. Ms. Anna Marrero testified that she received one bill for \$1,000 for the entire summer and a subsequent bill for \$1,600 because the company computer had overlooked her name when it was preparing bills. Tr. at 74. Representative W. Thomas Curtis expressed concerns that PGW has not fixed its computer system or developed an alternative customer response system which is user friendly and result driven. Tr. at 389.

Moreover, several individuals testified concerning PGW's customer service representatives. Customer Lydia Williams testified that she has problems with PGW's call center. Williams stated that "[y]ou always get a busy signal or you get told to hold on" unless you say "I smell gas." Tr. at 386. Ms. Maria Dirkson testified that PGW service people do not read meters in her area because "they say it is such a low poverty area and they can't get in some of the cellars because it is dirty and nasty ..." Tr. at 56. Mr. Ricardo Pearson characterized one PGW customer call center as having "a nasty attitude." Tr. at 72. He testified that he has been told by PGW service representatives on the phone that "if you can't pay [your bill], we will cut you off." Tr. at 72.

There was also testimony of the inefficient dispatch of PGW service persons. A particularly good example was presented by Mr. Samuel Silver, who testified that he owns three apartments adjacent to each other, each with a separate gas unit. Tr. at

79. He has a service plan with PGW to service the heating units. Id. He testified that at the beginning of each heating season he would call PGW to arrange to have service personnel come out to check the heating units. He testified that year after year, the Company prepares three separate service orders and dispatches three separate service persons to do the maintenance on the heaters, even though they are adjacent to each other. Id. at 80. Mr. Silver testified that he has repeatedly tried to get PGW to dispatch one service person to service all three heaters at the same time with no success. Id. PGW witness Knudsen acknowledged that there was a great deal of confusion in the dispatch of repair personnel into the field. Tr. at 146.

The OCA submits that the public input testimony demonstrates that PGW's quality of service needs to be improved, both in the interim period and in the long term.

C. Specific Commitments Necessary To Improve Quality Of Service.

1. Billing, Collections and Customer Service ("BCCS").

The OCA submits that the Company's BCCS system which has been in operation for over one year still does not generate the basic information needed to run the Company effectively and provide reliable customer service. OCA St. 1 at 46. The new interim management team acknowledges that the crisis associated with the failed implementation of the BCCS system in July 1999 still exists. Tr. at 166. One of the significant problems with the BCCS is the inability of the Company to offer accurate budget billing. Id.

It is still not clear whether the BCCS system will be repaired in the near future. OCA St. 1 at 47. Currently, the Company is projecting to spend \$22.7 million on a system that was approved for only \$9.7 million. These amounts do not include approximately \$5.5 million that was expensed on the Company's books nor the nearly \$4.0 million spent during 1999-2000 period in consulting costs associated with problems in implementing the system. Id. OCA witness LeLash explained how the failed implementation of BCCS has helped contribute to PGW's current financial crisis:

The Commission should be extremely aware of the cascading effect on cash which stems from not having the BCCS system on-line. For example, if bills are not sent out, then customers have no bills to pay and the Company does not have the cash flow which is so critical. If PGW does not have cash flow, then it must seek a rate increase so it can bill even higher rates on bills which hopefully will eventually be sent out. If BCCS cannot keep track of bills, then accounts receivable cannot be accurately determined, bad debt cannot be accurately calculated and the Company cannot know what amounts are due.

However, I see the greatest financial concern being that PGW does not know what its billings have been on a daily basis. Apparently, the legacy system was able to generate daily billing summaries which were used to determine many aspects of the Company's financial condition. The BCCS system has not been able to generate this data, and it is necessary that it be able to consistently do so soon.

OCA St. 1 at 47.

The OCA submits that PGW customers are being asked to support an interim rate increase for an amount which is more than necessary to address immediate cash flow needs while PGW is not yet in a position to present a credible plan for longer

term reform. To be able to do that, the Company's information systems must be fully functional and capable of supporting serious planning and decision-making.

A more immediate concern to the OCA is PGW's problem with budget billing. Both the Company's Tariff and Chapter 56 of the Commission's regulations require the Company to offer budget billing. Tariff at 3.35; 52 Pa.Code §56.12(7). PGW's budget billing program should allow customers to receive an equalized monthly bill over a 12-month period with the possibility of adjustments at four month intervals. Tr. at 164. Currently, approximately 120,000 PGW customers avail themselves of the budget billing option. Tr. at 165. The Company acknowledges that with an increase in GCR rates of \$97 million coupled with an interim rate increase, there will be an increased demand for budget billing. Tr. at 165. At this time, the Company cannot offer budget billing in accordance with its Tariff. Tr. at 166. The Company is unable to do the four and eight month adjustments. Adjustments can only be made at the end of a twelve-month cycle. Therefore, those customers currently on budget billing will not see their monthly budget amount reflect the upcoming increase in rates until the end of their 12-month budget billing cycle. Tr. at 166-167. By then they may have accrued significant underpayments. For instance, those customers whose budget billing cycle starts shortly before the rate increases take effect will have a budget bill based on the previous rate for a full 12 months before it is adjusted to reflect the new rates. Those customers will accrue a large underpayment which will have to be made up in the next 12-month cycle. Tr. at 167. The OCA submits that this is unacceptable. Consumers are facing potential increases of 30% or more this winter. It is crucial that the Company be in a position to

offer budget billing so that customers receive a monthly bill which is affordable and manageable. The Commission must direct PGW to take immediate steps to offer budget billing in conformity with its tariff and Chapter 56.

2. Mains Replacement.

PGW has an extensive system of cast iron mains. As its cash flow increasingly became a problem, mains replacement became a discretionary item for the Company. OCA St. 1 at 44. The Company's rate of replacement of these mains was cut in half over the last five years, to a level of approximately 0.5% or 9 miles per year. OCA St. 1 at 44. As OCA witness LeLash testified, according to a Replacement Study developed this year by Navigant Consulting, a replacement rate of 18 miles per year, or 1%, for PGW is necessary to reduce the risk of main breaks and incidents. OCA St. 1 at 44. Between 1989 and 1994, PGW annually reached the target of 1% replacement by replacing an average of 18.2 miles of existing mains each year. However, from 1995 through the present, PGW replacement rate has fallen to an average of 9.0 miles per year. Id.

As can be seen, temporary reductions in annual replacement rates as a result of cash shortages became an on-going policy of PGW which raises serious concerns about the safety of the Company's facilities. Id. at 45. The Commission has recognized this concern and directed PGW to take immediate actions to address any deficiencies in its distribution system. Gas Safety Plan for Philadelphia Gas Works, Docket No. A-125042 (Order entered September 13, 2000).

OCA witness LeLash testified about the impact of continuing the company's mains replacement program at its current rate:

A low level of replacement increases the prospect for increased breaks and incidents. While breaks have averaged between 350 and 400 per year, the system has benefitted from the recent mild winters. As noted by Navigant, "Since severe weather tends to cause breaks, and breaks tend to cause incidents, severe weather tends to cause incidents."

With the prospect of up to 800 breaks per year if Philadelphia experiences a colder than normal winter, the Company's replacement rate at the 0.56 percent level, which it has averaged during the recent past, is seriously deficient. An elevation in the average number of breaks will increase the number of experienced incidents. In prior cold winters such as 1977-1978 and 1993-1994 there were sharp increases in breaks (over 1,100 in 1977-1978) and a corresponding increase in the number of incidents.

OCA St. 1 at 45.

The OCA submits that PGW's deteriorating performance in mains replacement raises a serious public safety concern. Since the definition of a utility's performance benchmark is safe and adequate service, the OCA submits that it is vital that the 1% replacement rate is achieved and maintained. The costs to achieve a 1% replacement rate have already been provided for in the Company's base case capital budget and its cash flow requirements and in the interim rate proposal of the OCA. OCA St. 1 at 46. The Commission should establish as a prerequisite to any interim rate increase that PGW commit to actually achieving a 1% replacement rate.

3. Customer Service.

The OCA submits that the quality of service received by PGW's customers should be a determinant in whether or not customers should be required to pay higher rates on either an interim or permanent basis. The Commission's August 17 Order specifically stated that the Company must demonstrate throughout the interim rate period that it is providing safe and adequate service. August 17 Order at 11.

The OCA has serious concerns about the quality of service provided by PGW. As highlighted in Section V.B above, there was substantial public input testimony about the billing problems, poor call center performance, and inefficient dispatch of workers to the field. The OCA submits that part of these problems stem from the failed implementation of the BCCS. The Company's inability to gather and organize basic business information about itself and its customers, its ability to maintain its system of mains in an efficient and cost effective manner, and its ability to perform customer service and billing functions has left the Company in a position where it cannot adequately meet its customers' needs. OCA St. 1 at 48-49. PGW witness Knudsen admits that the problems PGW is facing cannot be overcome overnight. PGW-IR St. 1.0 at 14. He stated that PGW's problems are "complex and more difficult than I had believed ..." Id.

As OCA witness LeLash testified, in late May and early June, three consultant studies concerning the present state of the BCCS system, PGW's call center and PGW's Human Resources function were issued. OCA St. 1 at 49. These studies form the basis of the Company's "Transition to Excellence" plan. PGW-IR St. 1, App. C.

Anderson Consulting ("Andersen") did a study on the BCCS. OCA St. 1 at 49.

Vanguard Communications ("Vanguard") did a study on PGW's Call Center. Id. And The Hay Group performed a study on the Company's Human Resources function. Id. at 53. The studies were prepared by consultants hired by PGW who spent weeks at PGW interviewing Company employees, observing operations, and reviewing records. Id. Mr. LeLash testified that these reports provide a telling assessment of the present state of customer service at PGW and demonstrate more clearly than ever that the level of PGW's service is deficient. See OCA St. 1 at 49-54.

The OCA submits that the adequacy of service should be considered in determining the propriety of PGW's request. OCA St. 1 at 54. Rates should follow service. The long-term deficiencies of PGW's service to its customers and future progress to improve service should be a primary determinant as to whether or not customers should have to pay higher rates on either an interim or permanent basis and if so, what conditions may need to be imposed to ensure that service is improved. Any interim rate relief granted should be made contingent upon a meaningful commitment and plan to improve the quality of service.

4. Liquefied Natural Gas.

In its GCR proceeding the company described an upgrade to the liquifaction capacity at its Richmond LNG facility. The OCA supports the upgrade of the LNG facility and the Company should be directed to proceed with its LNG Program to ensure that PGW's system supply and reliability are maintained.

C. The Commission Should Only Grant Interim Rate Relief Subject To Certain Conditions.

The OCA submits that any interim rate relief granted in this proceeding must be subject to certain conditions so that basic protections are afforded ratepayers as a result of this interim rate procedure. The first set of conditions are set forth in the Commission's August 17 Order:

- PGW must file a full base rate case with the Commission on or before January 1, 2001;
- any interim rates ultimately granted are subject to refund at the conclusion of a full base rate case if the Commission determines that a lower level of rates is just and reasonable;
- PGW will not seek to recoup additional revenues from ratepayers if the Commission ultimately determines that a higher level of rates is just and reasonable; and
- PGW will commit to its "Transition to Excellence" plan for improvement and make a demonstration throughout the interim rate period that it is providing safe and adequate service.

The OCA submits further that certain other conditions should be satisfied to ensure that the Company is able to provide safe and adequate service during the interim period. First, the Company should be required to achieve a 1% replacement rate in its mains replacement program as provided for in the Company's base case capital budget. Second, the Company should commit to correcting the problems with its BCCS, particularly the need to rectify the budget billing problems, and provide periodic reports to BCS on the progress it is making correcting the BCCS problems. Third, the Company should proceed with its LNG Liquifaction Replacement Program to ensure that PGW's system supply and reliability are maintained. Finally, PGW must show improvement in its customer service functions and report on its progress to the Commission.

The Commission has often exercised its discretion to either reject a rate increase due to inadequate service or condition the receipt of a rate increase on a utility company's agreement to perform certain improvements. For example, in Pa.P.U.C. v. Pa. Gas and Water Co., 68 Pa.P.U.C. 191, 197 (1988), the Commission concluded that no rate increase could be justified based on the poor quality of service being offered by PG&W. In a case involving Pennsylvania-American Water Company ("PAWC"), the Commission went as far to say that PAWC "should have to demonstrate *actual evidence of improved service*" before its customers should have to pay an increased rate. Pa.P.U.C. v. Pennsylvania-American Water Co., 71 Pa.P.U.C. 210, 217 (1989) (emphasis added).

The Commission has also used its authority under Sections 523 and 526 to provide a utility with the option of accepting no rate increase or a rate increase that was dedicated entirely to distribution system improvements to accelerate progress toward providing safe and adequate service. Pa.P.U.C. v. Pa. Gas & Water Co., 79 Pa.P.U.C. 349, 359 (1993).

A utility rate increase has also been denied based upon inadequate service in other cases. See D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Comm'n, 466 F.2d 394, 422 (D.C. Cir. 1972) (holding that the Commission did not exceed the limits of due process because a utility cannot "disregard its public responsibilities [of adequate service] ... and yet insist that the public respond to its demands for higher fares." Pa.P.U.C. v. National Utilities, Inc., 87 Pa.P.U.C. 1, 6 (1997) (denying the company's rate increase entirely because of inadequate service); Pa.P.U.C.

v. Pa. Gas and Water Co., 68 Pa.P.U.C. 191, (denying a rate increase because of the company's failure to show that its customers were receiving adequate service).

## VI. CONCLUSION

For the reasons set forth above, the OCA submits that the Commission should allow PGW an interim base rate increase of no more than \$25 million, subject to the following conditions:

- PGW must file a full base rate case with the Commission on or before January 1, 2001;
- any interim rates ultimately granted are subject to refund at the conclusion of a full base rate case if the Commission determines that a lower level of rates is just and reasonable;
- PGW will not seek to recoup additional revenues from ratepayers if the Commission ultimately determines that a higher level of rates is just and reasonable;
- PGW commit to its "Transition to Excellence" plan for improvement and make a demonstration throughout the interim rate period that it is providing safe and adequate service.
- PGW should be required to achieve a 1% replacement rate in its mains replacement program as provided for in the Company's base case capital budget;
- PGW should commit to correcting the problems with its BCCS, particularly the need to rectify the budget billing problems, and provide periodic reports to BCS on the progress it is making correcting the BCCS problems;
- PGW should proceed with its LNG Liquifaction Replacement Program to ensure that PGW's system supply and reliability are maintained; and
- PGW must show improvement in its customer service functions and report on its progress to the Commission.

The OCA's recommendation satisfies the standards for interim rate relief set forth in the Commission's August 17, 2000 Order and should be adopted.



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# Appendix A

Proposed Findings of Facts  
And  
Conclusions of Law

## APPENDIX A

### PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

#### Proposed Findings of Fact:

1. PGW has not sought a base rate increase since 1992. PGW Petition for Interim Rates Procedure at ¶16.
2. The rate covenants in PGW's bond ordinances require PGW to provide at least 1.5x coverage of the debt service on outstanding PGW revenue bonds. PGW-IR St. 2. At 11.
3. With an interim rate increase of \$25 million, and no grant of \$18 million in project revenues from the City, PGW's debt service coverages would be 2.01x on its 1975 bonds and 1.50x on its 1998 bonds and the Company would end fiscal year 2001 with a year-end cash balance of \$11.2 million. OCA Sch. 2.1
4. With an interim rate increase of \$25 million, and a grant of \$18 million in project revenues from the City, PGW's debt service coverages would be 2.36x on its 1975 bonds and 2.11x on its 1998 bonds and the Company would end fiscal year 2001 with a year-end cash balance of \$11.2 million. OCA Sch. 3.1
5. PGW has traditionally used 4600 heating degree days to project revenues. OCA St. 1 at 39.
6. The Senior Citizen discount is still effective. OCA St. 1 at 20-21.
7. The Company has requested a Gas Cost Rate ("GCR") increase of \$97 million. OCA St. 1 at 31; OCA Sch. 2.1 at 1; OCA Sch. 3.1 at 1.
8. Pursuant to the terms of the Management Agreement, PGW can obtain a \$20 million temporary advance from the City. OCA St. 1 at 29; Management Agreement Section IV(3).
9. The Company's requested \$52 million interim base rate increase would place it in a better financial position with respect to debt service coverage and net earnings than at any time in the last eight years. OCA St. 1 at 21-22.
10. In the past eight years the Company's debt service coverage was never higher than 1.67x. OCA St. 1 at 21.

11. In the last eight years, the Company's net earnings were never greater than \$17 million and in FY1998 and FY1999 its net earnings were negative. OCA St. 1 at 21.
12. If the Company receives a \$52 million interim rate increase, the Company's net earnings in FY2001 would be \$26 million. OCA St. 1 at 21.
13. The Company's Billing Collection and Customer Service System ("BCCS") does not generate the basic information necessary for PGW to operate the Company effectively and provide reliable customer service. OCA St. 1 at 46.
14. An increase in the GCR rates of \$97 million, along with an interim base rate increase, will increase the customer demand for budget billing. Tr. 165.
15. The Company cannot currently offer budget billing in accordance with its Tariff. Tr. 166.
16. For PGW, a replacement rate of 1% per year is necessary to reduce the risk of main breaks and incidents. OCA St. 1 at 44.
17. Between 1989 and 1994, PGW's average rate of replacement of mains was 18 miles per year, or 1%. OCA St. 1 at 44.
18. Over the past 5 years, the Company rate of replacement of mains has been 9 miles per year, or 0.5%. OCA St. 1 at 44.
19. The costs to achieve a 1% mains replacement rate is already included in the Company's base capital budget. OCA St. 1 at 46.

**Proposed Conclusions of Law:**

1. All rates shall be just and reasonable. 66 Pa.C.S. §1301.
2. In order for the Company to receive an interim rate case, it must establish that an *interim rate increase is necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season until the Commission can conduct and rule on a full base rate proceeding.* August 17 Order at 7.
3. Any additional financial support beyond a \$25 million interim base rate increase, must be provided by the City of Philadelphia.
4. Every public utility shall furnish and maintain adequate, efficient, safe , and reasonable service. 66 Pa.C.S. §1501.
5. The Commission must consider the efficiency, effectiveness, and adequacy of service of each utility when determining just and reasonable rates. 66 Pa.C.S. §523.
6. The Commission may reject, in whole or in part, a request to increase rates where the Commission concludes that the service rendered by the utility is inadequate. 66 Pa.C.S. §526.
7. The Company must offer a budget billing option with the opportunity for adjustments three times a year. 52 Pa.Code §56.12(7).
8. The projection of revenues for PGW should be based upon 4600 heating degree days ("HDD").
9. Since the Senior Citizen Discount program is still effective, there should be no adjustment in projected revenues for its elimination.

## Appendix B

**Philadelphia Gas Works**  
**Alternative One**

<u>Assumptions:</u>	Rate Increase of \$25 million:	Yes
	\$18 million Payment to City:	Yes
	\$20 million Temporary Advance:	Yes
	Project Revenues From City:	No
	Revenue Reduction - 2.7% Warmer Weather	No
	Senior Citizen Moratorium	No
	\$5 million Productivity Savings	Yes
	GCR Costs of \$97 million	Yes
	Increase in Bad Debt Expense--\$12.54 million	Yes

Philadelphia Gas Works  
FY2001 Cash Flows and Balances  
Alternative 1- \$millions

	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	TOTAL
Opening Balance- cash includes 97.0 TXCP	2.0	0.7	1.1	19.3	23.8	9.8	20.4	48.8	70.5	81.6	59.8	30.3	2.0
<b>Receipts</b>													
Gas	25.8	27.2	37.0	48.2	59.6	68.8	76.8	72.6	60.1	44.2	38.3	35.5	594.1
Marginal Revenue-Weather @ \$4,000,000	0.2	0.2	0.2	0.3	0.4	0.5	0.5	0.5	0.4	0.3	0.3	0.2	4.0
Senior Citizens Discount @ \$1,500,000	0.0	-0.1	-0.1	-0.1	-0.1	-0.2	-0.3	-0.2	-0.2	-0.2	-0.1	-0.1	-1.5
Other	6.7	8.7	1.4	1.0	1.3	1.4	1.4	1.6	1.6	1.6	1.5	3.9	32.1
Drawn from Capital Funds-Principal \$34.8	12.6	14.6	7.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	34.8
Drawn from Capital Funds-Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drawn from Lease Funds-Principal \$10.3	0.0	0.0	0.0	0.0	6.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.0
Drawn from Lease Funds-Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Advance (Repayment) of Capital Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pension Withdrawal	0.6	3.0	0.0	5.5	0.0	0.0	0.0	0.0	0.0	0.0	13.6	0.0	22.7
Temporary Advance from City \$20,000,000	0.0	0.0	20.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	20.0
Rate Increase @ \$25,000,000	0.0	0.0	0.0	0.0	2.4	2.8	3.1	2.9	2.5	1.9	1.6	1.6	18.8
<b>TOTAL RECEIPTS</b>	<b>45.9</b>	<b>53.6</b>	<b>66.2</b>	<b>54.9</b>	<b>69.6</b>	<b>73.3</b>	<b>81.5</b>	<b>77.4</b>	<b>64.4</b>	<b>47.8</b>	<b>55.1</b>	<b>41.1</b>	<b>731.0</b>
<b>TOTAL</b>	<b>47.9</b>	<b>54.3</b>	<b>67.3</b>	<b>74.2</b>	<b>93.3</b>	<b>83.1</b>	<b>101.9</b>	<b>126.2</b>	<b>135.0</b>	<b>129.4</b>	<b>114.9</b>	<b>71.5</b>	<b>733.0</b>
<b>Disbursements</b>													
Labor	11.5	12.0	13.1	13.2	10.8	10.7	11.2	10.1	11.3	11.0	10.6	11.3	136.8
Natural Gas	25.8	27.2	24.7	26.6	34.9	37.6	30.8	30.6	29.7	28.7	25.8	25.4	347.8
Debt Service	0.0	3.9	0.0	0.1	25.9	2.7	0.0	4.0	1.7	1.4	37.9	13.3	90.9
TXCP Interest	0.0	0.1	0.0	0.1	0.2	0.4	0.2	0.6	0.4	0.2	0.0	0.0	2.2
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.2	0.0	0.0	18.2
Oth Disburse:Prod Savings @ \$5,000,000	9.9	10.0	10.2	10.5	11.8	11.3	10.9	10.4	10.3	10.2	10.3	10.3	125.9
<b>TOTAL DISBURSEMENTS</b>	<b>47.2</b>	<b>53.2</b>	<b>48.0</b>	<b>50.5</b>	<b>83.6</b>	<b>62.7</b>	<b>53.1</b>	<b>55.7</b>	<b>53.4</b>	<b>69.7</b>	<b>84.6</b>	<b>60.3</b>	<b>721.8</b>
Monthly Cash Flow	-1.3	0.4	18.2	4.5	-14.0	10.6	28.4	21.7	11.0	-21.8	-29.4	-19.2	9.2
Cumulative Cash Flow	-1.3	-0.9	17.3	21.8	7.8	18.4	46.8	68.5	79.6	57.8	28.3	9.2	
Opening TXCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
TXCP Issued During Month	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TXCP Issued Paid Down During Month	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ending TXCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
Opening Balance-Cash	2.0	0.7	1.1	19.3	23.8	9.8	20.4	48.8	70.5	81.6	59.8	30.3	2.0
Monthly Cash Flow	-1.3	0.4	18.2	4.5	-14.0	10.6	28.4	21.7	11.0	-21.8	-29.4	-19.2	9.2
Net TXCP Activity Monthly	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Ending Balance-Cash</b>	<b>0.7</b>	<b>1.1</b>	<b>19.3</b>	<b>23.8</b>	<b>9.8</b>	<b>20.4</b>	<b>48.8</b>	<b>70.5</b>	<b>81.6</b>	<b>59.8</b>	<b>30.3</b>	<b>11.2</b>	<b>11.2</b>
Cash Position Net of TXCP	-96.3	-95.9	-77.7	-73.2	-87.2	-76.6	-48.2	-26.5	-15.4	-37.2	-66.7	-85.8	-85.8

PHILADELPHIA GAS WORKS  
DEBT SERVICE COVERAGE  
ALTERNATIVE 1- \$000's

		BASE CASE	+/-	ALTERNATIVE 1
<b><u>FUNDS PROVIDED</u></b>				
1	Operating Revenues	\$644,876	\$25,000	\$669,876
2	Other Income	4,524	0	4,524
3	City Operating Grant	0	0	0
4	AFUDC (Interest)	355	0	355
5	1 thru 4 TOTAL FUNDS PROVIDED	649,755	25,000	674,755
<b><u>FUNDS APPLIED</u></b>				
6	Operating Expenses	591,022	0	591,022
7	Decrease in Productivity Savings		5,000	5,000
8	Increase in Bad Debt Expense		12,540	12,540
9	\$20.1M Capital Lease Cost	3,980	0	3,980
10	\$23M Capital Lease Cost	3,997	0	3,997
11	Less: Non-Cash Expenses	37,569	0	37,569
12	6 thru 11 TOTAL FUNDS APPLIED	561,430	17,540	578,970
<b><u>FUNDS AVAILABLE TO COVER</u></b>				
13	5-12 Revenue Bond Funds Available	88,325	7,460	95,785
14	9+10 Add-Back Lease Costs	7,977	0	7,977
15	13+14 FUNDS AVAILABLE EXCLUDING LEASE COSTS	96,302	7,460	103,762
<b><u>FUNDS APPLIED TO DEBT SERV</u></b>				
16	1975 Ordinance Bonds Debt Service	\$51,611	\$0	\$51,611
17	15/16 Debt Service Coverage 1975 Bonds	1.87	0.14	2.01
18	15-16 Net Available After Prior Debt Service	\$44,691	\$7,460	\$52,151
19	9+10 PMA & Other Capital Leases	7,977	0	7,977
20	18-19 Net Available After Prior Capital Leases	\$36,714	\$7,460	\$44,174
21	1998 Ordinance Bonds Debt Service	\$29,449	\$0	\$29,449
22	20/21 Debt Service Coverage 1998 Bonds	1.25	0.25	1.50
23	20-21 Net Available After 1998 Debt Service	\$7,265	\$7,460	\$14,725
24	1998 Ordinance Subordinate Bond Debt Service	\$1,990	\$0	\$1,990
25	23/24 Debt Service Coverage Subordinate Bond	3.65	3.75	7.40

# Appendix C

**Philadelphia Gas Works**  
**Alternative Two**

<u>Assumptions:</u>	Rate Increase of \$25 million:	Yes
	\$18 million Payment to City:	Yes
	\$20 million Temporary Advance:	Yes
	Project Revenues From City:	Yes
	Revenue Reduction - 2.7% Warmer Weather	No
	Senior Citizen Moratorium	No
	\$5 million Productivity Savings	Yes
	GCR Costs of \$97 million	Yes
	Increase In Bad Debt Expense--\$12.54 million	Yes

Philadelphia Gas Works  
FY2001 Cash Flows and Balances  
Alternative 2- \$millions

	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	TOTAL
Opening Balance- cash includes 97.0 TXCP	2.0	0.7	1.1	19.3	23.8	9.8	20.4	48.8	70.5	81.6	78.0	48.5	2.0
<b>Receipts</b>													
Gas	25.8	27.2	37.0	48.2	59.6	68.8	76.8	72.6	60.1	44.2	38.3	35.5	594.1
Marginal Revenue-Weather @ \$4,000,000	0.2	0.2	0.2	0.3	0.4	0.5	0.5	0.5	0.4	0.3	0.3	0.2	4.0
Senior Citizens Discount @ \$1,500,000	0.0	-0.1	-0.1	-0.1	-0.1	-0.2	-0.3	-0.2	-0.2	-0.2	-0.1	-0.1	-1.5
Other	6.7	8.7	1.4	1.0	1.3	1.4	1.4	1.6	1.6	1.6	1.5	3.9	32.1
Drawn from Capital Funds-Principal \$34.8	12.6	14.6	7.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	34.8
Drawn from Capital Funds-Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drawn from Lease Funds-Principal \$10.3	0.0	0.0	0.0	0.0	6.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.0
Drawn from Lease Funds-Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Advance (Repayment) of Capital Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pension Withdrawal	0.6	3.0	0.0	5.5	0.0	0.0	0.0	0.0	0.0	0.0	13.6	0.0	22.7
Temporary Advance from City \$20,000,000	0.0	0.0	20.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	20.0
Rate Increase @ \$25,000,000	0.0	0.0	0.0	0.0	2.4	2.8	3.1	2.9	2.5	1.9	1.6	1.6	18.8
<b>TOTAL RECEIPTS</b>	<b>45.9</b>	<b>53.6</b>	<b>66.2</b>	<b>54.9</b>	<b>69.6</b>	<b>73.3</b>	<b>81.5</b>	<b>77.4</b>	<b>64.4</b>	<b>47.8</b>	<b>55.1</b>	<b>41.1</b>	<b>731.0</b>
<b>TOTAL</b>	<b>47.9</b>	<b>54.3</b>	<b>67.3</b>	<b>74.2</b>	<b>93.3</b>	<b>83.1</b>	<b>101.9</b>	<b>126.2</b>	<b>135.0</b>	<b>129.4</b>	<b>133.1</b>	<b>89.7</b>	<b>733.0</b>
<b>Disbursements</b>													
Labor	11.5	12.0	13.1	13.2	10.8	10.7	11.2	10.1	11.3	11.0	10.6	11.3	136.8
Natural Gas	25.8	27.2	24.7	26.6	34.9	37.6	30.8	30.6	29.7	28.7	25.8	25.4	347.8
Debt Service	0.0	3.9	0.0	0.1	25.9	2.7	0.0	4.0	1.7	1.4	37.9	13.3	90.9
TXCP Interest	0.0	0.1	0.0	0.1	0.2	0.4	0.2	0.6	0.4	0.2	0.0	0.0	2.2
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Oth Disburse:Prod Savings @ \$5,000,000	9.9	10.0	10.2	10.5	11.8	11.3	10.9	10.4	10.3	10.2	10.3	10.3	125.9
<b>TOTAL DISBURSEMENTS</b>	<b>47.2</b>	<b>53.2</b>	<b>48.0</b>	<b>50.5</b>	<b>83.6</b>	<b>62.7</b>	<b>53.1</b>	<b>55.7</b>	<b>53.4</b>	<b>51.5</b>	<b>84.6</b>	<b>60.3</b>	<b>703.6</b>
Monthly Cash Flow	-1.3	0.4	18.2	4.5	-14.0	10.6	28.4	21.7	11.0	-3.6	-29.4	-19.2	27.4
Cumulative Cash Flow	-1.3	-0.9	17.3	21.8	7.8	18.4	46.8	68.5	79.6	76.0	46.5	27.4	
Opening TXCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
TXCP Issued During Month	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TXCP Issued Paid Down During Month	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ending TXCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
Opening Balance-Cash	2.0	0.7	1.1	19.3	23.8	9.8	20.4	48.8	70.5	81.6	78.0	48.5	2.0
Monthly Cash Flow	-1.3	0.4	18.2	4.5	-14.0	10.6	28.4	21.7	11.0	-3.6	-29.4	-19.2	27.4
Net TXCP Activity Monthly	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Ending Balance-Cash</b>	<b>0.7</b>	<b>1.1</b>	<b>19.3</b>	<b>23.8</b>	<b>9.8</b>	<b>20.4</b>	<b>48.8</b>	<b>70.5</b>	<b>81.6</b>	<b>78.0</b>	<b>48.5</b>	<b>29.4</b>	<b>29.4</b>
Cash Position Net of TXCP	-96.3	-95.9	-77.7	-73.2	-87.2	-76.6	-48.2	-26.5	-15.4	-19.0	-48.5	-67.6	-67.6

PHILADELPHIA GAS WORKS  
DEBT SERVICE COVERAGE  
ALTERNATIVE 2- \$000's

		<u>ALTERNATIVE 1</u>	<u>+/-</u>	<u>ALTERNATIVE 2</u>
<b><u>FUNDS PROVIDED</u></b>				
1	Operating Revenues	\$669,876	\$0	\$669,876
2	Other Income	4,524	0	4,524
3	City Operating Grant	0	18,000	18,000
4	AFUDC (Interest)	355	0	355
5	1 thru 4 TOTAL FUNDS PROVIDED	<u>674,755</u>	<u>18,000</u>	<u>692,755</u>
<b><u>FUNDS APPLIED</u></b>				
6	Operating Expenses	591,022	0	591,022
7	Decrease in Productivity Savings	5,000	0	5,000
8	Increase in Bad Debt Expense	12,540	0	12,540
9	\$20.1M Capital Lease Cost	3,980	0	3,980
10	\$23M Capital Lease Cost	3,997	0	3,997
11	Less: Non-Cash Expenses	37,569	0	37,569
12	6 thru 11 TOTAL FUNDS APPLIED	<u>578,970</u>	<u>0</u>	<u>578,970</u>
<b><u>FUNDS AVAILABLE TO COVER</u></b>				
13	5-12 Revenue Bond Funds Available	95,785	18,000	113,785
14	9+10 Add-Back Lease Costs	7,977	0	7,977
15	13+14 FUNDS AVAILABLE EXCLUDING LEASE COSTS	<u>103,762</u>	<u>18,000</u>	<u>121,762</u>
<b><u>FUNDS APPLIED TO DEBT SERV</u></b>				
16	1975 Ordinance Bonds Debt Service	\$51,611	\$0	\$51,611
17	15/16 Debt Service Coverage 1975 Bonds	<u>2.01</u>	<u>0.35</u>	<u>2.36</u>
18	15-16 Net Available After Prior Debt Service	\$52,151	\$18,000	\$70,151
19	9+10 PMA & Other Capital Leases	7,977	0	7,977
20	18-19 Net Available After Prior Capital Leases	<u>\$44,174</u>	<u>\$18,000</u>	<u>\$62,174</u>
21	1998 Ordinance Bonds Debt Service	\$29,449	\$0	\$29,449
22	20/21 Debt Service Coverage 1998 Bonds	<u>1.50</u>	<u>0.61</u>	<u>2.11</u>
23	20-21 Net Available After 1998 Debt Service	\$14,725	\$18,000	\$32,725
24	1998 Ordinance Subordinate Bond Debt Service	\$1,990	\$0	\$1,990
25	23/24 Debt Service Coverage Subordinate Bond	<u>7.40</u>	<u>9.05</u>	<u>16.44</u>

CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission  
v.  
Philadelphia Gas Works  
Docket No. R-00005654

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

Dated this 13<sup>th</sup> day of October, 2000.

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COMMONWEALTH OF PENNSYLVANIA  
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IN REPLY PLEASE  
REFER TO OUR FILE

October 13, 2000

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

Re: Pennsylvania Public Utility Commission  
v.  
Philadelphia Gas Works  
Docket No. R-00005654; R-00005654C0001-0004

732723

Dear Secretary McNulty:

Enclosed for filing please find an original and nine (9) copies of the Main Brief of the Office of Trial Staff in the above-captioned proceeding.

Copies are being served on all active parties of record.

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Sincerely,

Johnnie E. Simms  
Senior Prosecutor  
Office of Trial Staff

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ORIGINAL

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission, et al. :  
v. : Docket Number  
Philadelphia Gas Works : R-00005654  
: R-00005654C0001-C0004

732724

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MAIN BRIEF  
OF  
THE OFFICE OF TRIAL STAFF

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Johnnie E. Simms  
Senior Prosecutor

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Date: October 13, 2000

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## I. PROCEDURAL HISTORY

Pursuant to Section 2212(d) of the Natural Gas Choice and Competition Act, on July 1, 2000, the Philadelphia Gas Works (“PGW” or “Company”) became a regulated utility under the jurisdiction of the Pennsylvania Public Utility Commission (“Commission”).<sup>1</sup> 66 Pa. C.S. § 2212 (d). Prior to the passage of the passage of the Natural Gas Choice and Competition Act, 66 Pa. C.S. § 2201 *et seq.*, PGW was regulated by the Philadelphia Gas Commission.

On August 8, 2000, PGW filed a Petition for Establishment of Interim Rate Procedures and for a Declaratory Order (“Petition”) with the Commission at Docket No. P-00001831. In its Petition, PGW requested that the Commission order an expedited hearing and review schedule that would result in a Commission order establishing interim rates for PGW no later than November 15, 2000. The interim rate request represented an increase of approximately \$52 million that would be placed into effect on an interim basis, pending the Commission’s consideration of a full base rate filing by PGW.

PGW alleged in its Petition that rate relief was needed by early November in order to afford the Company the opportunity to “maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season.” Concurrent with its Petition,

PGW requested that the Commission issue a declaratory order addressing the ratemaking methodology to be used by the Commission in its consideration of the Company's proposed interim rates.

By Order entered August 17, 2000, the Commission granted PGW's request for an expedited proceeding in order for any rate decision to be placed into effect prior to the winter heating season and denied the request for a declaratory order. By hearing notice dated August 17, 2000, a pre-hearing conference was held on August 25, 2000, and a procedural schedule was adopted.

In accordance with the procedural schedule, on September 18, 2000, OTS presented the direct testimony and exhibits of Messrs. Metro, Weakley and O'Donnell. Evidentiary hearings were held in Philadelphia on September 27, 2000 and September 28, 2000, respectively. Additionally, public inputs hearings were held on September 26, 2000 and September 29, 2000, respectively.

This Main Brief is being filed in accordance with the procedural schedule that was adopted by Administrative Law Judge Chestnut at the pre-hearing conference of August 25, 2000. Moreover, this Main Brief is intended as an avenue of succinctly presenting OTS' recommendations to the Commission for its adoption in this proceeding.

---

<sup>1</sup> PGW is a municipally owned natural gas operation that provides service within the limits of the City of Philadelphia.

## II. INTRODUCTION

Prior to the enactment of the Natural Gas Choice and Competition Act, PGW, as a public utility furnished or rendered as a city natural gas distribution operation within its municipal limits was exempt from Commission jurisdiction. As previously discussed, pursuant to the Act, 66 Pa. C.S. § 2212(b), PGW became subject to the Commission's jurisdiction on July 1, 2000. Pursuant to section 2122(d) of the Public Utility Code, and until a Commission order on PGW's restructuring case, PGW's rates and calculation formula, as well as the procedure for implementing those rates, are controlled by PGW's tariff.<sup>2</sup> Section 2212(e) of the Act requires the Commission, when determining PGW's "revenue requirement" and "approving overall rate and charges," to "follow the same ratemaking methodology and requirements that were applicable to ["PGW"] prior to the Commission's assumption of jurisdiction over PGW. Also, the same ratemaking methodology has to be continued until "all approved bonds" have been "retired, redeemed, advance refunded or otherwise defeased." 66 Pa. C.S. §2212(e).

The ratemaking methodology applicable to PGW prior to the Commission's assumption of jurisdiction over PGW is best described as a "cash flow" method. As PGW witness Knudsen testified, "the ratemaking standards and methodology are set forth in the Management Agreement, which was adopted by ordinance by City Council." PGW-IR St. 1.0 at 17. Section VII of the Management Agreement

requires “that the rates shall be sufficient to produce revenues which are, in summary, sufficient to pay all operation and maintenance costs and expenses of conducting the Gas Works enterprise, as well as to pay the debt service including depreciation, employee retirement costs, a management fee to PFMC (the managing board of PGW, appointed by the Mayor), expenses of the Gas Commission, all sinking fund charges, general expenses, the \$18 million payment to the City plus interest if the payment is delayed, funds to provide 1.5x the annual debt service requirement and a reasonable amount of cash to serve as cash working capital. Id., at 17.

While Mr. Knudsen has eloquently described Section VII of the Management Agreement, OTS was further guided by the Commission’s Order of August 17, 2000 at Docket No. P-00001831. In that regard, the Commission in its Order stated as follows:

While it would clearly be inappropriate for the Commission to comment at this time on the merits of PGW’s request for interim rate relief, suffice it to say that PGW must present substantial evidence to support its assertion that an interim rate increase is necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season until the Commission can conduct and rule on a full base rate proceeding. In particular, PGW must present substantial evidence to support its assertion that an interim rate increase is necessary for PGW to comply with its covenants to the holders of any approved bonds. (Emphasis Added).

The Commission would be remiss if we did not underscore that our approval of an expedited interim rate “process” in no way

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<sup>2</sup> PGW is permitted to request modifications to its present tariff from the Commission.

lessens PGW's obligations to meet the requisite burden of proof to substantiate the need for an increase of any dollar amount.

Accordingly, OTS in analyzing PGW's filing was guided not only by the PGW's Management Agreement, but also, the Commission's Order of August 17, 2000, which ordered that this filing should be viewed as a mechanism to "maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season until the Commission can conduct and rule on a full base rate proceeding."

With the Commission's Order of August 17, 2000 as a guide, OTS has made certain recommendations with respect to PGW's interim rate request, which will satisfy the requirements set forth in that Order.

### III. OTS' ADJUSTMENTS

#### A. PGW Has Under Projected Its Natural Gas Costs

OTS is fully aware that PGW has filed a gas cost rate ("GCR") with this Commission for its review of PGW's gas costs at Docket No. R-00005619. Notwithstanding that GCR Filing, OTS submits that gas cost issues must be addressed in evaluating PGW's cash flow. Since PGW utilizes a cash flow methodology for ratemaking, its GCR costs and its base rates are interrelated, particularly when the utility is experiencing a cash flow problem. In that regard, PGW's month to month cash flow is affected in part by the amount of gas costs that are billed during the month. Accordingly, if the gas costs are dramatically increasing from month to the month, PGW's revenues and uncollectible accounts are going to be affected either negatively or positively due to its cash flow ratemaking methodology.

In order to ensure that PGW's cash flow is not adversely affected, a review of their projected gas costs is necessary. For projecting its commodity cost of natural gas, PGW utilizes forecasted pricing data produced specifically for PGW by Standard and Poor's Fuel Price Service. OTS St. No. 2 at 7. PGW's current PGC Filing included price projections based on the July 2000 Standard and Poor's publication.<sup>3</sup> Id., at 7. As demonstrated by PGW General Statement, page 8, PGW averred that there is a significant increase in natural gas prices. After reviewing PGW's price projections based on the July 2000 Standard and Poor's

publication, OTS has determined that recent natural gas forecasts show natural gas prices higher than the prices forecasted by PGW in July 2000.<sup>4</sup> OTS Exhibit 2, Schedule 2 shows the DRI forecasts for the 12 months ending August 2001, which indicates that PGW under projected their natural gas commodity costs by approximately \$62,721,752.<sup>5</sup> OTS St. No. 2 at 9.

Based upon the DRI forecasts for the 12 months ending August 2001, the question arises as to how to deal with PGW's under projected gas commodity costs of approximately \$62,721,752. The under projected gas commodity costs create major consequences, when dealing with a gas utility that operates on a "cash flow" methodology, and the utility is having difficulty with its cash flow. Consequently, in light of PGW's financial position, OTS recommends that PGW update their commodity cost projections before the record is closed in this proceeding. OTS St. No. 2 at 9. OTS' recommendation is not made without recognizing that by updating PGW's commodity costs will increase the natural gas costs paid by PGW's customers. However, to simply overlook the ever increasing projected gas costs would place PGW into an even greater cash flow bind. OTS submits that it is in the public interest that the PGW's natural gas commodity costs be current so as to avoid jeopardizing an already tenuous cash flow situation with PGW. There can be no dispute that in the absence of reflecting the current

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<sup>3</sup> The GCR period used in this Filing is September 1, 2000 through August 31, 2001.

<sup>4</sup> OTS Exhibit 2, Schedule 2, shows a comparison of PGW's DRI forecasts from July 2000 with the most recent data as of September 12, 2000.

<sup>5</sup> The NYMEX Natural Gas Futures from *Natural Gas Intelligence* was utilized as a source.

increase to natural gas costs, a large under collection would move PGW into default of its debt service because of its cash flow problems.

OTS recognizes that the question arises as to whether the current trend in gas costs will continue through August 2001. OTS witness Metro addressed that question by testifying in pertinent part as follows:

No one knows whether the current trend for gas costs will continue. However, at the time of the writing of this testimony, gas costs continue to increase. It appears that there are two major factors for the increased prices. First, there has been an early start to the heating season in the New England states and second, warmer than normal temperatures in the Southwest. The above normal temperatures in the Southwest are increasing the demand for natural gas that is used for electric generation.

OTS St. No. 2 at 10.

The more important question is whether the failure to reflect current gas costs will negatively affect PGW's cash flow during the heating season. As OTS witness Metro testified, if PGW's GCR is not updated to reflect the current increase to natural gas costs, PGW's cash flow would deteriorate, as an increase to gas costs without revenue recovery would place PGW into a deeper cash flow problem. *Id.*, at 11.

In addition to PGW updating its GCR Filing, OTS is recommending that PGW modify its tariff for making interim GCR Filings. Presently, PGW can make an Interim Filing subject to the approval of the Commission upon determination that the effective rate will result in over billings or under billings in excess of five percent (5%) of Factor "C" if not revised. OTS is recommending that PGW's

tariff be modified to permit PGW to operate pursuant to Title 52, Chapter 53, Section 64(b), which provides in pertinent part as follows:

...if there is a know and measurable change in gas costs during the effective period of an annual levelized rate previously approved by the Commission and the change, if reflected in a natural gas utility's tariffs, would result in an increase or decrease in its gas cost rate tariffs of 2% or more, the natural gas utility shall file a proposed tariff incorporating the recalculated rate in accordance with the quarterly filing provision of subsection (i)(5).

OTS St. No. 2 at 12.

It is the opinion of OTS that PGW, like other Commission jurisdiction local distribution gas companies (utilizing two percent (2%)), should not be restricted (to five percent (5%)) in filing for natural gas cost changes that are known and measurable. The five percent (5%) threshold is even more of a concern when considering PGW's cash flow problem. Quite naturally, if PGW has the ability to file for natural gas cost increases on a less restrictive basis, the Company will be in a position to alleviate some of its cash flow problems. OTS St. No. 2 at 12.

In terms of addressing the modification to PGW's tariff, Section 2122(d) provides that "[n]othing contained in this section shall prevent [PGW] from requesting or, if so requested, the [C]ommission from approving modifications [two percent] to the prior tariff [five percent] at any time prior to the effective date of the final order approving the restructuring plan and new tariff."

Consequently, OTS submits that its recommendations as they relate to PGW's GCR will go a long way in addressing its cash flow problems not only in

this proceeding and upcoming winter heating season, but on a long-term basis as well.

B. OTS' Accounting Changes To PGW's Interim Rate Filing

In this proceeding, as previously discussed, OTS made certain GCR recommendations in order to assist PGW with its cash flow problem. Consistent with the Commission's Order of August 17, 2000, OTS analyzed PGW's Interim Rate Filing in order to determine whether the Company had met its "burden of proof to substantiate the need for an increase of any dollar amount." Additionally, OTS made its review under the guidance that "PGW must present substantial evidence to support its assertion that an interim rate increase is necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season until the Commission can conduct and rule on a full base rate proceeding." Accordingly, OTS reviewed PGW's request for an across-the-board \$52 million increase in base rates, and made a determination that in certain areas, PGW did not meet the "requisite burden of proof" of substantiating the dollar amounts requested. After reviewing the Interim Rate Filing, OTS is recommending three adjustments.

1. PGW'S \$4 Million Marginal Revenue Loss-Weather Should Be Eliminated

In determining its budgeted operating revenues, PGW calculated its operating revenues based on normal weather using 4,600 degree days.<sup>6</sup> OTS St.

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<sup>6</sup> OTS does not agree with the 4,600 degree days. The 4,600 degree days is based on out-dated information, however, due to lack of time and since these rates are subject to refund, OTS accept the Company's degree

No. 1 at 4. After using the normal weather using 4,600 degree days, PGW includes a \$4 million reduction to revenues based on the fact that the last three years were warmer than normal. Id., at 4.

After reviewing the \$4 million adjustment, OTS determined that PGW did not provide in its Interim Rate Filing, any supporting schedules for the \$4 million revenue adjustment, and accordingly, OTS was unable to determine how PGW's adjustment was calculated. OTS St. No. 1 at 5. Aside from not providing the supporting schedules for its \$4 million adjustment, the adjustment is inappropriate, since the determination of rate relief in this proceeding should be based on normal weather. In determining base rate increases, the Commission requires gas revenues to be based on normal weather. Id., at 5. PGW's \$4 million revenue reduction is based on the fact that the last three years were warmer than normal. Not only does this \$4 million adjustment violates the Commission's practice, but, also violates the Company's 4,600 degree day standard.

Consequently, OTS is recommending that the marginal revenue loss-weather adjustment be eliminated. The Company in its rebuttal did not address OTS' recommendation that its marginal revenue loss-weather adjustment of \$4 million be eliminated.

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days for purposes of this case. The Commission typically uses a NOAA 30-year degree days for base rate purposes. OTS St. No. 1 at 4.

2. PGW'S Bad Expense Should Be Adjusted From \$57 Million To \$52 Million

In this proceeding, PGW has made a claim for bad debt expenses, which the Commission normally defined as uncollectible account expense.<sup>7</sup> As OTS witness Weakley testified, uncollectible accounts are specific receivables that are determined to be uncollectible in whole or in part, either because the debtors cannot pay or because the creditor finds it impracticable to enforce payment. OTS St. No. 1 at 6. Those accounts deemed uncollectible are charged against income. Id., at 6.

It is important to note that for ratemaking purpose, utilities generally compute uncollectible account expense on an annual prospective basis. While the uncollectible account expense is a prospective claim, the proper calculation begins with an historic analysis of actual net write-offs to gross revenues to develop an historic write-off ratio. OTS St. No. 1 at 6. For calculating purposes, net write-offs are gross write-offs less recoveries of amounts previously written off. Id., at 6. As Mr. Weakley testified, this ratio is then applied to projected revenues to determine the proper prospective allowances.

PGW's revised claimed for bad debt expense is \$57 million. The \$57 million claim represents an increase of \$9 million over the original filing and an increase of \$18 million over the historic fiscal year.<sup>8</sup> OTS St. No. 1 at 7. Notably, while the Company revised its claim for uncollectible account expense to \$57

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<sup>7</sup> PGW refers to uncollectible as "Bad Debts".

<sup>8</sup> Bad Debt Expense will change with any change in total gas revenues. OTS St. No. 1 at 7.

million in its Interim Rate Filing, none of the supporting schedules were included in the Filing. Accordingly, by PGW's failures to provide supporting schedules, there is a prima facie case for accepting OTS' recommendation of reducing the \$57 million to \$52 million for uncollectible account expense.

Moreover, OTS Exhibit No. 1, Schedule 4 details OTS' proposed allowance of \$52 million for uncollectible account expense. By way of further explanation to support OTS' recommendation, OTS witness Weakley recommended a bad debt percentage of 7.3922 percent based on a five-year average of bad debt expense to billed gas revenue.<sup>9</sup> As indicated in OTS Exhibit No. 1, Schedule 4, OTS witness Weakley utilized a five-year period of 1994 through 1998, to determine the average of bad debt expense. Application of a bad debt percentage of 7.3922 being to the projected total future test year sales revenues of \$705 million, results in an allowance of \$52 million.

With respect to the use of the five-year period, OTS is of the opinion that a five-year historic analysis is current enough to reflect present customer payment tendencies and sufficiently long enough to levelize any fluctuation in write-off activity by the Company. OTS St. No. 1 at 8. It must be noted that normally, OTS utilizes a three-year analysis in evaluating a historic trend, but due to PGW's billing and collection problems over the past few years, a five-year analysis is the best method. Id., at 8.

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<sup>9</sup> OTS is recommending that the bad debt ratio of 7.3922 percent be employed to determine the additional uncollectible accounts expense attributable to the final base rate increase to be determined in this proceeding. OTS St. No. 1 at 7.

In the rebuttal phase of the Interim Rate Filing proceeding, the only aspect of OTS' recommendations that was addressed by PGW was the uncollectible account adjustment. Specifically, PGW disagrees with OTS utilization of the five-year historical average. PGW-IR St. 1.1 at 10. The premise of PGW's objection to the five-year analysis is its belief that the five-year analysis covers a period when no base rate increases took place and when the GCR was relatively stable. *Id.*, at 10. In contrast, PGW is suggesting that the prospective period will see rate increases and a substantial increase in the GCR. To demonstrate its argument, PGW presented Schedule 2, which purportedly illustrates the percentage of bad debts in prior years, when there were base rate increases. PGW-IR St. 1.1 at 10. In response, as previously discussed, and unrebutted, OTS submits that with respect to its claim of \$57 million, PGW did not present any schedules to support its claim in the Company's case-in-chief. Additionally, the time period utilized by PGW in its Schedule 2 of June 30, 1978 through August 31, 1984 is a period not only reflecting rate increases, but different economic circumstances, particularly double digit inflation. N.T. 322-323. There can be no dispute that the different economic conditions of the time period 1978 through 1984 had a tremendous effect on PGW's customers' ability to pay their utility bills in a timely fashion. Moreover, PGW has testified that the Company intends to exercise great care in entering its low-income customers in payment arrangements or programs, and along with the twenty percent senior citizens discount, these programs should alleviate PGW's prospective uncollectible accounts. N.T. 190-191.

Interestingly, as previously discussed, the Company did not present any schedules in its Interim Rate Filing to support its \$57 million bad debt claim. On cross-examination, PGW witness Knudsen acknowledges that PGW used 8.4 ratio write-off factor based on the Company's recent experience of the last two or three years. N.T. 193. It appears that the Company's claim is based on a 3-year (1998-2000) historical average of bad debt expense to bill revenues. The problem with the Company's 3-year historical average, is unlike OTS, PGW used the 1999 bad debt expense and the revised estimate for 2000 without taking into consideration the Company's well documented computer billing problem. As OTS witness Weakley testified, OTS specifically avoided using a three-year analysis, specifically 1999 and 2000, due to the Company's billing and collection problems. OTS St. No. 3 at 8 and N.T. 321.

By utilizing the 1999 bad debt expense and the revised estimate for 2000, the Company has increased its bad debt expense claim in order to inflate its bad debt reserve. It should be noted that over sixty percent (60%) of the accounts receivable balance is reserved as uncollectible. Such a high percentage of accounts receivable balance reserved as uncollectible had to be done in order to write-off a large number of accounts. Consequently, the bad debt expense ratio for 1999 and 2000 is inflated and does not represent normal payment patterns of PGW customers.

The Company appears to be concerned that with a large rate increase, there will be a corresponding increase in uncollectibles. It must be noted that OTS

increased the Company's bad debt expense to recognize both the increases in the GCR and the interim base rate. The calculation for bad debt expenses takes the total gas revenues, including the rate increase times the bad debt ratio of 7.3922 percent.

Finally, the Company's argument that bad debt expense will increase with the substantial increase in rates is not relevant, since any increase in bad debt expense will not occur during the rate effective period. As PGW witness Knudsen acknowledged on cross-examination, "by late August it will be fairly clear to us who of those billed over the winter period are able to pay or not able to pay their bills accumulated over that period." N.T. 190. Mr. Knudsen failed to recognize that by late August, the rate effective period for this Interim Rate Filing will be close to expiring, if not over, due to the Company's upcoming base rate filing.

There is no question that PGW has not met its burden of proof with respect to its bad debt expense claim, and accordingly, OTS' adjustment should be adopted for this proceeding.

### 3. OTS' Variable Line Item Adjustments

OTS witness Weakley testified that variable line items refer to those items included in the financial statements whose dollar amounts change at various levels of base rate increases. OTS St. No. 1 at 8. These items from the income statement include other operating revenues, unbilled revenue adjustment and other income. Id., at 8. It is important to note that each of these items must be recalculated with any change to the revenue increase approved by the Commission.

Since each of these items must be recalculated with any change to the revenue increase, OTS witness Weakley has provided an example to demonstrate the manner in which the recalculation should be taken with respect to a revenue increase. OTS Exhibit No. 1, Schedule 6 is PGW's Income Statement that lists a number of scenarios including rate increases of \$20 million and \$30 million. OTS St. No. 1 at 8. As an example, under 'Other Operating Revenues' the Company projects they will receive \$11.4 million under the \$20 million scenario and \$11.6 million under the \$30 million rate increase scenario. Since OTS' recommendation of \$27.5 million falls between the \$20 million and \$30 million scenarios, Mr. Weakley took the three-quarters of the difference in the range and added it back to the \$20 million scenario in order to project the 'Other Operating Revenues' for a rate increase of \$27.5 million. Id., at 9. These changes have been highlighted in OTS Exhibit No.1, Schedules 1, 2 and 3.

As noted, OTS is proposing an Interim Rate Increase of \$27.5 million for PGW, in lieu of the requested \$52 million. It must be noted that the \$27.5 million recommendation incorporates OTS' recommended increase in purchase gas costs.

C. The Commission's Adoption of OTS' Recommended GCR Adjustments And Recommended Interim Rate Filing Will Improve PGW's Financial Position Sufficiently To Preserve Its Credit Rating

The purpose of OTS witness O'Donnell testimony was to address PGW's debt service coverage requirements, the Company's financial crisis and to determine whether OTS' recommendations addressed PGW's financial crisis.

PGW's debt service payments for all issues from the issuance date through maturity date is presented in OTS Exhibit No. 3. OTS Exhibit No. 3 is a reproduction of the entire copies of each ordinance, which fully describes PGW's debt service requirements and related information. OTS St. No. 3 at 3.

As Mr. O'Donnell testified, debt service coverage is a ratio of annual funds available to cover annual debt service divided by the annual debt service requirement (principal and interest). OTS St. No. 3 at 4. The ratio is usually required in bond indentures to be greater than 1.0 times so that adequate financial protection exists to avoid default on outstanding loans. OTS Exhibit No. 3. In reviewing PGW's specific debt service coverage requirement, the Rate Covenant set forth in Article IV, Section 403 of its 1975 and 1998 Bond Ordinances requires PGW to maintain minimum debt service coverage of 1.5 times for the 1975 Ordinance Revenue Bonds and the 1998 Ordinance Senior Revenue Bonds. For the 1998 Ordinance Subordinate Revenue Bonds the required debt service coverage is 1.0 times. OTS St. No. 3 at 4.

Based upon OTS' analysis by its witness, Mr. O'Donnell, OTS is in agreement with PGW witness Bisgaier that PGW will likely experience a downgrade in its credit rating if relief is not granted in the GCR and Interim Base Rate Proceedings. Based upon his analysis, Mr. O'Donnell has determined that OTS' recommended \$27.5 million provide PGW with positive cash flow for the fiscal year-ended August 31, 2001 such that all operating and maintenance expenses and debt service will be paid. OTS St. No. 3 at 8. Most important, as a

result of OTS' recommendation, PGW's debt service coverage will be greater than minimum required levels. As illustrated in OTS Exhibit No. 1, Schedule 3, OTS' recommendation will provide a debt service of 2.51 times for the 1975 Ordinance Bonds, when the minimum debt service coverage required is 1.5 times.

Concomitantly, OTS' recommendation will provide a debt service of 2.38 times for the 1998 Ordinance Senior Bonds, when the minimum debt service coverage required is 1.5 times. Moreover, adequate coverage was provided for the 1998 Ordinance Subordinate Bonds. Clearly, OTS has demonstrated that its recommended \$27.5 million for PGW's requested Interim Rate Filing is more than sufficient to cover its debt service coverage and to provide sufficient funds to maintain a minimal, adequate level of financial health through the winter heating season.<sup>10</sup>

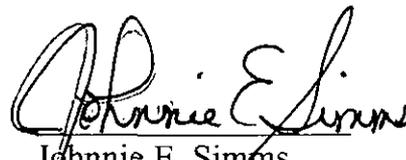
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<sup>10</sup> PGW commented in its rebuttal testimony that the Company "especially appreciate the OTS's recognition of the significant earnings and cash flow problems currently facing PGW and its customers. The only contested issue between PGW and OTS appears to be the Company's bad debt claim.

IV. CONCLUSION

OTS respectfully submits that our office recognized the significant earnings and cash flow problems currently facing PGW and its customers. While OTS and PGW have honest disagreement as to the extent of the problems, OTS has presented a recommendation that PGW should receive no more than \$27.5 million for its Interim Rate Filing. OTS sincerely believe that the \$27.5 million will assist PGW in maintaining a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season, including to the end of its fiscal year on August 31, 2001, and until the Commission can conduct and rule on a full base rate proceeding.

Respectfully submitted,

  
Johnnie E. Simms  
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Date: October 13, 2000

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility  
Commission 132725

v.

Philadelphia Gas Works

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CERTIFICATE OF SERVICE

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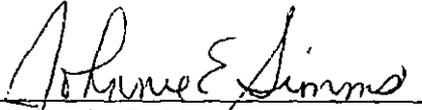
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Dated: October 13, 2000  
Docket No. R-00005654

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SECRETARY'S BUREAU  
OCT 13 11:29 AM '00

October 13, 2000

**ORIGINAL** VIA HAND DELIVERY

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Room B-20, North Office Building  
Harrisburg, PA 17120

**Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works;  
Docket No. R-00005654**

Dear Secretary McNulty:

DOCUMENT  
FOLDER

Enclosed for filing with the Commission are the original and nine (9) copies of the Main Brief of the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG") in the above-referenced proceeding. Also enclosed, please find a diskette containing PICGUG's Main Brief in Word format.

As shown by the attached Certificate of Service, all parties to this proceeding are being duly served. Please date stamp the extra copy of this transmittal letter and kindly return it for our filing purposes.

Very truly yours,

MCNEES, WALLACE & NURICK

By *Charis M. Burak*  
Charis M. Burak

Counsel to the Philadelphia Industrial and  
Commercial Gas Users Group

Enclosures  
CMB/lhe

c: Administrative Law Judge Marlane Chestnut (via federal express) (with diskette)  
Certificate of Service

33

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC  
UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-0000<sup>D</sup>



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**MAIN BRIEF OF THE PHILADELPHIA INDUSTRIAL  
AND COMMERCIAL GAS USERS GROUP**

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The Budd Company  
The Building Owners' and Managers'  
Association of Philadelphia  
Jefferson Health System  
Nabisco, Inc.

Newman & Company, Inc.  
Sunoco, Inc.  
Temple University  
12<sup>th</sup> Street Gym

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Counsel to the Philadelphia Industrial and  
Commercial Gas Users Group

Dated: October 13, 2000

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## I. INTRODUCTION

On August 8, 2000, the Philadelphia Gas Works ("PGW" or "Company") filed a Petition with the Pennsylvania Public Utility Commission ("PUC" or "Commission") claiming that the Company was facing a financial crisis and would be unable to meet its expenses and bond coverages as of January 1, 2001. Based upon these assessments, PGW petitioned the PUC requesting, among other provisions, the following: (1) establishment of an interim rate increase for the Company to be in effect during the winter heating season, until a full base rate proceeding can be held; and (2) establishment of a procedural schedule that would allow the PUC to render a decision regarding interim rates no later than November 8, 2000.

On August 15, 2000, the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG") filed an Answer to PGW's Petition. PICGUG is an ad hoc association of energy-intensive industrial and commercial customers receiving service from PGW under various rate schedules. PICGUG members use substantial volumes of natural gas in their businesses, and natural gas costs comprise a significant element of their respective costs of operation. Because any change in PGW's rates would impact the price PICGUG members pay for service, PICGUG is an active party to this proceeding. The membership of PICGUG is listed on the cover page of this Main Brief.

On August 17, 2000, the PUC entered an Order granting PGW's request for expedited review regarding interim rates. On August 24, 2000, PICGUG filed a Complaint in this proceeding. On August 25, 2000, Administrative Law Judge Marlane Chestnut convened a Prehearing Conference, in which the procedural schedule for this proceeding was developed. Pursuant to the procedural schedule, PICGUG filed Direct

Testimony in this proceeding on September 18, 2000. PICGUG received Direct Testimony from the Office of Consumer Advocate ("OCA"), the Office of Trial Staff ("OTS"), and the Office of Small Business Advocate ("OSBA"). PICGUG also received a letter from a coalition consisting of the Consumers Education and Protective Association, the Association of Community Organizations for Reform Now, the Action Alliance of Senior Citizens of Greater Philadelphia, and the Tenants Action Group ("CEPA, et. al."). On September 25, 2000, PICGUG received the Rebuttal Testimony of PGW. Evidentiary hearings were held in this proceeding on September 27-28, 2000, for the purpose of cross-examining witnesses and allowing the parties to present oral surrebuttal.

Pursuant to the procedural schedule and 52 Pa. Code Section 5.502, PICGUG files this Main Brief to address PGW's request for interim rate relief. For reasons discussed more fully herein, PICGUG posits that while some level of interim relief may be necessary for PGW during the winter heating season in order to ensure that PGW is able to provide adequate service, PGW has not presented substantial evidence that a \$52 million rate increase is necessary in order for the Company to maintain the minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season. Moreover, certain circumstances surrounding the Company mitigate PGW's need for rate relief. Accordingly, PICGUG submits that the PUC, in its discretion, should grant PGW the minimum level of rate relief necessary for the Company to meet the aforementioned requirements. The parties must have the opportunity to pursue further review of PGW's financial status during the Company's forthcoming full base rate proceeding, so the PUC must minimize the adverse customer impacts of any rate increase at this time.

## II. ARGUMENT

PICGUG recognizes that PGW is facing financial concerns entering into this winter heating season as a result of several years of financial mismanagement. PICGUG submits, however, that PGW has failed to meet the standard set forth by the PUC in order to obtain the requested \$52 million rate increase. According to the PUC,

PGW must present substantial evidence to support its assertion that an interim rate increase is necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season until the Commission can conduct and rule on a full base rate proceeding. In particular, PGW must present substantial evidence to support its assertion that an interim rate increase is necessary for PGW to comply with its covenants to the holders of any approved bonds.

Petition of Philadelphia Gas Works for Establishment of Interim Rate Procedures and for a Declaratory Order; Docket No. P-00001831, Order Establishing Interim Rate Procedures (hereinafter, "Interim Rate Order") (Aug. 17, 2000), pp. 7-8.

PGW has set forth evidence of financial conditions that may warrant consideration of a limited rate increase in order to ensure the Company's operational abilities during the upcoming winter heating season. At no point during this proceeding, however, has PGW presented substantial evidence that a \$52 million rate increase is necessary to maintain a minimum level of financial health and meet debt service requirements.

Instead, PICGUG would argue that several mitigating circumstances should temper any rate relief provided to PGW. Specifically, the PUC should consider the following mitigating circumstances with respect to PGW's interim rate request

proceeding: (1) the financial crisis, precipitating this proceeding, was of the Company's own making; (2) possible rate relief in the form of a waiver and loan by the City of Philadelphia would provide additional financial cushion for the Company; (3) a less dire financial picture may exist than that presented by PGW; and (4) the rate shock to PGW customers that would result from a rate increase of \$169 million, as requested by PGW. Based upon these mitigating circumstances, which will be detailed more fully herein, PGW's rate increase request of \$52 million is unnecessary and improper in this proceeding.

PICGUG would also note, however, that PGW has set forth valid concerns that warrant further consideration with respect to a possible limited rate increase. Specifically, PGW may be facing financial problems that could result in (1) a negative cash position, which could limit the Company's financial flexibility; (2) the inability of the Company to invest in ongoing system expansion and improvements; and (3) the loss of PGW's commercial paper program. For these reasons, PICGUG submits that the PUC has substantial latitude in determining the amount of rate relief that should be granted in this proceeding. PICGUG sets forth the following mitigating circumstances and concerns that should be considered by the PUC in determining the appropriate level of rate increase for PGW in this interim proceeding.

- 1. Several circumstances surrounding PGW's financial situation mitigate the need for approval of PGW's requested rate increase of \$52 million.*

PGW's financial crisis is one that has occurred of the Company's own making. As noted by PGW witness Knudsen, PGW's prior management did not file for a rate increase for several years, and was of the position that no rate increase was needed

until 2001. See Direct Testimony of Thomas Knudsen, PGW-IR St. No. 1.0 (hereinafter, "PGW St. No. 1.0"), p. 13. PGW's problems were then "discovered" upon the appointment of interim management on March 17, 2000; however, PGW waited until June 19, 2000, to file for rate relief. Id. Even more surprisingly, the Company chose to file for this rate relief with the Philadelphia Gas Commission ("PGC"), even in light of the Natural Gas Choice and Competition Act's ("Competition Act") provision specifically altering the change in regulatory jurisdiction over PGW from the PGC to the PUC on July 1, 2000. See 66 Pa. C.S. §2212(b).<sup>1</sup> As a result, PGW failed to file any rate increase request with the PUC until August 8, 2000, at which time the Company requested an expedited proceeding to address the present financial crisis.

PICGUG submits that PGW was fully aware of its financial crisis long before the filing of August 8, 2000. Because of the failure of the Company to take action with respect to this crisis, an interim proceeding on an expedited basis has been required. As a result, the intervening parties have had limited opportunity at best to review the Company's filing. Accordingly, the limited nature of this proceeding requires that the relief granted to the Company be nothing more than "interim" relief to ensure PGW's ability to provide adequate service during the 2000-2001 winter heating period. To look further than this period would deny the parties to the proceeding, as well as the ratepayers, the opportunity to fully examine, and if necessary refute, PGW's financial and managerial claims. Accordingly, the PUC must ensure that any rate relief provided to PGW is only the minimum needed for the Company to meet its debt service and bond

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<sup>1</sup> Although PGW claims that it was not until mid-July 2000 in which both agencies specified that the PUC would be the proper agency from which to obtain a rate increase, PICGUG submits that the clarity of the Competition Act was evident since its passage on June 22, 1999. See PGW St. No. 1.0, p. 13.

covenant obligations.<sup>2</sup> Long-term financial requirements should and can be more adequately addressed in PGW's forthcoming base rate proceeding.<sup>3</sup>

Second, PGW's need for increased interim rates can, and should be, offset by relief from the City of Philadelphia ("City"). The City is the owner of PGW, and as such, should take responsibility for the financial mismanagement that has occurred. According to PGW, the City has recently offered support to PGW by asking the Philadelphia City Council to approve a \$45 million loan to PGW, as well as indicating a willingness to waive or grant back the Company's yearly \$18 million payment to the City. This grant-back would most likely occur in such a manner as to assure that PGW will satisfy all applicable bond ordinances and rate covenants. See Rebuttal Testimony of Thomas Knudsen, PGW-IR St. No. 1.1 (hereinafter, "PGW St. No. 1.1"), pp. 4-5.

As a result of the City's actions, should they come to fruition, PGW will be able to obtain approximately \$63 million in additional cash-flow, or an increase of \$11 million above what PGW originally requested from the PUC. This short term loan, in addition to the City's waiver, would lessen the Company's need for an interim increase and ease the Company's cash situation in the next year. See Direct Testimony of Richard Baudino, PICGUG St. No. 1 (hereinafter "PICGUG St. No. 1"), p. 8. PGW has indicated, however, that even with the aforementioned relief from the City, the need for a rate

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<sup>2</sup> While any interim rate increase granted to PGW in this proceeding is subject to refund, PICGUG would note that any rate increase, coupled with the Company's Gas Cost Rate ("GCR") increase, will result in a significant impact upon ratepayers during the peak winter period. As a result, this financial impact may not be fully corrected even if refunds do result after review of PGW's base rate proceeding.

<sup>3</sup> Pursuant to the Interim Rate Order, PGW must file a full base rate case with the PUC no later than January 1, 2001. See Interim Rate Order, p. 11.

increase is not eliminated, partially because the City is "willing to do its part to help this Company survive over the next 12-18 months - but only as part of an overall assistance plan that includes a rate increase - not in place of it." See PGW St. No. 1.1, p. 6.

While PICGUG recognizes that the City's proposed relief may not completely eliminate PGW's fiscal problems, PGW's proposal, to obtain relief from the City in the amount of \$63 million plus a rate increase of \$52 million, amounts to nothing less than an attempt to obtain relief above that already requested. Specifically, the Company hopes to obtain \$52 million in rate increases, along with \$63 million from the City to help ease the Company's financial burden. Since PGW originally requested only a \$52 million rate increase from the PUC, the Company's current overall goal of \$115 million in relief during an interim rate proceeding falls nothing short of extreme. Rather, PICGUG submits that PGW's rate increase request should be viewed in light of the City's proposal, and the City's proposal should be considered a mitigating circumstance that reduces the Company's rate request substantially.

Third, PGW's cash flow projections may not be as dire as the Company predicts. Due to the expedited nature of this proceeding, the parties have only had limited opportunity to review the Company's cash flow projections for reasonableness. As a result, a more thorough review may have provided a better financial picture than that presented by the Company. See PICGUG St. No. 1, pp. 8-9.

In addition, PGW claims that if the Company does not receive rate relief in November 2000, the Company's bonds would be downgraded; however, as noted by PICGUG witness Baudino, none of the parties to this proceeding, including PGW, can predict with absolute certainty what will happen to the Company's bond rating if interim

relief is not granted. See Direct Testimony of Barbara Bisgaier, PGW-IR St. No. 2 (hereinafter, "PGW St. No. 2"), p. 13; see also PICGUG St. No. 1, p. 10. Because a bond agency has discretion in these ratings, it may choose to look at both present and expected future circumstances of a company when determining a bond rating, including PGW's forthcoming base rate proceeding before the PUC. As a result, PGW may fall short of the quantitative requirements for a particular rating, and still not be downgraded if the agency believes that PGW will have the opportunity to obtain relief in the future. Moreover, Standard and Poor's is already cognizant of PGW's historically weak interest coverage, and still allows PGW to maintain a BBB rating. See PICGUG St. No. 1, pp. 10-11.

Finally, the combined effect of PGW's interim rate increase request and GCR increase request on the ratepayers must be considered by the PUC when examining PGW's request. PGW's \$52 million rate increase request coupled with the Company's \$97 million GCR request would result in a total increase of \$149 million. Moreover, PGW recently noted in the GCR proceeding that this increase should be revised by an additional \$75 million, which would result in a combined increase to ratepayers of \$224 million.<sup>4</sup> This request results in a substantial increase to ratepayers, and could lead to rate shock. As utilized by the PUC in previous rate setting proceedings, the principal of gradualism should be considered in this proceeding in order to ensure that PGW's rates are increased in a gradual manner that ameliorates the financial impact to customers and prevents rate shock to ratepayers. See Pa. PUC v. Citizens Util. Water Co. of Pa., 1996 Pa. PUC LEXIS 167, \* 167 (March 29, 1996); see also Pa. PUC v. Equitable Gas Co., 73 Pa. PUC 301, 352-55 (November 21, 1990); Pa. PUC v. Nat'l Fuel Gas Distribution Corp., 73 Pa. PUC 552, 621 (Dec. 24, 1990); Pa. PUC v. Philadelphia Elec. Co., 74 Pa. PUC 1, 211-12 (May 16, 1990); Pa. PUC v. W. Pa. Water Co., 95 PUR 4<sup>th</sup> 470, 515-16

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<sup>4</sup> See Rebuttal Testimony of Craig White, PGW-GCR, St. No. 1.1, p. 6.

(July 1, 1988); Pa. PUC v. Pa.-American Water Co., 97 PUR 4<sup>th</sup> 469, 507-08 (Oct. 21, 1988). If, however, the PUC grants PGW's requested increase in the GCR, the Company's forecasted financial situation improves tremendously. See PICGUG St. No. 1, p. 10. As a result, the PUC could lower PGW's requested rate increase, thereby lowering the impact of these increases on PGW customers.

Based upon the aforementioned mitigating circumstances, the PUC should consider the significant combined effect of PGW's proposed increase coupled with the improvement in PGW's financial situation based upon a GCR increase. These issues, in addition to a financial crisis of PGW's own making and the forthcoming base rate proceeding, should temper PGW's interim rate request. Accordingly, the PUC should modify PGW's interim rate increase to adjust for these factors and to cushion the effect of rate shock on PGW's customers.

2. *PGW's current financial status may warrant a minimal, refundable rate increase in order to ensure that PGW is able to maintain operations and meet debt service requirements.*

Although PGW has not presented substantial evidence to support its \$52 million rate increase request, PICGUG recognizes several legitimate concerns regarding the Company's current status that should be considered by the PUC when determining the appropriate level of rate increase, if any, that should be approved for PGW.

First, PGW forecasts a negative cash position in the forthcoming months. Specifically, PGW argues that without a base rate increase, PGW's cash balance at the end of the 2000-2001 fiscal year would not provide PGW enough liquidity to make gas purchases in September-November, 2001 or a \$25 million bond service payment in

January, 2002. See PGW St. No. 1.0, pp. 8-9. Although interested parties have not had adequate opportunity to review PGW's filing for reasonableness, should PGW's negative cash position materialize, the Company would suffer a lack of flexibility needed to make the necessary gas purchases for customers. See id.; see also PICGUG St. No. 1, p. 7. As a result, PICGUG submits that a minimal rate increase may be needed in order to provide PGW with adequate cash flow during the winter period.

Second, the Company must continue to invest in system improvements and main replacements in order to ensure adequate and reliable service for its customers. See PICGUG St. No. 1, p. 7. For example, between 1989-1994, PGW replaced its cast iron mains on an average of 1% per year. This figure was then cut in half beginning in 1995 and continuing through the present, with PGW only replacing 0.5% of its mains during this time. See Direct Testimony of Richard Lelash, OCA St. No. 1 (hereinafter, "OCA St. No. 1"), p. 44. Because adequate main replacement is necessary to reduce the risk of main breaks and incidents, PGW's main replacement process should be a required, rather than discretionary, program. Accordingly, PGW should maintain necessary cash flow to continue this program, and be required to use a portion of this cash flow to ensure adequate main replacement during the winter heating season.

PICGUG would also note that PGW's possible negative cash position and the immediate need to continue main replacements presents concerns regarding the ability of PGW to provide adequate customer service. As noted previously, a negative cash position would limit the flexibility of PGW in making necessary gas purchases for customers. See PGW St. No. 1.0, pp. 8-9. Moreover, a low level of main replacement increases the possibility for increased breaks and incidents, which can be even further magnified during severe weather. See OCA St. No. 1, p. 45. As a result, these concerns

could limit PGW's ability to provide necessary services to its customers. Accordingly, PICGUG members' need for adequate service by PGW is the primary motivation for PICGUG's support of some rate relief for PGW, in spite of PGW's missteps in the previous years. PICGUG would again submit, however, that this increase should be the minimal amount needed in order to provide PGW with adequate cash flow during the winter period and ensure adequate service to ratepayers.

Moreover, PGW should also consider the short-term deferral of construction expenditures for those items that are not necessary for the safety and reliability of customer service.<sup>5</sup> Currently, PGW's cash flow projection shows an expected net construction expenditure of \$62.3 million. Because of the shortened time period for this proceeding, PICGUG was not able to thoroughly review PGW's proposed projects to determine those costs that may be discretionary. PICGUG recommends, however, that PGW review this projection to determine whether proposed projects included in the construction forecast may be deferred until the next fiscal year, especially in light of other concerns, such as main replacements. See PICGUG St. No. 1, p. 8.

Third, PGW has expressed valid concerns regarding the effects of this proceeding on the Company's commercial paper program. Currently, PGW's commercial paper is secured by a letter of credit provided by Morgan Guaranty Trust Company ("Morgan") that matures in June 2001. PGW requested a one-year extension of the Morgan letter of credit, which would allow the program to survive until June 2002. If Morgan does not grant the extension, PGW will need to find a letter of credit bank to

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<sup>5</sup> As noted above, PICGUG considers PGW's cast iron main replacement to be an obligation needed for the safety and reliability of customer service.

replace Morgan in 2001, which may be difficult to do as the number of banks that remain active in the municipal market is reducing. See PGW St. No. 2, pp. 6-9.

Because PGW's cash flow projections for fiscal year 2000-2001 rely upon \$97 million of commercial paper remaining outstanding for the entire year, if PGW were to lose the letter of credit that supports the commercial paper program, PGW could face a financial crisis. See id. at 7-9. The PUC should be aware, however, that Morgan has informed PGW that the search for new participants in the letter of credit could be delayed until November or December 2000. See id. at 9. Therefore, assuming the PUC grants the Company's requested GCR relief, a substantial amount of uncertainty surrounding the Company's financial future will have been addressed by the PUC, thus making it easier for Morgan to allow the Company to continue its commercial paper program through 2002. See PICGUG St. No. 1, pp. 12-13.

Based upon the aforementioned issues, PICGUG submits that there are concerns remaining regarding PGW's financial status, however, these concerns can be tempered based upon the City's preliminary relief proposal and the Company's GCR request. Accordingly, PICGUG submits that the PUC should examine these concerns in light of PGW's other proceedings, and grant the minimal relief necessary at this time.

### III. PROPOSED FINDINGS OF FACT

1. PGW was aware of the change in jurisdiction over the Company from the PGC to the PUC, pursuant to the Competition Act, prior to July 1, 2000. See PGW St. No. 1.0, pp. 12-14.
2. The City is in the process of considering a waiver of PGW's \$18 million yearly payment. See PGW St. No. 1.1, pp. 4-5.
3. The City has recently asked the Philadelphia City Council to approve a \$45 million loan to PGW. See id.
4. If the City provides a \$45 million loan to PGW and waives PGW's yearly payment of \$18 million, PGW's cash flow will improve by \$63 million. See id.
5. Technical failure of PGW to meet its bond covenants does not automatically result in a downgrade of PGW's bonds. See PICGUG St. No. 1, pp. 10-11.
6. Between 1995 and the present, PGW has reduced its cast iron main replacement to 0.5%. See OCA St. No. 1, p. 44.

#### IV. CONCLUSIONS OF LAW

1. PGW failed to provide substantial evidence to support its assertion that the entire interim rate increase request is necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season. See Interim Rate Order, p. 7.
2. PGW failed to present substantial evidence to support its assertion that the entire interim rate increase request is necessary for PGW to comply with its covenants to the holders of any approved bonds. See id. at pp. 7-8.

## V. CONCLUSION

**WHEREFORE**, the Philadelphia Industrial and Commercial Gas Users Group requests that the Pennsylvania Public Utility Commission:

1. approve the Philadelphia Gas Works' request for an interim rate increase only to the extent necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season;
2. require that PGW file a base rate case on or before January 1, 2001;
3. require that any interim relief provided would be fully subject to refund based on the outcome of the base rate proceeding;
4. prohibit PGW from seeking to recoup additional revenues from ratepayers if the PUC determines that a higher level of permanent rates should be granted during the base rate proceeding;
5. require PGW to commit to its "Transition to Excellence" plan and prove that it is providing safe and adequate service to customers; and

6. permit any other such relief that is consistent with PICGUG's Main Brief.

Respectfully submitted,

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Dated: October 13, 2000

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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.

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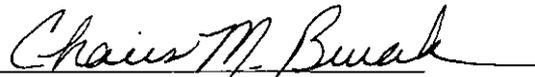
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October 13, 2000

OCT 13 2000

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Sent by Federal Express

Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works  
Docket No. R-00005654

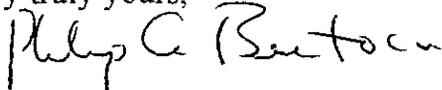
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Dear Secretary McNulty:

Enclosed for filing with the Commission are the original and nine (9) copies of the Main Brief of CEPA et al. in the above referenced proceeding. Also enclosed please find a diskette containing CEPA et al.'s Main Brief in Word format.

This filing is made pursuant to 52 Pa.Code §1.11(a)(2).

Very truly yours,



PHILIP A. BERTOCCHI

Counsel for CEPA et al.

Enclosures

cc:Administrative Law Judge Marlane Chestnut  
Certificate of Service

ORIGINAL

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY  
COMMISSION

Docket No. R-0000 5654  
R-0000 5654 C0001- C0004

v.

PHILADELPHIA GAS WORKS

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PA PUBLIC UTILITY COMMISSION  
MAIN BRIEF of CEPA, Action Alliance of SECRETARY'S BUREAU  
Senior Citizens, ACORN and Tenants' Action Group

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Date: October 13, 2000

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## **I. Introduction.**

The Philadelphia Gas Works, the nominal petitioner in this case, is not an “identifiable corporeal entity or agency”, but merely the “collective name for the real and personal property which is used to furnish gas service to more than half a million customers in the City of Philadelphia.” Dawes v. Philadelphia Gas Commission, 421 F.Supp.806, 811 n.1 (E.D. Pa. 1976); Management Agreement, p. 1.<sup>1</sup> The legal owner of this collection of assets is the City of Philadelphia, which through its Mayor, City Controller, Director of Finance and City Council and their appointees, resolves the major policy issues affecting PGW. In this enterprise, the City utilizes the Philadelphia Facilities Management Corporation (PFMC), a non-profit entity composed of mayoral appointees charged with maintaining the Gas Works “for the sole and exclusive benefit of the City” in “good order and efficient operating condition.” Management Agreement, Section I(3). The Philadelphia Gas Commission, whose members include the City Controller, two Mayoral appointees, and two appointees of City Council review and approve or recommend for City Council approval the utility’s annual Operating and Capital Budgets. Management Agreement, Section VI. In sum, the City of Philadelphia is PGW’s legal owner and bears the ultimate responsibility for the efficiency of its operations and the quality of its service.

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<sup>1</sup> The City Ordinance entitled “Agreement Between the City of Philadelphia and the Philadelphia Facilities Management Corporation for the Management and Operation of the Philadelphia Gas Works” (hereinafter “Management Agreement”) which has been amended from time to time , may be found in the Ordinances of the City of Philadelphia (From January 1 to December 31, 1972), pp. 1001 et seq. (Bill No. 455). The Management Agreement, as amended through December 31, 1995, is contained as Exhibit B in the Petition of Philadelphia Gas Works for Establishment of Interim Rate Procedures and for a Declaratory Order, Docket No. P-00001831 (hereinafter “Interim Rate Procedures Petition”).

In this proceeding, the City of Philadelphia, through PFMC and its appointees PGW's chief executives, has requested that the Commission grant an interim base rate increase in the amount of \$52 million effective November 10, 2000, an increase of approximately 10% in the average customer's monthly bill. In addition, PGW is requesting an increase in the Gas Cost Rate of at least \$97 million, also effective on the same date, an increase of approximately 20% in the average customers monthly bill. OCA St.1 at 23, 25. One impact of these increases, if granted, on residential customers is that an additional 40,000 PGW customers will become delinquent on their monthly bills. Tr. 192. If the Gas Cost Rate were to increase by an additional \$50 million beyond \$97 million, as hypothesized in PGW rebuttal testimony in its Gas Cost Rate filing, the number of customers becoming delinquent may be assumed to increase proportionally to the 50,000 range. And if the Gas Cost Rate were to increase by an additional \$75 million beyond \$97 million, another possible eventuality envisaged in the PGW's GCR rebuttal testimony, the number of customers becoming delinquent could increase to approximately 57,000.<sup>2</sup>

This interim base rate increase request follows almost a decade of management instability at PGW in which the utility's long and short term debt rose to almost \$1 billion. This instability culminated in a failed implementation in July, 1999 of a new Billing, Collections and Customer Service system (BCCS), which has seriously impaired PGW's ability to conduct its fundamental business operations, including accurate billing and related servicing of inquiries, disputes and complaints by PGW residential customers.

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<sup>2</sup> These estimates assume that there is a roughly proportional relationship between the number of customers becoming delinquent and the increase in overall rates (including both base rate increase and gas cost rate). The evidence supporting the validity of this assumption is the fact that PGW has stated that an increase of \$94 million (\$52 million base rate and \$42 million GCR) would cause 24,000 customers to become delinquent, and that an increase of \$149 million (\$52 million base rate and \$97 million GCR) would cause an additional 15,000-17,000 customers to become delinquent. Tr. 192.

In addition, PGW reports severe cash flow problems, due to the fact that it has exhausted its \$100 million line of tax exempt commercial paper, to be used for financing accounts receivable and for the purchase of inventory. Management Agreement, Section IV(3).

CEPA et al. urge the Commission to deny the requested interim base rate increase in its entirety for the following reasons:

(1) the proposed increased base rate is not just and reasonable, because PGW has failed and is currently failing to provide adequate, efficient and reasonable service in compliance with the requirements of its Tariff and the PUC's Standards and Billing Practices for Residential Utility Service, 52 Pa.Code §§56.01 et seq.;

(2) an interim base rate increase would not be just and reasonable, because ratepayers are likely to have to absorb a rate increase well over 20% arising from GCR increases alone, and because despite the fact that PGW's current crisis is due to the City's mismanagement, the City of Philadelphia has refused to commit its annual \$18 million "dividend" to PGW and has not fully committed other resources within its means to alleviate PGW's cash flow problems;

(3) an interim base rate increase is not necessary for the minimum financial health of the company or for PGW to satisfy the requirements of its bond covenants in FY 2001.

**II The Proposed Increased Base Rate Is Not Just and Reasonable, because PGW Has Failed and Is Currently Failing to Provide Adequate, Efficient and Reasonable Service in Compliance with the Requirements of Its Tariff and the PUC's Standards and Billing Practices for Residential Utility Service, 52 Pa.Code §§56.01 et seq.**

**A. Just and Reasonable Rates Presuppose Adequate Service.**

PGW contends that in ruling on its request for interim rate relief, the Commission should focus only on the level of rates which “would permit PGW to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season until the Commission can conduct and rule on a full base rate proceeding.” Interim Rate Procedures Petition at 1, ¶¶ 8-11; see also PGW-IR EXH. 1.1, ¶¶ 3-6. According to PGW, in making this determination, the Commission must focus narrowly on Section VII of the Management Agreement, without regard to whether a rate determined in such a manner complies with the requirement, imbedded in federal and state constitutional law, the Public Utility Code, and the Management Agreement as interpreted by the state Supreme Court, that such rate be “just and reasonable.”

The Commission has already rejected this view, when it declined to grant PGW’s request in its *Interim Rate Procedures Petition for a declaration limiting the scope of evidence admissible in this case to only financial matters pertaining to the level of interim rates necessary for PGW to maintain its operations pending completion of its base rate case.* Order Establishing Interim Rate Procedures, Docket No. P-00001831, ¶ 3. This rejection is not only appropriate, but required, by state, municipal, and federal law.

From the customer’s perspective, the impact of increased charges arising from “interim rates” on a household budget is indistinguishable from the impact arising from permanent rates. The ultimate standard for determining the level of an “interim” base rate increase, as for a permanent base rate increase, is whether the rate proposed is “just and reasonable.”

This is the broad federal constitutional standard which requires that regardless of the particular ratemaking “theory” or “methodology” utilized, the resulting rate must in

“total effect” or “impact” be “just and reasonable.” Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 602, 64 S.Ct. 281, 288 (1944). In determining whether a rate is “just and reasonable,” the ratemaker must not only consider financial and economic data reflecting a public utility’s anticipated capital needs, resources, revenues and expenses, but also less quantifiable factors such as level of service provided to ratepayers. In rejecting a claim by a public utility that rates should be increased without regard to service, the U.S. Court of Appeals for the District of Columbia Circuit has stated:

*If [the utility] is correct, it may disregard its public responsibilities at will...and yet insist that the public respond to its demands for higher rates. We cannot accept that position. We do not believe that the Constitution left the Commission impotent to deal with the situation confronting it in a sensible manner.*

D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission, 466 F.2d 394, 422 (D.C.Cir.1972), cert. denied, 409 U.S. 1086.

In this proceeding, as the Commission has recognized, it must, under Section 2212(e) of the Gas Choice Act, utilize the same “ratemaking methodology and requirements” as were applied by the Philadelphia Gas Commission. It is CEPA et al.’s position, as set forth in Part IV(A) below, that in the context of an interim, temporary or emergency base rate proceeding, the Philadelphia Gas Commission was not required to observe all the rate setting requirements set forth in the Management Agreement. The one requirement that must be observed is the federal constitutional requirement that the interim rate be “just and reasonable.” As the state Supreme Court has recognized, ratemaking by the Philadelphia Gas Commission, like ratemaking by the PUC, has been ultimately subject to the constitutional requirement that rates be just and reasonable. In Public Advocate v. Philadelphia Gas Commission, -- Pa.-- ,674 A.2d 1056(1996), the Court held that a 1991 Gas Commission order increasing PGW’s base rates in accordance

with the requirements of the Management Agreement was not unconstitutional, because, under the circumstances of that rate case, even with the inclusion of the \$18 million City Payment in the revenue requirement, the resulting rate met the overarching “just and reasonable” standard. As the Court stated: “the overall rate approved by the Commission for PGW’s 1991-92 fiscal year was constitutional since it was just and reasonable...”Id. at 1062, 1063. <sup>3</sup>

Similarly, in 1979, the Commonwealth Court remanded an appeal from a ratemaking order rendered by the Philadelphia Gas Commission pursuant to the Management Agreement with the instruction to provide “findings” and “reasons” why the increased rates were “just and reasonable.” Action Alliance, etc. v. Philadelphia Gas Commission, 45 Pa.Cmwlth.234, 406 A.2d 1155, 1158 (1979).

Moreover, the Management Agreement, consistent with the “just and reasonable” standard, implicitly recognizes that determination of “just and reasonable” rates must be made with a view to the level of management practice and customer service provided by the utility. The Management Agreement states in the “whereas” clauses at the beginning of the ordinance: “WHEREAS, the City desires to provide quality gas services to its citizens at reasonable rates...” Section I(5) of the Management Agreement states that PGW’s “primary obligation shall be to apply the highest standards of management

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<sup>3</sup> The record in that case did not contain evidence that PFMC and the PGW Management had failed to manage PGW according to required standards of management practice and diligence and had failed to provide quality gas services to citizens. In that case, the issue was whether an the Management Agreement’s provision of the \$18 million payment as part of the revenue requirement regardless of the level of service and managerial practice was per se unconstitutional. In contrast, in this case, where the issue is the amount of a proposed “interim” rate increase, and where there are substantial issues of service and management practice, inclusion of the \$18 million payment in the revenue requirement would not result in a “just and reasonable” rate.

In this respect, the Management Agreement is not inconsistent with the Public Utility Code, which provides that in performing its ratemaking functions:

The commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title....

66 Pa.C.S. § 523. Section 526 further provides that the commission may reject, in whole or in part, a request for an increase in rates, where the commission concludes that the “service rendered by the public utility is inadequate in that it fails to meet quantity or quality for type of service provided.” 66 Pa.C.S. §526.

**B. The Term “Service” in the Public Utility Code Includes Customer Service.**

PGW itself concedes at least as a general matter that “service inadequacies can be the basis for denial of a rate request...” PGW-IR St.1.1 at 23. However, PGW may well contend that the term “service” in this context refers only to the quantity or quality of gas delivered through the company’s system, not to PGW’s level of compliance with applicable customer service regulations which set standards for response to applications for service, billing requirements, budget billing plans, terminations procedures, etc. The Commission should reject this contention.

The Public Utility Code’s definition of “service” is very broad, including, inter alia, “any and all acts done, rendered, or performed, and any and all things furnished or supplied...by public utilities.” 66 Pa.C.S. §101. This definition of “service” under the Code encompasses both a public utility’s compliance with the terms of its applicable customer service regulations as well as quality and quantity standards applicable to the commodity delivered by the utility. See 66 Pa.C.S. §1501 (“...service and facilities shall be in conformity with the regulations and orders of the commission”). Indeed, the Pennsylvania Supreme Court has recognized that the standards contained in customer

service regulations like Chapter 56 of the Public Utility Code and the Philadelphia Gas Commission's "Gas Service Tariff" provide baseline definition for what constitutes adequate service in the full range of interactions between customers and their utility provider. Rohrbaugh v. Pennsylvania PUC, 556 Pa. 199, 727 A.2d 1080 (1999); cf. York Telephone & Telegraph Co. v. Pennsylvania PUC, 181 Pa.Super.11, 121 A.2d 605(1956)(under Public Utility Law, public utility was providing inadequate service due to failure to address large accumulation of unsatisfied service demands). Failure to comply with applicable customer service regulations constitutes grounds for assessment of a civil penalty by the PUC against the public utility. 66 Pa.C.S. §3301.

The Commission has applied these provisions in numerous rate cases. Pa.P.U.C.v. Tri-Valley Water Supply, Inc. 1996 WL 482989, \*3 (Pa.P.U.C.) ("It is well settled that, as long as the service remains substandard, ratepayers should not be required to pay rates which might be appropriate if the service were adequate."); Pa.P.U.C. v. Tri-Valley Water Supply, Inc., 1996 WL 481097 (Pa.P.U.C.)(rate settlement rejected due to substandard water quality and unresponsive customer service); Pa.P.U.C. v. Sunshine Hills Water Company, 77 Pa.PUC 1 (1992)(rate increase rejected due to utility's failure to provide adequate water quality); Pa.P.U.C. v. Pennsylvania American Water Co., 71 Pa. PUC 210, 2119 (1989)(requested rate increase for one district denied because utility failed to provide adequate water quality); Pa.P.U.C. v. Pennsylvania Gas and Water Co., 68 Pa. PUC 191, 197 (1988)(rate increase request denied in its totality on the basis of inadequate water quality).

**C. PGW's Customer Service is Inadequate in a Wide Range of Ways Including the Operations of the Call Center and Compliance with Customer Service Regulations Contained in the Tariff.**

PGW may also be expected to contend that PGW's level of service is not so inadequate as to foreclose any interim rate relief. PGW-IR St.1.1 at 23. However, it is beyond question that the level of customer service at PGW is far below any applicable adequacy standard. In fact, the inadequacy of PGW's customer service is so notorious that the PUC could take judicial notice of that fact. Suermann v. Hadley, 327 Pa. 190, 193 A. 645 (1937) (Court would take judicial notice of accumulated deficits in financial operations of City of Philadelphia resulting in total shortage of more than \$29 million); Holt v. Pariser, 161 Pa.Super. 315, 54 A.2d 89 (1947)(Court would take judicial notice of fact that automobile repair materials and parts were under governmental control in 1943-44, and could be obtained only after long delays and with great difficulty). As Mr. LeLash testified, the call center has performed so poorly over the past sixteen months since the failed implementation of the BCCS system that "substantial numbers of customers believe that you just cannot get through to PGW." OCA St. 1 at 52.

This common knowledge was confirmed at the September 26 Public Input Hearing. As PGW customer Lydia Williams put it: "You always get a busy signal." Or PGW customer William Chase ("they play the music, they keep you ½ hour on the telephone." Or PGW customer Sally Harris ("you get on the phone, you hear the music") who punctuated her testimony with the exclamation: "I want to hear music, I turn on my own."<sup>4</sup>

The inadequate performance of PGW's Call Center has been confirmed not merely

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<sup>4</sup> Quotations from testimony at the Public Input Hearings are approximate, based on counsel's notes, rather than the official transcript.

by anecdotal evidence presented at the Public Input Hearings, but also by outside consultants. PGW has engaged such consultants as Vanguard Communications, Andersen Consulting and the Hay Group to analyze and suggest strategies for improving PGW's customer service. PGW refers to the engagement of these consultants as evidence of its commitment of improve customer service going forward. PGW-IR St.1.0 at 14; PGW-IR St. 1.0 Appendix C.<sup>5</sup> The conclusions of these same consultants, however, also provide authoritative evidence of the vast deficiencies of the service that is currently being provided and which PGW customers have had to endure for quite some time. Vanguard reports that the industry standard for response time for in-coming calls to utilities was that 80% should be answered within 30 seconds. At PGW, the average call for billing information is answered in 15 to 30 minutes; the average call for service is answered in 3 to 6 minutes. As a result, 70% to 80% of calls for billing information are abandoned; 20% to 30% of PGW service calls are abandoned. These abandonment rates contrast with the industry standard of 4% to 5%. OCA St.1 at 52.

The likelihood that this condition in the Call Center can be remedied in a short time is virtually non-existent. The problem is not primarily one of acclimating the Call Center staff to the new information system, although BCCS training has been inadequate and needs to be developed and reinforced. OCA St. 1 at 51. Rather, as Vanguard suggests, what is required is a "full plan for organization, operational and technical changes, and ongoing reinforcement." OCA St. 1 at 43. Vanguard calls for the creation

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<sup>5</sup> In its Interim Rate Procedures Petition, PGW offered as partial justification for its requests the fact that a new management team was inaugurating a "Transitioning to Excellence" plan with the aim of providing, *inter alia*, "superior service to customers at the most reasonable rates possible." Interim Rate Procedures Petition, ¶ 17. Part of this program was a "host of ongoing investigations and reviews, many of which are being conducted by nationally recognized experts, to identify the appropriate reforms to return the company to financial health, to correct the customer billing and IT problems, and to improve customer service." (Emphases added) ¶ 18.

of a “totally different mindset ... that is focused on the customer”, a mindset obviously lacking at present. This view point is supported by the Hay Group, whose analysis of PGW’s human resources problems insists on the need to develop a service orientation at PGW, focused on meeting the customer’s needs. OCA St. 1 at 53.

In addition to the gross inadequacies of these generalized levels of service to be provided to all customers and applicants for service, PGW also fails to observe and honor consumer rights associated with monopoly provision of gas service which is a fundamental necessity of life. The PUC has long required through Chapter 56 and related programs basic elements of due process in dispute resolution, protections against unwarranted denial and termination of service, universal service programs, and budget billing. The PGW Tariff also contains similar provisions. However, PGW is presently failing to meet applicable standards of consumer protection contained in its own Tariff.

This is evident in the Memorandum of Understanding (MOU) which PGW has negotiated with Commission staff. Surprisingly, PGW offers the MOU as evidence of its progress in “transitioning to excellence,” when in reality, it most often lowers the bar establishing the level of consumer protections to be provided by PGW to its residential customers.<sup>6</sup> PGW’s Tariff traditionally contained provisions which assured that a customer who initiated a request for further review or a “dispute” with PGW would receive a written response from PGW stating the reasons for the denial, informing the customer of appeal rights to PGW’s regulatory agency, and the time within which appeal must be made.<sup>7</sup> Paragraph 16 of the MOU eliminates the requirement that PGW’s

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<sup>6</sup> See Interim Rate Procedures Petition, ¶ 18, and Memorandum of Understanding, Interim Rate Procedures Petition, Exhibit E.

<sup>7</sup> Philadelphia Gas Works Service Tariff, Pa. P.U.C. No. 1, §§5.1(A)(2); 5.1(C)(4), Original Page Nos: 57-58.

response be in writing. PGW no longer commits to a requirement which maintains the accountability of PGW personnel and provides the customer with documentary evidence concerning the issues raised, the response received, including information about the substance of the dispute and information concerning how and when to exercise appeal rights.

These changes and other similar changes constitute an admission by PGW that it can not currently provide a level of service required not only under its prior Tariff, but also under Chapter 56 (52 Pa.Code §§56.01 *et seq.*) to similarly situated customers of all other PUC regulated utilities. For instance, in contrast to the MOU, Chapter 56 provides that customers whose disputes are denied have the right to a written report explaining the grounds for the denial, informing them of their right of appeal, and the time frame within which to appeal. 52 Pa.Code §56.152; see also §§56.151(4);56.151(5).

Another consumer protection which PGW is unable to adequately provide is budget billing. PGW presently has approximately 120,000 residential participants in its “budget billing” program.<sup>8</sup> Tr. 165. At a time when the increase in natural gas prices assures rate increases of over 20% and even 30%, PGW is unable to provide assurance that it will be able to make even a single adjustment for present participants until the end of the participant’s budget billing year. Tr. 166. In addition, there is little doubt that PGW will not be able to make adjustments every four months in budget billing amounts to assure that customers will receive monthly bills throughout the year of roughly the same amount. Tr. 167.

The failed implementation of the BCCS system also has deprived low income

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<sup>8</sup> See Philadelphia Gas Works Gas Service Tariff, Pa.P.U.C. No.1, §3.35, Original Page No. 21.

customers of substantial benefits they receive under the PGW's customer assistance program, the Customer Responsibility Program. That Program allows customers who are at or below 135% of the Federal Poverty Standard to pay a percentage of their income (7.35%) for continued gas service, on the theory, common to most utility universal service programs, that customers who receive reasonably affordable bills, will establish better payment patterns and actually pay more than they would if they received bills that they cannot afford.<sup>9</sup> After July, 1999, as many as 20,000 CRP customers did not receive one or more monthly bills and fell behind on the payments due under the CRP program. In June, 2000, the Philadelphia Gas Commission ordered PGW to allow CRP customers to catch up on their CRP arrearages over an extended period of time. Although this solution was preferable to expulsion of CRP participants in arrears on their payments from the program, it is fundamentally inconsistent with the program's underlying concept. If a reasonable and affordable bill is 7.35% of a customer's income, how can that customer be reasonably expected to find each month money to pay an amortized part of an arrears that accumulated due to PGW's failed billings?

In July 2000, PGW was to send affected CRP customers a bill which contained a "pay by" amount including both their current monthly charge, and the total arrearage that had accumulated since the billing errors. Tr. 170. Then, in August, PGW was to begin billing affected CRP customers for their current monthly charges, and the installment on arrears. PGW was unable to comply with this order, with the result that customers received bills not in compliance with the Gas Commission order in August and September. Tr. 170. Although the company states that it is commencing compliance in October, 2000, the record contains no evidence that such compliance did in fact occur.

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<sup>9</sup> The regulations governing the Customer Responsibility Program are contained in the Philadelphia Gas Works Service Tariff, Pa.P.U.C. No. 1, §4.50, Original Page Nos. 44-51.

Even if it did occur, the fact remains that PGW's failure to properly bill CRP customers has placed these customers in danger of losing the benefits of participation in CRP because of the need to "amortize" arrearages which would not have occurred absent PGW's mistakes.

As OCA witness Mr. LeLash testified, when a utility fails to provide adequate service, and applying the "corollary that rates appropriately follow service, any PGW rate request, whether interim or permanent, could be denied based on existing service deficiencies." OCA St.1 at 9. Under the circumstances of this case, given the obvious and severe inadequacy of PGW's service, the Commission should deny PGW's proposed interim rate increase in its entirety.

**III. An Interim Base Rate Increase Would Not Be Just and Reasonable, because Ratepayers Are Likely to Have to Absorb a Rate Increase Well over 20% Arising from GCR Increases Alone, and because Despite the Fact that PGW's Current Crisis is Due to the City's Mismanagement, the City of Philadelphia Has Refused to Commit its Annual \$18 Million "Dividend" to PGW and Has Not Fully Committed Other Resources within Its Means to Alleviate PGW's Cash Flow Problems.**

The issue of the \$18 million City Payment has long been a subject of controversy in discussions concerning PGW.<sup>10</sup> Year after year, PGW (ostensibly pursuant to Section VII(b) and (c) of the Management Agreement), has made an annual payment to the City in a fixed amount, totally unrelated to the financial performance or level of service provided by the Gas Works. Ultimately, the state Supreme Court has upheld the \$18 million payment (if just and reasonable in impact within the context of a particular rate case), by resorting to analogy with investor owned utilities. Thus, in Public Advocate v.

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<sup>10</sup> See, e.g. Public Advocate v. Philadelphia Gas Commission, -- Pa --, 674 A.2d 1056 (1996); Action Alliance, etc. v. Philadelphia Gas Commission, 45 Pa.Cmwlth.234, 406 A.2d 1155, 1158 (1979).

Philadelphia Gas Commission, the Court justified payment at the \$18 million level as a reasonable return on the City's "equity" in the Gas Works. Public Advocate, 674 A.2d 1056, 1062-3. If the City's right to the \$18 million City Payment is to be analogized to characteristics of private ownership, then logic requires that the City accept another responsibility of private ownership – exposure to some measure of risk that a return on its equity may not be available in a given year, and even, that the City may be required to provide an infusion of resources in the form of a loan or a grant from the general fund. As Mr. LeLash testified, under traditional regulation of investor owned utilities, a cash crisis would require the City as the owner "either to provide capital or to facilitate the acquisition of additional debt." OCA St. 1 at 13.<sup>11</sup>

**A. The City Has Failed to Do Its Fair Share to Spare Ratepayers the Added Burdens of an Interim Base Rate Increase at This Time of Substantial Rate Increases Arising from the Run Up of Natural Gas Prices.**

In this case, the City has admittedly failed to fulfill its duties as the owner of PGW and its legal and statutory obligations under the Management Agreement to "apply the highest standards of management practice and diligence to the operation of the Gas Works." Management Agreement, §I(5). As Mr. Knudsen testified, "[i]t took more than ten years of neglect and bad decisions to create" the cash flow crisis facing the company, the failed implementation of the BCCS system, with attendant melt down of PGW's customer service. PGW-IR St.1.0 at 14, 15; PGW-IR St. 1.0 Appendix C; Tr. 163-173.

OCA's witness Mr. LeLash also confirmed that while weather may have been a

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<sup>11</sup> See also Mr. LeLash's testimony that in similar conditions, an investor owned utility's owners "would expect to receive reduced dividends and to infuse additional capital into the operation if the utility were precluded from pursuing additional debt financing." OCA St. 1 at 15.

contributing factor, the current financial crisis at PGW “is of PGW’s own making. Established regulatory remedies were available and the Company, for as yet unspecified reasons, did not seek rate adjustments.” OCA St.1 at 8. He further testified that during the past three year period, PGW “did not acknowledge or seek to remedy its deteriorating financial condition and its deteriorating service and operational effectiveness.” OCA St. 1 at 22.

There can be no dispute that the run up in natural gas costs this year, alone accounting for an increase in gas rates between 20% and 40%, will stretch many customers to their absolute financial limits and beyond. As Mr. LeLash testified when the contemplated increase from natural gas costs was about 20%, “ratepayers should not reasonably be expected to absorb any more than the 20% increase that will result from the increase in the GCR rate...” OCA St.1 at 25. Under such circumstances, it is all the more reasonable, even imperative, that the owner of a poorly performing and stressed public utility like PGW contribute substantial resources of its own to the utility before seeking additional funds in rates from ratepayers.

**A. The City’s Refusal to Waive Or “Grant Back” the \$18 Million City Payment Is Not Reasonable.**

*In this proceeding, the City has refused to abandon the position that the City Payment of \$18 million is an entitlement which should not be directly “granted back” to ratepayers to mitigate the impact of the overwhelming increases that are expected to flow from the run-up in natural gas costs. Instead, it has belatedly pursued the establishment of a \$45 million advance from City funds to PGW against future revenues, a measure which defers some rate burdens without eliminating them.*

At the same time, the City has not adopted an affirmative proactive plan to address

PGW's financial problems, but rather has continued to work in a reactive mode to deflect the full burden of increased costs on ratepayers. By its actions, it has not worked to create a regulatory and financial climate which would create confidence in the City's determination to put its own resources, financial, political, and technical to support and refurbish PGW. Instead, as the testimony in this case indicated, it has done just the opposite, pretending that its resources were not sufficient to restore confidence in PGW for the providers of short and long term credit, and depicting the proposed isolated "grant back" of the \$18 million and the \$45 million advance as one-time fixes. PGW-IR St.2 at 16. At the same time, it requests the Commission to grant a rate increase of a size which would make waiver or "grant back" of the \$18 million City payment unnecessary. PGW-IR. St.1.0 Appendix B, Page 2 of 5.

Recognizing the incongruity of requesting an "interim" base rate increase of \$52 million, \$18 million of which would be returned to the City at year's end with interest, the City vainly attempts to create the illusion that it is putting the \$18 million to the service of PGW's ratepayers. The company states that the City will provide a "limited 'backstop' if PGW cannot make its coverage requirements at the end of FY 2000. PGW St. 1.0 at 11. \$5 million of this \$18 million would be available to assure that bond debt service coverage ratios for FY 2000 were met, and any unused portion would be available for similar purposes in FY 2001.

Although PGW presents this willingness to "backstop" PGW's revenue bond debt service ratios as a significant contribution by the City to ratepayers, that action is hardly disinterested. First, despite PGW's claims, the ratepayers are not the owners of PGW in any legal sense. Second, as Ms. Bisgaier has pointed out, if PGW did encounter debt service coverage problems, the City would have a substantial interest in avoiding even a technical default by PGW in meeting debt service coverage ratios, because such a default

could reflect badly on the bond ratings of the City of Philadelphia's bond thereby increasing the City's future cost of capital. PGW-IR St.2 at 15.

Rather than cushion the shock on ratepayers of the coming substantial increase in the GCR, the City prefers to retain the \$18 million to cushion itself against the risk that financial projections may be significantly off. Better to let PGW's many working poor and low income ratepayers dig deeper into their domestic budgets, into their funds for medicine, day care, and food, than run the risk of having to actually lose money on PGW by having to dig into the City's general fund. Thus, the City claims that it will retain the \$18 million as a "life preserver," ostensibly for PGW but in actuality for the City. PGW St. 1 at 11.

The bottom line behind all the testimony is the City's determination not to have to resort to its own general fund to bail out its own utility which has suffered from years of City mismanagement. This determination is expressed in the over-heated statement that the City "will not jeopardize its own financial situation by foregoing PGW's required payment." PGW-IR St.1.0 at 11. Thus, as Mr. Knudsen testified, even if the time came when the City had to grant \$18 million to PGW, it would not do so until it had already received \$18 million in PGW revenues. Tr. 198-199.

**B. The City's Plan to Advance PGW \$45 Million Is Not Yet in Place and Serves to Defend Against Calls for More Substantial City Support for PGW.**

The City and PGW commenced proceedings to obtain a base rate increase of \$52 million in mid-June, 2000. Even though at that time, a \$52 million base rate increase, together with GCR projections, suggested that ratepayers were facing the prospect of a 20% rate increase, there was no movement on the part of the City to address the cash flow dimensions of PGW's problems through a temporary advance. PGW-IR 1.0 at 5.

Only in mid-September, almost three months after PGW's initial rate related filing, did the City grudgingly recognize the necessity of at least contributing to easing PGW's difficulties through a substantial interest free advance.

Moreover, when the City finally took action to secure an advance, the amount of the advance was calculated in a way which would lessen the need for the City to contribute the \$18 million payment. Indeed, City Council, on the Philadelphia Gas Commission's recommendation, appears to be in the process of amending the Management Agreement to raise the permissible ceiling for this type of advance from \$20 million to \$45 million. interest free, repayable in 24 months. PGW-IR St. 1.1 at 3,4. Although as OCA witness Mr. LeLash testified, securing an advance is the type of action one would expect from an owner of a utility with cash flow problems, the size of the advance once more serves the purposes of the City more than those of ratepayers.<sup>12</sup> Moreover, it is to be expected that arrangements will be made to minimize the actual cost of this advance to the City of Philadelphia by assuring that the fund from which the advance is drawn is promptly replenished and that interest on the fund accrues not to PGW and its ratepayers, but to the City of Philadelphia.<sup>13</sup>

**C. The Commission Should Reject the Argument that Satisfaction of PGW's Bond Covenants Requires that Project Revenues Arise From Rates Alone.**

The City through PGW invokes the requirements of its bond covenants in an attempt to buttress its argument that the potential "grant back" of the \$18 million in the event that PGW encounters debt service coverage problems is the most reasonable "use"

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<sup>12</sup> OCA St.1 at 11, 29.

<sup>13</sup> City Council is not expected to take a final vote on this proposed ordinance until the week beginning October 16, 2000. Philadelphia Daily News, 10/12/00.

(really “non-use”) of this resource for the benefit of ratepayers. However, the link between the bond covenants and the \$18 million is much more remote than the City claims. With respect to the “coverage covenants,” the covenants to assure sufficient revenues to satisfy debt service coverage ratios, the City concedes that the “grant back” of the \$18 million, or a portion of it could avert a technical default involving the failure to achieve the 1.5 coverage ratio. PGW-IR St. 2 at 16. However, the City suggests that funds derived from a City grant of \$18 million or other City or government subsidies could not be used to satisfy “rate covenants” which require payment of the costs of operating and maintaining PGW as well as timely payment of principle and interest on outstanding bonds and commercial paper. PGW-IR St.1.1 at 6; PGW-IR St. 2 at 11, 12. As Ms. Bisgaier testifies, a “technical default would occur if PGW paid principal and interest timely, but did not produce sufficient revenue from rates to cover all of its net operating expenses....” (Emphases added). PGW-IR St.2 at 12.

However, neither PGW’s Bond Ordinances, nor the First Class City Revenue Bond Act requires that “Project Revenues” be derived only from rates. The 1975 Bond Ordinance requires in pertinent part that the City will “impose, charge and collect in each Fiscal Year such gas rates and charges as shall, together with all other Project Revenues (as defined in the [First Class City Revenue Bond] Act)” cover “all Net Operating Expenses payable during such Fiscal Year.”<sup>14</sup> The First Class City Revenue Bond Act defines project revenues to include inter alia “rates...imposed or charged” and “all subsidies or payment payable by Federal, State or local governments or governmental agencies” for operating costs and debt service”(Emphases added). 53 P.S. §15902 (“Project Revenues”). The 1998 Bond Ordinance has similar requirements, at least to the

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<sup>14</sup> See General Gas Revenue Bond Ordinance of 1975, Section 4.03(b), PGW-IR-Exhibit 1.4 Vol. I (Exh. A); see also 1998 General Ordinance, PGW-IR-Exhibit 1.4 Vol. II ( Exh. F).

extent that a “grant back” of the \$18 million City Payment would be involved. Thus, a grant back of the \$18 million payment and a City subsidy over and above the \$18 million is potentially available to the City to avert technical defaults on PGW’s bond covenants.

In the end, the City’s arguments denying or diminishing the usefulness of the \$18 million payment and other City subsidies in lieu of an interim rate increase boil down to the claim that the bond rating agencies and the banks underwriting PGW’s Tax Exempt Commercial Paper programs would look unfavorably upon PGW’s obtaining the necessary interim project revenues from a “grant back” of the \$18 million City Payment and other governmental subsidies, rather than from ratepayers. PGW-IR St.2 at 16. In support of this view, the City offers the judgment of Ms. Bisgaier, whose firm Philadelphia Financial Management counsels the City extensively on financial issues related to its general revenue bonds. Her testimony, as might be expected, is from a perspective which reflects the City’s primary interest in protecting its own bond ratings, rather than incurring any potential risks for the sake of PGW and its ratepayers. Without underestimating the importance of perceptions in the financial community, there is little in this record concerning the City’s efforts to alter that perception by developing a proactive financial plan combining grants, advances, gas cost rate increases, and other non-base rate resources to assist PGW and its ratepayers in this difficult time.

In adopting its positions concerning a grant of the \$18 million City Payment and the provision of an advance, the City has failed to fully recognize and accept its ownership responsibilities and its accountability for PGW’s present financial and operational circumstances. Under the circumstances, the refusal to commit to an outright waiver or “grant back” of the \$18 million is unreasonable. As OCA witness Mr. LeLash testified, CEPA et al.’s insistence that the City must provide this waiver or “grant back” FY 2001 is “not unreasonable.” OCA St. 1 at 37. For this reason, the Commission should

reduce any interim increase that might be granted by \$18 million.

**IV. An Interim Base Rate Increase Is Not Necessary for the Minimum Financial Health of the Company or for PGW to Satisfy the Requirements of Its Bond Covenants in FY 2001.**

**A. There Are No Philadelphia Gas Commission Rules, Practices or Policies Other Than The “Just and Reasonable” Requirement For the Commission to Apply in Deciding This Interim Base Rate Case.**

Because of the “interim” nature of PGW’s request, a status hardly recognized either in the Management Agreement/Philadelphia Gas Commission regulations or in the Public Utility Code/PUC regulations, the PUC is not required to apply a particular ratemaking methodology in this case. Subject to the universal requirement that any rate assessed must be just and reasonable, the Commission need only determine what rate increase, if any, may be necessary, in combination with loans and grants which the owner in these circumstances may be reasonably expected to contribute, to maintain PGW’s minimal, adequate level of financial health.

As PGW has itself conceded, this interim rate proceeding is sui generis, and does not arise from existing state or municipal law or ordinance, or regulations issued pursuant thereto. Interim Rate Procedures Petition, ¶ 26. Rather, this proceeding is before the PUC because PGW’s owner, the City of Philadelphia, failed to anticipate how the passage of the Natural Gas Choice and Competition Act would impact on Philadelphia’s city natural gas operation in the period between July 1, 2000 and the fall of 2003, the projected effective date of PGW’s restructuring plan. Section 2212 of the Act provides little detailed guidance concerning how the PUC shall fulfill its regulatory responsibilities in this transitional period. The Act does not address timing constraints that might arise when a municipally owned utility must adjust to a different regulatory environment, to say nothing of problems related to timing arising from decreased revenues due to three

warmer than normal winters, changes in the City Administration due to the fall, 1999 mayoral elections, continued managerial instability at PGW, and the crippling of PGW's financial information and billing systems. Moreover, the Section was clearly not drafted with the expectation that PGW would seek any type of relief akin to emergency or temporary relief as defined in the Public Utility Code.

The Section 2212(d) provisions addressing the post-July 1, 2000, pre-restructuring plan period suggest that the Commission should look for guidance about an expedited, interim, temporary, or emergency rate proceeding to the existing PGW Tariff and the "policies or programs existing on the date that the commission assumes jurisdiction over ...[PGW]." 66 Pa.C.S. §2212(d). The term "tariff" under the Public Utility Code includes "[a]ll schedules of rates, all rates, regulations, practices, or contracts involving any rate or rates...." 66 Pa.C.S. §102. PGW invokes prior Philadelphia Gas Commission "practice" as justification for the claim that the PUC must institute a shortened time frame for this proceeding, and provide for a permanent base rate proceeding completed in five months. PGW-IR St. 1.0 at 16. However, it is doubtful whether the length of time that usually passes between the commencement of a proceeding and a decision is a policy, program, process, practice or procedure. After all, unlike the PUC, the Philadelphia Gas Commission regulates only one utility, PGW, and does not have the need, even for planning purposes, to establish uniform procedures applicable to many similarly situated utilities.

In addition, even if the length of time for a Philadelphia Gas Commission proceeding is a policy, program or practice, there still is the problem of determining what standard would have been applied in an expedited, interim, temporary or emergency rate proceeding. PGW does not present a shred of evidence concerning the standard that the Gas Commission would have applied in the circumstances of this case, or in similar past

circumstances. Philadelphia Gas Commission Regulation No.1 provides that “for good cause shown,” a “proposed new Tariff” may become effective fifteen days after proper public notice, subject to subsequent adjustment. However, “good cause” is not defined, and there is no suggestion that in such a situation, the Commission must apply the same standards for setting a temporary or interim base rate that would be applicable in the determination of the permanent base rate. In sum, PGW has presented no evidence that would support its claim that Philadelphia Gas Commission policies or programs requires that interim base rates must be set on the basis of its extreme interpretation of the Management Agreement, the Bond Ordinances, and the First Class City Revenue Bond Act.

**B. The Standard Defined by the Commission in its Order Establishing Interim Rate Procedures Requires Denial of PGW’s Interim Base Rate Increase Request.**

From this analysis, it follows that in making its determinations in this case, the Commission need only decide whether PGW has presented substantial evidence to support its claims that: (1) “an interim rate increase is necessary to maintain a minimal, adequate level of financial health required to fund operations and meet debt service requirements through the winter heating season until the Commission can conduct and rule on a full base rate proceeding” and; (2) an interim rate increase is necessary for PGW to comply with its covenants to the holders of any approved bonds.” Order Establishing *Interim Rate Procedures*, Docket No. P-00001831, at 7-8.

With regard to the first question, CEPA et al. believe that the answer is no. The Commission should accept the recommendations of OCA’s witness Mr. LeLash with regard to upward adjustment in revenues of \$4 million thereby rejecting PGW’s proposed contention that it should allow for weather 3% warmer than normal. It should also accept Mr. LeLash’s recommendation of a downward adjustment to revenues of \$1.5 million,

due to PGW's unbased assumption that the Senior Citizen discount would be curtailed in FY 2001. OCA St.1 at 38-44. However, CEPA et al. do not accept OCA's proposed \$5 million downward adjustment of productivity savings to be achieved in FY 2001. PGW's projections of \$14 million in productivity savings, however aggressive, are appropriate at a time when ratepayers and the City must tighten their belts under the stress of increased gas costs and PGW financial difficulties. PGW-IR St.1.1 at 9. As for OCA's proposed \$12.5 million upward adjustment in PGW's revenue requirement due to increased bad debt, CEPA et al. consider the magnitude of this increase to be speculative. In sum, the Commission should consider that the \$45 million advance from City funds will be fully available to PGW in FY 2001. So long as the GCR is set at realistic levels, PGW should be able to pay its operating expenses and debt service without a rate increase.

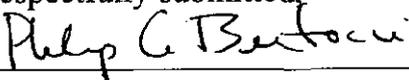
As for the second question, with the availability of the \$18 million City Payment as a "grant back," PGW should not have difficulty meeting its debt service coverage ratios in FY 2001. If the permanent base rate case is completed by June 1, 2000, there would be the possibility for added cushion in the range of \$6 million. PGW-IR St. 1.1 at 12.

In arriving at these conclusions, CEPA et al. rely on OCA's "Philadelphia Gas Works' Alternative No. 2." OCA St. 1, Schedule 3. This set of schedules, to be sure, assume a GCR increase of only \$97 million. However, they also assume only a \$20 million City Advance, rather than the \$45 million advance contained in the City's pending ordinance.

**V. Conclusion.**

For all the foregoing reasons, CEPA et al. respectfully request that the Commission deny PGW's request for an interim base rate increase.

Respectfully submitted,

  
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PHILIP A. BERTOCCI, ESQUIRE  
EDWARD A. MCCOOL, ESQUIRE

Date: September 13, 2000

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## Appendix A

### Proposed Findings of Fact and Conclusions of Law

#### Proposed Findings of Fact:

1. PGW's level of customer service is well below industry standards. OCA St 1 at 46-54; Tr. 166-170.
2. The present PGW financial crisis has been caused by factors within the City's control, including the failed implementation of the BCCS system, the failure to seek and obtain rate increases at appropriate intervals over the past eight years, the failure to secure stable management, and the failure to respond promptly and adequately to decreased revenues due to warmer than normal weather. PGW-IR St.1.0 at 14, 15; PGW-IR St. 1.0 Appendix C; Tr. 163-173.

#### Proposed Conclusions of Law:

1. The City of Philadelphia, not PGW's customers, is the legal owner of the Philadelphia Gas Works. Management Agreement.
2. In determining whether a rate is "just and reasonable," even an "interim rate," the Commission must consider whether the utility is providing adequate, efficient and reasonable customer service. Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 602, 65 S.Ct. 281, 288 (1944); D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission, 466 F.2d 394, 422 (D.C.Cir.1972), cert. denied, 409 U.S. 1086. Management Agreement; 66 Pa.C.S. §§523, 526.
3. In determining PGW's rates, the existing rules, policies and practices of the Philadelphia Gas Commission require that all rates be "just and reasonable." Public Advocate v. Philadelphia Gas Commission, – Pa.–, 674 A.2d 1056 (1996).
4. PGW's level of customer service is so inadequate as to justify denial of its request for an interim rate increase. 66 Pa.C.S. §§523, 526.
5. The City's refusal to waive or "grant back" the \$18 million payment in the context of this interim base rate case is not reasonable, and the Commission may take this refusal into account in determining the amount of rate relief, if any, to be granted. Public Advocate v. Philadelphia Gas Commission, – Pa.–, 674 A.2d 1056 (1996).

6. The City's claim that PGW revenues derived from a City grant to PGW may not be counted as revenues for purposes of compliance with the rate (as opposed to coverage) covenants in PGW's gas revenue bonds is without merit. 53 P.S. §15902; 1975 Bond Ordinance; 1998 Bond Ordinance.

7. Neither the Management Agreement nor Philadelphia Gas Commission regulations, policies or practices provide guidance in ordinance, regulation or precedent (other than the "just and reasonable" requirement) concerning the standards according to which PGW's request for interim rate relief must be judged. Public Advocate v. Philadelphia Gas Commission, – Pa.–, 674 A.2d 1056 (1996); Management Agreement.

CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission  
v.  
Philadelphia Gas Works  
Docket No. R-00005654

I hereby certify that I have this day served a true copy of the foregoing document, Main Brief of CEPA, Action Alliance of Senior Citizens, ACORN and Tenants' Action Group, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 13<sup>th</sup> day of October, 2000.

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CERTIFICATE OF SERVICE

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OCT 13 2000

Re: Pennsylvania Public Utility Commission  
v.  
Philadelphia Gas Works  
Docket No. R-00005654

PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

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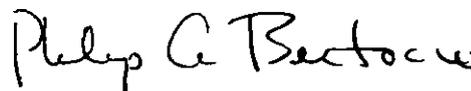
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ORIGINAL

October 13, 2000

VIA HAND DELIVERY

James McNulty, Secretary  
PA Public Utility Commission  
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Harrisburg, PA 17105

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SECRETARY'S BUREAU

RE: Pennsylvania Public Utility Commission v. Philadelphia Gas Works; Docket No. R-00005619; and Pennsylvania Public Utility Commission v. Philadelphia Gas Works; Docket No. R-00005654

Dear Secretary McNulty:

On behalf of Philadelphia Gas Works, enclosed for filing please find an original and three copies of its Motion to Consolidate the Record with regard to the above referenced matters. As indicated by the attached certificate of service, all parties of record have been served with a copy of this filing.

Please contact me if you have any questions with respect to the enclosed.

Respectfully submitted,

Alan Kohler

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

AK/kec  
Enclosures

cc: All Parties of Record w/enc.  
Hon. Marlane Chestnut w/enc.

DSH:24372.1

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

**DOCKETED**  
OCT 18 2000

PENNSYLVANIA PUBLIC UTILITY  
COMMISSION :

v. :

Docket No. R-00005619

PHILADELPHIA GAS WORKS :

**DOCKETED**  
OCT 18 2000

PENNSYLVANIA PUBLIC UTILITY  
COMMISSION :

v. :

Docket No. R-00005654

PHILADELPHIA GAS WORKS :

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**PHILADELPHIA GAS WORKS**  
**MOTION TO CONSOLIDATE THE RECORD**

Philadelphia Gas Works ("PGW"), pursuant to 52 Pa. Code § 5.103, submits this motion requesting the Commission to consolidate the records of two pending, interrelated cases involving the establishment of PGW's rates. While the two cases, as captioned above, have not been formally consolidated for decision making purposes, the development of the records have been administered in coordinated fashion and overlap to a significant degree. Furthermore, in the interests of efficiency, the litigants were generally successful in avoiding unnecessary duplication in the two evidentiary records. However, it is necessary and appropriate for the parties to rely on both records in arguing these matters before the Commission and for the Commission to rely on both records in deciding each case. In specific support of its Motion, PGW states as follows:

1. There are presently two PGW rate proceedings pending before the Commission. One case docketed at R-00005619, addresses establishment of PGW's gas cost rates ("GCR"), the other case, docketed at R-00005654, addresses a request by PGW for interim rate relief.

2. While not formally consolidated for decision making purposes, the records of the two cases have been administered by ALJ Chestnut in coordinated fashion. While the two cases address specific components of PGW's rates, PGW's underlying costs and business circumstances are directly relevant to both cases.<sup>1</sup> While the records are related, the parties were generally successful in avoiding duplication in the records of the two proceedings.

3. The records of both proceedings are now closed and main briefs in both cases are due on October 13, 2000. PGW submits this Motion concomitant with the filing of its main briefs requesting the Commission to consolidate the evidentiary records of the two proceedings and allow the litigants and the Commission to rely on both records in arguing and deciding each individual case.

4. PGW has conferred with each of the active parties to these proceedings and has been advised that no party opposes this request.

5. Consolidating the records is consistent with the Commission's interest in deciding both cases based on a broad and inclusive record.

6. Both records were developed by the same active parties, each of which had the opportunity to address or challenge all evidence submitted in both proceedings.

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<sup>1</sup> For example, PGW has asserted a claim that its need for interim rates has been exacerbated by increases in projected gas costs.

7. 52 Pa. Code § 5.407 allows consideration of records in other proceedings if the moving participant agrees to supply the Commission copies of the record when so required and the record of the other proceeding is referenced with specificity.

8. PGW agrees to supply the Commission copies of either record, if necessary, upon request.

9. PGW specifically identifies the entire GCR record and interim rate records for consolidation for argument and decision making purposes.

10. In the alternative, PGW requests the Commission to allow PGW (and any other party) to make specific references to the GCR record in its interim rate case brief. Concomitant with the filing of this Motion, PGW has submitted its main brief in the interim rate proceeding which contains several specific references to the GCR record. Each portion of the GCR record referenced was developed with the full participation of each of the active parties in the interim rate case. Accordingly, the references to the GCR record in PGW's interim rate case brief should be permitted and considered by the Commission.

WHEREFORE, for all of the foregoing reasons, PGW respectfully requests that its Motion be granted.

Respectfully submitted,



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*Attorneys for Philadelphia Gas Works*

Dated: October 13, 2000

**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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Dated: October 13, 2000

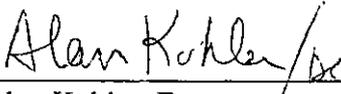
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OFFICE OF SMALL BUSINESS ADVOCATE  
Suite 1102, Commerce Building  
300 North Second Street  
Harrisburg, Pennsylvania 17101

DOCUMENT  
FOLDER

Bernard A. Ryan, Jr  
Small Business Advocate

(717) 783-2525  
(717) 783-2831 (FAX)

October 13, 2000

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
P.O. Box 3265  
North Office Building, Room B20  
Harrisburg, PA 17105-3265

**Re: Pennsylvania Public Utility Commission v.  
Philadelphia Gas Works  
(Interim Rate Increase Request)  
Docket No. R-00005654**

**DOCKETED**  
OCT 27 2000  
SECRETARY'S BUREAU  
OCT 13 AM 10:26  
P. 10/13/00

Dear Mr. McNulty:

The Office of Small Business Advocate ("OSBA") filed a Notice of Intervention in this proceeding on August 22, 2000. The participation of the OSBA in this proceeding did not address the major contention of a reasonable level of interim rate revenue. The OSBA strategically focused upon the rate design in this matter, recognizing the considerable effort and resources of the other Intervenor<sup>1</sup> that went to analyzing the proposed level of interim rates and recommending a level of interim rate revenue as reasonable. The rate design issue as proposed by PGW was not contentious.

The OSBA respects the time and resources of the Pennsylvania Public Utility Commission ("Commission"), and thus is providing this letter in lieu of a Main Brief. The Company has proposed a volumetric increase to base rates for all firm customer classes on an across-the-board

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<sup>1</sup>The parties referenced collectively as the Intervenor are: the Office of Consumer Advocate that filed a Complaint on August 22, 2000; the Office of Trial Staff that filed a Notice of Appearance on August 18, 2000; the Apartment Association of Greater Philadelphia ("AAGP") that filed a Petition to Intervene on August 21, 2000; the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG") that filed a Petition to Intervene on August 24, 2000; and the Consumers Education and Protective Association, the Association of Community Organizations for Reform Now, the Action Alliance of Senior Citizens of Greater Philadelphia and the Tenants' Action Group ("CEPA et al.") that also filed a Petition to Intervene on August 24, 2000.

**ORIGINAL**

basis. This volumetric increase is 13.52%, which produces \$52.0 million in additional revenue. As there was limited time in this proceeding, the record did not develop cost-of-service issues. The OSBA relied upon the safeguards that the Commission declared during this proceeding as a basis to develop cost-of-service issues through the full base rate case, specifically: (1) full base rates to be examined in a proceeding to convene no later than January 1, 2001; (2) refunding of interim revenues, as necessary, should the prospectively established permanent rates in PGW's rate base case prove lower than interim levels; and (3) foregoing any possibility of collecting additional revenues (retroactively) from ratepayers should the Commission determine that a permanent rate level in excess of the interim level is just and reasonable.<sup>2</sup> As was stated by the OSBA witness, Mr. Brian Kalcic, "In the absence of a fully developed record on cost-of service issues, the Company's interim rate structure is acceptable to OSBA".<sup>3</sup>

The Office of Small Business Advocate respectfully requests that the Commission order the approval of the rate design methodology submitted by the Philadelphia Gas Works in this proceeding. Additionally, the OSBA reserves the right to respond to Main Briefs submitted by the parties on this issue in a Reply Brief.

Respectfully submitted,

  
Angela T. Jones  
Assistant Small Business Advocate

cc: Honorable John M. Quain, Chairman  
Honorable Robert K. Bloom, Vice-Chairman  
Honorable Nora Mead Brownell, Commissioner  
Honorable Aaron Wilson, Jr., Commissioner  
Honorable Terrance J. Fitzpatrick, Commissioner  
Honorable Marlane R. Chestnut, Administrative Law Judge

Parties of Record

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<sup>2</sup>See, Order Establishing Interim Rate Procedure, Petition of Philadelphia Gas Works for Establishment of Interim Rate Procedures and for a Declaratory Order, Docket No. P-00001831, entered August 17, 2000, ordering paragraph 2.

<sup>3</sup>OSBA Stmt. No. 1 at 4.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY :  
COMMISSION :  
v. : Docket No. R-00005654  
PHILADELPHIA GAS WORKS :

11:00 AM  
00 OCT 13 AM 10:25  
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Certificate of Service

I certify that I am serving a copy of the Letter In Lieu of Main Brief on behalf of the Office of Small Business Advocate in the manner indicated upon the persons addressed below:

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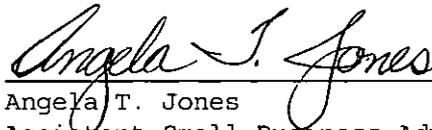
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ORIGINAL

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October 18, 2000

**VIA HAND DELIVERY**

James McNulty, Secretary  
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Harrisburg, PA 17105

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SECRETARY'S BUREAU

RE: Pennsylvania Public Utility Commission v. Philadelphia  
Gas Works; Docket No. R-00005654

Dear Secretary McNulty:

On behalf of Philadelphia Gas Works, enclosed for filing please find an original and three copies of its Motion to Take Official Notice or, In the Alternative, to Reopen the Record with regard to the above referenced matter. As indicated by the attached certificate of service, all parties of record have been served with a copy of this filing.

Please contact me if you have any questions with respect to the enclosed.

Respectfully submitted,



Alan Kohler  
For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

AK/jlg  
Enclosures

cc: All Parties of Record w/enc.  
Hon. Marlane Chestnut w/enc.

DSH:24457.1

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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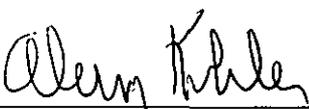
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\_\_\_\_\_  
Alan C. Kohler, Esq.

Dated: October 18, 2000

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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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PENNSYLVANIA PUBLIC UTILITY  
COMMISSION

v.

DOCKET NO. R-00005654

PHILADELPHIA GAS WORKS

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OCT 25 2000

**PHILADELPHIA GAS WORKS' MOTION TO TAKE  
OFFICIAL NOTICE OR, IN THE ALTERNATIVE,  
TO REOPEN THE RECORD**

Philadelphia Gas Works ("PGW") submits this motion, pursuant to 52 Pa. Code §§ 5.103, 5.408 and 5.571, requesting the Commission to take official notice of facts, not only relevant to, but of crucial importance, to the Commission's resolution of PGW's above-captioned interim rate case. The facts at issue relate to an announcement by Moody's Investors Service ("Moody's") that PGW's revenue bonds are on its Ratings Watchlist for possible downgrade depending on the outcome of the Commission's interim rate determination presently scheduled for November 9, 2000.

The announcement by Moody's was not issued until October 17, 2000 after the close of the record in these proceedings. This new evidence is highly relevant to the Commission's determination of whether interim rate relief for PGW is justified. Furthermore, the announcement by Moody's is a public record for which official notice is appropriate. Finally, taking official notice of the Moody's announcement will not prejudice the rights of any participant in this proceeding and PGW consents to the right of all participants to reference the

Moody's announcement in their reply briefs due on October 20, 2000 or to respond in any other timely way.<sup>1</sup>

Overall, official notice of the Moody's announcement is necessary for the Commission to issue a decision in this case based on a complete record. In the alternative, PGW requests that the Commission reopen the record in this proceeding to accept the Moody's announcement as a late filed exhibit pursuant to 52 Pa. Code § 5.571.

In specific support of this Motion, PGW states as follows:

1. Through the above captioned docket, the Commission is reviewing a request by PGW for interim rate relief. The matter was assigned to ALJ Chestnut for the development of a record. Testimony has been filed, hearings have been conducted and the evidentiary record has been closed. Main briefs were filed by the parties on October 13, 2000.

2. One of the critical issues in the case pertains to whether PGW requires interim rate relief to fulfil its bond covenants and maintain its credit worthiness.

3. On October 17, 2000, Moody's issued an announcement that the firm has placed PGW on its Ratings Watchlist for possible downgrade. The reasons provided by Moody's for this action is that, in Moody's assessment, PGW faces a cash crunch beginning in November that could get worse should the Commission's November 9, 2000 rate decision get held up or if PGW faces a warmer than normal winter. According to Moody's, if these issues are not resolved in

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<sup>1</sup> PGW's Interim Rate request is scheduled to be considered by the PUC at its November 9 public meeting. It is crucial to the Company's financial well-being that the Commission's consideration not be delayed.

PGW's favor, PGW could find itself on technical default on its bond covenants. The Moody's announcement is attached to this Motion as Exhibit "A".

4. As a reputable ratings agency, Moody's announcement is highly relevant to the issue of whether PGW requires interim rate relief to fulfill its bond covenants, to maintain its credit worthiness and to prevent downgrade of its municipal bonds to junk bond status.

5. Official notice of the fact of the Moody's announcement is completely appropriate. The Moody's announcement is public information in a form routinely issues by Moody's and other ratings agencies. The information is not subject to questions of authenticity or reliability.

6. Furthermore, taking official notice of the Moody's announcement will not prejudice the rights of any party to this proceeding. PGW consents to the right of all parties to reference and address the Moody's announcement in their respective reply briefs due on October 20, 2000 or to respond in some other timely way as the Commission may direct, so long as PUC consideration of PGW's interim rate request — now scheduled for November 9 — is not delayed.

7. Inclusion of the Moody's announcement in the record of these proceedings is not only appropriate, but is necessary for the Commission to resolve this interim rate case on a complete record.

8. In the alternative, PGW requests the Commission to reopen the record to accept the Exhibit attached to this Motion as a late filed exhibit pursuant to 52 Pa. Code § 5.571.

WHEREFORE, for all of the foregoing reasons, PGW requests the Commission to take official notice of the Moody's announcement, or in the alternative, reopen the record to accept the Moody's announcement as a late filed exhibit.

Respectfully submitted,



---

Daniel Clearfield  
Alan Kohler  
Wolf, Block, Schorr and Solis-Cohen,  
212 Locust Street, Suite 300  
Harrisburg, PA 17101  
(717) 237-7160

Dated: October 18, 2000

**MOODYS PLACES PGW ON WATCHLIST AS CASH CRUNCH NEARS**  
**PUC RATE FILING KEY TO INTEREST PAYMENT IN JANUARY 1, 2001**

Gas Utilities  
PA

**Opinion**

NEW YORK, Oct 17, 2000 -- Moody's Investors Service has placed Philadelphia Gas Works (PGW ) revenue bonds on its Ratings Watchlist for possible downgrade as the utility faces a cash crunch beginning in November that could get worse should the November 9, 2000 rate decision before the state Public Utilities Commission (PUC) be held up. Further, the utility's liquidity could also worsen should warm winter weather occur over the next several months . Moody's rates PGW's \$869.5 million senior lien obligations Baa2 and subordinate bonds, Baa3 both with a negative outlook. PGW's next interest payment date is January 1, 2001. If these issues are not resolved in PGW's favor, PGW could find itself in technical default then and have to use its debt service reserve to meet the required payment. Moody's will continue to monitor this situation.

PGW, which has been battered by successive warm winters, (warm winter weather impacts gas sales and revenue) as well as past management problems, has filed for a major rate hike to mitigate the financial impact of the recent significant increase in gas costs. In addition, PGW filed for a base rate hike that should assist the utility's ongoing liquidity. While Moody's believes the PUC's interim rate proceeding should result in a November 9 decision that should grant some level of rate increase, should the decision be delayed or the increase granted not be sufficient, PGW's financials could worsen.

In addition, to soften the overall rate impact, the city council is expected to approve an ordinance to provide PGW a \$45 million non-recourse loan with a two-year payback schedule. The ordinance is currently before the Philadelphia City Council.

For further information on PGW's credit position, please refer to Moody's Municipal Research Report dated August 2000.

**Analysts**

Dan Aschenbach  
Analyst  
Public Finance Group  
Moody's Investors Service

Yaffa Rattner  
Senior Credit Officer  
Public Finance Group  
Moody's Investors Service

Chee Mee Hu

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Director  
Public Finance Group  
Moody's Investors Service

## **Contacts**

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COMMONWEALTH OF PENNSYLVANIA



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October 19, 2000

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Re: Pennsylvania Public Utility Commission v.  
Philadelphia Gas Works (Interim Rate Increase Request)  
Docket No. R-00005654

Dear Mr. McNulty:

Please be advised that the Office of Small Business Advocate will not be filing a Reply Brief in the above-docketed proceeding. As evidenced by the enclosed certificate of service, a copy of this letter has been served on all active parties in this case.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Angela T. Jones  
Assistant Small Business Advocate

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FOLDER

Enclosures

cc: Hon. Marlane Chestnut  
Administrative Law Judge

Parties of Record

ORIGINAL

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY  
COMMISSION

v.

PHILADELPHIA GAS WORKS

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:

Docket No. R-00005654

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CERTIFICATE OF SERVICE

I certify that I am serving a copy of the foregoing document on behalf of the Office of Small Business Advocate by first class mail (unless otherwise indicated) upon the persons addressed below:

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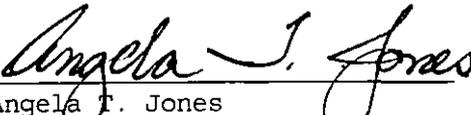
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Assistant Small Business Advocate

Dated: October 19, 2000