



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

IN REPLY PLEASE
REFER TO OUR FILE

December 26, 2001

Daniel Clearfield, Esquire
Wolf, Block, Schorr and Solis-Cohen LLP
212 Locust Street
Suite 300
Harrisburg, PA 17101

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

Dear Mr. Clearfield:

By letter dated December 12, 2001, Philadelphia Gas Works submitted an informational filing, requesting permission to utilize the reserve account funds established by the Joint Petition for Full Settlement of PGW's Petition for the Establishment of Interim Rates and Related Appeal (Interim Rates Settlement), which was approved by the Commission by Order adopted on February 21, 2001. Pursuant to the Interim Rates Settlement, PGW was permitted to increase the non-gas portion of its Gas Cost Rate (GCR) in March 2001 to produce \$7 million in revenues by August 31, 2001, in order to recover additional bad debt expense associated with escalating gas costs. Additionally, the Interim Rates Settlement established a reserve account consisting of that \$7 million in revenues along with GCR overcollections up to \$18 million for a total of \$25 million. The stated purpose of the reserve account was to provide funds that could be utilized by PGW as necessary to meet bond ordinance covenant requirements, i.e., debt service and/or timely payment of obligations when due, through January 2002.

Following the Commission's ruling on PGW's base rate request, the Interim Rates Settlement provided for PGW to make a projection of its debt service and cash obligations through January 2002. To the extent PGW identified a cash deficiency that would cause a bond ordinance covenant violation, it would be permitted to utilize the reserve fund, or a portion of it, to cover this deficiency. To request such permission, it was necessary for PGW to submit an informational filing by December 31, 2001, which the Commission would then address by Secretarial Letter within ten days.

Through this filing, PGW seeks Commission approval to retain the amount of \$17.58 million pursuant to the reserve fund created by the Interim Rates Settlement. As explained in the filing, this amount is comprised of \$10.58 million in GCR overcollections and an additional \$7 million included in PGW's December 1, 2001 GCR quarterly adjustment filing that it believes was authorized by the Interim Rates Settlement. As to the \$7 million increase to the GCR permitted under the Interim Rates

Settlement for the period from March 1 through August 31, 2001, PGW indicates that it has already spent those funds.

In support of its request to retain the reserve account, PGW has submitted an affidavit of Joseph Bogdonavage, Senior Vice President for Finance, providing information relating to its cash flow through January 2002. Based upon that data, PGW maintains that absent the ability to use the reserve funds, it will have insufficient cash from revenues to meet its cash obligations through January 2002 and avoid a breach of its bond covenants. Specifically, even if it is permitted to use the reserve funds, PGW is projecting a cash deficiency of \$18.4 million on January 25, 2002 and a \$8.4 million deficit at the end of January 2002. PGW explains that the 44% warmer than normal weather in November, with similar trends occurring in December, have significantly impacted its cash flow during this period. Particularly with major expenses facing PGW in January 2002, including a debt service payment of \$24.3 million, a \$32.7 million natural gas invoice and \$1.9 million in payroll and other disbursements, PGW submits that the reserve accounts are needed to ensure that it meets its debt service and cash obligations.

With respect to other reasonably available sources of revenue, PGW indicates that it has been unable to identify any source other than the reserve account that would enable it to meet these expenses. PGW acknowledges the possibility of a loan from a bank or the City of Philadelphia, but explains that its existing \$45 million City loan is fully extended and its commercial paper program will be fully extended at \$97 million by the end of this month. Also, PGW notes that a loan is not a revenue source. Additionally, PGW considered whether further cost reductions were possible, but did not believe it could do so without seriously damaging programs or service improvement initiatives. Similarly, PGW does not view capital spending reductions as a reasonable alternative since that would compromise programs such as main replacement and liquefied natural gas refurbishment, which are related to safety and reliability.

Responses to PGW's informational filing have been submitted by the Office of Consumer Advocate (OCA), the Office of Trial Staff (OTS), the Office of Small Business Advocate (OSBA) and Consumers Education and Protective Association, the Association of Community Organizations for Reform Now, Action Alliance of Senior Citizens of Greater Philadelphia, and the Tenants' Action Group (collectively CEPA). In related filings, the OCA has filed a Petition for Enforcement of Settlements and the OTS has filed a Formal Complaint against PGW's December 1, 2001 GCR quarterly adjustment filing.

The OCA's response to the informational filing opposes PGW's inclusion of an additional \$7 million in the reserve fund through increasing the 2002 GCR rate. As to PGW's request to retain the \$10.58 million in GCR overcollections, the OCA urges the

Commission to carefully consider whether PGW has demonstrated a cash deficiency that would cause a bond covenant violation before authorizing use of the reserve account funds. In particular, the OCA questions whether a cash deficiency warranting such relief exists when PGW has the ability to borrow from the capital fund. The OTS response focuses on the \$7 million increase to the GCR rate that was included in the December 1, 2001 quarterly update filing and contends that ratepayers should not be obligated to pay this additional amount to further fund the reserve account. CEPA and the OSBA oppose the entire request of PGW to retain funds in the reserve account, emphasizing their objections to the \$7 million increase.

In addressing PGW's informational filing, we view the request as having two components that must be treated separately. As to the \$10.58 million in GCR overcollections that is in the reserve account established by the Interim Rates Settlement, our inquiry focuses upon whether PGW has sufficiently identified a cash deficiency warranting the use of that fund so as to meet its debt service requirements, including the fulfillment of cash obligations as they become due through January 2002.

Initially, we are satisfied that PGW has exhausted all reasonably available revenue sources and that it is not incumbent upon PGW to borrow from its restricted capital fund rather than utilize the reserve account. We note that bond proceeds are not revenues and cannot be relied upon to meet debt service requirements. Also, we recognize that PGW will need to borrow from that fund even if it is permitted to utilize the reserve account. Due to the requirement for PGW to reimburse that fund, it is important to minimize the level of that borrowing to ensure its continuing ability to comply with bond covenants.

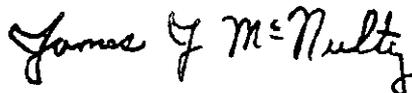
Further, with regard to PGW's cash flow situation, we are convinced that the significant cash deficiency projected for January 2002 warrants PGW's use of the \$10.58 million in the reserve account as a measure to enable it to meet debt service requirements and avoid a violation of the bond covenants. Even if PGW is permitted to utilize the entire \$17.58 million it has identified as being in the reserve account, it has demonstrated a cash deficiency of \$18.4 million on January 25, 2002 and a \$8.4 million deficit at month's end. We recognize that the significantly warmer than normal weather during November and at least part of December has had a major adverse impact on PGW's cash flow situation. Given the major expenses facing PGW during that time period, including a debt service payment, commodity purchase invoices, and pipeline demand charges, we believe that it is necessary and appropriate to permit PGW to utilize the \$10.58 million in the reserve account toward payment of these cash obligations through January 2002.

As to the additional \$7 million sought to be collected by PGW, however, we agree with the parties who have opposed that recovery and we are disallowing that portion of the request. PGW's addition of \$7 million to the 2002 GCR is not supported by a reasonable interpretation of the Interim Rates Settlement. Clearly, the \$7 million identified for recovery in the Interim Rates Settlement and for inclusion in the reserve account was already collected during the period from March 1, 2001 through August 31,

2001. In permitting the one-time recovery of \$7 million to reflect increased bad debt expenses during the 2000-2001 winter heating season, the Commission envisioned it being available to PGW as part of the reserve account, especially since it would not need to be reconciled with actual costs. Further, the Commission emphasized that beyond the \$7 million recovered through August 31, 2001, the Interim Rates Settlement established the "potential additional \$18 million" in the reserve fund as being available to PGW only if it develops a GCR overcollection and only if it is needed to satisfy bond debt service. Order adopted February 21, 2001, at page 6. The fact that PGW has spent the \$7 million it recovered for bad debt expense rather than placing it in the reserve account does not justify the insertion of an additional \$7 million into the 2002 GCR.

With respect to the need for PGW to remove the \$7 million from its 2002 GCR and to refund any of that amount already collected from ratepayers, we will defer the mechanics and timing of those actions to the disposition of the other formal proceedings currently pending on those issues. Specifically, we note that OCA's Petition for Enforcement of the Settlements and OTS' Formal Complaint against the December 1, 2001 GCR quarterly adjustment filing provide appropriate vehicles for implementing our decision to disallow recovery of the \$7 million in question.

Very truly yours,



James J. McNulty

cc: Parties of Record
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