

Wolf, Block, Schorr and Solis-Cohen LLP

212 Locust Street
Suite 300
Harrisburg, PA 17101
T: 717 237 7160
F: 717 237 7161
www.wolfblock.com

DOCUMENT
FOLDER

Mark S. Stewart
Direct Dial: 717-237-7191
Direct Fax: 717-237-2771
E-Mail: mstewart@WolfBlock.Com

June 4, 2001

RECEIVED
2001 JUN -7 AM 9:02
PA P.U.C.
SECRETARY'S BUREAU

Philip Bertocci, Esquire
Community Legal Services
1424 Chestnut Street
Philadelphia, PA 19102

RE: Philadelphia Gas Works' Permanent Base Rate Filing,
Docket Nos. R-00006042 and R-00006042C0001, et al.

Dear Phil:

Enclosed please find PGW's response to CEPA's On-the-Record Data Requests.

If you have any questions, please call me at your convenience.

Very truly yours,



Mark S. Stewart

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

MSS/jlg
Enclosure

cc: Parties of Record (w/enc)
ALJ Cynthia Fordham (w/enc)

DSH:27530.1

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).

VIA FIRST CLASS MAIL

Johnnie Simms, Esq.
Office of Trial Staff
PA Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265
E-mail: Simmsj@puc.state.pa.us

David M. Kleppinger, Esquire
McNEES, WALLACE, NURICK
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
E-mail: Dkleppinger@mwn.com

Charis M. Burak, Esquire
McNEES, WALLACE, NURICK
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
E-mail: Cburak@mwn.com

Angela Jones, Esq.
Office of Small Business Advocate
Commerce Building, Suite 1102
300 North 2nd Street
Harrisburg, PA 17101
E-mail: Anjones@state.pa.us

Craig A. Doll, Esq.
25 North Front St., 2nd Floor
Harrisburg, PA 17101-1606
E-mail: Cdoll76342@aol.com

Tanya McCloskey, Esq.
James Mullins, Esq.
Steve Keene, Esq.
Office of Consumer Advocate
5th Floor, Forum Place Bldg.
555 Walnut Street
Harrisburg, PA 17101-1921
E-mail: TmcCloskey@paoca.org

Stanley E. Brown, Esq.
Pa. Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
P.O. Box 3265
Harrisburg, PA 17105-3265
E-mail: browns@puc.state.pa.us

Richard Lelash
Financial and Regulatory Consultant
18 Seventy Acre Road
Redding, CT 06896
(OCA)
E-mail: Lelash@sprintmail.com

Jackie Sparkman, Esquire
School District of Philadelphia
Office of General Counsel
2130 Arch Street, 5th Floor
Philadelphia, PA 19103
Fax: (215) 988-0579
E-mail: jmondre@mondreenergy.com

DOCKETED
JUN 07 2001

DOCUMENT FOLDER

015399

01 JUN 7 AM 9:14
RECEIVED
STATE PUBLIC UTILITY COMMISSION

Lance Haver
6048 Ogontz Avenue
Philadelphia, PA 19141
(CEPA)

Brian Kalcic
Excel Consulting
Suite 720-T
225 S. Meramec Avenue
St. Louis, MO 63105
(OSBA)
Fax: (314) 725-2022

Richard A. Baudino
J. Kennedy and Associates
570 Colonial Park Dr., Suite 305
Roswell, GA 30075
E-mail: Rbaudino@jkenn.com

Larry Speilvogel
203 Hughes Road
King of Prussia, PA 19406
(PICGUG)

Wendell F. Holland, Esq.
Obermayer, Rebmann Maxwell
& Hippel LLP
One Penn Center, 19th Fl.
1617 John F. Kennedy Blvd.
Philadelphia, PA 19103-1895
E-mail: wfh@obermayer.com

Philip Bertocci, Esq.
Edward A. McCool, Esq.
Community Legal Services
1424 Chestnut Street
Philadelphia, PA 19102
Fax: (215) 981-0434
E-mail: pbertocci@clsphila.org

Dated: June 4, 2001


Mark S. Stewart, Esquire

Wolf, Block, Schorr and Solis-Cohen LLP

212 Locust Street
Suite 300
Harrisburg, PA 17101
T: 717 237 7160
F: 717 237 7161
www.wolfblock.com

PA P.U.C.
SECRETARY'S BUREAU

2001 JUN -7 AM 9:02

RECEIVED

Mark S. Stewart
Direct Dial: 717-237-7191
Direct Fax: 717-237-2771
E-Mail: mstewart@WolfBlock.Com

June 4, 2001

Charis Burak, Esquire
McNees, Wallace & Nurick
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166

DOCUMENT
FOLDER

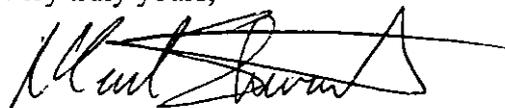
RE: Philadelphia Gas Works' Permanent Base Rate Filing,
Docket Nos. R-00006042 and R-00006042C0001, et al.

Dear Charis:

Enclosed please find PGW's response to PICGUG's On-the-Record Data Request.

If you have any questions, please call me at your convenience.

Very truly yours,



Mark S. Stewart
For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

MSS/jlg
Enclosure

cc: Parties of Record (w/enc)
ALJ Cynthia Fordham (w/enc)

DSH:27516.1

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).

VIA FIRST CLASS MAIL

Johnnie Simms, Esq.
Office of Trial Staff
PA Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265
E-mail: Simmsj@puc.state.pa.us

David M. Kleppinger, Esquire
McNEES, WALLACE, NURICK
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
E-mail: Dkleppinger@mwn.com

Charis M. Burak, Esquire
McNEES, WALLACE, NURICK
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
E-mail: Cburak@mwn.com

Angela Jones, Esq.
Office of Small Business Advocate
Commerce Building, Suite 1102
300 North 2nd Street
Harrisburg, PA 17101
E-mail: Anjones@state.pa.us

Craig A. Doll, Esq.
25 North Front St., 2nd Floor
Harrisburg, PA 17101-1606
E-mail: Cdoll76342@aol.com

Tanya McCloskey, Esq.
James Mullins, Esq.
Steve Keene, Esq.
Office of Consumer Advocate
5th Floor, Forum Place Bldg.
555 Walnut Street
Harrisburg, PA 17101-1921
E-mail: TmcCloskey@paoca.org

Stanley E. Brown, Esq.
Pa. Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
P.O. Box 3265
Harrisburg, PA 17105-3265
E-mail: browns@puc.state.pa.us

Richard Lelash
Financial and Regulatory Consultant
18 Seventy Acre Road
Redding, CT 06896
(OCA)
E-mail: Lelash@sprintmail.com

Jackie Sparkman, Esquire
School District of Philadelphia
Office of General Counsel
2130 Arch Street, 5th Floor
Philadelphia, PA 19103
Fax: (215) 988-0579
E-mail: jmondre@mondreenergy.com

015400

DOCKETED
JUN 07 2001

RECEIVED
SECRETARY'S BUREAU
01 JUN -7 AM 9:04

DOCUMENT
FOLDER

Lance Haver
6048 Ogontz Avenue
Philadelphia, PA 19141
(CEPA)

Brian Kalcic
Excel Consulting
Suite 720-T
225 S. Meramec Avenue
St. Louis, MO 63105
(OSBA)
Fax: (314) 725-2022

Richard A. Baudino
J. Kennedy and Associates
570 Colonial Park Dr., Suite 305
Roswell, GA 30075
E-mail: Rbaudino@jkenn.com

Larry Speilvogel
203 Hughes Road
King of Prussia, PA 19406
(PICGUG)

Wendell F. Holland, Esq.
Obermayer, Rebmann Maxwell
& Hippel LLP
One Penn Center, 19th Fl.
1617 John F. Kennedy Blvd.
Philadelphia, PA 19103-1895
E-mail: wfh@obermayer.com

Philip Bertocci, Esq.
Edward A. McCool, Esq.
Community Legal Services
1424 Chestnut Street
Philadelphia, PA 19102
Fax: (215) 981-0434
E-mail: pbertocci@clsphila.org

Dated: June 4, 2001


Mark S. Stewart, Esquire



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Office Of Administrative Law Judge
P.O. Box 3265, Harrisburg, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

DOCUMENT
FOLDER

June 4, 2001

In Re: R-00006042
R-00006042C0001-et al.

(See letter dated 02/13/01)

Pennsylvania Public Utility Commission v. Philadelphia Gas Works

Requesting a general rate increase of \$65,000,000.

Cancellation Notice

This is to inform you of the following cancellation:

Type: Further Hearings
Date: Friday, May 25, 2001
Wednesday-Thursday, May 30-31, 2001
Time: 10:00 a.m.
Location: Philadelphia, Pennsylvania
Presiding: Administrative Law Judge Cynthia W. Fordham

DOCKETED
JUN 06 2001

Please mark your records accordingly.

pc: Judge Fordham
June Perry - LA, Keystone 3NW
Eric Levis - BPL, Keystone 3NE
Office of Trial Staff (2)
Consumer Advocate
Small Business Advocate
Bill Barrett - FUS
Judy Weaver, Scheduling Officer
Beth Plantz
Docket Section
Calendar File



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

IN REPLY PLEASE
REFER TO OUR FILE

June 20, 2001

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-00006042

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.

FOLDER
DOCUMENT
ORIGINAL

Sincerely,

Johnnie E. Simms
Senior Prosecutor
Office of Trial Staff

JES:alb

c: Parties of Record
Honorable Cynthia W. Fordham

RECEIVED
01 JUN 20 PM 2:38
PA.P.U.C.
SECRETARY'S BUREAU

58

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

:
:
:
:
:
:

Docket No. R-00006042

MAIN BRIEF
OF THE
OFFICE OF TRIAL STAFF

DOCUMENT
FOLDER

DOCKETED
JUN 21 2001

Johnnie E. Simms
Senior Prosecutor

The Office of Trial Staff
P.O. Box 3265
Harrisburg, Pa. 17105-3265
(717) 787-1976

Dated: June 21, 2001

RECEIVED
01 JUN 20 PM 2:33
PA.P.U.C.
SECRETARY'S BUREAU

TABLE OF CONTENTS

	Page:
I. INTRODUCTION.....	1
II. SUMMARY OF ARGUMENT.....	3
III. STANDARD OF REVIEW FOR PGW RATE CASES.....	7
IV. REVENUES.....	10
1. The Company’s Average Use Per Residential And Commercial Customers Is Incorrect	10
2. The Company’s Projection Of The Number of Residential And Commercial Heating Customers And The Usage For These Customers Is Incorrect.....	20
3. Any Adjustments To The Average Use Per Customers And The Average Number Of Customers Impact The Cost Of Gas Expense.....	26
V. EXPENSE ADJUSTMENTS.....	29
1. Introduction	29
2. The Company’s Rate Case Expense Should Be Adjusted.....	30
3. The Company’s Bad Debt Expense Should Be Adjusted.....	34
4. The Company’s Promotional Activities Should Be Adjusted.....	37
5. OTS Recommended Rate Relief of \$44 Million Provides Sufficient Coverage To Preserve PGW's Credit Rating.....	39

VI. NON-GAS RELATED GCR EXPENSES	42
1. Introduction.....	42
2. The Recovery of Purchase Electric Expenses Should Be Excluded From The GCR Mechanism.....	44
3. The Recovery of Customer Responsibility Program Costs Should Be Excluded From the GCR Mechanism	44
4. The Recovery of Conservation Works Program Costs Should Be Excluded From The GCR Mechanism	46
5. The Recovery of Senior Discount Program Costs Should Be Excluded From The GCR Mechanism	47
VII. MISCELLANOUS ISSUES.....	50
1. PGW's Senior Citizens Discount Program.....	50
2. OTS Is Agreeable To Meeting With PGW In An Attempt To Resolve Tariff Issues.....	53
VIII. RATE STRUCTURE	54
1. PGW's Should Perform A Fully Allocated Cost of Service At Both Present and Proposed Rates.....	54
2. The Company's Revenue Allocation Is Improper.....	56
3. PGW's Propose Residential GS Customer Charge And Commercial Customer Charge Should Be Lowered	59
IX. CONCLUSION.....	65

APPENDIX A

Management Agreement Between The City of Philadelphia and
the Philadelphia Facilities Management Corporation

APPENDIX B

Proposed Findings of Fact

APPENDIX C

Proposed Conclusion of Law

APPENDIX D

Proposed Ordering Paragraphs

APPENDIX E

Table I - Income Statement

APPENDIX F

Table II - Cash Flow Statement

APPENDIX G

Table III - Debt Service Coverage

TABLE OF CITATIONS

Page:

CASES

<u>Allegheny Center Associates v. Pennsylvania Public Utility Commission ,</u> 131 Pa. Commw. 352, 570 A.2d 149 (Pa. Cmwlth. 1990).....	33
<u>Pennsylvania Public Utility Commission , et al v. Philadelphia Gas Works,</u> R-00005619 (Order entered November 22, 2000).....	42
<u>Pennsylvania Public Utility Commission v. National Fuel Gas Distribution</u> <u>Corp.</u> 54 Pa. PUC 401, 416-417, 40 PUR4th 101, 117-118 (1980).....	32
<u>Pennsylvania Public Utility Commission, et al v. Philadelphia Gas Works,</u> R-00005619	42
<u>Pennsylvania Public Utility Commission, et.al. v. Philadelphia Gas Works,</u> R-00005654 (Order entered November 22, 2000)	37

STATUTES

52 Pa. Code §§53.52 and 53.53	2
52 Pa. Code §53.42(a)	1
52 Pa. Code §53.45(b)(4)	2
Public Utility Code, 66 Pa. C.S. §1308(d)	1
Section 2212(e) of the Public Utility Code (“Gas Choice Act”).....	7

I. INTRODUCTION

On January 5, 2001, Philadelphia Gas Works (“PGW” or “Company”) filed Supplement No. 7 to Tariff Gas-Pa. P.U.C. No. 1 to become effective March 6, 2001, containing proposed changes in rules, regulations and rates calculated to produce \$65,000,000 in additional annual revenues. By Order entered February 8, 2001, the Pennsylvania Public Utility Commission (“Commission”) instituted an investigation into the lawfulness, justness and reasonableness of the proposed rate increase. Pursuant to section 1308(d) of the Public Utility Code, 66 Pa. C.S. §1308(d), Supplement No. 7 to Tariff Gas – Pa. P.U.C. No. 1 was suspended by operation of law until October 6, 2001 unless otherwise directed by Order of the Commission. In addition, the Commission ordered that the investigation include consideration of the lawfulness, justness and reasonableness of PGW’s existing rates. The matter was assigned to the Office of Administrative Law Judge for resolution by hearings and for issuance of a Recommended Decision.¹

In addition to filing Supplement No. 7, PGW filed a petition for waiver of potentially applicable notification and filing requirements and establishment of expedited hearing schedule for base rate proceeding, which the Commission granted in part and denied in part. PGW’s request for waiver of 52 Pa. Code §53.42(a) which requires that a utility file with the Commission written notice

¹ The matter was assigned to Administrative Law Judge Cynthia Williams Fordham.

30 days prior to the filing was granted. PGW's request to provide notice to customers under the alternative method set forth in 52 Pa. Code §53.45(b)(4) was granted. PGW's request for waiver from providing the information required at 52 Pa. Code §§53.52 and 53.53 was denied.

A prehearing conference in this proceeding was held on February 23, 2001 before Administrative Law Judge ("ALJ") Fordham. Evidentiary hearings were in Philadelphia on May 22, 2001 through May 24, 2001. The Office of Trial Staff presented the testimony and exhibits of Messrs. Metro, Deardorff, Keim, Kubas and Weakley.

The matter is now ripe for Briefing by the Parties for consideration of their respective positions and recommendations by Administrative Law Judge Fordham and the Pennsylvania Public Utility Commission.

II. SUMMARY OF ARGUMENT

In this proceeding, the Office of Trial Staff (“OTS”) had the opportunity to review PGW’s base rate Filing, and submit interrogatories, supplemented by informal discovery to determine that PGW should not receive any more than \$33 million or \$44 million, with the inclusion of the \$11 million interim rate settlement. OTS’ recommended rate increase of \$44 million was based upon a number of adjustments to PGW’s Filing, which OTS deemed necessary.

The first adjustment focuses on the residential and commercial normalized sales. After examining the Filing, OTS determined that the average use per residential heating customer should be increased to 103.91 Mcf per year and the average use per commercial heating customer should be increased to 477.11 Mcf per year. Since PGW understated its average use per customer for residential and commercial, a weather normalization adjustment was needed. Accordingly, based upon increased average use per residential heating customer, the Company will receive \$12,892,000 in additional revenue at proposed rates for residential customers and an additional \$6,859,000 in additional revenue at proposed rates for its commercial customers.

In the Filing, PGW included a \$100,000 rate case payment to the Lukens Energy Group for its testimony and study developing a revenue requirement that PGW would require if it was an investor owned utility. Since PGW is not an investor owned utility, and all the parties, including the Commission are fully aware that PGW is a “cash flow” utility, the Lukens’ testimony and study has no

relevance in this proceeding. Accordingly, OTS recommended a \$100,000 reduction in PGW's rate case expense. Further, OTS recommended that the remaining rate case expense be normalized over a two-year period. Based on these two adjustments, OTS is recommending that the claimed rate case expense of \$875,000 be reduced by a total of \$362,000.

OTS made two other expenses adjustments in the areas of Promotional Activities and Bad Debts. With respect to the Promotion Activities, the Company claimed \$1,645,000 for promotional activities for various residential conversion incentives for developers and customers for appliance conversions. Since, PGW does not have the ability to flex rates for its incentive activities, OTS is recommending that \$385,000 be allowed to be recovered in rates for Promotional Activities. The \$385,000 allowance represents the highest amount that was ever expended by PGW in any one year for its Promotional Activities. In fact, since its inception, PGW has only expended a total of \$558,103, which far below its base rate claim of \$1,645,000.

After reviewing the Company's bad debt expense claim of \$65 million, OTS is recommending a write-off percentage of 7.6160 based on a five-year average of actual net write-offs to gross revenues. Accordingly, when the write-off percentage is applied to the projected total future test year sales revenues of \$802.6 million, the result is an allowance of \$60.1 million for bad debt expense.

OTS is of the opinion that the Commission should order PGW to perform a fully allocated class Cost of Service Study for its next base rate Filing. In the area

relevance in this proceeding. Accordingly, OTS recommended a \$100,000 reduction in PGW's rate case expense. Further, OTS recommended that the remaining rate case expense be normalized over a two-year period. Based on these two adjustments, OTS is recommending that the claimed rate case expense of \$875,000 be reduced by a total of \$362,000.

OTS made two other expenses adjustments in the areas of Promotional Activities and Bad Debts. With respect to the Promotion Activities, the Company claimed \$1,645,000 for promotional activities for various residential conversion incentives for developers and customers for appliance conversions. Since, PGW does not have the ability to flex rates for its incentive activities, OTS is recommending that \$385,000 be allowed to be recovered in rates for Promotional Activities. The \$385,000 allowance represents the highest amount that was ever expended by PGW in any one year for its Promotional Activities. In fact, since its inception, PGW has only expended a total of \$558,103, which far below its base rate claim of \$1,645,000.

After reviewing the Company's bad debt expense claim of \$65 million, OTS is recommending a write-off percentage of 7.6160 based on a five-year average of actual net write-offs to gross revenues. Accordingly, when the write-off percentage is applied to the projected total future test year sales revenues of \$802.6 million, the result is an allowance of \$60.1 million for bad debt expense.

OTS is of the opinion that the Commission should order PGW to perform a fully allocated class Cost of Service Study for its next base rate Filing. In the area

of revenue allocation and rate design, OTS recommended that the Company increase rates to the LBS Large Direct, TriGen Direct, and NGV Direct customer classes in order to recover costs that are allocated to them. In addition, the Company should reduce the rates to the GTS Trans customer class. By making these changes, all four of these customer classes will move towards their respective costs. In the area of customer charges, OTS is recommending that the Residential customer charge be set at \$12, the Commercial customer charge be set at \$18 and that the Commission adopt the Company's proposed customer charge of \$50 for Industrials.

In the Company's GCR proceeding at docket number R-00005619, the Commission instructed "that the appropriateness of PGW's practice of including non-gas costs in its GCR be addressed as an issue in the base rate filing that is to be made by PGW on or before January 1, 2001, and a specific recommendation concerning this practice is to be presented to the Commission by the OALJ as a part of the resolution of that case." In complying with the Commission's instruction, OTS is recommending that purchase electric expenses, the Customer Responsibility Program, the Conservation Works Program, and the Senior Citizens Discount Program recovery mechanism be transferred from the GCR mechanism to base rates.

In further addressing the Senior Citizens Discount Program, OTS is recommending that the program be closed to any additional customers, that PGW

submit a plan to the City Council of Philadelphia to phase out the program, and that the program undergo a recertification of its participants for a determination of their continued eligibility for receiving a senior citizen discount.

III. STANDARD OF REVIEW FOR PGW RATE CASES

Ordinarily a discussion regarding the standard of review for a rate case would not be necessary, however due to the ratemaking methodology applicable to PGW such a discussion is necessary. Moreover, the manner in which PGW has attempted to present its case in this proceeding necessitates a discussion regarding the standard of review of rate cases.

Section 2212(e) of the Public Utility Code (“Gas Choice Act”) requires the Commission, when determining PGW’s “revenue requirement and approving overall rates and charges,” to “follow the same ratemaking methodology and requirements that were applicable to [PGW] prior to the assumption of jurisdiction” by the Commission over PGW until all “approved bonds have been retired, redeemed, advance refunded or otherwise defeased.”²

By all accounts, the ratemaking methodology applicable to PGW prior to the assumption of jurisdiction by the Commission on July 1, 2000 was the “cash flow” method. The genesis for the “cash flow” method is the Management Agreement between the City of Philadelphia and the Philadelphia Facilities Management Corporation, dated December 29, 1972 and adopted on the same date as an Ordinance by the City Council of Philadelphia. (See Appendix A). The “cash flow” method of ratemaking is established in Section VII of the

² By all accounts the “approved bonds” have not been “retired, redeemed, advance refunded or otherwise defeased” as of this date and will not be “retired, redeemed, advance refunded or otherwise defeased” prior to the date of the Commission’s Order in this instant case.

Management Agreement, which provides in pertinent part, as follows, that the Philadelphia Gas Commission (“PGC”):

shall fix and regulate rates and charges for supplying gas to customers . . . which . . . will, in each fiscal year produce revenue, at a minimum:

- (a) Sufficient to pay all of the operation and maintenance costs and expenses of conducting the Gas Works enterprise and to pay the interest and amortization becoming due in such fiscal year on debt incurred for the Gas Works, including but not limited. . . .
 - (i) To provide cash, or equivalent, for working capital in such reasonable amounts as may be determined by Company to be necessary and as shall be approved by the Gas Commission.³

In addition to providing cash for working capital, the Management Agreement, by all accounts, requires the Commission to set rates so that PGW’s bond ordinance covenants are honored.

In the instant proceeding, PGW has filed a future test year ending August 31, 2001. In the rebuttal phase of the proceeding, PGW appears to argue that the foreseeable future test year is extended to August 31, 2002. OTS respectfully submits that the Company in its Filing selected August 31, 2001 as the ending date for the future test year, and that should be date used for the resolution of this proceeding. Moreover, this notion that the Commission is obligated to fund

³ The itemization of costs and expenses required to be covered in PGW ‘s rates, pursuant to Section VII, of the Management Agreement, includes depreciation, retirement costs, all sinking fund charges payable for principal and interest on PGW bonds, capital additions, working capital and an annual \$18 million base payment to the City.

whatever budget the Company and the Philadelphia Gas Commission decides should be dismissed as illogical.

Consequently, the only issue in this proceeding from a “cash flow” perspective is whether there is sufficient cash for the Company at the end of the fiscal year August 31, 2001. It must be noted that in the Joint Petition For Full Settlement of Interim Rates and Related Appeal at Docket No. R-00005654, PGW made the following representation:

PGW expects that the above financial and operational steps set forth above will be sufficient to enable them to meet their financial obligations through January, 2002. If, however, these steps are not sufficient, PGW agrees that it shall request additional rate relief to meet any shortfall only as a last resort after pursuing in good faith all other sources of revenue reasonably available.

As the Settlement clearly provides, if “PGW identifies a cash deficiency that would cause a Bond Ordinance covenant violation, PGW will be permitted to utilize the reserve fund to cover this deficiency” from the GCR over-recovery.⁴

Consequently, this proceeding must be decided upon in the context of a future test year ending August 31, 2001.

⁴ Judicial Notice by the Commission should recognize that PGW has not made a Quarterly GCR Filing in either March 2001 or June 2001 seeking the recovery of a \$11.5 million projected under recovery at the current GCR, and is maintaining the currently effective rate of \$6.6959/Mcf.

IV. REVENUES

1. The Company's Average Use Per Residential And Commercial Customers Is Incorrect

OTS, through the testimony of its witness Joseph Kubas, addressed the operating revenue issues relating to PGW's request for \$65,000,000 in additional annual revenue filed on January 4, 2001. There are two types of test years. A historic test year is a twelve-month period selected by a Company that represents a recent full year of actual data.⁵ A future test year normally represents a year of actual and projected data ending one year after the end of the historic test year.⁶ In the instant case, as previously discussed, PGW has selected a future test year ending August 31, 2001. PGW's future test year ending August 31, 2001 includes projected customer data, sales and revenues.

In determining present and proposed operating revenue, and expenses, one must be reminded that the Company did not provide operating revenues for the future test year ending August 31, 2001 using present rates.⁷ As OTS witness Kubas explained, PGW determined proposed operating revenues by projecting the average number of customers paying the proposed customer charge, the projected volume of gas, and then making various adjustments for non billed revenue and miscellaneous revenue.⁸ The question arises, whether PGW's claimed average use

⁵ See OTS St. No. 2 at page 2.

⁶ See OTS St. No. 2 at page 2.

⁷ The Company is requesting total adjusted proposed operating revenues of \$755,484,000 for the future test year ending August 31, 2001. See PGW Volume II, Exhibit A-1-1.

⁸ See OTS St. No. 2 at page 3.

per customer and projected number of customers should be relied upon in this proceeding. In that regard, OTS is of the opinion that PGW has understated both the number of residential heating and commercial heating customers as well as the average use per customer for these classes.⁹

By way of background, PGW is projecting total sales volumes of 58,498,387 Mcf and 512,891 total customers.¹⁰ In proposing the average number of customers and average usage per customer for the test year ending August 31, 2001,¹¹ PGW based its customer count claim on projections and adjustments to historic data. Additionally, PGW's average usage per customer claim is also based on projections and adjustments made to historic data. In each instance, the average usage adjustments reflect the use of 4,555 normalized heating degree-days to projected total sales.¹²

Since rates are determined based on normal weather, a weather normalization calculation is necessary. The OTS calculation demonstrates that PGW has understated the average use per customer for these classes. As OTS witness Kubas explained, "weather normalization" is a methodology¹³ used to restate historic test year actual sales on a per customer basis to reflect the level of sales that the utility would have achieved had actual heating or cooling degree

⁹ See OTS St. No. 2 at page 4.

¹⁰ See PGW Exhibit HSG-1, Schedule 4-A.

¹¹ The Company used the historic sales period of September 1, 1999 through August 31, 2000 to determine total usage and customer counts with adjustments and projections for the test year ending August 31, 2001.

¹² See PGW St. 4 at page 4.

¹³ See Pennsylvania Public Utility Commission v. Natural Fuel Gas Distribution Company, 83 Pa. PUC 286 (1994).

days been equivalent what is “normal”.¹⁴ A weather normalization adjustment is necessary because the establishment of a proper revenue requirement for ratemaking purposes is dependent upon the development of a normal test year. In support of a weather normalization adjustment, OTS witness Kubas testified as follows:

Variations in temperatures have a direct effect on a gas utility’s sales related to heating. A colder than normal winter will result in increased gas sales while, conversely, a warmer than normal winter will result in reduced gas sales. It has become the recognized gas industry practice to normalize gas sales, revenues and expenses when actual Degree-days vary significantly from normal degree-days for any given test year.¹⁵

The Company utilized a two step process in developing normalized usage for the residential and commercial heating class. The first step developed by the Company was the base load usage, which is a non-heating load, determined by averaging sales during July, August and September of 1998.¹⁶ The second step is the development of normal heating usage, which the Company did by adjusting actual historic sales using a computer model and a normal year of 4,555 heating days to determine the normal heating usage.¹⁷ The mathematical calculation for the two-step process is the base load usage plus the normal heating usage equals

¹⁴ See OTS St. No. 2 at pages 4-5.

¹⁵ See OTS St. No. 2 at page 6.

¹⁶ See OTS St. No. 2 at page 8.

¹⁷ See PGW St. No. 4 at page 4.

the total usage for that particular class.¹⁸ By using the two-step process, the Company is claiming an average usage of 100.94 Mcf per residential heating customer¹⁹ and for commercial customers, the Company is claiming an average of 445.21²⁰ Mcf per customer.²¹

After performing its analysis, OTS has concluded that PGW has understated the average use per customer for its residential heating and commercial heating customers. Based upon the weather normalized heating load for the year 2000 and using actual sales for July, August and September of 2000 to determine base load.²² PGW's average usage per residential heating customer should be increased to 103.91 Mcf per year, and the average usage per commercial heating customer should be increase to 477.11 Mcf per year.

It must be noted that in determining its total usage and customer counts, PGW utilized the historic sales period of September 1, 1999 through August 31, 2000, together with adjustments, projections and customer counts for the test year ending August 31, 2001.²³ OTS is of the opinion that the Company's actual sales for the year 2000 should be the basis for projecting the number of customers and weather-normalized usage in this proceeding. The use of the Company's actual sales for the year 2000 is required by PGW's candid admission that the Company

¹⁸ See OTS Exhibit No. 2, Schedule 1.

¹⁹ 41,679,007 Mcf divided by 412,910 customers.

²⁰ 8,486,143 Mcf divided by 19,061 customers.

²¹ See PGW Exhibit HSG-1, Schedule 4A, page 1.

²² See OTS St. No. 2 at page 9.

²³ See OTS St. No. 2 at page 7.

had a history of billing discrepancies that were corrected during 2000.²⁴

Accordingly, common sense dictates that the Commission should not rely on projections, base load, and heat load calculations made before the billing discrepancies were corrected in the year 2000.²⁵

By increasing PGW's projected use per residential heating customer to 103.91 Mcf per year when determining proposed rates,²⁶ the Company will receive \$12,892,000 in additional revenue at proposed rates.²⁷ Likewise, by increasing PGW's projected use per commercial heating customer to 477.11 Mcf per year when determining proposed rates,²⁸ the Company will receive \$6,859,000 in additional revenue at proposed rates.²⁹

In the rebuttal phase of the proceeding, PGW through its witness, Craig White testified that OTS' average use per customer analysis was not correct.³⁰ PGW witness White suggests that the Company's forecasted gas model is a highly accurate predictor of PGW's sale levels.³¹ In support of the Company's position, Mr. White provided a schedule that compares firm sendout to projected sales using

²⁴ See PGW St. No. 1 at page 25.

²⁵ See OTS St. No. 2 at page 10.

²⁶ See OTS Exhibit No. 2, Schedule 3, page 2, column D, Line 4.

²⁷ See OTS Exhibit No. 2, Schedule 3, page 2, column C, Line 14.

²⁸ See OTS Exhibit No. 2, Schedule 4, page 2, column C, Line 4.

²⁹ See OTS Exhibit No. 2, Schedule 4, page 2, column C, Line 14.

³⁰ See PGW St. No. 4.1, at page 2.

³¹ See PGW St. No. 4.1, at page 1.

the Company's forecasting model.³² According to Mr. White, the calculated sendout in the schedule utilized the same customer counts, same base load factors, same heating load per degree day factors, and the same monthly historical utilization factors that were used in preparing the projected, fully forecasted test year for this rate filing.³³ Along with the previously described inputs and replacing the number of average heating degree days with the actual number of heating degree days, Mr. White concludes that for the most recent five month period from November 2000 through March 2001, PGW's forecasting model is only off 2%.³⁴

In response, OTS would respectfully submit that PGW's analysis is seriously flawed and lacking in evidentiary support. PGW's analysis only utilized five months, while OTS' analysis covered twelve months. As OTS witness Kubas explains, the five months selected by PGW witness White occurred during a period of record high gas prices.³⁵ Clearly, the normalizing of sales based on five months is not long enough for a proper analysis. In addition, the data for this period was skewed by high gas prices, combined with PGW's requested rate increases. These factors undoubtedly caused PGW's customers to use less gas. While PGW witness White's suggestion, unsupported by any empirical evidence, that gas prices have "fluctuated" in the past and the computer has been accurate in

³² See PGW St. No. 4.1, at page 2.

³³ See OTS St. No. 4.1, at page 2.

³⁴ See OTS St. No. 4.1, at page 3.

³⁵ See OTS St. 2SR, at page 3.

the past, is without merit.³⁶ Particularly, since Mr. White has provided no evidence that gas prices was ever as high as they were this past winter and that the computer model was accurate in the past. Indeed, if the computer model has been so accurate and reliable, the question that needs to be answered, is why is the *Company experiencing financial difficulty as suggested by the Company's* testimony in this proceeding? As Mr. White explained, "the key to any forecasting model, is the consistency and accuracy of the input data that is used to develop the factors that are utilized to project sales and send-out."³⁷ OTS submits that Mr. White's explanation is the key to the problem with the Company's forecasting model since there is no independent method of determining the consistency and accuracy of the model when there is no evidence of what numerical input data was used to develop the factors, which determined the projected sales and send-out.

Additionally, by Mr. White's own admission, all of the inputs utilized for the Company's claimed Filing time period, which was September 1, 1999 through August 31, 2000, were utilized for the time period of November 2000 through March 2001. Clearly, it is possible that some of these inputs have changed over time and should have been updated.³⁸ Most important, with respect to PGW's calculated sendouts using inputs, is the fact that there is no record evidence or schedules detailing with any numerical specificity outlining the inputs that were

³⁶ See Tr. 552.

³⁷ See Tr. 548.

³⁸ See OTS St. No. 2SR, at page 2-3.

utilized. Case in point, does anyone associated with this proceeding, other than PGW know (1) what base load factors were utilized; (2) what heating load per degree day factors were utilized; (3) what monthly historical utilization factors were utilized. There can be no dispute that any questions surrounding the numerical factors utilized by PGW in its computer model would have to be answered in the negative, as PGW simply identified the inputs without the numerical identification of the factors that were inputted into the computer model. Undoubtedly, in its Reply Brief, PGW will indicate that the numerical identification of the inputs would have been provided if OTS had requested the information through discovery. While that may be correct, it must be noted that PGW has the burden of proof, and it is the Company not OTS that has referenced the inputs in support of its position in this proceeding.

In comparison, OTS' assumptions and inputs for determining the appropriate average use per customer are succinctly described and illustrated in OTS Statement No. 2 and OTS Exhibit No. 2. Notably, based on the actual number of customers and monthly sales volumes in 2000, OTS was able to determine the base load for each residential heating class customer.³⁹ After reviewing the actual sales volumes and heating degree day data and assuming that base load is the sales in July, August, and September 2000, OTS witness Kubas determined that the base load should be 2.25 Mcf per month per residential heating

³⁹ See OTS St. No. 2, at page 10.

customer.⁴⁰ The 2.25 Mcf per month was calculated by dividing the monthly sales for the months of July, August, and September 2000 by the number of customers (2,891,933 divided by 1,285,035 = 2.25).⁴¹ By using the average base load per customer, OTS witness Kubas was able to determine the total base load volumes for the residential heating class, which is quantified by using the number of customers each month multiplied by the average base load for the residential heating class.⁴²

OTS witness Kubas' analysis continued because by using the average base load per customer, he was able to determine the average annual normalized sales for each residential heating class customer.⁴³ By dividing the total normalized usage of 44,069,567 Mcf,⁴⁴ by the average of 424,099 customers,⁴⁵ OTS witness Kubas determined that the total annual normalized usage for January 2000 through December 2000 was 103.91 Mcf.⁴⁶ The difference between OTS' annual normalized usage of 103.91 Mcf and the Company's Filing of an annual normalized usage of 100.94, results in a difference of 2.97 Mcf.⁴⁷

⁴⁰ See OTS St. No. 2, at page 10.

⁴¹ See OTS Exhibit No. 2, Schedule 3, page 1, column E, line 34.

⁴² See OTS Exhibit No. 2, Schedule 3, page 1, column D.

⁴³ See OTS Exhibit No. 2, at page 12.

⁴⁴ See OTS Exhibit No. 2, Schedule 3, page 1, column J, line 16.

⁴⁵ See OTS Exhibit No. 2, Schedule 3, page 1, column B, line 24.

⁴⁶ See OTS Exhibit No. 2, Schedule 3, page 1, column E, line 24.

⁴⁷ See OTS Exhibit No. 2, Schedule 3, page 2, column C, line 4.

Consequently, OTS is recommending that Company increase the projected use per residential heating customer to 103.91 Mcf per year when determining proposed rates.⁴⁸

OTS witness Kubas did a similar analysis with respect to the commercial customers, and determined an average use per commercial customer of 477.11 Mcf⁴⁹ and the normalized usage was 9,094,190 Mcf,⁵⁰ which results in a total average annual sales for January 2000 through December of 477.11 Mcf.⁵¹ The difference between OTS' recommended annual normalized usage of 477.11 Mcf and the Company's claimed of 445.21 is 31.90 Mcf for the average commercial heating customer.⁵²

Consequently, OTS is recommending that the Company increase the projected use per commercial heating customer to 477.11 Mcf per year when determining proposed rates.⁵³

In reviewing the above most recent paragraphs, it is clear to anyone as to how OTS' recommendation was derived in this proceeding, as there are no mysteries as to how the recommended figures for average use per residential and commercial heating customers were calculated. In contrast, the Company's claim is not supported by any schedules or explanation, other than the

⁴⁸ See OTS Exhibit No. 2, Schedule 3, page 2, column D, line 4.

⁴⁹ See OTS Exhibit No. 2, Schedule 4, page 1, line 24.

⁵⁰ See OTS Exhibit No. 2, Schedule 4, page 1, column D, line 6.

⁵¹ See OTS Exhibit No. 2, Schedule 4, page 1, column E, line 24.

⁵² See OTS Exhibit No. 2, Schedule 4, page 2, column C, line 4.

⁵³ See OTS Exhibit No. 2, Schedule 4, page 2, column D, line 4.

identification of factors, without specificity as to the figures used in determining PGW's average use per residential and commercial heating customers.

In the rejoinder phase of the proceeding, PGW witness White testified that the Company's computer model is highly accurate, since it is based on a send-out model that the Company has used since the 1980s.⁵⁴ In an attempt to validate the model, Mr. White "backcasted" the model, which means that PGW "ran" the model with the actual degree days for the five months of November 2000 through March 2001 and determined that model was off by approximately 2%.⁵⁵ OTS submits that the reliance on five months is insufficient for this type of analysis.

2. The Company's Projection Of The Number of Residential And Commercial Heating Customers And The Usage For These Customers Is Incorrect

In this proceeding, PGW is projecting 412,910 residential heating customers and 19,061 commercial heating customers.⁵⁶ A monthly analysis illustrating the Company's projected 412,910 residential heating customers and 19,061 commercial heating customers has been presented in OTS Exhibit No. 2, Schedule 1. After reviewing the Company's filing, OTS is recommending that the projected number of residential heating customers should be increased by 11,189, and the number of commercial heating customers should be increased by 51.⁵⁷

⁵⁴ See Tr. 548.

⁵⁵ See Tr. 548 and Tr. 550.

⁵⁶ See PGW Exhibit HSG-1, Schedule 4-1, page 1.

⁵⁷ See OTS St. No. 2 at page 16.

The disagreement surrounding the Company's position is that the projected number of customers in the residential heating and commercial heating classes for the last four months of 2000 do not match the actual number of customers in these classes for the last four months of 2000.⁵⁸ There is no question that the actual *number of residential heating and commercial heating customers that PGW served in calendar year 2000* should be the guide in determining the projected number of customers and projected sales in this instant proceeding.

In order to determine the average number of residential heating customers in this case, OTS added the number of actual residential heating customers for each month in the year 2000, and divided the total by 12 months. The result of OTS' analysis indicates that the average number of residential customers in the year 2000 was 424,099.⁵⁹ OTS' calculation of 424,099 is 11,189 more than the 412,190 residential heating customers claimed by the Company in its proof of revenue schedules.⁶⁰ With regard to the number of actual commercial heating customers for the year 2000 and the projected number of commercial heating customers, the difference is 51 customers (19,112 – 19,061).⁶¹

By recognizing the additional residential heating customers, the proposed increase in revenues is \$27,114,000.⁶² For clarity purposes, OTS witness Kubas

⁵⁸ See OTS St. No. 2 at page 16.

⁵⁹ See OTS Exhibit No. 2, Schedule 3, page 1, column B

⁶⁰ See PGW Volume III, Exhibit HSG-1, page 1 and OTS Exhibit No. 2, Schedule 3, page 3, line 3.

⁶¹ See PGW Exhibit HSG-1, Schedule 4A, page 1 and OTS Exhibit No. 2, Schedule 4, page 3, column C, line 3.

⁶² See OTS Exhibit No. 2, Schedule 3, page 4, column C, line 21.

provided a detailed explanation as to how the additional residential heating customers will affect a number of the proposals as follows:

The Company will receive customer charge revenue from these additional 11,189 residential heating customers paying the proposed \$15.00 monthly customer charge. This would increase proposed revenue by \$2,014,000 (11,189 X 15.00 X 12),⁶³ as shown on OTS Exhibit No. 2, Schedule 4, page 3, column C, line 18. The Company will also receive sales revenue from these 11,189 additional residential heating customers paying the commodity and GCR. Assuming that these customers will use an average of 100.940 Mcf per year, as projected by the Company, the additional Mcf sales for these 11,189 additional residential heating customers would be 1,129,546 Mcf (See OTS Exhibit No. 2, Schedule 3, page 3, column C, line 6). The additional sales revenue associated with this 1,129,546 Mcf is \$11,860,000, as shown on line 15. The total additional revenue for the residential heating class including customer charge and sales is **\$13,874,000**, as shown on line 21. If the Commission also accepts my recommendation described above to increase the average sales to 103.913 Mcf per year, the additional volumes associated with all customers including the additional 11,189 residential heating customers would be 2,390,560 Mcf, as shown on OTS Exhibit No. 2, Schedule 3, page 4, column C, line 6. The total additional revenue for the residential heating class for these two adjustments is **27,114,000** as shown on line 21.⁶⁴

A corresponding quantification of an increase in proposed revenue was done by recognizing the 51 additional commercial heating customers. With the recognition of the 51 additional commercial heating customers, the additional revenue for the commercial heating class would be \$7,149,000.⁶⁵ As was done with the additional residential heating customers, OTS witness Kubas provided

⁶³ If OTS' recommended customer charge is adopted, the proposed revenue increase will be \$1,611,216 (11,189 X 12.00 X 12).

⁶⁴ See OTS St. No. 2, at pages 19-20.

⁶⁵ See OTS Exhibit No. 2, Schedule 4, page 4, column C, line 21.

similar testimony regarding the additional commercial heating customers as follows:

The Company will receive customer charge revenue from these 51 additional commercial heating customers paying the proposed \$25.00 monthly customer charge. This would increase proposed revenue by \$15,000 (51 X 25.00 X 12)⁶⁶ as shown on OTS Exhibit No. 2, Schedule 4, page 3, column C, line 18. The Company will also receive sales revenue from these 51 additional commercial heating customers paying the commodity and GCR. Assuming that these customers will use an average of 445.21 Mcf per year, as projected by the Company, the additional Mcf sales for these 51 additional residential heating customers would be 22,711 Mcf (See OTS Exhibit No. 2, Schedule 4, page 3, column C, line 6). The additional revenue associated with this 22,711 Mcf is \$256,000, as shown on line 15. The total additional revenue for the commercial heating class including customer charge and sales is **\$271,000**, as shown on line 21. If the Commission also accepts my recommendation described above to increase the average sales to 477.11 Mcf per year, the additional volumes associated with all customers including the additional 51 commercial customers would be 632,379 Mcf, as shown on OTS Exhibit No. 2, Schedule 4, page 4, column C, line 6. The total additional revenue for the commercial heating class for these two adjustments is **\$7,149,000**, as shown on line 21.⁶⁷

In response to OTS' recommended increase in residential and commercial heating customers, PGW witness White testifies that "while Mr. Kubas' recommended increase in total customers may be reasonable, the suggested

⁶⁶ If OTS-recommended customer charge is adopted, the proposed revenue increase will be \$11,016 (51 x 18.00 x 12).

⁶⁷ See OTS St. No. 2, at pages 20-21.

increase in annual usage per customer is not reasonable.”⁶⁸ Accordingly, PGW conceded that revenue should be increased by slightly less than \$2 million to reflect the additional revenue the Company will be receiving from these additional customers paying the proposed monthly customer charges.⁶⁹ PGW reached the conclusion that additional customers should be added by reviewing the Company’s billing records for February 2001 and comparing those numbers to the number of customers projected in the original filing for March 2001. After comparing the actual records for February 2001 and the projected numbers for March 2001, PGW concluded that the residential customers should be increased by 9,709 customers and the number of commercial customers should be increased by 700 customers.⁷⁰

The problem with PGW’s partial concession is that the increase in the number of residential and commercial customers does not go far enough. Case in point, PGW’s updated number for increased customers is based only on a one (1) month analysis. Clearly, any analysis that relies solely on data from one (1) month and not the entire year has to be viewed with suspicion, and the suspicion is justified in this case. In that regard, there is evidence that the actual number of residential heating customers varies from month to month. For example, as OTS witness Kubas, testified, the actual number of customers in March of 2000 was 5,035 less than the average for the year, indicating that using a one month total is

⁶⁸ See PGW St. No. 4.1, at page 8.

⁶⁹ See PGW St. No. 4.1, at page 8.

⁷⁰ See PGW St. No. 4.1, at pages 6-7.

not indicative of a normal year.⁷¹ Consequently, the OTS utilization of a 12-month average is the appropriate method, and not an adjustment based only on one (1) month.⁷²

More disturbing than the one (1) month adjustment proposed by the Company in the rebuttal phase of the proceeding, is the Company's refusal to add usage for these additional 10,409 customers.⁷³ In support of the Company's position, PGW witness White once again relies upon the incongruous position that the sales forecasting computer model is accurate, and increasing customer counts while the current per customer usage remained the same or was increased, would result in an over estimation of sales and revenue.⁷⁴ OTS respectfully submits that it is illogical to suggest to this Commission that 10,409 additional customers will not use any gas, and accordingly, the Company's argument should be rejected.

The Company attempted to bring some credibility to this discussion by suggesting that PGW is reporting in its most recent GCR Filing that usage per

⁷¹ See OTS Exhibit No. 2, Schedule 3, page 1, column B.

⁷² If the Commission does not accept OTS' twelve (12) month average adjustment for customers, the Commission should at least adopt the Company's one (1) month adjustment for customers.

⁷³ See PGW St. No. 4.1, at page 7.

⁷⁴ See PGW St. No. 4.1, at page 7.

customer is decreasing.⁷⁵ Aside from the fact that the GCR Filing has not been the subject of any discovery or litigation, the Company in this proceeding did not present any studies, analysis or any proof that usage per customer is decreasing. Moreover, with the Company's admitted poor billing records, it is unclear as to how any historical usage pattern could be measured against the year 2000 billing records. In fact on rejoinder, PGW witness White testifies that, for the first time, one factor contributing to the increased number of customers was the conversion to a new billing system and a correction to the number of customer charges that should be billed.⁷⁶ The problem with the Company's arguments is the obvious inconsistencies. While the Company is touting the accuracy of its sales forecasting computer model, which depends to some degree on the number of customers inputs, the Company readily admits to past flaws with its billing system. With such inconsistencies, there is absolutely no reason for the Commission to adopt the Company's position.

In contrast, OTS witness Joseph Kubas has comprehensively presented how OTS' recommended customer counts were derived. Accordingly, the Commission should approve the total number of residential and commercial heating customers and total usage for both residential and commercial heating

⁷⁵ See PGW St. No. 4.1, at page 8.

⁷⁶ See Tr. 555.

customers as recommended by OTS based on the year 2000 data.⁷⁷ These two revenue adjustments total \$34,263,000 as shown on Table 1 attached.

3. Any Adjustments To The Average Use Per Customers And The Average Number Of Customers Impact The Cost Of Gas Expense

OTS' proposed adjustments to the average use per customer and the average number of customers have an impact on the cost of gas expense. Previously, OTS increased the sales to reflect a higher average use for the additional residential and commercial heating class customers. An additional 1,227,873 Mcf is needed for the residential heating class, which, when multiplied by the average cost of gas of \$6.7745, increases the cost of gas to \$8,318,000.⁷⁸ An additional 608,047 Mcf is needed for the proposed average use per commercial heating customer, which when multiplied by \$6.7745, increases the cost of gas expense to \$4,119,000.⁷⁹

In addressing the increase in sales to reflect a higher number of residential customers by an additional 1,129,546 Mcf, multiplied by the average cost of gas of \$6.7745, the increase in gas expense is \$7,652,000.⁸⁰ An additional 22,711 Mcf is needed to serve the additional commercial heating class multiplied by \$6.7745 the increase in the cost of gas expense is \$154,000.⁸¹

⁷⁷ See OTS Exhibit No. 2, Schedule 3, at page 4 and OTS Exhibit No. 2, Schedule 4, at page 4.

⁷⁸ See OTS Exhibit No. 2, Schedule 3, at page 2, column C, line 17.

⁷⁹ See OTS Exhibit No. 2, Schedule 4, at page 2, column C, line 17.

⁸⁰ See OTS Exhibit No. 2, Schedule 3, at page 3, column C, line 24.

⁸¹ See OTS Exhibit No. 2, Schedule 4, at page 4, column C, line 24.

In conclusion, if both the average use per customer and number of customer adjustments proposed by OTS are accepted by the Commission, the total cost of gas adjustment would be \$16,195,000 for the residential heating class.⁸² The total cost of gas adjustment for the commercial heating class would be \$4,284,000.⁸³ These adjustments total \$20,479,000 as shown on Table 1 attached.

⁸² See OTS Exhibit No. 2, Schedule 3, at page 4, column C, line 24.

⁸³ See OTS Exhibit No. 2, Schedule 4, at page 4, column C, line 24.

V. EXPENSE ADJUSTMENTS

1. Introduction

By way of background, as previously discussed, PGW has requested a total increase of \$65 million to base rates. The Company is requesting a \$45 million increase in its customer charge plus a \$20 million increase in its volumetric rates.⁸⁴ On February 21, 2001, the Commission adopted a Settlement Agreement, which granted PGW a base rate increase of \$11 million that was included in the customer charge. This interim increase effectively reduces the Company's customer charge requested increase from \$45 million to \$34 million and reduces its overall request to \$54 million.⁸⁵

After reviewing the Company's Filing, OTS is of the opinion that PGW's total revenue increase should be limited to \$33 million, by including the \$11 million interim rate relief, the total revenue increase will be \$44 million. OTS is recommending three expense adjustments, which are as follows: (1) an adjustment to the Company's bad debt expense claim based on an historic write-off ratio; (2) an adjustment to rate case expense; and (3) an adjustment to the Promotional Activities expense.

⁸⁴ See OTS St. No. 1, at page 2.

⁸⁵ See OTS St. No. 1, at page 3.

2. The Company's Rate Case Expense Should Be Adjusted

In this proceeding, PGW has claimed \$875,000 of rate case expense as an annual expense for the future test year.⁸⁶ The estimated total of \$875,000 consists of expenses associated with the base rate and gas cost proceedings in fiscal year 2000-2001. After reviewing the rate case expense, OTS has determined that two adjustments to the \$875,000 claim will be necessary. OTS' two adjustments are that the consulting fee of \$100,000 budgeted for the Lukens Energy Group, Inc. be disallowed and that the remaining rate case expense be normalized over a two-year period.⁸⁷ OTS' adjustments would reduce the Company's rate case expense claim by a total of \$362,000.⁸⁸

In its base rate Filing with the Commission, PGW requested as part of its rate case expense, \$100,000 for Lukens Energy Group, Inc. By all accounts, PGW had engaged the Lukens Energy Group, Inc. to review the cost-of-service study and develop a revenue requirement that PGW would require if the Company were an investor owned utility.⁸⁹ In its case in chief, PGW witness Knudsen described PGW witness Lukens' direct testimony as follows:

Finally, Mr. Lukens of Lukens Energy Group, Inc. will present an analysis (PGW Statement 6) showing that PGW ratepayers would be required to pay significantly higher rates if PGW were not a municipally owned utility. It is my hope that this testimony will assist the parties in understanding the inherent differences between traditional rate making for privately

⁸⁶ See OTS St. No. 1, at page 9.

⁸⁷ See OTS St. No. 1, at page 9.

⁸⁸ See OTS St. Exhibit No. 1, Schedule 5.

⁸⁹ See OTS St. No. 1, at page 10.

owned utilities and the Cash Flow Method required for PGW as a municipal utility with unique legal requirements.⁹⁰

In conjunction with the above quotation from PGW witness Knudsen's direct testimony, PGW witness Lukens described the purpose of his direct testimony as follows:

I have been asked by Philadelphia Gas Works (PGW) to review the Cost of Service filed in this case and develop an estimate of cost of service that PGW would require if it were an investor-owned utility (IOU). The hypothetical circumstance that I have in mind in preparing this testimony is that PGW is sold to private investors. The principal differences between PGW's costs as a municipal entity vis-a-vis an IOU structure result from elimination of PGW's tax exempt status and the need to pay investors a competitive return on capital. In the testimony that follows, however, I consider PGW's entire cost of service.⁹¹

Regardless of PGW's may have laudable intentions, the indisputable fact is that what revenue requirement PGW would require if it were an investor owned utility has no relevance in this proceeding. Everyone should have known or should know what ratemaking methodology is applicable to PGW, and having a consultant to provide testimony distinguishing a municipal owned utility from an investor owned utility served no useful or relevant purpose in this proceeding.

In response to OTS' recommendation to disallow the \$100,000 consulting fee for the Lukens Energy Group, Inc., PGW presented the following rebuttal through its witness, Joseph R. Bogdonavage:

⁹⁰ See PGW St. No. 1, at page 5.

⁹¹ See PGW St. No. 6, at page 4.

The testimony was submitted in direct anticipation of the likelihood that some party might try to argue (notwithstanding the law) to utilize some ratemaking approach used for non-municipals.⁹²

The problem with PGW's attempt in the rebuttal phase of the proceeding to suggest that the testimony was prepared in "anticipation" of an issue in this proceeding is simply without merit. Moreover, as PGW witness Bogdonavage acknowledged on cross-examination, neither Knudsen nor Lukens, the only PGW witnesses to address the purpose for Lukens' direct testimony in the Company's case-in-chief, described the Lukens direct testimony as being prepared in the "anticipation of an issue" presented by other parties' in their direct testimony.⁹³

In Pennsylvania Public Utility Commission v. National Fuel Gas Distribution Corp. 54 Pa. PUC 401, 416-417, 40 PUR4th 101, 117-118 (1980), the Commission in pertinent part provide some insight as to their responsibility in adjudicating rate case expense as follows:

. . . If a particular utility should decide to expend more or less than its allowance, for whatever reason it may choose, that is a management decision for it to make. Our decision in this and every case is to determine the reasonable annual expense allowance to be charged to ratepayers. (emphasis supplied).

Accordingly, while the management of PGW may have some need to know the difference between investor owned utilities and municipal owned utilities, such analysis has no relevance this instant proceeding. Clearly, the associated expense

⁹² See PGW St. 3.1, at page 11.

⁹³ See Tr. 604.

for the Lukens Energy Group should not be included in the reasonable annual expense allowance to be charged to PGW ratepayers.

Moreover, only prudently incurred expenses are incorporated in rate case expense claims, and it is the burden of the public utility to prove that the rate case expenses incurred are just and reasonable.⁹⁴ In the instant proceeding, PGW has failed its burden to prove that the expenses associated with the Lukens Energy Group are relevant and thus just and reasonable to be included as a rate case expense claim. In that regard, the Company's attempt to suggest that in its direct case, the Company presented testimony from Lukens in anticipation of the opposing parties raising issues regarding the difference between investor owned utilities and municipal owned utilities is without merit. Additionally, there was absolutely no need for PGW to present testimony that PGW ratepayers would be required to pay significantly higher rates if PGW were not a municipally owned utility, since that it is not an issue in this proceeding.⁹⁵

Consequently, the consulting fee of \$100,000 rate case expense claim for the Lukens Energy Group, Inc. should be disallowed.

The other adjustment for PGW's rate case expense claim is OTS' recommendation that the remaining rate case expense should be normalized over a two-year period. As OTS witness Weakley explained, the Commission views prudently incurred rate case expense as an ongoing, although recurring at irregular

⁹⁴ See Allegheny Center Associates v. Pennsylvania Public Utility Commission, 131 Pa. Commw. 352, 570 A.2d 149 (Pa. Cmwlth. 1990).

⁹⁵ See PGW St. No. 1, at page 5.

intervals, expense relative to the rendering of utility service.⁹⁶ Based upon the fact that rate case expense is ongoing, although recurring at irregular intervals, the rate case expense is subject to normalization for ratemaking purposes, not amortization.⁹⁷

With respect to the utility in question, PGW does not have a recent history of filing base rate cases, as the last base rate increase was in 1991.⁹⁸ By way of background, PGW filed this instant request for a base rate increase in January 2001, and the result of its restructuring filing will not become effective until either late 2002 or early 2003. Accordingly, two (2) years is a reasonable normalization period to be imposed in this proceeding for rate case expense.⁹⁹ Notably, PGW used a two (2) year period for its rate case expense incurred during its Interim Filing with the knowledge that Company would be filing this base rate increase before the expiration of two (2) years.

Consequently, OTS' recommended two (2) year normalization period for PGW's rate case expense should be adopted by the Commission.

3. The Company's Bad Debt Expense Should Be Adjusted

In this proceeding, PGW has made a claim for bad debt expenses, which the Commission normally defines as uncollectible account expense.¹⁰⁰ As explained by OTS witness Weakley, uncollectible accounts are specific

⁹⁶ See OTS St. No. 1, at page 9.

⁹⁷ See OTS St. No. 1, at page 9.

⁹⁸ This analysis excludes the interim rate Filing at Docket No. R-00005654.

⁹⁹ See OTS St. No. 1, at page 10.

¹⁰⁰ PGW refers to an uncollectible as "Bad Debts".

receivables that are determined to be uncollectible in whole or part, either because the debtors do not pay or because the creditor finds it impracticable to enforce payment.¹⁰¹ Those accounts deemed uncollectible are charged against income.

It is important to note that for ratemaking purposes, 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.¹⁰² For calculating purposes, net write-offs are gross write-offs less recoveries of amounts previously written off. As Mr. Weakley testified, this ratio is then applied to projected revenues to determine the proper prospective allowances.

OTS witness Weakley provided a description of how the Company's claim for uncollectible account expense was developed as follows:

The Company's bad debt expense is based on funding the bad debt reserve balance. The Company projects the ending accounts receivable balance by assuming that 90.5% of billed revenues will be collected and by estimating amounts that will be written-off during the year. The Company's then takes the estimated the ending accounts receivable balance and applied a reserve factor of 35% resulting in its claimed bad debt expense for the future test year. The Company's bad debt expense is the amount needed to adjust the bad debt reserve balance to the desired level.

¹⁰¹ See OTS St. No. 1, at pages 5-6.

¹⁰² See OTS St. No. 1, at page 6.

The Company's bad debt claim should not be used in setting rates since it does not reflect actual write-offs. (emphasis added).¹⁰³

Based on a desire to adjust the bad debt reserve balance to a desired level, the Company's revised claim for bad debt expense is \$65 million, which OTS submits is inappropriate.

OTS submits that the appropriate allowance for PGW's uncollectible account expense is \$61.1 million.¹⁰⁴ OTS is recommending a write-off percentage of 7.6160% based on a five-year average of actual net write-offs to gross revenues.¹⁰⁵ Accordingly, when the write-off percentage is applied to the projected total future test year sales revenues of \$802.6 million, the result is an allowance of \$61.1 million.¹⁰⁶

As previously discussed, OTS is proposing the use of a five-year analysis of prior years uncollectible accounts expense. OTS submits 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.¹⁰⁷ OTS' bad debt recommendation is consistent with the Commission decision in the interim rate proceeding of Pennsylvania Public Utility

¹⁰³ See OTS St. No. 1, at pages 6-7.

¹⁰⁴ See OTS Exhibit No. 1, Schedule 4.

¹⁰⁵ See OTS St. No. 1, at page 7.

¹⁰⁶ The write-off ratio of 7.6169% should be employed to determine the uncollectible accounts expense attributable to the final base rate gas revenues to be determined in this proceeding.

¹⁰⁷ See OTS St. No. 1, at page 8.

Commission, et.al. v. Philadelphia Gas Works, R-00005654 (Order entered November 22, 2000), which provides in pertinent part as follows:

Based upon the evidence before us, we shall adopt the position of the OTS and base PGW's uncollectible accounts expense upon the application of the recommended bad debts percentage of 7.3922 percent. We arrive at this conclusion for a number of reasons. First, we find the OTS method of determining the bad debt percentage to be reasonable and consistent with the Commission's policy of allowing known and measurable adjustments. We are mindful that the purpose of an adjustment such as this is to determine a normal level of expense by levelizing fluctuations in this expenses such as: write off or collection activities by PGW, economic conditions, or increased consumption due to weather. We are also of the opinion that the five-year period chosen by the OTS is of sufficient length to achieve that purpose. Further, we find the PGW bad debt percentage of 8.4 percent to be speculative in nature in that it has submitted no calculation to support the reasonableness of this proposal.¹⁰⁸

OTS submits that the bad debt percentage 7.6160 is known and measurable, and the recommendation is based on a five-year average of actual net write-offs to gross revenues.¹⁰⁹

Accordingly, OTS' recommended bad debt account expense adjustment should be adopted by the Commission.

4. The Company's Promotional Activities Should Be Adjusted

In this proceeding, the Company has claimed \$1,645,000 for promotional expense.¹¹⁰ PGW allocated the \$1,645,000 for promotional expense as follows:

(1) Major Accounts - \$1,210,000 and (2) \$435,000 allocated for various

¹⁰⁸ mimeo at page 17.

¹⁰⁹ See OTS Exhibit No. 1, Schedule 4.

¹¹⁰ See PGW Volume, Revised Exhibit C-4.

residential conversion incentives for developer and customers for appliance conversions.¹¹¹

The nature of PGW's promotional activities were explained by OTS witness Weakley as follows:

Promotional dollars are used to compete against alternate fuel sources. These promotional dollars are aimed at new construction or existing facilities that wish to convert to natural gas. The incentive dollars are designed to offset the equipment costs to the customer and make the installation of gas appliances more attractive. Promotional Activities are mainly incentive payments to attract new or expand existing demand for gas service. PGW's marketing department expects an increase in these expenditures primarily due to the planned initiative to aggressively promote the use of natural gas in the market place.¹¹²

After reviewing PGW's promotional activities, OTS initially recommended that the total claimed be denied. However, on cross-examination, PGW witness White informed the court that PGW did not have the ability to compete against alternate fuel sources by flexing their rates.¹¹³ In recognition of the Company's inability to flex its rates, OTS modified its recommendation to allow \$385,000 for Promotional Activities to be recovered from PGW's ratepayers.¹¹⁴ The amount of \$385,000 was based on the fact that during each of the last two years, PGW has budgeted approximately \$1.6 million for Promotional Activities; however, since the inception of the program, the total incentive payments have totaled only

¹¹¹ See OTS Exhibit No. 1, Schedule 6.

¹¹² See OTS Exhibit No. 1, at page 11-12.

¹¹³ See Tr. 567.

¹¹⁴ See Tr. 743.

\$558,103, for approximately twenty-one (21) customers. While PGW has budget \$1.6 million for Promotional Activities, at no time has the Company expended more than \$383,193 in any one year. In fact, PGW only expended \$383,193 in 1999 and \$94,120 in 2000. Clearly, when austerity should be the rule of the day, with PGW's self proclaimed, financial crisis, the Promotional Activity claim should be limited to an amount that is reasonable, and represent some proximity to the actual amounts expended in the past.

Accordingly, \$385,000 should be the amount allowed to be recovered by PGW for Promotional Activities.

5. OTS Recommended Rate Relief of \$44 Million Provides Sufficient Coverage To Preserve PGW's Credit Rating

OTS witness Deardorff testified that the debt service coverage ratios calculated from OTS' recommended increase in revenue are well in excess of the minimum requirements set forth in the Bond Ordinances.¹¹⁵ In fact, the coverage ratios provide ample cushion to alleviate any fears of the credit rating agencies that PGW will not meet its debt service.¹¹⁶

In the rebuttal phase of the proceeding, PGW witness Knudsen criticizes OTS' recommendation by suggesting that \$44 million increase (including the interim rate settlement of \$11 million) does not provide the needed cash flow. In response, OTS submits that OTS Exhibit No. 1, Schedule 2 shows a cash flow analysis for the fiscal year ended August 31, 2001 of an ending cash balance of

¹¹⁵ See OTS St. No. 5, at pages 4-5.

¹¹⁶ See OTS Exhibit No. 5, Schedule 3.

\$9.2 million. The OTS ending cash balance of \$9.2 million is significant when compared to the Company's filed ending cash balance at the end of the fiscal year of \$10 million. In fact, the Interim Rate increases (of \$11 million in the customer charge and \$7 million in the GCR) raise the Company's ending cash level by approximately \$12.5 million. Consequently, the ending cash balance using OTS' recommendation plus the interim rate relief is approximately \$21.7 million.¹¹⁷

Another rebuttal criticism by PGW witness Knudsen is the belief that the OTS' recommendation does not satisfy PGW's cash requirements in the four months following the fiscal year.¹¹⁸ A close examination of Mr. Knudsen's testimony reveals that the criticism is not based on the future test year of August 31, 2001 used in this proceeding but rather, refers to the fiscal year ended August 31, 2002. When the Company is suggesting that OTS' recommended \$44 million is not enough cash flow, it must be remembered that the analysis was done by the Company without considering any of OTS proposed adjustments, such as bad debt expense and rate case expense. On cross-examination, PGW witness Bogdonavage acknowledged that the Company's schedule designed to reflect the impact of OTS' recommended \$44 million increase did not reflect OTS' corresponding adjustments to the Company's Filing.¹¹⁹ Consequently, any analysis regarding OTS' recommended \$44 million increase which does not consider the corresponding adjustments is seriously flawed, and should not be

¹¹⁷ See OTS St. No. 1SR, at pages 1-2.

¹¹⁸ See PGW St. No. 1.1, at page 5.

¹¹⁹ See Tr. 602-603.

considered in deciding the merits of OTS' recommended \$44 million recommendation.

There are several observations that must be made by the Commission in the rebuttal phase of the proceeding. Not only is the Company shifting the focus from August 31, 2001 to August 31, 2002 and beyond, but the Company is also using changes in its rebuttal schedules to reflect the Company's projected cost of gas, which not only has not been decided by the Commission, but is also twelve months beyond the test year.¹²⁰

Finally, in the rebuttal phase of the proceeding, the Company presents the testimony and study of PGW witness Sullivan. The problem with Mr. Sullivan's testimony and study is that it extends outside of the future test year, by using PGW's fiscal years ending August 31, 2002 through August 31, 2006.¹²¹ Undoubtedly, between August 31, 2002 and August 31, 2006, PGW will be filing for additional base rate increases, accordingly, Mr. Sullivan's testimony and study serves no ratemaking purpose for this instant proceeding.

¹²⁰ See PGW St. No. 3.1, at page 4.

¹²¹ See PGW St. No. 8, Table 10.

VI. NON-GAS RELATED GCR EXPENSES

1. Introduction

In a matter that came before the Commission as a Petition for an "Expedited Proceeding" to consider PGW's 2000-2001 Gas Cost Rate ("GCR") Filing at Docket No. R-00005619 ("GCR Proceeding"), a number of the intervening and/or opposing parties objected to the inclusion of certain non-gas costs expenses in the GCR.¹²² In addressing the issue of including certain non-gas expenses in the GCR Proceeding, the Commission concluded in pertinent part as follows:

The Commission concludes that while the intervenors object to the inclusion of certain non-gas expenses in the GCR, no party disputes that pursuant to Section 2212(d), for purposes of the GCR filing in this proceeding, these costs must be properly included in the computation of the GCR. However, we agree with the Intervenors and hereby direct PGW to address the appropriateness of including non-gas costs expenses in the GCR as well as its impact on customers. Further, the appropriateness of PGW's practice of including non-gas costs in its GCR shall be addressed as an issue in the base rate filing that is to be made by PGW on or before January 1, 2001, and a specific recommendation concerning this practice is to be presented to the Commission by the OALJ as part of the resolution of that case(emphasis supplied).¹²³

The essence of PGW's argument is the belief that the GCR assures dollar-for-dollar recovery of the non-gas costs, and the matter should be addressed in the restructuring proceeding.

¹²² See Pennsylvania Public Utility Commission, et al v. Philadelphia Gas Works, R-00005619 (Order entered November 22, 2000).

¹²³ See Pennsylvania Public Utility Commission, et al v. Philadelphia Gas Works, R-00005619 at page 10.

OTS respectfully disagrees, as the Commission at a minimum has the authority to direct PGW to eliminate the non-gas costs in its restructuring filing, and not to have a re-litigation of the issue in the restructuring proceeding as if there is some merit to including non-gas costs in a GCR mechanism.

By way of background, the issue of non-gas cost in the GCR mechanism is of significant importance because it is the only mechanism upon which a gas utility is guaranteed to receive dollar-for-dollar recovery for its expense. The GCR, as its very name indicates, is designed to recover changes in gas costs incurred by a local distribution company ("LDC"). As OTS witness Keim explained, the GCR should only reflect increases or decreases in gas costs.¹²⁴ Generally, gas costs constitutes a large percentage of the total operation and maintenance costs incurred by LDCs, and due to the extreme volatility of gas costs, the Commission has a policy of recognizing the volatility in the GCR mechanism. Consequently, assuming a least cost procurement determination, LDCs are allowed to recover their respective gas costs through the GCR mechanism. If a utility such as PGW is permitted to include non-gas costs in its GCR mechanism, the resultant dollar-for-dollar recovery removes any incentive to control the costs of these non-gas costs expenses. Accordingly, PGW like all other Pennsylvania gas utilities should be allowed to recover only gas costs expenses through its GCR mechanism.

¹²⁴ See OTS St. No. 4, at page 3.

2. The Recovery of Purchase Electric Expenses
Should Be Excluded From The GCR Mechanism

As explained by OTS witness Metro, PGW includes in the Total Applicable Fuel Expense in its GCR approximately \$965,000 for purchased electric.¹²⁵ The purchased electric costs represent the electrical usage by the plants and buildings of the Company. Accordingly, it is easy to classify purchased electric expenses as a non- natural gas cost.¹²⁶ OTS is of the opinion that purchased electric expense should be removed from the fuel cost and properly included in the Company's Operations and Maintenance Claim in base rates.

With the removal of purchased electric expense from PGW's GCR, approximately \$965,000 will be removed from the Total Applicable Fuel Expense and placed into Operations and Maintenance Expenses.

3. The Recovery of Customer Responsibility Program Costs
Should Be Excluded From the GCR Mechanism

PGW's Customer Responsibility Program ("CRP") is a low-income customer assistance program, which appears to be similar to other Customer Assistance Programs ("CAP") of other Pennsylvania gas utilities.¹²⁷ As OTS witness Keim explained, CAPs are designed as alternatives to traditional collection methods for low income, payment troubled customers. Generally, customers participating in CAP programs agree to make monthly payments based on household family size and gross income.

¹²⁵ See OTS St. No. 3, at page 32.

¹²⁶ See OTS St. No. 3, at page 33.

¹²⁷ See OTS St. No. 4, at page 2.

While PGW's CRP appears to comply with most of the requirements for low-income customer assistance programs as contained in the Commission's Order Regarding Revisions to the Customer Assistance Program Policy Statement, there is one element of the program that OTS submits needs to be revised.¹²⁸ The revision concerns the method of recovery of CRP program costs incurred by PGW. The costs associated with the CRP program are recovered through PGW's GCR mechanism. OTS is of the opinion that recovery through the GCR mechanism is improper since (1) the costs of the CRP are non-gas costs and do not belong in the GCR mechanism; and (2) the reason the costs are in the GCR mechanism is to guarantee PGW will recover all of its costs associated with the CRP program.¹²⁹ No other Pennsylvania gas utility is recovering its customer assistance program costs through its GCR mechanism, but rather through their base rates. Recovering customer assistance program costs through base rates, where the amount of the expense allowed is fixed, provides an incentive for those gas utilities to manage the costs and size of the program. As the CRP program is presently constituted, PGW has no incentive to manage the costs and size of the program, since the costs have a fully guaranteed recovery through the GCR mechanism.

¹²⁸ See Customer Assistance Program Policy Statement at Docket No. M-00991232 (Order entered April 9, 1999).

¹²⁹ See OTS St. No. 4, at page 3.

While OTS is not advocating recovery of the costs associated with the CRP program, we are recommending that the CRP costs of \$36,852,448 be removed from the GCR mechanism and recovered in base rates.¹³⁰

4. The Recovery of Conservation Works Program Costs Should Be Excluded From The GCR Mechanism

As OTS witness Keim explained, the Conservation Works Program ("CWP") is a customer program designed to provide cost-effective energy savings to PGW's low-income customers who participate in the Customer Responsibility Program ("CRP") and is intended to reduce the overall long-term costs of the CRP.¹³¹ The program appears to provide energy conservation measures such as thermostats, weather stripping, insulation, etc.

While OTS is not disagreeing with the concept of the program, we do disagree with the recovery mechanism. In that regard, like the CRP program, the CWP costs are recovered in PGW's GCR mechanism, which OTS submits improperly provides for dollar-for-dollar recovery of non-gas costs. Moreover, with the dollar-for-dollar recovery available for the CWP program there is no incentive for PGW to control the program's costs.

Consequently, like the CRP program, the CWP costs should be recovered through an allowance in base rates. As Mr. Keim explained, base rate recovery for the costs of the CWP is the proper method since the annual cost is a fixed,

¹³⁰ See OTS St. No.4, at page 5 and OTS Exhibit No. 4, Schedule 1, page 4.

¹³¹ See OTS St. No. 4, at page 5.

budgeted amount, without the volatility of gas costs.¹³² Moreover, the CWP expenses have been stable in recent years, can easily be projected, and are not volatile.

Accordingly, the amount of CWP costs to be included in base rate should be \$2,200,000.¹³³

5. The Recovery of Senior Discount Program Costs Should Be Excluded From The GCR Mechanism

PGW's Senior Citizen Discount ("SCD") program is a customer assistance program which provides for reduced monthly charges to those customers who are City residents, 65 years of age or older, and pay for gas service at their residence.¹³⁴ Customers meeting the age and residential requirements pay only 80 percent of their total monthly bill for gas service and receive a discount of 20 percent. The cost of the program for the twelve months ended August 2001 is \$21,884,717.¹³⁵

OTS has made several recommendations in this proceeding regarding the SCD program; however, in this section of the Main Brief, only OTS' recommendation regarding the cost recovery of the SCD program will be discussed. In that regard, as with the previous programs and/or expenses, the SCD program costs are being recovered through PGW's GCR mechanism.¹³⁶ There

¹³² See OTS St. No. 4, at page 6.

¹³³ See OTS Exhibit No. 4, Schedule 2, at page 2.

¹³⁴ See OTS St. No. 4, at page 5.

¹³⁵ See OTS Exhibit No. 4, Schedule 1, at page 4.

¹³⁶ See OTS Exhibit No. 4, at page 8.

should be no dispute that SCD costs are non-gas costs, and it is OTS' position that since the costs are non-gas costs, such costs do not belong in the GCR mechanism. It is indisputable that having non-gas costs in the GCR mechanism for the purpose of seeking full dollar-for-dollar recovery for programs discourages any incentive for utility management to control program costs. As Mr. Keim discussed, recovery of the SCD program costs should be in base rates since inclusion of these program costs in base rates will encourage management to exercise additional control over the program so as to keep it within the cost constraints built into rates.¹³⁷

The total of all of OTS proposed adjustments to PGW's social programs, if adopted, will result in the following social costs being shifted from the GCR mechanism to the base rates of PGW: (1) Customer Responsibility Program of \$36,852,448; (2) Conservation Works Program of \$2,200,000; and (3) Senior Citizen Discount Program of \$21,884,717. As Mr. Keim explained, the shift of social costs from the GCR mechanism will result in a total shift of \$60,937,165 from the GCR to base rates. The effect of OTS' recommendation results in an

¹³⁷ See OTS Exhibit No. 4, at page 9.

increase in base rates of \$60,937,165 and a reduction in the GCR of \$1.0175 per Mcf (\$60,937,165 / 59,886,185 Mcf).¹³⁸

With these recommendations, the net impact on the customer's bill will be zero in this proceeding. Notwithstanding this proceeding, if the recommendations are adopted, any future GCR proceedings will only deal with gas costs, and the volatility of those costs. Continuing to allow PGW full recovery of social costs in a GCR mechanism, provides absolute no incentive to control the costs of the programs.

¹³⁸ See OTS Exhibit No. 4, Schedule 2, at page 2.

VII. MISCELLANEOUS ISSUES

1. PGW's Senior Citizens Discount Program

Earlier in this Brief, OTS recommended that the cost recovery for PGW's Senior Citizens Discount Program ("SCD") be transferred from the GCR mechanism to base rates. As previously noted, the cost of the SCD program for the twelve months ended August 2001 is \$21,884,717. Accordingly, OTS has three (3) recommendations regarding the SCD. First, the SCD program should be closed to any additional customers as of the date of the Order in this proceeding. Second, the Commission should find that it is appropriate to phase out the program and request the Philadelphia City Council pass an ordinance to that effect. Third, all customers currently in the SCD program should be re-certified for eligibility.

With respect to program closure, OTS is of the opinion the program does not satisfy the just and reasonable standard and the future cost of the SCD program may become so large so as to be completely unmanageable. By all accounts, customers who receive the senior citizen discount are not means-tested for income eligibility, which suggests that some customers are receiving the discount even though they have the ability to pay their gas bill. Simply put, Bill Gates, the owner of Microsoft, could participate in the SCD program if he met the requirements of being 65 years old or older and a customer of PGW living in Philadelphia. Such a scenario of having all senior citizens being eligible for a discount regardless of income fails the just and reasonable standard of the Public

Utility Code.¹³⁹ As OTS witness Keim testified, there is no precedent in Pennsylvania for a program that allows all senior citizens to receive a discounted bill even though some have the ability to pay their bills in full.¹⁴⁰ By the Company's own admission, the majority of those customers receiving the senior citizen discount are above the 150 percent of the Federal poverty level, which is the threshold for eligibility to participate in PGW's CRP program.¹⁴¹

Like the Social Security program of the United States, PGW's SCD program is premised on the fact that non-senior customers, principally the baby boom generation, are subsidizing the senior citizens discount. Accordingly, as the baby boomer generation nears the SCD eligibility age of 65 and older, more and more customers may be eligible for the discount, with fewer customers being in a position to subsidize the discount.

To ease the transition period for PGW's senior citizen customers, OTS is recommending a phase out period over five (5) years. Under OTS witness Keim's recommendation, the discount would be reduced by four percent (4%) each year, so in the second year of the phase out, the discount would be sixteen percent

¹³⁹ See 66 Pa. C.S.A. §1308(c).

¹⁴⁰ See OTS St. No. 4, at page 8.

¹⁴¹ See OTS St. No. 4, at page 8.

(16%) and in the third year it would be twelve percent (12%), eight percent (8%) in the fourth year, and four percent (4%) in the final year of the phase out.¹⁴²

Since the phase out program will require approval by the Philadelphia City Council, OTS is recommending that the Commission direct PGW to submit a plan to the City which phases out the SCD program over a five-year period.¹⁴³

The most troubling aspect of the SCD program is PGW's admission that since 1998, PGW has not monitored the program participants to ensure that all those receiving discounts are in fact eligible to receive the senior citizen discount.¹⁴⁴ A re-certification is necessary to determine whether a senior citizen's household receiving a discount in fact has a senior citizen to continue to live in the household.

Moreover, it will provide PGW with the opportunity to set a fixed limit on the number of customers enrolled in the SCD program. It is OTS' recommendation that those re-certified senior citizens who are determined to be at 150% of the Federal poverty level or below should be enrolled in the CRP program.¹⁴⁵ OTS submits that the CRP program may prove to be a better program due to the low payments requirements under the CRP program due its payment plans.

¹⁴² See OTS St. No. 4, at page 11.

¹⁴³ See 66 Pa. C.S.A. §2212(r)(2)

¹⁴⁴ See OTS Exhibit No. 4, Schedule 3.

¹⁴⁵ See OTS St. No. 4, at page 10.

2. OTS Is Agreeable To Meeting With PGW In An Attempt to Resolve Tariffs Issues

In this proceeding, OTS witness Metro has raised several tariff issues addressing PGW's service. The tariff issues were: (1) PGW's tariff needs to have tariff language that defines the curtailment rules and priority of service; (2) PGW's NGV tariff should be eliminated; (3) PGW provides interruptible service to apartment complexes that may not have alternate fuel; (4) PGW's transportation tariff does not comply with the Commission's Transportation Regulations; and (5) PGW does not read all of its customers' meters on a timely basis.¹⁴⁶ In response, PGW witness White, testified that 'PGW is willing to continue to work with the Trial Staff at the conclusion of this base rate proceeding – in a workshop environment – to determine whether a specific plan and tariff provision could be mutually agree to.'¹⁴⁷ OTS is agreeable to such a meeting in a workshop environment in order to find a mutually agreeable solution to the tariff issues addressed in OTS witness Metro testimony; however we are compelled by the Commission to address the purchase electric expense inclusion in PGW's GCR mechanism.

¹⁴⁶ See OTS St. No. No. 3, at pages 25-26.

¹⁴⁷ See PGW St. No. 4.1, at page 14.

VIII. RATE STRUCTURE

1. PGW's Should Perform A Fully Allocated Cost of Service At Both Present And Proposed Rates

The Company describes the cost of service study ("COSS") that it filed in this proceeding as an unbundled, fully allocated cost of service study completed in December 2000. The study uses a basic three-step process of cost analysis:

(1) functionalization; (2) classification; and (3) allocation.¹⁴⁸ The purpose of the Company's COSS was to assign the total costs incurred by PGW to each customer class and to compare the costs assigned to each customer class to the revenue produced by the rates proposed by the utility.¹⁴⁹ The costs assigned in PGW's COSS to each customer class have been compared to the revenue produced by the rates in the Company's proposed Gas Rate Tariff, as presented in its Base Rate Case filing of January 2001.¹⁵⁰ As OTS witness Metro explained the costs and other information used in the PGW COSS and in developing the Tariff were for PGW's Fiscal Year 2001 Budget.

The Company's COSS compares the revenue generated by the proposed tariff per customer class to the revenue needed to match the cost to serve each customer class. Simply put, the Company first determines, on an annual basis, through a cash flow analysis, the level of surplus it must have to meet the monthly

¹⁴⁸ See PGW St. No. 5, at page 8.

¹⁴⁹ See OTS St. No. 3, at page 3.

¹⁵⁰ See PGW St. No. 5, at page 2

cash flow needs of the test year. Second, the Company then determines the revenue requirement to achieve the needed surplus. Third, the Company then determines the cost to serve each customer class. Finally, the Company compares the revenue requirements by customer class to the costs required to serve each customer class.¹⁵¹

It must be noted that the Company's COSS is not used to determine the revenue requirement of specific customer classes. The Company predetermines the revenue requirement by relying on their cash flow analysis.¹⁵² The best definition for the Company's COSS is a "cost allocation" study.

For the purposes of this proceeding, OTS utilized the Company's COSS as a costing guide to compare whether the Company's proposed rates recover the costs of the customer class. It must be noted that the Company's COSS is not needed in a cash flow filing except for (1) a comparison between proposed revenues and class cost responsibility and (2) a guide to set customer charges.¹⁵³

Based upon the Company's Filed COSS in this proceeding, OTS recommends that in PGW's next base rate filing, the Company should perform a fully allocated class COSS at both present and proposed rates.¹⁵⁴

¹⁵¹ See OTS St. No. 3, at page 4.

¹⁵² See OTS St. No. 3, at page 7.

¹⁵³ See OTS St. No. 3, at page 8.

¹⁵⁴ See OTS St. No. 3, at page 9.

2. The Company's Revenue Allocation Is Improper

As previously noted, the Company in this base rate filing is requesting a \$65 million rate increase. The rate increase consists of both increases in the customer charge and in the volumetric rates for each of the customer classes.

In an attempt to equally distribute the \$65 million increases to all customer classes, the Company appears to suggest that the percentage increase for each class would be 15.14 percent. A close examination of PGW's proposal actually shows an increase in rates to the Residential class by an additional one-half percent to 15.64 percent and an increase in rates to the remaining classes to 13.44 percent. The Company claims that the proposal would reduce the level of over-recovery of costs from these other classes.¹⁵⁵ After examining the Company's proposal, OTS is of the opinion that the Company's revenue allocation is improper. Case in point, there are several customer classes in which the revenues do not equal the costs allocated to that customer class.¹⁵⁶

In this proceeding, PGW chose not to increase present rates for the customer classes LBS large Direct, TriGen Direct, and NGV Direct even though their revenues do not equal their allocated costs. Moreover, Rate Class GTS Trans is paying rates that are far above its allocated costs.¹⁵⁷ Accordingly, OTS is recommending that the Company should increase rates to the LBS Large Direct, TriGen Direct, and NGV Direct customer classes in order to recover costs that are

¹⁵⁵ See OTS Exhibit No. 3, Schedule 1.

¹⁵⁶ See OTS St. No. 3, at page 11.

¹⁵⁷ See OTS St. No. 3, at page 11.

allocated to them.¹⁵⁸ In addition, the Company should reduce the rates to the GTS Trans customer class. By adopting OTS' recommendation, a revenue neutral rate change would be created and move all four of these customer classes towards their costs.

It is important to note that OTS witness Metro re-stated the Company's revenue request based upon OTS witness Kubas' adjustments to the customer number and sales levels for the residential and commercial heating customers.¹⁵⁹ As illustrated by OTS Exhibit Number 3, Schedule 2, OTS witness Kubas' adjustments result in the Company receiving approximately \$2 million additional revenues at proposed rates. Simply put, the Company filed for \$65 million and by incorporating the additional customers and sales, the Company would receive approximately a \$67 million revenue increase. It is important to use the correct sales volumes in order to ensure the correct level of total revenues by customer class.

In order to ensure the proper revenue allowances, OTS scripted two revenue allowance scenarios. The first scenario describes a revenue allowance comparing the Company's proposed \$65 million revenue request versus the OTS recommended \$44 million level of revenue increase. The second scenario describes a revenue allowance for the Company based upon transferring the social programs and electric costs for PGW's GCR mechanism to base rates.

¹⁵⁸ See OTS St. No. 3, at page 12.

¹⁵⁹ See OTS Exhibit No. 3, Schedule 2.

OTS Exhibit Number 3, Schedule 3(Revised) illustrates the revenue allocation at OTS' \$44 million level of revenue increase. The OTS recommended revenue level results in an allocation that resets the volumetric rates back to present rates for all customer classes except for the Residential class. The Residential class would then make up the remaining volumetric increase. The reason for this revenue allocation is that the Residential class is being subsidized by the other customer classes, accordingly, the Residential class should not receive a volumetric revenue decrease until the other classes obtain the maximum reduction.¹⁶⁰

The second scenario for revenue allocation involves the recognition that OTS has proposed the costs associates with the Purchased Electric Expense, the Customer Responsibility Program, the Senior Discount Program and the Conservation Works Program be removed from PGW's GCR and transferred to PGW's base rates for cost recovery. The effect of removing the collection of social costs and electric costs from the GCR and placing this cost recovery in base rates is to increase base rate revenues by approximately \$61.9 million and reduce

¹⁶⁰ See OTS St. No. 3, at page 15 (Revised).

the GCR revenues by the same amount.¹⁶¹ The total base rate revenue allowance proposed by OTS in the second scenario is \$105.902 million. This figure is derived by adding the \$61.9 million (social costs) and the OTS recommended proposed revenue increase. Concomitantly, OTS also proposes to reduce the GCR costs by \$61.9 million.

In closing, OTS is proposing that the \$61.9 million is a fixed number that is to be included within base rates. OTS allocated the \$61.9 million based upon customer class sales volumes.¹⁶²

The selection of the scenarios will depend on the Commission's adoption of OTS' recommendation regarding non-gas costs in the GCR mechanism.

3. PGW's Proposed Residential GS Customer Charge And Commercial Customer Charge Should Be Lowered

In this proceeding, the Company is proposing a customer charge for the Residential customer class of \$15.00 per month. The \$15.00 per month customer charge proposal is based on the current level of customer charges in effect by other Pennsylvania LDCs.¹⁶³ The Company's proposal represents a 87.5 percent increase from present rates.¹⁶⁴ In addition to the increase in Residential customer charges, the Company is also proposing a \$25 customer charge for the Commercial GS customers and a \$50 customer charge for Industrial GS customers. Currently, the

¹⁶¹ See OTS St. No. 3, at page 17.

¹⁶² See OTS Exhibit No. 3, Schedule 4 (Revised).

¹⁶³ See PGW St. No. 9, at page 6.

¹⁶⁴ See OTS Exhibit No. 3, Schedule 1.

Commercial GS customer charge is \$10 and the Industrial GS customer charge is \$20.

The Company has included within its Filing a calculation of customer costs per bill by service classification.¹⁶⁵ In support of its position, PGW avers that the warmer than normal weather during the last three winters adversely affected the Company's ability to collect sufficient revenues to meet operating, maintenance, and debt service requirements. Therefore, to assist in mitigating the impact of warmer than normal weather in the future, PGW is proposing the recovery of a greater portion of its fixed costs in a fixed monthly customer charge. The increase in the customer charge will generate approximately \$44.5 million of the requested total increase of \$65 million.¹⁶⁶

The Company's Exhibit HSG-1, Schedule 2 illustrates PGW's cost of service details as of August 31, 2001. The cost of service provides for a Residential GS customer class, on a per unit basis of \$39.94 per month, for the Commercial GS customer class, on a per unit basis of \$106.41 per month, and the Industrial GS customer class, on a per unit basis of \$280.85 per month.¹⁶⁷ As previously noted, in this proceeding, the Company is proposing a customer charge of \$15.00 for the Residential GS customer class. OTS is of the opinion that the

¹⁶⁵ See PGW Exhibit HSG-1, Schedule 2.

¹⁶⁶ See PGW St. No. 4, at page 6.

¹⁶⁷ See PGW St. No. 4, at page 8.

Company's current customer charges for the Residential GS, Commercial GS, and the Industrial GS need to be updated to match the current industry customer charge levels and permit the Company to receive a sufficient level of revenues per month. The only question that remains, is at what rate level will the respective customer charges be set for ratemaking purposes.

In supporting its request to update its customer charges, the Company performed a study.¹⁶⁸ A similar customer charge study was performed for the Residential, Commercial, and Industrial customer classes by OTS witness Metro.¹⁶⁹ The customer charge study performed by OTS differed in two ways from the Company's study. First, OTS updated PGW's study by including in its analysis the most recent base rate filings approved by the Commission, which were T.W. Phillips and Penn Fuels/North Penn. Second, OTS calculated the average customer charge, the high customer charge, and the most recent customer charge for seven of the largest natural gas utilities. The gas utilities relied upon by OTS in its study were Columbia Gas of Pennsylvania, Equitable Gas, National Fuel Gas Distribution, PECO Gas, Peoples Natural Gas Company, T.W. Phillips and Penn Fuels/North Penn Gas Company.

OTS Exhibit Number 3, Schedule 5 provides an analysis of OTS' customer charge study by showing that the average Residential customer charge is \$10.35 per month, the average Commercial customer charge is \$16.79 per month, and the

¹⁶⁸ See PGW St. No. 4, at page 8.

¹⁶⁹ See OTS Exhibit No. 2, Schedule 5.

average Industrial customer charge is \$59.40 per month. OTS would note that the averages utilized by OTS witness Metro for the Commercial and Industrial classes are estimates. The estimates were necessary due to each gas utility utilized in the study using different usage amounts for Commercial and Industrial customers, which required Mr. Metro to "mix and match" customer charges with volumes. For example, Columbia Gas of Pennsylvania defines Commercial customers as those whose annual usage is between 600 and 6,000 Mcf, while Peoples defines Commercial customers with annual usage from 0-500 Mcf and through 500-1,000 Mcf. Consequently, the calculations that are depicted in the study are Mr. Metro's best efforts to group the customer charges of the seven utilities.

Based upon his analysis, OTS witness Metro recommends that PGW's Residential customer charge be set at \$12, the Commercial charge be set at \$18, and the Industrial customer charge be set at \$50.¹⁷⁰ In providing additional assistance to the Commission, OTS Exhibit Number 3, Schedule 7 shows the OTS proposed customer charges with the revised number of customers and sales proposed by OTS witness Kubas. Additionally, OTS Exhibit Number 3, Schedule 6, shows the OTS proposed customer charges at the Company's proposed revenue increase of \$65 million.

In the rebuttal phase of the proceeding, PGW witness White criticized OTS witness Metro's recommendation for customer charges for the apparent failure to

¹⁷⁰ PGW proposed a customer charge of \$50 for the Industrial Customers.

consider Equitable's residential customer charge in the OTS study.¹⁷¹ Moreover, Mr. White testified that Equitable should be used in determining an appropriate customer charge for PGW.¹⁷² In both instances, Mr. White misrepresented OTS' customer charge study. In that regard, on cross-examination, Mr. White acknowledged that OTS' recommended customer charge for PGW was based on Equitable's residential customer charge.¹⁷³ In fact, it is indisputable that a review of OTS Exhibit Number 3, Schedule 5 will show that Equitable's Residential customer charge was utilized in setting the OTS recommended customer charge for PGW.

It must be noted that after having to acknowledge that OTS utilized Equitable in its customer charge study and insisting that Equitable was necessary for the study, the Company attempts to diminish the effect of Equitable during cross-examination.¹⁷⁴ Notwithstanding this attempt, the fact is clear that Equitable provides service to inner-city Pittsburgh, which is similar to inner-city Philadelphia. While Equitable does serve outside the city of Pittsburgh, this fact does not lessen the similarities between PGW and Equitable.

It must not be overlooked that PGW's customer charge of \$15 per month is not based on specific costs, but was randomly selected, as PGW could have selected \$8 or \$40 for their customer charge.¹⁷⁵

¹⁷¹ See PGW St. No. 4.1, at Page 13.

¹⁷² See PGW St. No. 4.1, at Page 5.

¹⁷³ See Tr. 684.

¹⁷⁴ See Tr. 727.

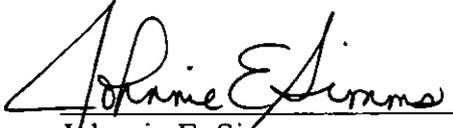
¹⁷⁵ See Tr. 686.

In the final analysis, the Company strongly urged that Equitable with its Residential customer charge of \$11.65 be utilized in determining an appropriate customer charge for PGW. OTS utilized Equitable, along with other gas utilities, and rounded Equitable's \$11.65 to a recommended Residential customer charge of \$12.00 for PGW.

IX. CONCLUSION

For the foregoing reasons, the Pennsylvania Public Utility Commission should order the Philadelphia Gas Works to produce changes in rules, regulations, and rates calculated to produce no more than \$33,000,000 in additional annual revenues.

Respectfully submitted,


Johnnie E. Simms
Senior Prosecutor

Dated: June 21, 2001