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August 21, 2001

PUBLIC UTILITY COMMIS
PHILADELPHIA

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
2nd Floor, 7 North
400 North Street
Harrisburg, PA 17120

Filed by Federal Express

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Re: CEPA et al. v. Philadelphia Gas Works, Docket No. R-00006042

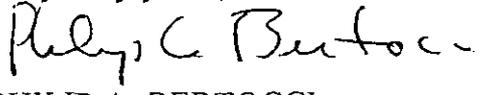
Dear Secretary McNulty:

I represent the Consumers Education and Protective Association (CEPA), the Association of Community Organizations for Reform Now (ACORN), Action Alliance of Senior Citizens of Greater Philadelphia, and the Tenants' Action Group (TAG) (collectively "CEPA et al.") in the above-captioned matter.

Enclosed please find for filing an original and nine copies of the Exceptions of CEPA et al. to the Recommended Decision issued August 8, 2001.

As evidenced by the Certificate of Service attached to this filing, all parties to the proceeding are being served with copies of these Exceptions.

Very truly yours,



PHILIP A. BERTOCCI

Attorney for CEPA et al.

cc: Certificate of Service
Commission's Office of Special Assistants w/computer disk

Enclosures

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AUG 21 2001

PUBLIC UTILITY COMMISSION
SECRETARY'S OFFICE

PENNSYLVANIA PUBLIC UTILITY :
COMMISSION :

v. :

Docket No. R-00006042

PHILADELPHIA GAS WORKS :

EXCEPTIONS OF CEPA et al. TO THE RECOMMENDED DECISION

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Date: August 22, 2001

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CEPA et al.'s EXCEPTIONS TO THE RECOMMENDED DECISION

The Consumers Education and Protective Association (CEPA), the Association of Community Organizations for Reform Now (ACORN), the Tenants' Action Group (TAG) and Action Alliance of Senior Citizens of Greater Philadelphia (collectively "CEPA et al.") - Complainants hereby submit these Exceptions to the Recommended Decision of the Administrative Law Judge issued on August 8, 2001.

I. Introduction and Summary of Argument

The Recommended Decision (hereinafter "R.D.") denied the Philadelphia Gas Works (PGW) request for a base rate increase of \$65 million (\$54 million plus the \$11 million current interim base rate) as not "just and reasonable." Conclusion of Law 8, R.D. at 110. In reaching this conclusion, the R.D. correctly identifies the constitutionally based "just and reasonable" standard as controlling. Conclusion of Law 4, R.D. at 110. The R.D. also rejects PGW's almost groundless insistence that rates set pursuant to the formula contained in the Management Agreement are presumed to be "just and reasonable." Conclusion of Law 5, R.D. at 110. The R.D. properly acknowledges the Commission's legal obligation in setting rates to review, inter alia, individual test year expenditures for prudence and to make determinations concerning to what degree and if at all customers may be required to fund that portion of PGW's revenue requirement which is necessary solely to satisfy cash flow as opposed to debt service ratio needs. R.D. at 20-26.

The R.D. is fatally flawed, however, in its recommendation that PGW be awarded a base rate increase of \$44 million (\$33 million plus the current \$11 million interim base rate increase), and in many other recommendations including but not limited to increasing

the residential customer charge from \$8 to \$12. These determinations are contrary to law, and are against the weight of the evidence. Equally troubling is the R.D.'s failure to make specific findings concerning the inadequacies of PGW's service and the City's responsibility for the Company's cash difficulties derived from a decade of shortsighted and irresponsible management decisions. In the absence of such findings, required by the proper application of the balancing of customer and ownership interests inherent in the "just and reasonable" standard, the R.D. does not give any weight or sufficient weight to these factors in arriving at the recommended rate order.

The result is a recommended base rate increase which, if approved, would indeed require residential customers to shoulder the full burden of all PGW's mismanagement, while continuing to endure service which has been, and despite PGW's optimistic hopes, continues to be seriously inadequate.¹ At the same time, the R.D. would prematurely set in motion tariff restructuring which would have the effect of exempting some of PGW's largest commercial and industrial customers from sharing in these new burdens. R.D. Recommendations 20-22, at 114 and 89-106.

¹ CEPA *et al.* invite the Commission to revisit the transcripts of the Public Input Hearings for first hand accounts of recent customer experiences. These accounts are fully consistent with the most recent such customer account appearing as a letter to the editor in the Philadelphia Inquirer just this past Sunday, August 19, 2001: "...I have spent the past two years attempting to straighten out a billing error with PGW and have experienced nothing but frustration and anger. Although PGW acknowledges that I have been incorrectly billed for gas service for the year prior to my purchasing the house we now live in, there has yet to be an adjustment to my bill (but they continue to include finance charges every month). My attempts to resolve this matter have resulted in hours of wasted time on the telephone and at the local PGW office. I have routinely been confronted with indifferent, surly people who are either incapable or uninterested in being helpful."

II. Specific Exceptions

Exception No. 1. Recommendation 2 Authorizing an Overall Rate Increase of \$44 Million Is Contrary to Law and Is Not Supported by the Weight of the Evidence.

The R.D. recommends that PGW should be “authorized to file a Tariff supplement designed to change rules, regulations and rates calculated to produce \$33,000,000 in additional revenue in addition to the \$11,000,000 interim relief implemented in March 2001. R.D., Recommendation 2, at 111. This Recommendation is contrary to law and is against the weight of the evidence.

a. In Applying the “Just and Reasonable Standard,” the R.D. Fails to Take into Account the Continued Inadequacy of PGW’s Service.

Recommendation 2 is contrary to law, because the ratemaker must take the adequacy of service into account when applying the “just and reasonable” standard to a rate increase request. In this case, the R.D. failed to recognize that service adequacy constituted part of the applicable standard.

CEPA et al. and OCA proposed specific Conclusions of Law holding that the ratemaker in applying the “just and reasonable” standard must take service into account. CEPA et al. requested a Conclusion of Law that “[i]n determining whether a rate is “just and reasonable” the Commission must consider whether the utility is providing adequate, efficient and reasonable customer service. Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 602, 65 S.Ct. 281, 288 (1944); D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission, 466 F. 2d 394, 22 (D.C. Cir. 1972), cert. denied, 409 U.S. 108; Management Agreement; 66 Pa.C.S. §§523, 526.” CEPA et al. Main Brief, Appendix A, Proposed Conclusion of Law 2. OCA requested a Conclusion of Law that the “Commission must consider the efficiency, effectiveness, and

adequacy of service of each utility when determining just and reasonable rates. 66 Pa.C.S. § 523.” OCA Main Brief, Proposed Conclusion of Law 3. Both CEPA and OCA requested Conclusions of Law that the Commission may reject a rate increase in whole or in part on the basis of the inadequacy of service. CEPA et al. Main Brief, Appendix A, Proposed Conclusion of Law 4; OCA Main Brief, Proposed Conclusion of Law 4.

Without explanation and without justification, the R.D. did not accept any of these Proposed Conclusions of Law. CEPA et al. Main Brief, at 7-21.

b. The R.D.'s Failure to Make Findings of Fact Concerning the Inadequacy of PGW's Service Is Contrary to the Weight of the Evidence.

CEPA et al. requested a Finding of Fact that “PGW’s level of customer service is well below industry standards.” CEPA et al. Main Brief, Appendix A, Proposed Finding of Fact 1. In addition, contrary to the weight of the evidence, the R.D. failed to grant specific OCA proposed Findings of Fact which addressed the inadequacy of call center performance, continued BCCS problems which prevent budget billing in accordance with the Tariff, and the existence of a virtually unprecedented 3,513 outstanding informal complaints concerning PGW pending before the PUC’s Bureau of Consumer Services. OCA Main Brief, Proposed Findings of Fact, 22, 23, 24. After a fifteen page discussion of the alleged hardships suffered by PGW’s large Commercial and Industrial customers under PGW’s transportation regime, the R.D. did not devote even one page to analysis of the evidence concerning the inadequacy of residential service, and did not issue a single finding on the subject.

At the same time, in its “discussion,” the R.D. offers the observation that “[a]lthough there are service problems, the entire rate case should not be denied pending

resolution of the problems.” R.D. at 69. This weak statement does not satisfy any legal requirement, because it does not translate into either the recognition of an obligation to give specific weight to adequacy of service factors or into findings of fact which would support the weight assigned to such factors.

The impression that the R.D. gave no weight to the inadequacy of service is further supported by the R.D.’s failure to present any specific computation describing how the \$44 million was derived. Given the number of specific non-service related adjustments discussed and apparently granted, the original \$65 million request could easily have been reduced to \$44 million and even below.

Exception No. 2. The R.D.’s Recommendation 5 Rejecting CEPA’s Requests Concerning the \$18 Million City Payment Is Contrary to Law and against the Weight of the Evidence.

The R.D. Recommendation 5 states “[t]hat the recommendation that the Commission require the City to waive the \$18 million payment from the Philadelphia Gas Works is denied.” R.D. at 112.

This Recommendation misconstrues the remedy sought by CEPA et al., is not supported by any legal authority, and is contrary to the weight of the evidence.

a. Recommendation 5 is Contrary to Law.

CEPA et al. have not requested that the Commission “require” the City to waive or “grant back” the \$18 million payment. Rather, CEPA et al., on the model of D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission, 466 F. 2d 394, 22 (D.C. Cir. 1972), cert. denied, 409 U.S. 1086, have sought a recommendation that the Commission deny PGW’s request for an increase in base rates above the interim increase

already granted, with the provision that the case may be reopened once PGW's owner the City of Philadelphia has committed to waive or grant back the \$18 million payment. CEPA Main Brief, at 36. In accepting such a recommendation, the Commission would be acting squarely within its authority and duties under the Public Utility Code to grant only rates that are just and reasonable. 66 Pa.C.S. §1301. In this case, as in D.C. Transit, the need for an equity infusion, to compensate for the profligate exhaustion of PGW's short term tax exempt commercial paper program, combined with PGW's continuing failure to provide adequate service, fully justifies such Commission action.²

The R.D.'s rejection of CEPA's request that the Commission establish waiver or grant back of the \$18 million as a condition precedent for any further rate relief is based on misapplication of the law. The \$18 million payment, the R.D. states, is justifiable because such payments are "commonplace for municipal utilities such as PGW." R.D. at 28. Whether a rate is "just and reasonable" however, does not ultimately depend on the reasonableness of any particular component, but rather on the "total effect" or "impact" which is determined as part of a process balancing the rights of a utility against the rights of its customers. Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 602, 64 S.Ct. 281,288 (1944). The issue is not, then, whether such payments are "commonplace" among utilities. Rather, the issue is whether it would be "just and reasonable" to provide a rate increase under the circumstances of this case, where the effect of that rate increase would be to make customers pay the full bill for serious historical mismanagement, while continuing to receive inadequate service. This error of law is especially surprising because the R.D. itself recognizes that just because certain expenses are required by the Management Agreement does not always guarantee that they are recoverable in a "just and reasonable" rate. R.D. Conclusion of Law 5, at 110.

² For PGW's historical mismanagement justifying establishing an equity infusion as a condition precedent for increased rates, see CEPA et al. Main Brief, at 21-23, 29-32. See CEPA et al. Main Brief, at 12-21 for discussion of the grounds for denying further rate relief on the grounds of continuing service inadequacy.

b. Recommendation 5 Is Not Supported by the Record and/or Is Contrary to the Weight of the Evidence.

The R.D.'s recommendation on this issue rests on implicit factual findings which are not supported in the record or are contrary to the weight of the evidence.

In reaching the conclusion that the City Payment is "reasonable and commonplace for municipal utilities," the R.D. relies in part on the Management Audit, which devotes less than one full page to the subject. Administrative Counsel Attachment No. 1 at X-12, X-13. The Management Audit, however, does not address the issue whether the City Payment must be made under all circumstances, only whether it must be made under normal circumstances.

Moreover, the Management Audit suggests that the payment is not unreasonable when considered as a "dividend on equity investment," or when considered as a percentage of annual revenues. This standard once again ignores what distinguishes this case from most others – that PGW has through historical mismanagement been reduced to a situation where it is incapable of providing adequate service. Under these circumstances, an investor owned utility would not be entitled to a "return on investment" or a payment calculated as a percentage of revenues. OCA St.1, at 13, 14. As a municipal utility, PGW should not be permitted to obtain a return that would have been denied to an investor owned utility.

In addition, the Management Audit's opinion concerning the reasonableness of the \$18 million payment is based on at least two errors of law. The first is that the 1975 and 1998 bond ordinances make payment of the City Payment a "priority." Such is not the case, as the R.D. itself recognizes, when it quotes Ms. Bisgaier's expert testimony that the City payment is not a factor in determining whether PGW has met its debt service

coverage ratios. R.D. at 30. The second, is its suggestion that the amount of \$18 million would not appear *unreasonable* as a payment “in lieu of taxes.” Such a consideration is irrelevant because the City itself does not claim that the payment is “in lieu of taxes,” and if it did, the payment would under state law be considered an illegal tax on PGW customers. Public Advocate v. Philadelphia Gas Commission, 637 A2d. 676, 685 (Pa.Cmwlth. 1994), reversed on other grounds, Public Advocate v. Philadelphia Gas Commission, 544 Pa.129, 674 A.2d 1056 (1996).

In a somewhat similar vein, the R.D. suggests that the \$18 million is justifiable on the grounds that the Company receives benefits due to its municipal status greater than \$18 million annually. R.D. at 28. However, this argument misses the point. Public ownership of many types of municipal facilities, like libraries and parks, yield tax and other savings for the benefit of the citizens who use these facilities. Those savings are not grounds for the City demanding that citizens compensate the City for savings achieved by dint of municipal ownership.

While implicitly finding that the \$18 million City Payment is reasonable in amount, the R.D. also totally ignores overwhelming record evidence of gross *mismanagement and inadequate service*. As CEPA et al. have demonstrated, PGW’s customer service is well below industry standards. CEPA et al. Main Brief, at 12-21. In addition, PGW’s present financial crisis has been caused by factors within the City’s control, including the failed implementation of the BCCS system, the failure to seek and obtain rate increases at appropriate intervals over the past eight years, the failure to secure stable management, and the failure to respond promptly and adequately to decreased revenues due to warmer than normal weather. CEPA et al. Main Brief, at 22-23, 29-31. Despite Proposed Findings of Fact on these issues, the R.D. does not contain a single explicit finding on these issues. See CEPA et al. Main Brief, Appendix A, Proposed

Findings of Fact 1, 2.

Exception No. 3. The R.D.'s Recommendations 20 and 21 Restructuring PGW's Transportation Tariff Are Premature and Contrary to Law.

In Recommendation 20, the R.D. states that “the Philadelphia Industrial and Commercial Gas User Group’s recommendation to lower the volume eligibility requirement for transporting as to 15,000 is granted.” Recommendation 21 provides that “the Philadelphia Industrial and Commercial Gas Users Group’s recommendation to permit transportation customers to aggregate facilities services by multiple accounts, to expand the buyer’s group to a maximum of ten individual customers, to permit transportation customers to make intra-day nominations and to require the Philadelphia Gas Works to provide daily imbalance information to transportation customers are granted.” R.D. Recommendations 20, 21, at 114.

In making these recommendations, the R.D., if adopted, would require extension of present transportation services to a newly defined customer class and impose significant new operations requirements upon a utility which is currently incapable of meeting the minimum needs of its residential customers, who constitute the vast majority of customers. These recommendations are not merely recommendations approving changes in rates payable by any class of ratepayers.

The Commission is without authority to make these changes in PGW’s Tariff, unless PGW requests such changes. Section 2212(d) of the Gas Choice Act provides that PGW’s “prior tariff” shall apply in the period between assumption of PUC jurisdiction over PGW’s Tariff and the effective date of PGW restructuring plan. The only provision for amendment to the “prior tariff” during this period is contained in the qualification that “[n]othing contained in this section shall prevent a city natural gas distribution operation from requesting or if so requested the commission from approving, modification to the

prior tariff at any time prior to the effective date of the final order approving the restructuring plan and new tariff.” 66 Pa.C.S. §2212(d). The transportation related amendments recommended by the R.D. were not proposed by the Company, were not implicit in amendments proposed by the Company, and are not necessary to enable the Commission to fulfill its responsibilities in ruling on the proposed Base Rate Increase. They are beyond the authority of the Commission and the scope of this proceeding, and therefore contrary to law.

In addition, these changes are in some cases likely to produce results which are inconsistent with Gas Choice Act Section 2203(6). That Section provides in pertinent part: “After notice and hearings, the commission shall establish for each natural gas distribution company an appropriate nonbypassable, competitively neutral cost-recovery mechanism which is designed to recover fully the natural gas distribution company’s universal service and energy conservation costs over the life of these programs.” 66 Pa.C.S. §2203(6). Under PGW’s “prior tariff, rate schedules and riders” currently in effect, the costs of the CRP program, PGW’s low income customer assistance program, and the costs of the CWP program, PGW low income conservation program, are funded through the Gas Cost Rate, which is paid by all PGW firm customers. To the extent that increased availability of transportation causes present firm customers to migrate to transportation, these customers will be “bypassing” the Gas Cost Rate, and at the same time, their share in the costs of PGW’s universal service programs. The effect of this “bypass” would be to raise the GCR costs on the remaining firm customers, overwhelmingly residential customers, contrary to purpose of the universal service provisions of the Gas Choice Act.

Exception No. 4. CEPA et al. Support the R.D.'s Recommendations Concerning the Senior Citizen Discount, But Disagree with Certain Points in the R.D.'s Discussion of the Issue.

CEPA et al. agree with the R.D.'s recommendations rejecting proposals to eliminate the Senior Citizen Discount Program and deferring the transfer to base rates of that portion of Senior Citizen Discount program costs which are contained in the GCR until the time of PGW's restructuring proceeding. R.D., Recommendations 16, 22, at 113, 114. These recommendations are consistent with existing law and supported by substantial evidence.

The R.D. wisely exhibited caution in its treatment of a Senior Citizen program which serves over 90,000 elderly PGW residential customers, many of whom live on fixed incomes. In so doing, the R.D. follows the General Assembly, which recognized at a minimum that the maintenance of an existing discount for Senior Citizens receiving that discount is not an unreasonable discrimination in rates, but takes into account the situation of a vulnerable population with settled incomes and settled household budgets.³ While a Senior Citizen discount may be "unprecedented" for utilities regulated by the Commission, by the same token, PUC regulation of PGW itself is unprecedented because PGW is the only municipally owned gas utility regulated by the PUC with respect to service provided within municipal limits. Moreover, in our society generally, discounts to Senior Citizens regardless of means is generally accepted, and perhaps, where a fundamental necessity of life is involved, even required by common decency.

However, CEPA et al. take issue with the R.D. statement that Section 2212(r) of the Gas Choice Act "authorizes the Commission to approve a Senior Citizen Discount

³ Moreover, the General Assembly did not foreclose the Commission from ultimately approving as "just and reasonable" a Senior Citizen Discount Program which does not require a means test.

Program or discontinue the current program.”(emphasis added). R.D. at 109. To the contrary, Section 2212(r)(2) states that senior citizens receiving discounted gas rates as of the effective date of the initial, restructured tariff “shall be entitled to continue to receive such discount under the terms of the prior tariff unless and until the program is modified by ordinance of the governing body of the city....” In other words, although Philadelphia City Council may change the conditions under which Senior Citizens receive the discount, the Commission itself is without authority on its own initiative or at the request of a non-PGW party to “discontinue” the program as to those “grandfathered senior citizens.” 66 Pa.C.S. §2212(r)(2).

Exception No. 5. CEPA et al. Support the OCA’s Exception No. 2 Concerning the R.D.’s Failure to Reduce the Recommended Base Rate Increase by the \$6.8 Million in OCA Recommended Expense Reductions.

CEPA et al. support Exception No. 2 filed by the OCA in this matter and hereby incorporate that Exception herein by reference.

Exception No. 6. CEPA et al. Support OCA’s Exception No. 4 Concerning the R.D.’s Failure to Recommend Concurrent Conditions with Regard to Service Improvements in Connection with the Recommended Base Rate Increase.

In the event that the Commission does not accept CEPA et al.’s request for denial of a Base Rate Increase above existing levels pending satisfaction of pre-conditions relating to improvements in service and an equity infusion by the City, CEPA et al. support OCA’s Exception No. 4 to the R.D.’s failure to recommend concurrent service conditions in connection with any Base Rate Increase. That Exception is incorporated herein by reference.

Exception No. 7. CEPA et al. Support OCA's Exception No. 5 Concerning the R.D.'s Failure to Recommend the OCA's Proposals with Regard to Rate Design for the Base Rate Increase.

In the event that the Commission does not accept CEPA et al.'s request for denial of a Base Rate Increase above existing levels pending satisfaction of pre-conditions relating to improvements in service and an equity infusion by the City, CEPA et al. support OCA's Exception No. 5 to the R.D.'s failure to recommend the Rate Design proposed by OCA for the Base Rate Increase. That Exception is incorporated herein by reference.

Exception No. 8. CEPA et al. Support OCA's Exception No. 6 Concerning the R.D.'s Failure to Recommend the OCA's Proposals with Regard to the Increase in the Customer Charge.

In the event that the Commission does not accept CEPA et al.'s request for denial of a Base Rate Increase above existing levels pending satisfaction of pre-conditions relating to improvements in service and an equity infusion by the City, CEPA et al. support OCA's Exception No. 6 to the R.D.'s failure to recommend that the monthly residential Customer Charge be fixed at \$11.50. That Exception is incorporated herein by reference.

Exception No. 9. CEPA et al. Support OCA's Exception No. 7 Concerning the R.D.'s Failure to Recommend the OCA's Proposals with Regard to Determination of the Residential Volumetric Commodity Charge.

In the event that the Commission does not accept CEPA et al.'s request for denial of a Base Rate Increase above existing levels pending satisfaction of pre-conditions relating to improvements in service and an equity infusion by the City, CEPA et al. support OCA's Exception No. 7 to the R.D.'s failure to recommend the OCA's proposals concerning the residential volumetric commodity charge. That Exception is incorporated herein by reference.

Exception No. 10. CEPA et al. Support OCA's Exception No. 10 Concerning the R.D.'s Failure to Recommend the OCA's Proposals with Regard to Non-Standard Rates.

CEPA et al. support OCA's Exception No. 10 to the R.D.'s failure to recommend the OCA's proposals concerning non-standard rates. That Exception is incorporated herein by reference.

III. Conclusion

CEPA et al. contend that the only proper template for adjudicating this proposed base rate increase is D.C. Transit. That case sets the standard for ratemakers faced with a base rate increase from a utility whose level of historic mismanagement has resulted in an inability to provide adequate service to customers. That case rejected the attempts by the owner to obtain rates which would have the effect of requiring customers to pay the full costs of prior mismanagement while at the same time continuing to suffer ongoing service deficiencies. The R.D. in this case, with the exception perhaps of the provisions concerning restructuring of PGW's Transportation tariff, treats PGW as if it were a utility which was functioning at average or even a little above average in terms of historical quality of management and present level of service. The R.D. may represent a "first cut," by posing the question what rates might conceivably be justified if this were a garden variety rate case and PGW were a normal utility. But the R.D. is not a legally adequate response to the core issues in this case.

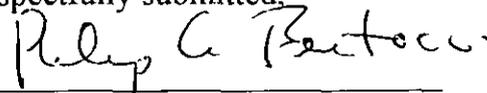
The R.D. has left the task of real adjudication to the Commission -- because the real issue here is how to weigh the owner's continued refusal to accept any financially significant responsibility for PGW's current condition and the need to recognize the serious and continuing inadequacy of PGW's service. In ordering the Management Audit, and offering it into the record, the Commission has laid a foundation for Findings

of Fact and Conclusions of Law which would support a rate order which required much more from the owner and meaningful guarantees to customers before any significant rate increase above the \$11 million interim base rate increase would be granted.

For the foregoing reasons, CEPA et al. urge the Commission to:

- (a) grant these Exceptions;
- (b) declare that the requested base rate increase above the existing interim base rates are unjust and unreasonable;
- (c) order that before any elevation in base rates above the interim \$11 million granted in November, 2000, the City must commit to waive or grant back the \$18 million City payment for at least FY 2002;
- (d) deny PGW's requested base rate increase above existing interim base rates, with the provision that this case may be reopened once the City satisfies the pre-condition set forth in Paragraph (b).
- (e) grant PGW customers such other relief as is just and reasonable.

Respectfully submitted,



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

Attorneys for CEPA, ACORN, TAG and
Action Alliance of Senior Citizens

R-00006042

CERTIFICATE OF SERVICE

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

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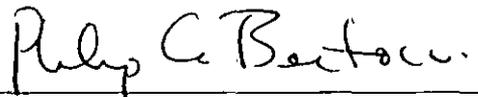
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Date: August 21, 2001



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

IN REPLY PLEASE
REFER TO OUR FILE

August 22, 2001

Honorable James J. McNulty
Secretary
Pennsylvania Public Utility Commission
P. O. Box 3265
2nd Floor-Keystone Building
400 North Street
Harrisburg, PA 17105-3265

ORIGINAL

Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00006042

Dear Secretary McNulty:

On August 7, 2001, Administrative Law Judge Cynthia Williams Fordham issued her Recommended Decision in the above-captioned proceeding in which she recommends that Philadelphia Gas Works file a Tariff Supplement designed to produce \$33,000,000 in additional revenue in addition to the \$11,000,000 interim relief implemented in March 2001.

While Administrative Law Judge Fordham's Recommended Decision did not adopt all of the Office of Trial Staff's recommendations, we support the Recommended Decision. Accordingly, by this letter, the Office of Trial Staff advises the Commission that it will not be filing Exceptions to the Recommended Decision. The Office of Trial Staff does, however, reserve the right to file Reply Exceptions to any Exceptions, which may be filed by other parties to the proceeding.

Please contact me if you have any questions.

Very truly yours,

Johnnie E. Simms
Johnnie E. Simms
Senior Prosecutor

01 AUG 22 AM 10:50
SECRETARY'S BUREAU

cc: Cheryl Walker Davis, Director-Office of Special Assistants
Honorable Cynthia Williams Fordham
Service List

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DOCKETED
AUG 29 2001

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :

v. : Docket No. R-00006042

Philadelphia Gas Works :

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Letter** of the Office of Trial Staff, dated August 22, 2001, either personally, by first class mail, electronic mail, express mail, or by fax upon the persons listed below:

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10/10/2001 10:10:51 AM

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Senior Prosecutor
Office of Trial Staff

Dated: August 22, 2001
Docket No. R-00006042



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August 22, 2001

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01 AUG 22 PM 3:52

DOCUMENT
FOLDER

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 Exceptions of the Office of Consumer Advocate, in the above-referenced proceeding.

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

Sincerely yours,

Tanya J. McCloskey
Senior Assistant Consumer Advocate

Enclosure
cc: All parties of record
Hon. Cynthia Fordham
Office of Special Assistants

64332

ORIGINAL

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

DOCKET NO. R-00006042

OFFICE OF CONSUMER ADVOCATE'S
EXCEPTIONS

DOCUMENT
FOLDER

DOCKETED
AUG 23 2001

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Dated: August 22, 2001

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I. INTRODUCTION

On August 7, 2001, the Office of Administrative Law Judge issued the Recommended Decision of Administrative Law Judge (ALJ) Fordham in the above-captioned proceeding. In her Recommended Decision (R.D.), the ALJ properly rejected PGW's proposal to increase its base rates by \$65 million (\$54 million plus \$11 million of interim rate relief), finding that such a result is not just and reasonable. The OCA strongly supports the ALJ's conclusion in this regard. Importantly, the OCA submits that the ALJ established the correct legal standard when she found that PGW's rates must be just and reasonable in accordance with the Pennsylvania Public Utility Code. R.D. at 33-34. The ALJ resoundingly, and correctly, rejected PGW's attempts to force this Commission to be no more than a "rubber stamp" of any decision made by the Philadelphia Gas Commission (PGC). Rather, the ALJ recognized that Section 2212 of the Public Utility Code, which brings PGW under the Commission's jurisdiction, must be interpreted in a manner consistent with, and in harmony with, the remainder of the Public Utility Code. The just and reasonable standard of Section 1301 provides the cornerstone for this determination. 66 Pa.C.S. §1301. Any other interpretation, particularly the interpretation forwarded by PGW, would render the Act meaningless and would leave Philadelphia gas consumers without any protection.

Although properly recognizing the legal standard to be applied in this case, the OCA respectfully submits that the ALJ failed in applying this standard to the facts before her. It is axiomatic that in determining whether rates are just and reasonable, the Commission must balance the interests of ratepayers and the interests of the Company. Despite the testimony of record on the inadequate quality of service provided by PGW and the basic unaffordability of PGW's rates following the dramatic increases in gas

costs this past winter, the ALJ found a \$33 million rate increase, in addition to the \$11 million interim rate increase, to be just and reasonable. The OCA disagrees.

The OCA submits that although far better than the Company's proposed increase, the recommendation of a \$33 million rate increase (in addition to the \$11 million interim rate increase) still requires ratepayers to substantially provide for PGW's cash working capital needs to resolve its current financial crisis – a crisis that is of the Company's own making. A \$33 million rate increase above currently existing rates will allow the Company to have coverage ratios on its bonds far in excess of the minimum required and far in excess of what it has achieved in the past eight years while at the same time providing the Company a cash cushion far in excess of any achieved in the past eight years. This level of rate increase will effectively require ratepayers to correct a problem which took many years to develop, without the City, as owner and manager of the utility, making a substantial contribution. And, it will require ratepayers to pay rates in excess of what can be considered just and reasonable given the low quality and high price of service that they have been experiencing.

PGW's financial crisis did not develop overnight, and it should not be corrected overnight at the expense of current ratepayers. Despite a deteriorating financial condition, PGW and its owner did not act. Over years of financial deterioration, PGW never sought base rate relief from the Philadelphia Gas Commission, and its owner, the City, did not make a significant equity contribution. Indeed, the City has required that the \$18 million payment to the City be made each year.

Given the circumstances that PGW and its ratepayers now face, the OCA submits that the Commission must determine an appropriate level of rate increase to assist the Company with its present financial situation, but not remedy all, or even many, of its problems through this one base rate case. To

reach this balance, the OCA recommends that the Company's rates be set to meet its debt service coverage requirements, after giving consideration to service quality issues. When established in this manner, the OCA submits that a rate increase of \$10.5 million over the interim level of rates (\$21.5 million when the \$11 million interim rate increase is included) will meet PGW's projected expenses, including the payment to the City, the mains replacement program, the LNG plant upgrade, the fixes to its new computer system, and the Transition to Excellence program, while meeting the bond coverage requirements. If the Company requires additional cash flow, it should seek a grant back of the \$18 million payment to the City as project revenues, or further assistance from the City in the form of loans. PGW should not simply turn to its ratepayers to solve the multitude of problems affecting PGW at this time. The OCA also submits that any rate relief granted should be subject to specific conditions to ensure that the quality of service at PGW continues to improve.

II. EXCEPTIONS

EXCEPTION 1: The ALJ Erred In Awarding The Company A \$33 Million Increase Over The \$11 Million Interim Rate Increase (R.D. 34-69; OCA M.B. 17-40; OCA R.B. 11-25).

In her R.D., the ALJ recommends that the Commission adopt a proposed revenue requirement increase of \$33 million over existing rates. This \$33 million increase is in addition to the \$11 million interim rate increase implemented as part of the Settlement between PGW and the Commission's Law Bureau. R.D. at 69. The effect of the recommendation is for base rates to be increased by \$44 million over the base rates in effect last year at this time. The OCA excepts to this recommendation. As will be explained below, this increase is not justified given the circumstances of this case. PGW is entitled to a revenue increase of no more than \$10.5 million over the current interim rate increase of \$11 million (\$21.5 million total base rate increase from last year at this time).

As the OCA has discussed throughout this case, PGW has again presented the Commission with a request for a significant rate increase in the context of a financial crisis – one substantially of its own making. PGW's request was made despite last year's unprecedented Gas Cost Rate increase of \$237 million and an interim base rate increase of \$11 million.¹ In this case, ratepayers are being asked to fund an operation which, by consensus, has been poorly run in the past, thereby contributing to its current financial crisis. Stratified Management and Operations Audit of Philadelphia Gas Works, §III.E

¹ The parties to PGW's recent Gas Cost Rate filing have recently filed a stipulation that, if approved, will result in the GCR being lowered by \$70 million with a further reduction proposed for December 1, 2001 depending on updated gas price projections. The OCA supports this reduction as welcome relief, but the burden of the nearly \$248 million of rate increases over the past year (\$237 million GCR and \$11 million interim base rate) is not totally relieved by the recent GCR reduction.

(Administrative Counsel Att. 1); OCA St. 1-S at 8-9; PGW St. 1.0 (rev.) at 23. The public input testimony in this case demonstrates that current service at PGW remains troubled, and improvements have been slow to be realized.

Given these circumstances, OCA witness LeLash recommended that PGW be allowed to increase its base rates by \$10.5 million over the \$11 million interim rate increase recently granted (\$21.5 million total base rate increase over last year at this time). This \$10.5 million increase, which is based on PGW's Revised FY 2001 Budget, will allow the Company to meet its operating expenses, including the costs for its mains replacement program, its LNG plant upgrade and the corrections to the Billing Credit and Collection System (BCCS), and still meet its debt service coverage requirements for both its 1975 bonds and its 1998 bonds. Additionally, this level of rate increase allows the Company to make its \$18 million payment to the City.

The OCA submits that this recommendation is soundly based and any greater award would require ratepayers to pay excessive rates. The ALJ's recommendation would have ratepayers fund debt service coverage requirements far in excess of the minimum required for the bonds and far in excess of any level attained in the recent past. Implementation of a \$33 million rate increase above the \$11 million interim rate increase will result in debt service coverage ratios of 2.85x and 2.97x on the 1975 and 1998 bonds, respectively and net earnings of \$33.2 million. OTS St. 1 at 3, Exh. 1, Sch. 3. As OCA witness LeLash testified, however, such coverage ratios and net earnings level are far greater than any achieved in the recent past:

It has been eight years since the Company's last rate increase in 1992. During that period of time, the Company's net earnings were never greater than \$17 million and in FY 1998 through FY 2000 earnings were negative.

* * *

Over the past eight years, debt coverage was never higher than 1.67 times and in several cases it approached the bond covenant minimum of 1.50 times.

OCA St. 1 at 22.

The OCA submits that the ALJ's award of a \$33 million rate increase above the \$11 million interim rate increase does not adequately address the interests of ratepayers. PGW's impaired financial condition is mostly one of its own making and a significant result of the ongoing failure of the City to make any significant equity contribution to PGW. OCA St. 1 at 7. Over years of financial deterioration, PGW never sought base rate relief from the Philadelphia Gas Commission. Now, PGW has reached the maximum of its short term borrowing which it uses to provide cash flow and working capital and seeks to correct these financial problems by requiring its ratepayers to support all of its cash needs. The OCA submits, however, that ratepayers must not bear the full brunt of these failures. OCA witness LeLash testified:

Apparently, for a variety of reasons, PGW's past management and the City did not respond to the serious deterioration in the operation of the Company and the level of service being provided to its ratepayers. The consequences of this failure are not appropriately borne by ratepayers. Therefore, the responsibilities of PGW's ratepayers must be defined and hopefully limited. Should this demarcation not be established, then the City will be able to abrogate any real responsibility and the deficiencies of the past will, more than likely, continue.

OCA St. 1 at 17-18.

Although the ALJ's recommendation takes a step in limiting the exposure of ratepayers to these failures, it does not go far enough under the circumstances of this case. OCA witness LeLash captured the unique circumstances of this case as follows:

PGW is facing an atypical set of circumstances. Wholesale gas costs are at unprecedented levels, the Company's bad debt expense is escalating, and the Company has

acknowledged that it will have another base rate investigation in its mandated restructuring case which has to be filed no more than 14 months from now. Under these circumstances, rates should be set only to meet the Company's coverage requirements. The rates should not incorporate amounts to remedy past management and financial deficiencies . . . With a moderation in the wholesale cost of natural gas and measurable improvement in operations and service, some of PGW's long-term needs could be addressed differently.

OCA St. 1-S at 3-4.²

The OCA submits that the recommendation of the OCA to set rates to meet the bond coverage requirements better reflects a balancing of the interests of ratepayers and the Company in this case and produces a result that is just and reasonable. The OCA's recommendation for a \$10.5 million rate increase above the \$11 million interim rate increase now in effect (\$21.5 million total base rate increase) properly addresses PGW's financial situation over the next 12 to 18 months, until its subsequent restructuring filing, which the Company states will also include a base rate filing. OCA St. 1-S at 3. This level of increase will allow PGW to *begin* to restore its financial health while not overburdening ratepayers. As such, it reaches a reasonable and fair balance of the interests in this proceeding.

The OCA would also note that its recommendation fully reflects all of the Company's proposed expenditures. In making his recommendation, OCA witness LeLash started with PGW's Revised FY 2001 Budget which included its planned or projected expenditures. Mr. LeLash also adopted the Company's assumption that the Company will successfully issue its planned \$100 million of bonds (which was completed) and renew its \$100 million short term credit line (which was also completed). OCA St. 1 at

² As noted, a settlement has been reached that will provide some rate relief to customers through a reduction of \$70 million in the GCR. This reduction, however, does not offset the \$248 million of rate increases that PGW customers have experienced in the last year.

29-30; Exh. BB-3; PGW Reply Brief at 22. Mr. LeLash also assumed that the \$18 million payment would be made to the City.³

Mr. LeLash then determined the revenue increase necessary for the Company to achieve a coverage on the 1998 Ordinance Bonds of 1.5 times. As shown on Schedule 1 attached to OCA witness LeLash's Direct Testimony, a rate increase of \$21.5 million (\$10.5 million plus the \$11 million interim relief) achieves this coverage requirement.⁴ OCA St. 1 at 30; Sch. 1, Line 2. This level of increase would allow the Company to meet its expenses, make the \$18 million payment to the City, achieve a bond coverage of 1.5x on the 1998 Ordinance Bonds, achieve a 2.01x bond coverage on its 1975 bonds, and end the year with \$34 million in cash. *Id.*; PGW St. 3.1 at 2. If the City grants back the \$18 million payment as project revenues to PGW, PGW would achieve bond coverages of 2.11x on its 1998 Bond Ordinance and 2.36x on its 1975 Bond Ordinance.⁵ OCA St. 1, Sch. 2, Lines 25 and 20.

³ Mr. LeLash made certain accounting adjustments that reduced the Company's operating budget by \$6.8 million. Mr. LeLash then made an offsetting increase in the Company's revised FY 2001 level of bad debt expense to increase further the bad debt expense by \$6.8 million. OCA St. 1 at 32. Since the adjustments offset each other, these adjustments did not change the analysis or the underlying budget revenue requirement in the OCA's proposal. In her R.D., the ALJ rejects the OCA's increase to the bad debt expense but adopted the OCA's expense adjustments. As set forth in Exception 2, however, an adjustment to the ALJ's \$33 million rate increase recommendation is necessary to reflect the other OCA expense adjustments that were adopted by the ALJ.

⁴ Since the budget utilized in the analysis did not reflect the interim rate increase provided by the Settlement, the total base rate increase amount also does not reflect the interim rate increase. The \$11 million interim rate increase is separated out of the OCA's presentation for ease of comparison.

⁵ Project revenues represent funds supplied by the City, in this case the grant back of \$18 million payment, that qualifies for inclusion as above-the-line operating revenue in the coverage calculation. The City maintains a grant revenue fund as part of its operating budget. This fund is used to provide grants to various City agencies. Tr. at 785.

The OCA submits that its recommendation properly addresses PGW's financial situation over the next 12 to 18 months, until its subsequent restructuring filing, which the Company states will also include a base rate filing. OCA St. 1-S at 3. By working from the Company's own budget, the OCA's recommendation recognizes PGW's planned expenditures and provides for its debt service coverage. With this level of increase, the Company's progress towards correcting its financial crisis can continue, and its efforts to improve safety and customer service can also continue. As OCA witness LeLash explained, this focus is critical at this time:

The emphasis of this proceeding should not be to build up enough cash in the short-run to ensure financial health in the long-term. Rather, the emphasis should be on what rates the Company requires to get through its present financial situation and this period of unprecedented wholesale gas costs.

OCA St. 1 at 25.⁶

The OCA submits that its revenue requirement determination and the recommended short term focus of this proceeding produces rates which are just and reasonable. As such, the OCA submits that its \$10.5 million increase over the \$11 million interim rate relief (\$21.5 million total base rate increase over last year at this time) should be adopted subject to the conditions set forth herein. Any additional cash needs of the Company should be provided by its owner, the City of Philadelphia. The ALJ's recommendation requires ratepayers to provide too much revenue to the Company given the circumstances of this case.

⁶ As noted above, over the past year, ratepayers have experienced \$237 million in GCR rate increases and an additional \$11 million in interim base rate increase. The parties to PGW's recent GCR have reached a settlement which will result in PGW's GCR rate being reduced by \$70 million in September of 2001 with a further reduction expected in December 2001, if approved. The OCA supports this reduction and settlement, but notes that ratepayers are still bearing a significant burden.

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief at pages 17-32 and Reply Brief at pages 11-35, PGW should be awarded a rate increase of no more than \$10.5 million in addition to the \$11 million interim rate relief implemented in 2001.

EXCEPTION 2: The ALJ Erred In Failing To Adjust The OTS Recommendation For The OCA Expense Adjustments Adopted In The Recommended Decision (R.D. 50-69; OCA M.B. 32-39).

Although the ALJ recommends adoption of the OTS' recommended \$33 million increase, the ALJ also recommends acceptance of the OCA's expense adjustments. The OCA made adjustments to BCCS remediation (\$800,000), Consultant Studies/Costs (\$424,000), Non-Recurring Expenses (\$1,840,000), rate case expense (\$412,000), Employee Consultants (\$258,000), Equipment Rentals and Leasing Information Technology (\$632,000), Lobbying Expense (\$115,000), Operating Leases (\$601,000), Non-recurring Material Purchases (\$100,000) and CRP amortization offset (\$1,637,000). The OCA's adjustments, which the ALJ adopted, totaled \$6.8 million.⁷ R.D. at 62-68.

The OCA also proposed an adjustment to increase the Company's bad debt expense by \$6.8 million. The ALJ, however, rejected the OCA's proposal to increase the Company's bad debt expense. R.D. at 61-62. This rejection is of import because the OCA's recommended increase of PGW's bad debt expense offset the effect of the OCA's other adjustments to PGW's revenue requirement. Thus, the OCA's proposed revenue increase recommendation reflected the net effect of the downward adjustments and the increase to the bad debt expense. OCA M.B. at 39. Since the ALJ has rejected the OCA's

⁷ The ALJ adopted the OTS adjustments regarding rate case expense. There is an overlap between the OTS and the OCA adjustments which must be eliminated if the OTS adjustment is adopted. Eliminating this double count reduces the total OCA adjustments to be subtracted from the OTS revenue requirement recommendation to \$6.4 million.

proposal to increase PGW's bad debt expense, she has removed the "offset." Therefore, the effect of the OCA adjustments remains and must be applied to the \$33 million rate increase recommendation of the ALJ if this recommendation is adopted. This reduces the \$33 million increase by the amount of the OCA adjustments that were adopted. If the \$33 million recommendation of Judge Fordham is adopted, and the overlap between the OCA and OTS rate case expense adjustment is eliminated, this level of rates must be reduced to \$26.6 million in accord with the remainder of the Recommended Decision.

The OCA submits that the ALJ erred in failing to recognize the OCA's adjustments in her rate increase recommendation. The maximum rate increase that should be awarded the Company under the ALJ's decision is \$26.6 million. The OCA submits that if the OCA's rate increase recommendation is rejected, that the OCA's expense adjustments should nevertheless be properly reflected in any revenue requirement awarded.

EXCEPTION 3: The ALJ Erred In Failing To Address Quality Of Service Issues And In Failing To Consider The Significant Public Input On Affordability When Determining The Just And Reasonable Level Of Rates (R.D. 104-105; OCA M.B. 60-72; OCA R.B. 25-33).

At page 34 of the R.D., the ALJ correctly finds that PGW's rates must be just and reasonable. R.D. at 34. The ALJ also concludes that in determining whether the rate is just and reasonable, the interests of ratepayers must be balanced against the Company's financial needs. R.D. at 35. The ALJ, however, after noting that PGW has service problems, does not appear to consider this important fact in balancing the interests of ratepayers. R.D. at 69. The OCA submits that the ALJ erred in failing to address

PGW's quality of service in her recommendation for a rate increase.⁸ When the testimony in this proceeding is fully considered, the OCA submits that its proposed rate increase of \$10.5 million over and above the \$11 million interim rate increase, subject to the conditions recommended by the OCA, strikes the appropriate balance and produces rates that are just and reasonable.

As the OCA has set forth in this proceeding and in the interim rate proceeding, in determining whether any rate increase for PGW is just and reasonable, the Commission must consider the quality of service being provided by the utility. As OCA witness LeLash explained:

The regulatory process has consistently followed the principle that a utility operation is only entitled to rate increases if its service is adequate and reasonable. Such a principle enforces the requirement that, in providing a monopoly service, utility owners have a responsibility to maintain and operate the utility in the most efficient and reasonable manner possible. Failure to fulfill these requirements can result in the withholding of rate relief. In effect, regulation requires that utility owners provide effective management and sufficient capital to fulfill the on-going obligation to serve.

OCA St. 1 at 13. In other words, "rates should follow service." OCA St. 1 at 60.

Pennsylvania law is clear that the Commission has discretion to withhold, to limit, or to condition rate relief on the quality of service. Section 526(a) of the Public Utility Code provides:

The commission may reject, in whole or in part, a public utility's request to increase its rates where the commission concludes, after hearing, that the service rendered by the public utility is inadequate in that it fails to meet quantity or quality for the type of service provided.

⁸ The ALJ addresses Quality of Service and the Management Audit in two pages of the recommendation without reaching a conclusion or finding on either point. The OCA provided extensive analysis in this regard. See, OCA M.B. at 60-72; OCA R.B. at 25-33. When the Management Audit Findings, the public input testimony and the testimony of OCA witness LeLash regarding service quality are considered, the OCA submits that the Commission must find that the rate increase recommended by the OCA, with the conditions recommended by the OCA, constitutes a just and reasonable level of rates. Any greater increase, or any fewer conditions, will not meet this standard.

66 Pa.C.S. §526(a). Section 523(a) also states that “[t]he commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title.” 66 Pa.C.S. §523(a).

The Courts have long held that service is an essential consideration in determining just and reasonable rates. The U.S. Court of Appeals for the District of Columbia Circuit perhaps stated this consideration best in D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Comm’n, 466 F.2d 394, 422 (D.C. Cir. 1972)(D.C. Transit). In D.C. Transit, the Transit Commission had made a fare increase contingent upon steps designed to correct serious deficiencies in the service that the Company furnished to the public. The Court summarized the Company’s argument and concluded as follows:

Transit’s argument has one central theme: its revenues cannot be permitted to fall below the level of fair return, and surely not below the breakeven point, no matter what the circumstances, and even if its management is uneconomical and inefficient and its service inadequate. If Transit is correct, the Commission is powerless to sanction corrective measures by deferring further consideration of a fare increase. *If Transit is correct, it may disregard its public responsibilities at will . . . and yet insist that the public respond to its demands for higher fares. We cannot accept that position. We do not believe the Constitution left the Commission impotent to deal with the situation confronting it in a sensible manner.*

D.C. Transit, 466 F.2d at 422 (emphasis added). As far back as Smythe v. Ames, 169 U.S. 466 (1898) the United States Supreme Court has recognized that service is an essential consideration in determining just and reasonable rates. Smythe v. Ames, 169 U.S. at 547 (“[W]hat the public is entitled to demand is that no more be extracted from it for the use of a public highway than the services rendered by it are reasonably worthy.”)

The Commission considers service quality when determining just and reasonable rates and has often exercised its discretion to either reject a rate increase or condition a rate increase when it finds service to

be inadequate. See, Pa. PUC v. Pa. Gas and Water Co., 68 Pa. PUC 191, 197 (1988)(denying a rate increase because of the Company's failure to show that its customers were receiving inadequate service); Pa. PUC v. National Utilities, Inc., 87 Pa. PUC 1, 6 (1997)(denying the Company's rate increase entirely because of inadequate service); Pa. PUC v. Pennsylvania American Water Co., 71 Pa. PUC 210, 219 (1989)(PAWC should "have to demonstrate actual evidence of improved service" before its customers should have to pay an increased rate) and Pa. PUC v. Pa. Gas & Water Co., 79 Pa. PUC 349, 359 (1993)(Utility provided the option of accepting no rate increase or a rate increase dedicated entirely to distribution system improvements to accelerate progress toward providing safe and adequate service).

The OCA submits that PGW's long-term service problems and its progress toward improved service should be the primary determinants in what level of rates is just and reasonable. The public input testimony, the testimony of OCA witness LeLash, and the Management Audit raise many concerns about the level of PGW's service. The ALJ appeared to recognize these service problems, but did not appear to explicitly consider these service problems when recommending a rate increase. R.D. at 69. The OCA submits that when fully considered, it is clear that a rate increase, no greater than that recommended by the OCA, should be implemented, subject to the conditions discussed in Exception 4 below.

The OCA fully discussed the Management Audit and the public input testimony in its Main Brief and Reply Brief and will not repeat that entire discussion here. See, OCA M.B. at 61-62, 65-67; OCA R.B. at 27-33. As the Management Audit has made clear, many areas of PGW's customer service are inadequate.⁹ For example, the Management Audit found that "PGW's level of service, as measured by

⁹ OCA witness LeLash presented testimony on various Company studies that confirm these
(continued...)

abandonment phone rates and response time of the call center, is one of the worst in the industry.”

Administrative Counsel Att. 1 at p. VIII-7. Other problems identified with PGW’s service include insufficient staffing levels at the Call Center, inadequate training of employees on the billing system, lack of a functioning billing system, overwhelmingly negative customer opinion of PGW, and poor responsiveness to customer complaints. Administrative Counsel Att. 1 at p. VIII-11, VIII-16 to VIII-17, VIII-26.

The public input testimony confirms these Audit findings and presents critical evidence to the Commission of the impact on customers of these problems identified in the Management Audit. The OCA summarized some of the public input testimony in its Main Brief and Reply Brief and will not repeat all of this summary here. OCA M.B. at 65-67; OCA R.B. at 31-33. Testimony of incorrect bills or no bills at all, long wait times on the telephone or at the office to address any problems, and poor customer service when finally connected with a customer service representative were heard at the public input hearings. See, e.g., Tr. 90 (no bill for four months); Tr. 195 (confusion, disorder, billing errors, incorrect billing or no bills at all); Tr. 215 (no bill for 4 years despite contact with PGW asking for a bill and then sent a bill for \$4,000 with late charges); Tr. 186-187 (billed for 3 months when the gas was shut off); Tr. 356 (never receives a response from customer service no matter what time of day); Tr. 382 (spends hours on hold waiting for customer service); Tr. 184, 188, 292-293, 352-353, 356, 360, 382, 391 (complaints about extraordinarily long wait times on the telephone).

The impact of these failings on customers is significant. As testified to at the public input hearings, PGW’s customers, like any other utility customer, should be able to call the utility, have their phone calls

⁹(...continued)
findings of the Management Audit. OCA St. 1 at 55-60.

answered properly, and have their bills delivered on time with accuracy. Tr. 184-185. The record here demonstrates that PGW has not yet achieved these basic requirements for providing adequate service.

Additionally, the public input testimony compellingly demonstrates that the significant and rapid increases in customers' rates over the past year associated with skyrocketing natural gas costs have simply made rates unaffordable for many.¹⁰ For example, a customer testified that: "[w]e are not getting raises at the rates that these bills are going up. We can't choose not to have gas... The company's debt, we are like Jonah and they are like the whale." Tr. 283-284. With respect to the impact that the sudden and dramatic increases in rates has had on consumers, a customer testified that "[l]ast month I got a bill for \$474. When I got it for the first time in my 30 years I sat down and I cried because I was scared. It scares me." Tr. 402. Regarding the impact of a significant increase on the service territory as a whole, a customer testified: "My concern is not only for myself, but others as a whole... People are going to try anything and everything to cook, try to keep warm. So I speak not only for myself but for the elderly, the children of families that are neglected." Tr. 285-286. Another customer touched upon the long-term effect of a significant rate increase as she testified that: "I think there is going to be a mass exodus if this continues and these rates continue to rise. I myself don't know how people that live on a fixed income can afford to live in this city any longer. And I have no intention when I retire of retiring in Philadelphia." Tr. 385. See also, Tr. 418-19.

The OCA submits that the Commission must give full consideration to these matters when *determining a level of rate increase that will produce just and reasonable rates*. Ratepayers should not be

¹⁰ The effect of these dramatic increases in natural gas costs have been compounded by PGW's attempts to collect these costs from customers in less than a 12-month time frame.

expected to pay even higher rates without the receipt of safe and adequate service. Additionally, rates that are unaffordable to many gas consumers will only serve to harm the community as well as PGW. See, e.g. Tr. 367-368 (Church closed its food bank as a result of large increases in its gas bills). The OCA submits that its revenue requirement recommendation, which fully includes the Company's expenditures to rectify its BCCS problems, to maintain its mains replacement program, to proceed with its LNG project, and to continue its progress on its Transition to Excellence Program while at the same time mitigating the burden on ratepayers, reaches a result that is just and reasonable.

As such, the OCA submits that the ALJ recommendation, which does not give full consideration to these quality of service issues, should not be adopted. The OCA's recommended revenue requirement, which recognizes these quality of service issues and affordability issues, should be adopted.

EXCEPTION 4: The ALJ Erred Failing To Impose Conditions On Any Rate Increase Awarded Based On Quality Of Service Considerations And The Management Audit (R.D. 104-105; OCA M.B. 60-72; OCA R.B. 25-33).

As set forth above, and as found by the ALJ, PGW's service has been a significant problem. R.D. at 69. The record demonstrates that PGW's service has failed even the most rudimentary test of adequacy. Significant and far-reaching changes are needed – many of which have been identified by the Management Audit – and the Commission should ensure that any rate increase granted is properly utilized to implement these necessary changes to improve customer service. The Company has committed to many of these changes and improvements through its plan to implement recommendations identified in the Management Audit. *The Commission should include appropriate conditions in its Order in this base rate proceeding to ensure continued, orderly progress towards these improvements.*

As discussed above, the Commission has exercised its discretion to condition a rate increase on service improvements. Pa. PUC v. Pa. Gas & Water Co., 79 Pa. PUC 349, 359 (1993)(Utility provided the option of accepting no rate increase or a rate increase dedicated entirely to distribution system improvements to accelerate progress toward providing safe and adequate service). In the instant case, the OCA recommends that the Commission require that PGW meet a number of conditions if it is granted any rate increase to ensure that progress continues toward improving customer service and to ensure that basic protections are afforded ratepayers as a result of this proceeding. The OCA recommends the following five conditions:

- PGW should be required to maintain at least a 1% replacement rate in its mains replacement program;
- PGW should continue its commitment to correcting the problems with the BCCS, particularly the need to rectify the budget billing problems;
- PGW should continue to work with the Commission to implement the recommendations of the Stratified Management And Operations Audit consistent with the Philadelphia Gas Works Implementation Plan;
- PGW should improve its customer service in a timely manner, particularly its call center performance; and
- PGW should continue its progress on its Transition to Excellence Plan.

OCA M.B. at 72.

The OCA submits that these conditions are particularly necessary given the significant problems identified in this proceeding with PGW's service. For example, OCA witness LeLash explained the significance to the Company's operations of the failures in the BCCS system:

The problems associated with the BCCS system hampered all of PGW's operations and were particularly damaging to the Company's relationship with its customers. However,

the problematic BCCS implementation was only the final element in a deterioration in operations extending back over several years which undermined the Company's financial and management capability to address new problems and provide customers with reasonable service.

OCA St. at 55-56. As Mr. LeLash noted, the problems with this system continue:

A review of the current status of the BCCS and associated systems shows that several specific areas need further improvement. Billing exceptions, while dramatically reduced, still are occurring at a rate somewhat less than 300 per day. (PGW St. 1.0, page 26). A large number of errors are occurring with reference to payment arrangements and the bill calculation process (PGW St. 1.0, page 29). The Company has also acknowledged that, at least through February of this year, it was having problems making adjustments to customers' budget billing plans. (Response to CEPA-I-47)

OCA St. 1 at 54. The Management Audit also concludes that problems with the BCCS are negatively affecting customer service. Administrative Counsel Att. 1 at p. VIII-17.

The inadequacy of PGW's customer service has also been documented on the record of this proceeding through the public input testimony, the Management Audit, and the Company's own studies. For example, the Company's own study, the Vanguard Report, confirms the Management Audit findings that PGW's Call Center performance is seriously deficient. OCA St. 1 at 58; Administrative Counsel Att. 1 at page VIII-8. Additionally, as OCA witness LeLash noted, there is evidence that there are a significant number of customer complaints being pursued against PGW. Mr. LeLash testified:

As of February of this year, there were 3,513 informal complaints pending before the Commission's Bureau of Consumer Services (BCS). This level of pending complaints has been increasing at a rate of 300 to almost 700 per month and apparently PGW has been able to respond to only about 40% of them to date (Response to CEPA-I-52)

OCA St. 1 at 60. The OCA submits that long-term service improvements must be implemented before ratepayers can be expected to pay even higher rates.

As to issues regarding safety, the OCA submits that it is vital that PGW maintain at least a 1% mains replacement rate of its cast iron mains. OCA St. 1 at 53; Administrative Counsel Att. 1 at page IX-35 to IX-37. Pa. PUC v. Philadelphia Gas Works, Docket No. R-00005654, slip op. at 28 (Nov. 22, 2000). This 1% replacement rate is necessary to reduce the risk of main breaks and incidents. OCA St. 1 at 51. Although PGW has been achieving a replacement rate this year that puts it on target to meet this 1% rate, it has not met this level of replacement in several years. Given the important safety considerations, the OCA submits that the Commission should require the Company to meet at least this 1% replacement rate as a condition of any rate increase.¹¹

The OCA has set forth fully its support of these conditions in its Main Brief. OCA M.B. at 67-72. As the public input testimony, Management Audit, and the Company's own studies demonstrate, these conditions are necessary to ensure the provision of safe and adequate service for PGW's customers. See, e.g., OCA St. 1 at 51-60. For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief, the OCA submits that any rate relief granted PGW be subject to the conditions recommended by the OCA.

EXCEPTION 5: The ALJ Erred In Allocating A Disproportionate Amount Of The Rate Increase To Residential Customers (R.D. 73-79; OCA M.B. 47-51; OCA R.B. 38-39).

In the Recommended Decision, the ALJ finds that the residential class is being subsidized and recommends that the OTS rate design be adopted as a means of increasing rates to collect the \$33 million increase since it allocates the bulk of the rate increase to the residential class. R.D. at 19, 73-76. OTS

¹¹ The OCA would note that its revenue requirement recommendation includes the cost of the 1% mains replacement rate.

based its revenue allocation on the PGW class cost of service study presented by Company witness Howard Gorman. OCA St. 2-R at 2. The OTS adopted PGW's class cost of service study, but does not adopt the Company's proposed class revenue responsibilities. Instead, OTS developed an alternative class revenue responsibility recommendation that allocates the bulk of the rate increase to the residential class in an attempt to mitigate the perceived subsidy. The OCA excepts to the ALJ's recommendation. The OCA submits that the Company's original proposal for spreading the allowed rate increase among the customer classes should be adopted and then scaled back proportionally to reflect the level of rate increase awarded.

Initially, the OCA submits that the ALJ's conclusion that the residential class is being subsidized by the other rate classes is incorrect. R.D. at 19. As OCA witness Miller explained, a subsidy occurs if a product is being provided to a customer or a class of customers at a price less than the marginal or incremental cost of serving those customers. OCA St. 2-R at 3. Class cost of service studies fail to measure or indicate the presence or absence of subsidies because they are based on total costs, not on marginal or incremental costs, and a gas utility's marginal or incremental costs are much less than its total costs. Id.

As to why the concept of a subsidy focuses on marginal or incremental costs, rather than total costs, Mr. Miller stated:

There are two reasons. First, if the prices paid by residential customers exceed the marginal or incremental costs of serving them, then residential customers are making a positive contribution towards the recovery of the utility's fixed (*i.e.*, non-marginal) costs. Because of this positive contribution, the non-residential customers are better off than if the residential class simply disappeared, which would leave the non-residential customers with the full responsibility for paying all of the utility's fixed costs.

OCA St. 2-R at 4. Mr. Miller continued:

The second reason is that prices based on marginal costs have a special relationship to the recovery of total costs. This special relationship exists in industries with so-called "constant returns to scale", which occur if the production of all products can be doubled by doubling all of the inputs. Where there are constant returns to scale, if each product is sold at a price equal to its marginal cost, then the total revenue is exactly equal to total cost, neither more nor less. However, if an industry is subject to increasing returns to scale -- as is the gas distribution industry -- then prices equal to marginal costs will not be high enough to recover the industry's total costs. In short, because PGW's gas distribution business is subject to economies of large scale, PGW can recover its total costs only by charging some (or all) customers prices higher than the marginal or incremental cost of serving them.

Id. Mr. Miller concluded:

This necessary divergence between prices and marginal costs does not constitute a subsidy. Class cost of service studies, which are procedures for allocating a utility's total costs, are one of the tools used to determine how far above marginal costs the rates for each customer class should be set. However, even if there are differences between the rates actually set and the results of a particular class cost of service study, these differences are not subsidies unless the rates for some customers are less than the marginal or incremental costs of serving those customers...My own review indicates that PGW's marginal costs are much less than the total costs allocated to the residential class, and less also than the rates paid by residential customers.

OCA St. 2-R at 4-5.

Thus, the ALJ incorrectly finds that the residential class is being subsidized by the other customer classes. As Mr. Miller explained, even if the Commission accepts the Company's class cost of service study as the proper allocation of PGW's total costs, there is no subsidy of the residential class because the difference between residential revenues and the costs allocated to the residential class in this study is not equivalent to a subsidy. OCA St. 2-R at 3.

The ALJ also erred in adopting the OTS revenue allocation in that it is based on the Company's cost of service study which overstates the costs that should be allocated to the residential class. As OCA

witness Miller explained, the Company's cost of service study, upon which the ALJ relies, improperly allocates certain costs and credits.¹² If the Company's cost of service study is to be used as the principle support for the allocation of revenue responsibility, these allocations should be corrected. OCA St. 2 at 21-25. When these allocations are corrected, the difference between the costs allocated to the residential class and the revenues collected from that class is reduced. OCA St. 2-R at 2-3; OCA St. 2, Exh. 2-C. The corrected cost of service study does not support the extreme revenue responsibility recommendations adopted by the ALJ. Rather, it supports the allocation proposed by PGW, which the OCA has adopted.¹³

It is important to note that even under the OCA's proposed revenue responsibility allocation, residential ratepayers will still be responsible for 80% of any rate increase awarded. The other firm service customer classes will be responsible for only 20% of the revenue increase, but they account for 25% of PGW's test year firm sales volumes and pay 24% of the revenues at present rates. OCA St. 2, Exh. 2-B, Table REM-2, OCA Exh. 2-Table 4.

¹² The OCA proposed three major adjustments to the Company's COSS. The specific modifications were 1) PGW's investment in distribution mains be allocated on the basis of the peak and average demand method as in Pa. PUC v. Peoples Natural Gas Co., 63 Pa. PUC 6, 42 (1985); 2) an allocation of a portion of administrative and general salaries and office supply and expenses on the basis of plant investment; and 3) the allocation of A&G credits of \$12 million for duplicate charges in accord with the allocation of Construction Work in Progress. The OCA discussed these adjustments in detail in its Main Brief at pages 40-47 and its Reply Brief at 35-38.

¹³ In her R.D., the ALJ did not rule on the OCA's recommended changes to the cost of service study. The ALJ recommended that these modifications be taken up in PGW's restructuring proceeding since the Company's cost of service study is only being used as a guide in this proceeding. R.D. at 73. The OCA does not except to the recommendation to take these issues up in the restructuring proceeding. It would be improper, however, for the Commission to impose a disproportionately high increase on the residential customers on the basis of the Company's uncorrected cost of service study.

Neither the cost of service studies in this proceeding nor the circumstances of this proceeding support allocating all, or almost all, of this rate increase to residential customers. As PGW witness White testified, increasing the residential allocation beyond the recommendation of the Company “would only serve to increase the burden on the customers having the most difficulty paying their bills.” PGW St. 4.1 at 17. As the OCA has set forth above, the public input testimony demonstrates the significant burden that recent rate increases have imposed on residential customers. To further that burden with an improper allocation based on a perceived subsidy would be improper.

For the reasons set forth above, and for the reasons set forth in the OCA’s Main Brief at 40-51, and the OCA’s Reply Brief at 38-39, the OCA submits that the ALJ’s recommendation to allocate the bulk of this rate increase to residential ratepayers should be rejected. PGW’s revenue allocation, scaled back proportionately to reflect the final rate increase award, should be adopted.

EXCEPTION 6: The ALJ Erred In Adopting A \$12.00 Customer Charge For Residential Customers (R.D. 78; OCA M.B. 51-56; OCA R.B. 39-41).

At page 78 of the R.D., the ALJ adopted a residential customer charge of \$12.00. The OCA submits, however, that based on the Company’s direct customer costs and the principle of gradualism, a residential customer charge level no higher than \$11.50 should be implemented in this proceeding. As such, the ALJ’s recommendation to increase the residential customer charge to \$12.00 should be rejected.

OCA witness Miller conducted an analysis of the costs that are appropriately included in the customer charge. As set forth by Mr. Miller, direct customer costs should represent the carrying costs of the Company’s investment in services, meters, and house regulators, plus the cost of meter reading and part of the costs of customer records and collection. OCA St. 2 at 6. This is in accord with the Commission’s

decisions in Pa. PUC v. Pennsylvania-American Water Co., 82 Pa. PUC 381 (1994) and Pa. PUC v. West Penn Power Co., 73 Pa. PUC 454 (1990).

OCA Exhibit 2-B, Table REM-4 sets forth the direct costs calculated by Mr. Miller for PGW. As can be seen, *if the full amount of the Company's request is granted*, the direct customer costs for the residential class are \$12.17 per customer per month. The ALJ, however, did not recommend that the full rate increase request be implemented.

Furthermore, the principles of gradualism should be applied to the proposed customer charge. Pa. PUC v. National Fuel Gas Distribution Corp., 73 Pa. PUC 552, 621-23 (1990). Under the ALJ's recommendation, PGW's residential customers will see an increase in their customer charge since last year at this time of nearly \$4.00 per month, from \$8.00 to \$12.00. Although the OCA acknowledges that the bulk of this residential customer charge increase was implemented as part of the Settlement between Law Bureau and PGW in the Interim Rate Case, it must be recognized that the rates resulting from that Settlement were designed to recover one year's worth of revenue increase in less than six month's time. OCA St. 2 at 14. Under the Settlement, the customer charge was set at a level of \$11.66 per month. This rate, however, was not designed to reflect direct customer costs or other ratemaking principles, but was designed to allow recovery of the rate increase in a shortened time frame.

When direct customer costs are analyzed, as well as the principles of gradualism applied, the OCA submits that a residential customer charge of no more than \$11.50 per month should be implemented. As can be seen in ALJ Finding of Fact No. 42, the average residential customer charge for the seven largest natural gas companies in Pennsylvania is \$10.35 per month. R.D. at 14; OTS Exh. 2, Sch. 5. A residential customer charge of \$12.00 per month for PGW customers is out of line with this statewide average. If

anything, PGW's customers, who have experienced significant rate increases over the past year and have paid for such rate increases in a shortened time frame, should see their customer charge reduced to a level more representative of direct customer costs. The OCA submits that its proposed customer charge of \$11.50 achieves this end.

For the reasons set forth in the OCA's Main Brief at 51 to 56 and the OCA's Reply Brief at 39-41, the OCA submits that the ALJ's recommendation should not be adopted. The OCA recommends that a residential customer charge of no more than \$11.50 be adopted.

EXCEPTION 7: The ALJ's Recommended Volumetric Charge Should Not Be Adopted (R.D. 79; OCA M.B. 56).

The ALJ adopted the OTS' recommendation to increase the residential volumetric commodity charge and retain the commodity charge at its current level for all other customer classes. R.D. at 79. This recommendation is based on the ALJ's adoption of a \$44 million rate increase, the OTS proposed allocation of this increase primarily to the residential class, and the adoption of a \$12 per month customer charge for the residential class. As set forth above, the OCA excepts to these recommendations which form the basis of the residential commodity charge. As such, the OCA excepts to the resulting commodity charge.

In this case, the residential commodity charge will be a function of the level of rate increase awarded, the volumes adopted, the allocation of that rate increase to each customer class, and the determination of the appropriate customer charge. If the OCA's recommendations in this proceeding are

adopted, the residential commodity charge should be \$6.559 per Mcf instead of the \$7.0051 per MCF recommended by the ALJ.¹⁴ R.D. at 79.

The OCA would note that the ALJ also adopted the OCA's and OTS' recommendations that electricity costs and bad debt expense that are currently recovered in the GCR be collected through base rates. R.D. at 83, 112. The OCA submits that this recommendation must be accounted for when designing the resulting base rate commodity charge.¹⁵ See, OCA St. 2 at 17-21.

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief at 56, the OCA's proposal regarding the residential commodity charge should be adopted.

EXCEPTION 8: The ALJ Erred In Not Recommending That The Gas Costs Contained In Base Rates Be Rolled Out To The GCR (R.D. 79-83; OCA M.B. 56-57).

The OCA recommended in this proceeding that the gas costs which are currently part of the base commodity charge be removed from base rates and reflected in the Gas Cost Rate (GCR) since these costs represent a cost of gas. The OCA presented this recommendation in connection with its discussion of the removal of non-gas costs from the GCR. OCA St. 1 at 49. The ALJ discusses this recommendation at page 82 but does not make a specific recommendation in this regard. R.D. at 79-83. The OCA submits

¹⁴ The ALJ notes that the OCA proposes a residential commodity charge of \$10.3895 while she adopts a residential commodity charge of \$7.0051. The \$10.3895 charge recommended by the OCA includes the test year GCR charge of \$3.8336 per Mcf. The ALJ's discussion focuses on the base rate excluding the GCR charge. If the GCR is excluded from the rate recommended by the OCA to compare with the ALJ's recommendation, the OCA's recommended commodity charge is \$6.559 per Mcf. OCA St. 2, Exh. 2-B, Table REM-1. The test year GCR charge of \$3.8336 per Mcf is that contained in the Company's presentation. Exh. HSG-1, Sch. 4A and 5A; OCA St. 2 at 11-12, 16-17.

¹⁵ The OCA also recommended that the gas costs included in base rates be rolled out to the GCR as part of this proceeding. The ALJ did not address this issue and the OCA excepts below. If this recommendation is accepted, the removal of the gas costs from base rates must also be incorporated into the design of the base commodity charge.

that all gas costs are more properly collected in the GCR charge, not the base rate commodity charge. These costs can be removed from the base rate commodity charge and included in the GCR in the final design of the commodity charge. This change should be effectuated in this proceeding. The correct amount to be rolled out of base rates is \$3.1638 per Mcf. This rate is the current base cost of gas of \$3.18 per Mcf minus the \$0.0162 per Mcf for the cost of purchased electricity included in the GCR at present rates. OCA St. 2 at 18-20, Exh. 2-B, Table REM-1. See also, OCA M.B. at 56-57.

EXCEPTION 9: The ALJ Erred In Making Significant Tariff Changes To Transportation Tariffs While Deferring Other Rate Structure Issues To The Restructuring Proceeding (R.D. 89-104).

At pages 89-104, the ALJ recommends adoption of significant tariff changes proposed by PICGUG. These tariff changes are proposed as modifications of PGW's current transportation requirements and are intended to allow for greater transportation on PGW's system. The ALJ adopts PICGUG's recommendation to permit transportation customers to aggregate facilities served by multiple accounts, to expand buyer's group to a maximum of ten individuals, to permit transportation customers to make intra-day nomination, and to require PGW to provide daily imbalance information to transportation customers. The OCA submits, however, that these recommendations may be premature, particularly in light of the ALJ's recommendation to defer other issues, such as issues regarding the recovery of senior discount costs and universal service program costs through the GCR, to the restructuring proceeding. R.D. at 84-87.

The ALJ's recommendation to adopt PICGUG's proposed tariff changes is intended to enable more large customers of PGW to transport natural gas. In so doing, however, these customers will no longer be subject to PGW's GCR. In other words, the customer will be able to bypass the GCR. For

PGW, however, the GCR recovers more than just gas costs. Indeed, PGW's *current* GCR recovers bad debt expense, costs associated with its universal service programs, the cost of the senior discount, and the cost of purchased electricity.¹⁶ The OCA does not disagree with the ALJ that the treatment of these universal service program costs in the GCR should be taken up in the restructuring proceeding. The effect of the ALJ's decision to adopt the PICGUG tariff changes outside of the restructuring proceeding, however, is to allow customers to bypass many of these universal service costs. Such a result, for example, could be found to be inconsistent with Section 2203(6) of the Public Utility Code which requires that a natural gas distribution company's universal service program costs be recovered through a non-bypassable, competitively neutral mechanism. 66 Pa.C.S. §2203(6).

The OCA submits that these issues should be regarded as a whole in the restructuring proceeding, consistent with the ALJ's recommendation regarding other fundamental tariff and allocation issues. In this manner, the effect of increased transportation can be properly reflected in the tariffs and rates of PGW based on the outcome of the restructuring proceeding.

EXCEPTION 10: The ALJ Erred In Rejecting The OCA's Modifications To PGW's Proposed Changes To Its Non-Standard Rates (R.D. 87; OCA M.B. at 58-59).

In the R. D., the ALJ recommends that PGW be allowed to modify its tariff so that the Company can enter into individual contracts with commercial and industrial customers at negotiated prices and/or terms for an agreed upon period. R.D. at 88. The OCA suggested three modifications to the Company's proposal, but Judge Fordham rejects all three as being "too restrictive." R.D. at 88. The OCA submits,

¹⁶ Collection of the bad debt expense in the GCR will terminate on September 1, 2001 consistent with the settlement between PGW and Law Bureau. Under the ALJ's decision, the cost of purchased electricity will also be removed from the GCR.

however, that the three modifications proposed by the OCA are necessary to ensure that sales customers are not disadvantaged by any contracts entered into under this new tariff provision.

The OCA recommended three modifications to PGW's proposal. First, the OCA recommended that Section 2.3b on the negotiated rate should be modified so that it is identical to the provisions of PGW's interruptible rate schedules. The OCA's proposed language is as follows: "*[T]he negotiated rate(s) shall not be less than 110% of the incremental gas cost for gas sold under the negotiated contract plus an adjustment for all applicable taxes, as determined by the Company.*" OCA St. 2 at 26.

Second, the OCA recommended that an additional provision be added to ensure that PGW obtains a benefit of additional sales volume in exchange for any discounts below the interruptible rates otherwise available to the customer. The OCA recommended the addition of a minimum take or full requirements provision to accomplish this purpose. OCA St. 2 at 27.

Third, the OCA recommended a provision that is designed to prevent a customer from walking away from a negotiated price if gas prices fell below the negotiated price. Without such a provision, PGW may obtain long-term supply for the customer at a specified rate and then the customer could walk away, leaving PGW with the long term supply arrangement. The OCA recommended a provision that would make clear that PGW may use a specific gas source to determine the incremental cost of gas for the negotiated contract only if the contract includes a requirement for the customer to take or pay for 80% of the gas in that specific purchase. OCA St. 2 at 27.

The OCA submits that these modifications to PGW's proposal should be adopted. These modifications ensure that sales customers are not disadvantaged by any contracts entered into by PGW under this tariff provision.

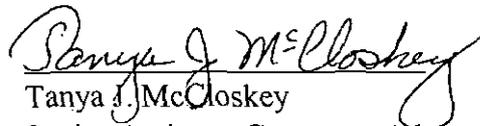
III. CONCLUSION

For the reasons set forth above and for the reasons set forth in the OCA's Main Brief and the OCA's Reply Brief, the OCA submits that these Exceptions should be granted. PGW should be awarded a rate increase of no more than \$10.5 million in addition to the \$11 million interim rate increase previously granted, subject to the following five conditions:

- PGW should be required to maintain at least a 1% replacement rate in its mains replacement program;
- PGW should continue its commitment to correcting the problems with the BCCS, particularly the need to rectify the budget billing problems;
- PGW should continue to work with the Commission to implement the recommendations as per the Philadelphia Gas Works Implementation Plan for the Stratified Management and Operations Audit;
- PGW should improve its customer service in a timely manner, particularly its call center performance; and
- PGW should continue its progress on its Transition to Excellence Plan.

Additionally, the OCA's recommendations regarding allocation of the rate increase, rate design and tariff changes should be adopted.

Respectfully submitted,


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Dated: August 22, 2001
65126

CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

Docket No. R-00006042

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

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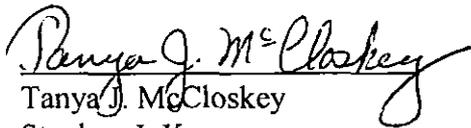
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01 AUG 22 PM 14:06
SECRETARY'S BUREAU

RE: Pennsylvania Public Utility Commission v. Philadelphia
Gas Works, Docket No. R-00006042

Dear Secretary McNulty:

On behalf of Philadelphia Gas Works, enclosed please find an original and nine copies of its Exceptions with regard to the above referenced matter. All parties of record have been served as evidenced by the attached Certificate of Service.

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

Very truly yours,

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

DC/lww
Enclosure

cc: Hon. Cynthia Fordham w/enc.
Office of Special Assistants w/enc. (and disk)
All Parties of Record w/enc.

DSH:28590.1

ORIGINAL

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility
Commission

v.

Philadelphia Gas Works

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Docket No. R-00006042

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APPENDIX A - Philadelphia Gas Works - Gas Service Tariff (pp. 113-127)

I. INTRODUCTION AND SUMMARY OF EXCEPTIONS

The Administrative Law Judge's ("ALJ") Recommended Decision, correctly recognized that Philadelphia Gas Works ("PGW") has a significant need for rate relief. However, the ALJ failed adequately to appreciate the completely unique circumstances and legal standards applicable to PGW. Such recognition is absolutely critical if PGW is to achieve financial stability and maintain its service improvement plan.

The decision failed to recognize completely that PGW is a unique entity with special financial considerations and a special ratemaking approach. Specifically:

- PGW's owner – PGW is owned by the City of Philadelphia and its citizens, which includes PGW's customers. Indeed, for all intents and purposes, PGW and Philadelphia are one and the same. PGW does not have shareholders who serve as a deep pocket to provide equity infusions. The City has limited resources, which it can only enhance by turning to its citizens.¹ Forcing the "City" to cover a PGW obligation forces the same set of citizens to bear that cost — either directly or indirectly.
- PGW's municipal status – On the other hand, PGW's status as a municipally-owned utility carries many benefits for ratepayers. A PGW- sponsored study showed that, if PGW were an investor-owned utility, its revenue requirement would be at least \$40-\$50 million higher than PGW has sought here.² This study showed that PGW's status and relationship to the City produces literally millions of dollars in savings due to the Company's access to tax exempt bonds and its exemption from various federal, state and local taxes and fees.³ But as a municipal, its revenue requirement is determined by the Cash Flow Method — the method used by most municipal utilities⁴ — which requires ratepayers to fund the Company's reasonable cash working capital needs as well as cover its annual operating and maintenance expenses and debt service coverage requirements.

¹ PGW St. 7.0 (Davis) at 4-5.

² PGW St. 6.0 (Lukens) at 17.

³ *Id.*; PGW St. 7.0 (Davis) at 3.

⁴ Tr. 497 (Sullivan).

- PGW's services – PGW offers a myriad of services which are not provided to customers of other utilities, including a senior citizen discount, one of the largest low income assistance programs of any utility, appliance repair services that require special resources, such as a blacksmith to make custom replacement parts for outdated furnaces, and eight district offices to provide easy community access for customers.⁵
- PGW's customers – PGW has an unusually high level of low income customers within its service area, including 150,000 people living at or below 150% of the poverty level.⁶ As a result, PGW historically has had high bad debt expense, in 7% - 9% range.
- PGW's location – PGW is the only utility in Pennsylvania with an all urban, completely city bound, service territory. Accordingly, PGW has less of an opportunity to attract new industrial customers and experiences increased costs associated with installing and replacing mains and facilities.⁷
- PGW's oversight – PGW, unlike other utilities, must serve no fewer than five masters: the PUC; its Board – the Philadelphia Facilities Management Corporation (“PFMC”); the City administration; the Philadelphia Gas Commission (“PGC”); and Philadelphia City Council. All of these regulatory or oversight bodies have the ability to impose mandates on PGW which have the potential to conflict with each other; e.g., OTS’ suggestion to eliminate the senior discount program and City Council’s mandate to maintain it.

Because of this unique status, when PGW was placed under PUC regulatory supervision, the General Assembly also mandated that PGW continue to have its rates set, not under the traditional standards in Chapter 13 of the Public Utility Code, but pursuant to its “prior ratemaking methodology and requirements.” While that prior standard required PGW’s rates to be “just and reasonable,” it used a methodology for determining a specific level of just and reasonable rates — the Cash Flow Method — that is different from that which is traditionally used by the PUC for most incumbent utilities. Why the difference? Because unlike investor owned utilities, PGW: 1) has no source of equity and pays not one dime of dividend or return to equity investors; and

⁵ Tr. 654; PGW St. 1.2 (Knudsen) at 3.

⁶ Tr. 654.

⁷ Tr. at 675.

therefore 2) must obtain 100% of its cash for operations and plant investments (through the repayment of bonds) from ratepayers. There can be no pretending that the City of Philadelphia is an equity investor with risk capital capable of meeting the emergent needs of PGW. It is not, and it cannot.

The ALJ's Recommended Decision also fails to recognize PGW's precarious financial situation. Several years of abnormally warm winter weather, combined with unprecedented hikes in gas costs in the winter of 2000-01, sent PGW into a financial crisis. The crisis was fueled chiefly by its need for cash to pay off its obligations to bondholders and gas suppliers and an unprecedented level of uncollectibles. While the crisis was relieved somewhat by the interim rate settlement approved by the PUC in February 2001, as well as the reduction in natural gas prices (most recently reflected in the proposal of PGW and the other parties to reduce its current GCR by an unprecedented \$171 million with a 20% reduction for residential customers), PGW's financial situation continues to be difficult.

Gas costs, while having mitigated, continue to be approximately 30% higher than in November 2000. PGW's financial advisor testified that the Company had more difficulty than ever before in issuing bonds and renewing its commercial paper this summer, and that the investment community was watching the regulatory developments to determine whether it would continue to give PGW the benefit of the doubt.⁸ Interim CEO Thomas Knudsen testified that PGW was a company "on the brink."⁹ He explained that the full \$65 million is needed to stabilize PGW's financial health, by reducing its outstanding short term borrowing, funding some portion of

⁸ Tr. 467-68.

⁹ Tr. 619.

the company's capital program through internally generated funds, and establishing minimally acceptable levels of end-of-year cash working capital.

At the same time, the full award will allow PGW to go forward with its efforts to systematically improve the safety and reliability of its system (through its main replacement and LNG refurbishment projects) and its customer service enhancements (through its efforts to improve call center responsiveness and reduce uncollectibility).¹⁰ While PGW has many unique aspects, it recognizes that ultimately, its service, safety and reliability must satisfy industry standards. As part of the effort to achieve that goal, the Company has committed to over \$16.5 million in force reductions and productivity savings¹¹ which are already built into its \$65 million revenue requirement request (and without which PGW's need for rate relief would be that much higher). Moreover, the Company has accepted virtually all of the recommendations of the PUC's management audit and is in the process of putting these improvements in place. Significantly, the Company's efforts and budget for implementing these steps have already been reviewed and acknowledged by its several reviewing bodies.¹² Accordingly, if the ALJ's recommendations are adopted hard choices will have to be made concerning the potential cut back or elimination of these essential programs and efficiency steps, threatening significantly all of its forward progress. The ALJ's implication, that PGW has overstated what it really needs to meet these goals simply

¹⁰ Tr. 619-22.

¹¹ PGW M.B. at 7.

¹² Before PGW ever filed its request it had to pass muster from several public representatives including the Administration. Its proposed budget — on which its rate request was based — was considered, and approved by the Philadelphia Gas Commission ("PGC") in an on the record, public process. The Company's full, \$65 million request is consistent with the determination of that body and the public policy priorities of the City of Philadelphia. There has been no cynical attempt to "game" the system.

fails to appreciate that this is not a case in which granting two-thirds of a utility's inflated request will be adequate. A granting of the entire request — or a substantial portion — is crucial if PGW is to continue the progress that it has been able to achieve to date.

Finally, the Recommended Decision failed to consider that PGW's base rate hike comes at a time when the Company, after suffering with ratepayers from the effects of the highest gas prices in the last twenty years, is in the process of reducing rates by unprecedented levels and agreeing to an early reduction in its GCR of \$135 million with an anticipated additional \$36 million likely on December 1.¹³ The result: if the PUC grants PGW's full base rate request, the average residential heating customer will see a decrease of over 16% (with similar reductions — over 15% — for commercial and industrial customers).¹⁴ The inevitable conclusion: the PUC may approve PGW's rate hike secure in the knowledge that it can stabilize PGW's financial health with no negative customer impact.

II. EXCEPTIONS

A. EXCEPTION NO. 1-- The ALJ Erred in Several Observations About the Applicable Ratemaking Method Even Though The Decision Implicitly Adopted the Cash Flow Method in Establishing PGW's Revenue Requirement.¹⁵

The Recommended Decision made only one, explicit affirmative finding with respect to the ratemaking standard: that rates set for PGW must be "just and reasonable."¹⁶ The ALJ claimed to "reject" PGW's alleged position that the Commission has no discretion in setting rates. In

¹³ Joint Petition for Complete Settlement, R-0016378 (PGW 2001-02 GCR) at ¶¶ 1 and 3.

¹⁴ See, PGW Statement in Support of Joint Settlement, R-00016378 (PGW 2001-02 GCR).

¹⁵ This Exception excepts to the following portions of the Recommended Decision: Section III.A.1.

¹⁶ R.D. at 109, ¶4.

response to PGW's evidence that the prior ratemaking methodology was the Cash Flow Method, the Recommended Decision stated simply, "PGW contends that the rates established pursuant to the Management Agreement and the Cash Flow Method are presumed to be just and reasonable. . . . The other parties correctly dismiss this proposition . . ."17 The ALJ also incorrectly asserted that PGW was insisting that the Commission was bound to accept whatever budgeted levels of revenues and expenses had been approved in its City budget approval process.18

At the same time, however, the ALJ adopted the revenue requirement recommendation of the OTS19 which explicitly utilized the Cash Flow Method in coming to its recommendations.20 A specific delineation of the appropriate standard is not absolutely necessary if the PUC continues to evaluate PGW's revenue requirement using the Cash Flow Method. But, a Commission clarification of these legal requirements would be helpful to eliminate potential future problems and to clearly signal to the investment community that the PUC intends to follow the dictates of the Public Utility Code.

To be clear, PGW never argued that the just and reasonable requirement did not apply to PGW rate setting or that the PUC was precluded from finding that specific elements of PGW's request were not just and reasonable. PGW's position was that:

- The Public Utility Code requires that, in setting rates for PGW, the PUC use PGW's prior ratemaking methodology and requirements. 66 Pa. C.S. § 2212(e).21

17 R.D. at 34.

18 R.D. at 22.

19 R.D. at 69.

20 OTS M.B. at 7.

21 The PUC has already made this precise finding in its Order approving the interim rate settlement:
(continued...)

- Decisions of the PGC and appellate law establish that PGW's prior overall ratemaking requirement was that its rates had to be just and reasonable.²²
- Those same decisions make clear that the prior ratemaking method (or formula) for setting just and reasonable rates for PGW was the Cash Flow Method, which instructs that PGW's rates be set to provide for reasonable allowances for each of the items set out in Section VII of the Management Agreement²³ (an ordinance of the City that established the ratemaking approach that was required by the PGC). The items identified in Section VII of the Management Agreement that are required to be covered by PGW's rates include expenses, debt service, the annual City payment, and a reasonable amount of cash working capital as determined by the Commission. The PGC gave effect to the just and reasonable requirement by exercising its discretion to determine the degree to which each revenue and expense item should be included in rates within a "zone of reasonableness."²⁴

²¹(...continued)

In regulating PGW, the Commission will comply with its statutory obligations under the Public Utility Code, including Section 2212(e) Section 2212(e) requires, *inter alia*, that the Commission, in determining PGW's revenue requirement and approving overall rates and charges, "follow the same ratemaking methodology and requirements that were applicable to [PGW] prior to the assumption of jurisdiction by the commission" and permit PGW to "impose, charge or collect rates or charges as necessary to permit . . . PGW to comply with its covenants to the holders of any approved bonds." 66 Pa. C.S. § 2212(e). In the Commission's judgement, authorization of the rate changes and cash reserves in the proposed settlement are consistent with our statutory obligations under Section 2212(e). . . ."

PGW v. Pa. PUC, R-00005654, Feb. 22, 2001 Opinion and Order at 7-8 and n. 1.

²² See *Public Advocate v. Philadelphia Gas Comm'n*, 674 A.2d 1056, 1062 (Pa. 1996); *Action Alliance of Senior Citizens of Greater Philadelphia v. Philadelphia Gas Comm'n*, 406 A.2d 1155, 1158 (Pa. Cmwlth. 1979); PGW Exh. JRB Rejoinder-2, 1982 Supplemental Opinion and Order at 5.

²³ PGW Exh. TEK-2 at 16 (Section VII).

²⁴ PGW Exh. JRB Rejoinder-2, 1982 Supplemental Opinion and Order at 9-10. As detailed by the PGC, this zone was created by a variety of factors affecting the parties' projections of the individual expense and revenue items. The PGC decided where to set each item within the zone by balancing the interests of customers and PGW. *Id.* As discussed *infra*, if rates are set using the Cash Flow Methodology — typically used by municipal utilities — the results are presumed just and reasonable. Importantly, this does not mean that any calculation offered by PGW which utilizes this method automatically must be accepted — only that if rates are properly established using the Cash Flow Method they are presumed to be just, reasonable and constitutional.

The ALJ repeatedly and incorrectly asserted that PGW's position was that the Commission must set rates pursuant to the Management Agreement Ordinance, and the Cash Flow Method detailed therein, "without the application of any ratemaking principles or law" and "without regard to whether the rates are just and reasonable."²⁵ However, PGW never made such an argument. PGW's position is not that ratemaking principles or law do not apply.²⁶ Rather, its position is that those principles and legal requirements, such as the just and reasonable requirement, are satisfied when the Commission utilizes the Cash Flow Method in the Management Agreement to set rates.²⁷ In other words, if rates are appropriately set using the Cash Flow Methodology, then that result cannot be ignored or modified on the ground that some other result would be "more reasonable" or "fair."

The decisions of the Philadelphia Gas Commission are indisputably the best source for determining what PGW's prior ratemaking method was and how it should be applied. Despite PGW's sponsorship of testimony and evidence, in the form of PGC decisions, defining the prior method and its application, the ALJ ignored this evidence. Instead, the ALJ cited a decision from a hearing examiner of the PGC on PGW's FY 2001 Operating Budget which was not adopted by the

²⁵ R.D. at 22.

²⁶ Indeed, PGW explicitly acknowledged that its rates had to meet the requirement of being just and reasonable. PGW M.B. at 12 and 16.

²⁷ The Pennsylvania Supreme Court found that rates set pursuant to the City of Philadelphia's ordinance adopting the Management Agreement were presumed to satisfy the constitutional requirement of being just and reasonable. *Public Advocate*, 674 A.2d at 1061. Similarly, the Gas Commission found that "the Cash Flow Method, comprised of all items contained in Section VII of said Ordinance/Agreement, is just and reasonable for rate-making purposes" PGW Exh. JRB Rejoinder-2, 1982 Supplemental Opinion and Order at 7.

Gas Commission.²⁸ Even so, the ALJ overlooked the most pertinent section of the hearing examiner's decision which in fact confirms that PGW's prior ratemaking method set rates to cover the expenses identified in the Management Agreement.²⁹

In order to clarify PGW's prior ratemaking method and the Commission's obligations under it and Section 2212(e) of the Code for future proceedings, the Commission should explicitly acknowledge that: (1) PGW's prior ratemaking requirement is that rates must be just and reasonable and the prior ratemaking method is the Cash Flow Method as described at Section VII of the Management Agreement; and (2) until all PGW's bonds are defeased, Section 2212(e) of the Code requires the Commission to set rates for PGW by following the Cash Flow Method and complying with Section VII of the Management Agreement.

²⁸ PGW R.B. at Appendix A.

²⁹ R.D. at 23 and Appendix A. The PGC hearing examiner described PGW's prior ratemaking method as follows:

Prior to the effective date of the Gas Choice Act, the Commission was obligated by Section VII of the Management Agreement to fix rates which will in each fiscal year produce revenues sufficient to pay all of PGW's operation and maintenance costs and expenses and the interest and amortization becoming due on PGW's debt (as detailed in Section VII ¶ 1(a)(i) through (v)). Moreover, rates must be set to produce revenues sufficient to make an annual payment of \$18 million to the City, to provide appropriations for prepayment of debt and capital additions approved by the Commission and City Council, and to provide cash working capital in such amounts determined necessary by the Company and approved by the Commission (as detailed in Section VII ¶ 1(b)(i) through (iii)). This rate-setting obligation was transferred to the PUC effective July 1, 2000.

R.D. at Appendix A, p. 9 (emphasis added).

Ultimately, the Commonwealth Court has defined PGW's ratemaking methodology just as the Company has in this proceeding: the "tailoring [of PGW's rates] to anticipated need for cash." *Action Alliance*, 406 A.2d at 1156.

B. EXCEPTION NO. 2 -- The ALJ Erred by Finding that Section 1301 of the Public Utility Code Offsets Section 2212(e)'s Ratemaking Obligations and that there is No Presumption that Rates Set Pursuant to the Management Agreement/Cash Flow Method are Just and Reasonable.³⁰

In the face of “crystal clear” statutory language³¹ and a directly on point Pennsylvania Supreme Court decision³² to the contrary, the ALJ found that the requirements of Section 2212(e) of the Public Utility Code were “offset” by the general terms of Section 1301 and that no presumption exists that rates set pursuant to the Management Agreement’s Cash Flow Method are just and reasonable.³³ This was error.

The traditional requirement that PUC-regulated utility rates be just and reasonable resides in Section 1301 of the Code.³⁴ The ALJ found that Section 1301 “offsets” the Commission’s obligations under Section 2212(e) of the Code. Section 2212(e) of the Code requires the Commission to set PGW’s rates by following its prior ratemaking methodology as well as the requirement to ensure that PGW’s rates enable it to satisfy its bond covenants and unambiguously states that the PUC must adhere to these requirements “notwithstanding any other provision of this title to the contrary.”³⁵ Thus, by the clear and unambiguous language of the statute, Section 1301 cannot offset the Commission’s obligations under Section 2212(e) of the Code, and any position to

³⁰ This Exceptions excepts to the following portions of the Recommended Decision: ALJ Conclusions of Law Nos. 4 and 5; Section III.A.5 and 6.

³¹ *Common Cause/Pennsylvania v. Itkin*, 653 A.2d 1113, 1117 (Pa. Cmwlth. 1993) (describing language similar to Section 2212(e)'s “notwithstanding any other provision” language to be “crystal clear and free of ambiguity”).

³² *Public Advocate*, 674 A.2d at 1061.

³³ R.D. at 109, ¶¶ 4-5.

³⁴ 66 Pa. C.S. § 1301.

³⁵ 66 Pa. C.S. § 2212(e). The title is Title 66.

the contrary is plainly erroneous.³⁶ The plain meaning of “notwithstanding any other provision of this title to the contrary” is that the requirements placed on the PUC by Section 2212(e) are in fact paramount to any other provisions of Title 66, the Public Utility Code.³⁷ Therefore, the Commission must set PGW’s rates in accordance with its prior ratemaking method as demanded by Section 2212(e), and those rates will be lawful under the Public Utility Code.

Interestingly, while citing the portion of the Pennsylvania Supreme Court’s decision that refers to a constitutional just and reasonable requirement, the ALJ failed to cite and ignored the portion of that very same case that held that rates set by the Management Agreement Ordinance and its mandated Cash Flow Method for setting rates are presumed constitutional and just and reasonable. In *Public Advocate v. Philadelphia Gas Comm’n*, the Supreme Court declared: “Thus, it is presumed that rates set in accordance with the [Management Agreement Ordinance] are constitutional.”³⁸

Thus, the ALJ’s finding that “there is no presumption that rates set pursuant to the Management Agreement/Cash Flow Method are just and reasonable” is flatly wrong. Accordingly,

³⁶ 1 Pa. C.S. § 1921(b).

³⁷ See *Commonwealth v. Eddings*, 772 A.2d 956, 959-960 (Pa. 2001) (holding that a statutory provision “notwithstanding any other provision of this title or other statute to the contrary” was explicit language, and ignoring this language would “lead to absurd results”); *Common Cause/Pennsylvania v. Itkin*, 635 A.2d 1113, 1116-1118 (Pa. Cmwlth. 1993) (holding that a statute containing the phrase “notwithstanding any other provision” would be paramount, even if in direct conflict with another statutory provision, because the “notwithstanding” language was “crystal clear and free of ambiguity”); *Burrell School Dist. v. City of Lower Burrell*, 608 A.2d 605, 606 (Pa. Cmwlth. 1992) (where statutory provision explicitly stated that it applied “notwithstanding any other provision of the Act,” provision prevailed over a provision found in another statute); and *Borough of West Chester v. Taxpayers of Borough of West Chester*, 566 A.2d 373, 375-376 (Pa. Cmwlth. 1989) (finding that a provision “notwithstanding any other provision” was a special provision, and, pursuant to 1 Pa. C.S. § 1933, would prevail over a general provision within the same statute).

³⁸ *Public Advocate*, 674 A.2d at 1061.

PGW requests that the Commission reject the ALJ's Conclusions of Law Nos. 4 and 5, and explicitly find that: (1) the requirements of Section 2212(e) of the Code are paramount to any other provision of Title 66, including Section 1301; and (2) rates set by following PGW's prior ratemaking method, the Cash Flow Method in Section VII of the Management Agreement Ordinance, are presumed constitutional and just and reasonable.

C. EXCEPTION NO. 3 – The ALJ Erred by Overlooking the Evidence that PGW's End of Test Year Cash Flow Needs Will Only Be Satisfied By Implementation of PGW's Full, \$65 Million Request.

Despite the ALJ's implicit adoption of the Cash Flow Method to set rates for PGW,³⁹ the Recommended Decision completely overlooked the extensive record evidence showing that adequate end-of-test year cash working capital is produced only by implementation of the full \$65 million rate request. The PUC should therefore grant this full request whether or not it adopts the proposed pro forma revenues and expense adjustments suggested in the Recommended Decision.

The ALJ and the OTS's overall recommendation that PGW be permitted to increase its base rates by \$44 million (in excess of its pre-interim rate level) was determined by using the Cash Flow Method.⁴⁰ The Cash Flow Method specifically requires that PGW's rates be tailored to satisfy the Company's cash needs.⁴¹ But, both the ALJ and OTS erroneously concluded that a \$44 million rate increase would be sufficient to provide PGW with the level of cash it actually needs to pay its bills when they come due. As OTS admitted, the sufficiency of the rate award must be judged by whether the Company will have enough cash to pay its bills in each month of the

³⁹ See R.D. at 69 and 1001, ¶ 2; OTS M.B at 7.

⁴⁰ OTS M.B. at 7-8.

⁴¹ See, *Action Alliance*, 406 A.2d at 1156.

fiscal/test year, and also whether its cash balance at year end is sufficient to permit PGW to meet its obligations in the first four months of the next fiscal/test year.⁴²

PGW submitted testimony that it needed an end-of-year cash balance of \$35 - \$40 million to meet its cash flow requirements — needed by PGW to be able to pay its gas bills and debt service obligations in the first four months of the following fiscal year.⁴³ These end of year needs have become even more acute due to the increase in natural gas prices that PGW --- and the whole industry has experienced in the last year.⁴⁴ But, the OTS \$44 million recommendation would only produce between \$9.2 million and \$14.7 million (as corrected)⁴⁵ in end-of-year cash, even assuming the validity of all of OTS' pro forma adjustments.

Additionally, OTS's claimed levels of end-of-year cash were calculated assuming that all of the Staff's pro forma adjustments actually will come to fruition.⁴⁶ But, as detailed later in a

⁴² Tr. 747; PGW St. 1.0 (Knudsen) at 20; OTS Exh. 1, Sch. 2; St. 1-S (Weakley) at 2. The test year used by PGW was the 12 months ending August 31, 2001. PGW's cash obligations from September - December exceed revenues collected during that period (*See*, Tr. 594-596 and 611; PGW St. 1.0 (Knudsen) at 20). Unless the Company is able to utilize cash accumulated at the end of the prior period it will simply not be able to pay its bills when due.

⁴³ PGW M.B. at 23.

⁴⁴ While PGW's 2001-02 GCR is going down, PGW's cash flow analysis was based not on the GCR level it actually experienced in 2000-01 but in a pro forma level reflection of going forward conditions. PGW St. 1.0 (Knudsen) at 8-9. That pro forma level of gas costs was very close to PGW's projected GCR level. Projected total GCR rate at December 1, 2001, including gas costs in base rates: \$6.78, (of which approximately 5% are gas costs); total cost of gas assumed in PGW pro forma budget/test year: \$6.78/Mcf, OTS St. 2 at 24.

⁴⁵ In surrebuttal, OTS claimed that when the \$18 million interim rate increase was considered in addition to OTS' \$33 million recommendation, the total end-of-year cash flow was \$21.7 million. OTS St. 1-S at 2. But, Mr. Weakley incorrectly assumed that PGW would continue to collect in base rates the full \$18 million interim increase over and above whatever the PUC awards here; in fact, only \$11 million is in the base rates. PGW R.B. at 26-27. Hence, OTS end-of-year cash is only \$14.7 million, not \$21.7 million as OTS has claimed.

⁴⁶ OTS Exh. 1, Sch. 1; Tr. 745-46.

separate exception, its largest dollar adjustment — an increase to pro forma revenues because of a claimed \$12 million increase in annual sales revenues (net of additional gas costs) has no chance of actually occurring. If these additional revenues do not materialize, PGW's cash flow will be near zero or negative (\$12 million minus \$9.2 – \$14.7 million) just when it needs a reserve of cash to make gas purchases critically needed to keep costs down and maintain reliability.

Finally, neither the Company's analysis, nor the OTS revision took into account the late-filed evidence that PGW's short-term line of credit, while renewed for another year, was continued on the condition that PGW will pay down at least \$20 million of its line by the end of August, 2002.⁴⁷ This will create additional needs for cash working capital from internal sources, further justifying the need to permit PGW to satisfy its pro forma target.

As noted, Mr. Knudsen carefully explained the total level of year ending cash from all sources needed by the Company to be able to sustain itself was \$35 - \$40 million. No party disputed the \$35 - \$40 million with any empirical or other evidence. It was also undisputed that on a pro forma basis, the OTS's recommendation would not produce this needed level and only the full, \$65 million rate increase would get PGW anywhere near its target.⁴⁸ Even at the full \$65

⁴⁷ PGW St. 2.2 (Bisgaier); PGW Exh. BB-3.

⁴⁸ The only response that any party made to PGW's testimony was the claim that PGW historical end-of-year cash levels had not reached these targets. OCA St. 1.0 (Lelash) at 22-23; OCA M.B. at 27. The fact that historical end-of-year cash levels have not reached this current target is no more relevant than the fact that historically investor-owned utilities would rarely actually earn their cost of equity. Moreover, when the historical year end cash balances were realized, PGW still had short-term commercial borrowing capability. PGW has no such capability at the present time; its commercial paper line of credit is 100% utilized. The OCA also attempted to refute PGW's evidence by pointing to PGW's projection of its actual FY 2001 end-of-year cash balance (OCA St. 1.0 (Lelash) at 22), completely ignoring the fact that this actual balance contains the effects of the City's \$45 million emergency loan and gas purchase deferrals made in 2001 to conserve cash. Tr. 585-86. It also failed to consider PGW's new obligation to pay down its outstanding commercial paper balance by August, 2002.

million, PGW's end-of-year cash would fall well short of these appropriate targets.⁴⁹ Therefore, it was error for the ALJ to establish PGW's revenue requirement at less than \$65 million.⁵⁰

1. The ALJ Erred By Failing to Recognize That the Full Rate Request Must Be Granted to Permit PGW to Satisfy All of Its Bond Covenants.

The full, \$65 million rate increase request is also necessary to enable PGW to meet all of its bond covenants, and as such, the Commission is required by the Public Utility Code to allow the full request, again notwithstanding whether the PUC adopts all of the ALJ's recommended pro forma adjustments. The ALJ's dismissal of this legal requirement was serious error.

The Public Utility Code requires the PUC to "permit [PGW] to impose, charge or collect rates or charges as necessary to permit [PGW] . . . to comply with its covenants to the holders of any approved bonds."⁵¹ As the Commission recognized in its February 22, 2001, Interim Rate Settlement Order (adopting a settlement between PGW and the PUC Law Bureau), PGW must comply with the following bond covenants;

- (1) a covenant that requires PGW to maintain funds that are 150% of its annual debt service obligation [debt service coverage covenant];
- (2) a covenant that requires PGW and its owner, the City of Philadelphia, to charge rates that permit PGW to have sufficient cash to pay all of its obligations, including its debt service obligation, during each fiscal year in full when they are due [rate covenant]; and

⁴⁹ PGW M.B. at 30.

⁵⁰ Even if the PUC grants the full rate request, as is justified by the evidence, PGW's end-of-year cash balances will fall short of the target, but the Company will be much closer to satisfying its total cash working capital needs.

⁵¹ 66 Pa. C.S. § 2212(e). While Section 2212(e) provides an, explicit direction to ensure that PGW has sufficient revenues to satisfy its bond covenants, the PUC should note that the prior ratemaking method, the Cash Flow Method embodied in Section VII of the Management Agreement, also required that PGW's rates be set to allow PGW to comply with its bond covenants. PGW St. 1.0 (Knudsen), Exhibit TEK-2 (Management Agreement) at Section VII(1)(a)(v).

(3) a covenant that requires PGW and the City to continuously maintain and operate the Gas Works.⁵²

The Recommended Decision, however, failed to recognize that the full, \$65 million is needed if PGW is to have “sufficient cash to pay all of its obligations, including its debt service obligation during each fiscal year, in full when they are due.” As discussed above, a \$44 million rate award simply does not satisfy this standard because it would leave PGW woefully short of cash at the end of fiscal year 2000-01 (August 31, 2001), such that it will be in real danger of not having sufficient cash to meet its obligations during the pre-winter storage injection and gas buying season.⁵³

No party disputed the need to permit PGW the opportunity to satisfy its bond covenants,⁵⁴ but several claimed that PGW’s obligation somehow could be met with revenues derived from sources other than ratepayer funding and the ALJ appeared to adopt this argument.⁵⁵ But, in the last several months, the Company has called upon every source available to it to obtain additional cash including the reimbursement of construction costs from bond proceeds,⁵⁶ the borrowing of the

⁵² See *Pa. PUC v. PGW*, R-00005654, Opinion and Order of February 22, 2001 at ¶ 1; Joint Petition for Full Settlement at ¶ 10. The above is virtually a verbatim quote from the Joint Petition for Settlement entered into between the PUC Law Bureau and PGW. The Commission’s February 22, 2001 Order (Ordering Paragraph No. 1) specifically adopted and approved “each and every term” of the Joint Petition for Settlement.

⁵³ See PGW M.B. at 38-39.

⁵⁴ See Tr. 748 (Weakley); OCA St. 1-S (Lelash) at 15.

⁵⁵ R.D. at 29-31. This argument, mainly propounded by OCA and CEPA in relation to the City, was also rejected by the PGC, and therefore cannot be part of PGW’s prior ratemaking method. PGW Exh. JRB Rejoinder-2, 1982 Executive Summary at 5 (Public Advocate argues that cash working capital should not be funded through rates, but rather by borrowing from City or outside sources); 1982 Supplemental Opinion and Order at 7 (rejecting argument).

⁵⁶ In the midst of its cash flow crisis last winter, the Company also implored City agencies to
(continued...)

maximum amount from its commercial paper program, and a \$45 million, temporary loan from the City.⁵⁷ The only other “source” of funds conceivably available to offset a greater rate increase would be to force PGW to forego making its City payment. But the ALJ properly found that the Commission may not legally make up PGW’s revenue requirement by ordering it to forego the City payment.⁵⁸ The Public Utility Code mandates that this legitimate charge⁵⁹ must be included in rates.⁶⁰

Likewise, the Public Utility Code requires that the PUC permit PGW to “charge or collect rates” necessary to permit it to meet its bond covenants. The evidence establishes unequivocally that PGW needs the full \$65 million rate increase to satisfy its bond covenant requiring it to have sufficient cash on hand to pay its obligations when they come due. The Recommended Decision’s failure to recognize this legal obligation must be reversed.

2. The ALJ Erred By Failing to Accept the Findings of an Independent Engineering Report to Bondholders.

Finally, the ALJ further erred by failing to accept the results of an independent study, conducted in conjunction with PGW’s most recent bond issuance, which verified that PGW had a need for substantial rate relief over the next five years. The independent engineering firm of Black and Veatch prepared a report to potential bondholders on PGW’s financial situation to advise them

⁵⁶(...continued)

partially pre-pay their gas bills and delayed gas pipeline demand charge obligations. *See* PGW St. 7.0 (Davis) at 2; PGW St. 1.0 (Knudsen) at 12.

⁵⁷ PGW M.B. n. 95.

⁵⁸ R.D. at 28-29 and 110, ¶5.

⁵⁹ The PUC’s own Management Audit found this charge to be reasonable. Administrative Counsel Attach. No. 1 at X-12.

⁶⁰ 66 Pa. C.S. § 2212(f).

in connection with purchasing PGW's bonds. The conclusion of this independent analysis was that PGW's finances were adequate to satisfy its obligations to bondholders, but only if PGW was able to raise its rates by an average annual amount of \$53 million (over and above the pre-interim rate levels).⁶¹ The report indicated that an increase of at least that amount was needed to meet crucial financial goals, including the pay down of its fully maxed commercial paper program, the funding of capital construction partially from internally generated funds (as opposed to the present, 100% external financing situation) and the establishment of an adequate level of working capital. The sponsor of the report indicated that an award that was higher than \$53 million in 2001 would allow PGW to meet these key financial goals slightly sooner than the five year time frame assumed in the report.⁶²

The ALJ dismissed the Engineering Report findings claiming that "since the engineering report did not consider the just and reasonable standard or balance the interests of the ratepayers against the Company's financial needs, it cannot be used to prescribe the amount of rate relief required."⁶³ This misstates the significance of the Engineering Report. First, it clearly constituted independent verification that PGW had a significant revenue requirement — well in excess of the \$44 million recommended by the ALJ — chiefly driven by the Engineering Report's recognition of PGW's substantial cash working capital requirement and its need to meet current and longer term goals.⁶⁴

⁶¹ PGW St. 8.0 (Sullivan) at 2-3; PGW Exh. TJS-2 at B-44.

⁶² PGW Exh. TJS-2 at B-44.

⁶³ R.D. at 35.

⁶⁴ PGW Exh. TJS-2 at B-44. The ALJ's focus on the Report being used to "prescribe" rates is misplaced. The Report is evidence of PGW's revenue needs. As evidence, the Report and Mr.

(continued...)

Second, and just as important, the Engineering Report was circulated to investors and reflects their expectations and assumptions about future rate levels.⁶⁵ PGW was able to issue bonds and renew its commercial paper in June of this year in significant part because of the assurances made in the Engineering Report.⁶⁶ PGW's financial advisor was able to testify on the basis of first-hand experience, that, relying on this report, investors presently are giving PGW "the benefit of the assumption."⁶⁷ If those assumptions do not come to fruition, the evidence is that PGW will not be able to enter the financial markets in the future on reasonable terms, a result that, at best, would significantly increase costs to customers and further shake PGW's financial viability.

The ALJ misconstrued this evidence and overlooked the fact that all utilities have a right to rate levels that permit them to attract and maintain capital⁶⁸ — and PGW is no exception. Indeed, PGW's prior ratemaking method required that such access to capital be maintained.⁶⁹ As indicated previously, PGW's continued ability to attract capital will depend on whether or not it can satisfy investor expectations. Investors willing to lend PGW funds buying its long-term bonds rely on these reports to make their investment decisions. Investor expectations are reflected in the Engineering Report. The Engineering Report, therefore, clearly represented the minimum level of

⁶⁴(...continued)

Sullivan's testimony are no less probative in weight than testimony of the other experts.

⁶⁵ PGW M.B. at 37; Tr. 466-67.

⁶⁶ See, Tr. 466-68.

⁶⁷ *Id.* at 468.

⁶⁸ Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944).

⁶⁹ PGW Exh. JRB Rejoinder-2, 1982 Opinion and Order at 18.

rate award that the Commission can reasonably award here and still adhere to PGW's prior ratemaking requirements, its bond covenants, as well as to maintain the Company's access to financial markets.

D. EXCEPTION NO. 4 -- The ALJ Erred by Granting OTS' Recommendation to Increase the Average Annual Usage of PGW's Residential and Commercial Heating Customers to Levels Which the Evidence Showed the Company Had Never Before Experienced.⁷⁰

The ALJ granted a revenue adjustment proposed by OTS, significantly reducing PGW's revenue requirement, based upon its position that the Company's firm sales to residential and commercial heating customers will increase by 7%, or 4.2 Bcf, based on actual year 2000 data.⁷¹ In so doing, the ALJ ignored testimony from PGW that it has never experienced a 7% annual increase in firm sales.⁷² Moreover, under design day peak demand conditions, the ALJ's recommended increase would constitute a 14% increase. PGW would not even have the capacity contracts and storage available to accommodate the ALJ's recommended increase under design conditions.⁷³ The ALJ's recommendation is further belied by the fact that PGW's residential usage has actually decreased by 10% per customer per year since 1984.⁷⁴

The ALJ also repeated the error of OTS in relying on actual 2000 data which, she claimed, was required because PGW acknowledged that it corrected certain billing discrepancies during that

⁷⁰ This Exception excepts to the following portions of the Recommended Decision: Ordering Paragraph No. 6; Section III.B.3.

⁷¹ R.D. at 39-50 and 111, ¶ 6.

⁷² Tr. 551.

⁷³ *Id.*

⁷⁴ Tr. 551.

year.⁷⁵ However, once again, the ALJ failed to consider PGW evidence that, even though the billing system was substantially remedied in 2000, PGW's data collection system did not produce accurate ancillary reports in 2000, which were the source of the data used by OTS for its adjustment.⁷⁶ Thus, OTS' proposed increases, and consequently the ALJ's adopting thereof, are plainly based on faulty data.⁷⁷

In contrast, PGW's proposed average customer usage was based on an extremely accurate model that projected sendout for the period of November 2000 through March 2001 within 2% of the actual sendout.⁷⁸ The ALJ, as did OTS, failed to understand PGW's model, suggesting that PGW compared sendout to sales.⁷⁹ The ALJ is simply not correct. PGW's model projected sendout — which was gathered from PGW's nine (9) city gate stations and verified by the pipeline's data as opposed to the ALJ and OTS' reliance on readings from some 520,000 meters — and then applied a percentage of unaccounted for gas in order to get the estimated sales.⁸⁰ PGW

⁷⁵ R.D. at 42.

⁷⁶ Tr. 553-54; PGW St. 4.1 (White) at 4-5.

⁷⁷ Comparisons of billings to sales for the period ending February 2001 evidenced this inaccuracy, and even reflected months as having negative sales. PGW Exh. CW-R-1; PGW St. 4.1 (White) at 4. The evidence also showed that application of estimating factors to year 2000 data, which normally produced results within 5-6% of actual data, resulted in a 30% variation. Tr. 553-54.

⁷⁸ PGW St. 4.1 (White) at 2-3; Tr. 548-50.

⁷⁹ R.D. at 43.

⁸⁰ The ALJ suggests that PGW's calculations were not substantiated. R.D. at 43-45. This suggestion simply repeats OTS' strawman attacks on PGW's model and data, which suggested that the Company had created some mystery about how it arrived at its numbers. OTS M.B. at 17, 19-20. To the contrary, PGW set forth its data in its initial filing. OTS and the parties were free to request any additional information they desired. PGW then verified that data on rebuttal, identifying the factors and inputs and stating that they remained constant (admitted by OTS at page 15 of its Main Brief).

then verified this projection by comparing the projected sendout with the actual sendout for November 2000 through March 2001 and was accurate within 2%.⁸¹

Given the high degree of accuracy of PGW's sales forecast, and the fact that the evidence clearly contradicted the ALJ's recommended 7% increase in pro forma sales an increase PGW has never historically experienced, the PUC must reject the ALJ's recommendation to increase usage by residential and commercial heating customers and her corresponding \$34 million increase in pro forma revenues. (With offsetting of \$20.479 million additional gas costs, the net decrease to PGW's revenue requirement is \$13.784 million).⁸²

E. EXCEPTION NO. 5 -- The ALJ Erred by Finding That PGW's Residential and Commercial Customer Counts Should Be Increased as Proposed by OTS.⁸³

Based on a recommendation by OTS, the ALJ also recommended an increase of 11,189 in the number of PGW's residential heating customers and of 51 in the number of commercial heating customers with a corresponding increase in pro forma revenues.⁸⁴ In so doing, the ALJ incorrectly stated that PGW "concurred that additional customers should be added."⁸⁵

PGW has never concurred that additional customers should be added to its pro forma revenue calculation. Instead, the Company's witnesses explained that PGW's new billing system

⁸¹ Tr. 548-50 and 573. Sales during this time period represent 72% of PGW's firm sales, the vast majority of which are weather sensitive. Tr. 687. Thus, the period provides an appropriate sample on which to test the accuracy of PGW's model.

⁸² See OTS St. 2.0 (Kubas) at 19-24. However, as detailed in Exception No. 10 and n. 82, these figures are based on PGW's cost charges, which the ALJ did not recommend.

⁸³ This Exception excepts to the following portion of the Recommended Decision: Ordering Paragraph No. 6; Section III.B.3.

⁸⁴ R.D. at 50 and 111, ¶ 6.

⁸⁵ R.D. at 50.

is able to more accurately determine the number of customer charge billings by ensuring that each meter carries a customer charge.⁸⁶ PGW has not suddenly found some 11,000 residential heating customers — it is now simply able to more accurately bill customer charges for all customers. Obviously, such a revision, which PGW itself agreed should be made, only increases pro forma revenues for additional customer charges — not additional sales.⁸⁷ Thus, the Commission must reject the ALJ's recommendation that the OTS' adjustment be granted. Instead, and at most, only the \$1.54 million in increased revenues identified by PGW as appropriately tied to the additional customer charge billings should be included in pro forma revenues.⁸⁸

F. EXCEPTION NO. 6 -- The ALJ Erred by Ignoring the Evidence and the Requirements of Section 2212(e) and Allowing PGW Only \$61.1 Million in Bad Debt Expense.⁸⁹

In endorsing OTS' proposed bad debt expense allowance, the ALJ ignored the Commission's obligations under Section 2212(e) as well as the evidence. The ALJ found it

⁸⁶ Tr. 555.

⁸⁷ The ALJ compounded her error of accepting OTS' faulty customer counts by then assigning additional revenues to PGW based on the erroneously increased usage of these phantom customers that do not really exist. The ALJ's recommendation was made despite the proven accuracy of PGW's usage forecasting model and the evidence of a real decrease in residential usage since 1984. Thus, of OTS' total \$34 million increase in pro forma revenues, at most \$1.54 million in additional customer charges is appropriate.

⁸⁸ During the proceedings below, PGW indicated it would accept a nearly \$2 million increase in projected revenues based on the additional 9,709 meters to which a residential customer charge and 700 meters to which a commercial customer charge would be assigned. PGW St. 4.1 (White) at 7. However, the \$2 million figure was based on the granting of PGW's proposed \$15 and \$25 residential and commercial customer charges. The ALJ only recommended a \$12 and \$18 customer charge for those classes. R.D. at 110, ¶ 3. Accordingly, the amount of appropriate additional revenues would be reduced. Ultimately, PGW's revenue request still should not be reduced because the end of year cash balances produced by the full \$65 million increase are already at barely minimal levels.

⁸⁹ This Exception excepts to the following portions of the Recommended Decision: Ordering Paragraph No. 10; Section III.B.4.c.

“important to note” that OTS utilized the traditional method used for other, investor-owned utilities, in determining PGW’s bad debt expense.⁹⁰ However, PGW is not an investor owned utility nor is it like other utilities due, among other things, to its service population comprising of 150,000 people who live at or below 150% of the poverty level. While the analysis adopted by the ALJ may be common in proceedings involving investor-owned utilities, PGW’s prior ratemaking method governs here.⁹¹ The evidence showed that given the demographics of the population served, PGW has traditionally had high levels of uncollectible. This level then is significantly affected by increases in gas costs — as the Company experienced last winter.⁹² Using investor owned utilities with dissimilar demographics’ historical averages to determine a reasonable level of bad debt expense results in completely unreasonable results.

The ALJ’s decision also gives short shrift to other evidence in the record which clearly supported a bad debt expense of at least \$65 million, as proposed by the Company. Indeed, even the OCA recommended that the Company’s bad debt expense be increased to nearly \$72 million. The ALJ dismisses OCA’s recommendation, suggesting that OCA was incapable of analyzing bad debt expense and asserting that it was the only party to suggest an increase.⁹³ The ALJ could just as easily have observed that OTS was the only party to suggest decreasing PGW’s proposal. In

⁹⁰ R.D. at 59.

⁹¹ The ALJ states that PGW’s proposed \$65 million bad debt expense is “not substantiated.” R.D. at 61. Nothing could be more incorrect. PGW’s figure is substantiated by its prior ratemaking method and requirements. 66 Pa. C.S. § 2212(e). See PGW M.B. at 28-29.

⁹² While the settlement of PGW’s 2001-02 GCR proceeding will mitigate the extraordinarily high level of gas costs of last winter, the level projected for December 1, 2001, \$3.60/mcf (plus \$3.18/mcf in gas rates), is consistent with the level of natural gas costs assumed by the Company in its pro forma revenue, expense and cash flow projection. See, OTS St. 2 at 24. (Average cost of gas per Mcf assumed in PGW pro forma test year calculations: \$6.78.

⁹³ R.D. at 61.

addition, the ALJ's recommendation to accept OTS' \$61.1 million bad debt expense is contradicted by the following evidence from the record:

- None of the five years utilized by OTS to calculate its bad debt ratio, is representative of current conditions in which PGW faces arrearages at a level of 40% of all customers and accounts receivable of over \$200 million.⁹⁴
- OTS' bad debt ratio of 7.6% was far off of the actual bad debt percentage for the 1999-2000 total gas revenues, which was 10.2%.⁹⁵ This level was verified as accurate by an independent audit.⁹⁶
- Applying OTS' bad debt ratio to PGW's actual total gas revenues for 1999-2000 would leave PGW \$12 million short of its actual booked bad debt expense for that year.⁹⁷
- The Philadelphia Gas Commission's approval of the FY 2001 budget for PGW ratifies the reasonableness of PGW's proposed \$65 million bad debt expense because it allows the Company nearly \$68 million in bad debt expense.⁹⁸

These facts clearly show that the ALJ's recommendation on bad debt expense is outside of the "zone of reasonableness" and contrary to law.⁹⁹ Therefore, the PUC must reject it, and grant PGW's proposed \$65 million bad debt expense. (This results in an increase to the ALJ's proposed revenue requirement of \$3.872 million).

⁹⁴ Tr. 754-55.

⁹⁵ Tr. 757-58.

⁹⁶ *Id.*

⁹⁷ Tr. 758-59.

⁹⁸ PGW Reply Brief at Appendix A. The PGC hearing examiner's recommended decision, upon which the ALJ relies in other instances and which is attached to the Recommended Decision, contained the nearly \$68 million bad debt expense allowance. R.D. at Appendix A, p. 31.

⁹⁹ See PGW Exh. JRB Rejoinder-2, 1982 Supplemental Opinion and Order at 9-10.

G. EXCEPTION NO. 7 -- The ALJ Erred by Disallowing \$100,000 of PGW's Rate Case Expense Incurred in Conjunction with the Testimony of the Lukens Energy Group, Inc.¹⁰⁰

The ALJ recommended that PGW be denied \$100,000 in expenses incurred as part of its rate case expense in relation to the testimony of Jay Lukens, of the Lukens Energy Group, claiming that the expense and the testimony was "not necessary."¹⁰¹ The Lukens testimony examined the benefits to ratepayers that PGW's municipal status and ratemaking provide compared to the methods employed for investor-owned utilities and found that PGW's rates would be \$40 - \$50 million higher if it were investor-owned.¹⁰² As such, it was a reasonable expense and helped to create a context for part of PGW's claims. Moreover, generally, the proponent of a rule or order is permitted to present its case as it sees fit.

H. EXCEPTION NO. 8-- The ALJ Erred by Disallowing PGW's Lobbying Expenses of \$115,000 and Reducing its Proposed Promotional Expenses.¹⁰³

1. Lobbying Expense.

In disallowing PGW \$115,000 worth of lobbying expenses, the ALJ relied solely on past PUC precedent which found that such costs cannot be recovered through rates.¹⁰⁴ However, all of the cited cases were decided under Chapter 13 of the Public Utility Code. Pursuant to Section 2212(e), those precedents are not applicable in this proceeding -- PGW's prior ratemaking

¹⁰⁰ This Exception excepts to the following portions of the Recommended Decision: Ordering Paragraph No. 7; Section III.B.4.a.1.

¹⁰¹ R.D. at 54.

¹⁰² See PGW St. 6.0 (Lukens) at 17; PGW St. 3.1 (Bogdonavage) at 11.

¹⁰³ This Exception excepts to the following portions of the Recommended Decision: Ordering Paragraphs Nos. 9 and 11; Section III.B.4.b and 4.e.

¹⁰⁴ R.D. at 65-66.

methodology and requirements are what the Commission “shall” follow in setting the Company’s rates.

Turning to that prior methodology, historically the PGC has included lobbying expenses as a legitimate expense in rates.¹⁰⁵ Indeed, the PGC has budgeted for these expenses in PGW’s FY 2001 budget and this amount was approved by the PGC.¹⁰⁶ At the relatively modest amount of \$115,000, the PGC has regularly found these lobbying expenses to be within the zone of reasonableness, and therefore just and reasonable. Accordingly, the PUC must reach the same conclusion.

2. Promotional Expense.

The Commission should also reject the ALJ’s limitations on PGW’s promotional expenses. The ALJ, as well as OTS whose recommendation she adopted, recognized that promotional expenses are an appropriate expense for PGW to recover through rates because the Company lacks the ability to flex its rates.¹⁰⁷ The ALJ also acknowledged that PGW’s promotional efforts to attract new and expanded load benefitted all of its customers and produced a positive return for the Company.¹⁰⁸ Furthermore, the PGC, while administering PGW’s prior ratemaking method, allowed for the recovery of these expenses through rates.¹⁰⁹

The sole basis for the ALJ’s reduction of PGW’s proposed promotional expenses was that the Company did not spend the full, budgeted amounts in the prior two (2) years during which the

¹⁰⁵ PGW St. 3.1 (Bogdonavage) at 6-9.

¹⁰⁶ R.D. at Appendix A, p. 38; PGW R.B. at Appendix A.

¹⁰⁷ R.D. at 56.

¹⁰⁸ R.D. at 57-58.

¹⁰⁹ R.D. at 57.

program was in place.¹¹⁰ The ALJ's reliance on the past fails to comprehend that, under PGW's prior ratemaking method, its rates are tailored to its future or anticipated need for cash.¹¹¹ Under the ALJ's logic, PGW would never be able to spend more on its promotional efforts than it did in the infancy of its program. Given the excellent return that PGW's program has produced,¹¹² and the requirements of the Cash Flow Method, the Commission must reject the ALJ's recommended disallowance and grant the full \$1.6 million of promotional expenses.

I. EXCEPTION NO. 9 -- The ALJ Erred by Accepting the OCA's Expense Adjustments, but Rejecting its Corresponding Increase in PGW's Bad Debt Expense.¹¹³

The ALJ recommends that the Commission should grant OCA's various expense adjustments,¹¹⁴ but at the same time rejects OCA's recommended bad debt allowance of \$71.8 million.¹¹⁵ However, OCA presented its \$6.8 million of downward expense adjustments in conjunction with a concomitant \$6.8 million increase in PGW's bad debt expense allowance.¹¹⁶ These adjustments were clearly intended to offset each other.¹¹⁷

¹¹⁰ R.D. at 57-58.

¹¹¹ *Action Alliance*, 406 A.2d at 1156; PGW Exh. JRB Rejoinder-2, 1982 Supplemental Opinion and Order at 8-9.

¹¹² R.D. at 58.

¹¹³ This Exception excepts to the following portions of the Recommended Decision: Ordering Paragraph No. 11; Section III.B.4.d.

¹¹⁴ R.D. at 62-64 and 111, ¶ 11.

¹¹⁵ R.D. at 61.

¹¹⁶ OCA St. 1.0 (Lelash) at 32; OCA M.B. at 25.

¹¹⁷ OCA M.B. at 25. PGW's acceptance of the majority of these adjustments was based upon this understanding. If the adjustments will not be offset by an allowance of additional revenues through rates, then the adjustments are not valid, PGW excepts to them, and the ALJ's

(continued...)

Thus, by granting the OCA expense adjustments without its proposed offsetting revenue requirement increase, the ALJ potentially thwarted her recommendation that the Commission adopt OTS' revenue requirement and proposed \$44 million rate increase (including interim relief). As asserted above, PGW believes that the full \$65 million requested rate increase is required by the evidence and the law governing this proceeding. However, if the Commission adopts the ALJ's revenue requirement recommendation, and also desires to uphold the granting of the OCA expense adjustments, then the Commission must allow PGW an additional \$6.8 million in revenues from rates in order to achieve a net rate increase of \$44 million, including the \$11 million interim rate relief.¹¹⁸

J. EXCEPTION NO. 10 -- The ALJ Erred in Calculating and Adopting the Revenue Requirement Recommended by OTS Which Requires a Rate Increase that Is Actually \$2.1 Million Higher than the Cited \$33 Million.¹¹⁹

The Recommended Decision explicitly recommends that the Commission approve the OTS' recommendation for a \$33 million increase in rates in addition to the \$11 million interim rate increase presently in effect.¹²⁰ OTS witness Weakley testified however, that OTS' recommendation was derived by starting with PGW's proposed \$65 million rate increase proposal and subtracting its various expense adjustments.¹²¹ However, the result of subtracting each of

¹¹⁷(...continued)

recommendation that they be accepted and that PGW's revenue requirement be reduced by \$6.8 million should be rejected by the Commission.

¹¹⁸ As detailed in Exception 10, the cumulative net increase would actually be \$46.1 million.

¹¹⁹ This Exception excepts to the following portions of the Recommended Decision: Ordering Paragraphs Nos. 2 and 6-10; Section III.B.

¹²⁰ R.D. at 69 and 110, ¶ 2.

¹²¹ Tr. 745-46; OTS Exh. 1, Sch. 1.

OTS' expense adjustments from PGW's proposed \$65 million increase is a \$35.1 million increase in rates in addition to the \$11 million interim relief — not a \$33 million increase as recommended by the ALJ. The following calculations demonstrate this \$2.1 million error:

<u>Expense Adjustment</u>	<u>PGW proposed \$65 million</u>
Net decrease from increased customer counts and average usage (\$33,856,232 million increased revenues - \$20.479 million increased gas costs) ¹²²	- \$13,377,232
Normalization of rate case expense and elimination of Lukens testimony expense ¹²³	- \$362,000
Reduction to allowed promotional expenses (\$1.645 million - \$385,000) ¹²⁴	- \$1.260 million
Lower bad debt expense allowance (\$65 million - \$61.128 million) ¹²⁵	- \$ 3.872 million
<u>Sub-Total</u>	<u>\$46,128,768</u>
Interim rate increase	- \$11 million
<u>Total Rate Increase</u>	<u>\$35,128,768</u>

As argued above, PGW believes that the evidence and the law require the Commission to find that the full \$65 million increase is justified. Additionally, as explained above, the PUC

¹²² R.D. at 49; OTS St. 2.0 (Kubas) at 19-24. The ALJ further erred by overstating this adjustment. In the Recommended Decision, the ALJ cites the increase in PGW's revenues for the increased residential and commercial customers and usage as a total of \$34.263 million. However, the increases cited by the ALJ were derived using PGW's proposed customer charges. As OTS indicated in footnotes (which were reproduced in the Recommended Decision but not commented on), using OTS' customer charges which were adopted by the ALJ, the total revenue increase is \$33,856,232.

¹²³ R.D. at 51; OTS Exh. 1, Sch. 5.

¹²⁴ R.D. at 59; Tr. 744-45.

¹²⁵ R.D. at 60; OTS Exh. 1, Sch. 4.

should reject the ALJ's recommended adoption of OTS' individual expense adjustments as contrary to the evidence and law governing this case. Nonetheless, if the PUC adopts the ALJ's endorsement of OTS' recommended revenue requirement, it must properly calculate that revenue requirement and allow PGW to increase its rates by \$35.128 million in addition to the \$11 million interim rate increase.

K. EXCEPTION NO. 11 -- The ALJ Erred by Excluding Purchased Electricity Costs from PGW's GCR.¹²⁶

ALJ Fordham recommended that PGW immediately recover in base rates, as opposed to its GCR, the costs for purchased electricity and bad debts.¹²⁷ At the same time, the ALJ recommended that the Commission defer addressing the issue of the presence of the Company's Senior Citizen Discount, Conservation Works Program, and Customer Responsibility Program until its restructuring proceeding.¹²⁸

With respect to purchased electricity costs, PW has traditionally recovered this cost as part of its GCR since it is substantially related to the operation of its LNG plants and gas moving equipment. Moreover, PGW reiterates its position that, under Section 2212(d) of the Code, the Commission must defer its decision on the treatment of all of these costs until its restructuring case. Further, deferring consideration of all of these costs until PGW's restructuring, at which time the PUC can comprehensively review these issues, simply makes more sense than the piecemeal

¹²⁶ This Exception excepts to the following portions of the Recommended Decision: Ordering Paragraph No. 15; Section III.C.4.a-c.

¹²⁷ R.D. at 83-84.

¹²⁸ R.D. at 84-87.

approach suggested by the ALJ. The ALJ's recommendation must be rejected with respect to electricity costs.

L. EXCEPTION NO. 12 -- The ALJ Erred in Recommending That PGW Immediately Put in Place A System Which Would Permit Virtually All PGW Customers to Transport Natural Gas On its System Rather Than Upon Implementation of Restructuring.¹²⁹

Under the mistaken impression that she was merely "facilitat[ing] the changes that will occur in [PGW's] restructuring proceeding,"¹³⁰ the ALJ recommended the adoption of several changes to PGW's transportation rules in its present tariff, namely:

- i. Reduction of the minimum volume eligibility to 15,000 Mcf from 75,000 Mcf;¹³¹
- ii. Customers may aggregate multiple services and multiple accounts to meet the 15,000 Mcf threshold;¹³²
- iii. Unrelated customers may form buyers' groups of up to ten (10) individual customers to reach the 15,000 Mcf/yr threshold;¹³³
- iv. Transportation customers should be able to make intra-day nominations;¹³⁴
- v. The Company is obligated to provide information on daily imbalance information to transportation;¹³⁵
- vi. The Company is obligated to provide timely lost and unaccounted for gas information to transportation customers.¹³⁶

¹²⁹ This Exception excepts to the following portions of the Recommended Decision: Ordering Paragraphs Nos. 20-21; Section III.C.5.c.

¹³⁰ R.D. at 96.

¹³¹ R.D. at 93-96 and 112, ¶ 20. PGW's present tariff permits customers to reach the 75,000 Mcf/yr minimum by combining three customer accounts. See, PGW Pa PUC Tariff No.1 page 113. (App. A, hereto).

¹³² R.D. at 97.

¹³³ R.D. at 98-99.

¹³⁴ R.D. at 99-101.

¹³⁵ R.D. at 101-103.

¹³⁶ R.D. at 103-104.

While any one of these recommendations would be troubling because of the legal and operational impediments to its implementation, when combined, they amount to an order that the full unbundling of PGW's gas system that the Legislature mandated be implemented by September 2003 occur at the conclusion of this case. There are literally thousands of customers whose various locations and accounts, when combined, would satisfy the 15,000 Mcf threshold. When the ability to merge accounts and locations is combined with the ability to create "buyers groups" of up to 10 individual customers that in total satisfy the minimum, transportation would be available to virtually every one of PGW's over 500,000 customers (if for example several residential customers combined with a single large user). This result was clearly not contemplated by the Legislature. Obviously, if ordered by the Commission, PGW's efforts to progressively put in place the systems needed for full unbundling would be stymied while it sought to create the rates, rules, systems and operational procedures necessary to completely unbundle its system some two years prior to the target date set forth in the Act. Accordingly, these recommendations are premature and contrary to clearly delineated time frames the state legislature allotted PGW for restructuring.

From a legal perspective, the Public Utility Code clearly provides that, until the effective date of the Commission's final order approving PGW's restructuring plan and new tariff, PGW is to continue operating and providing service in accordance with its pre-PUC tariff, policies and programs.¹³⁷ PGW's current tariff contains specific rates, rules and terms and conditions governing transportation service involving: 1) the availability of transportation service including the ability to combine accounts or customers; 2) the character of the service; 3) the rates for the

¹³⁷ 66 Pa. C.S. § 2212(d); *see* PGW M.B. at 10.

service; 4) and conditions of use (including line loss rules, notice and balancing, nominations, intra-day nominations and imbalance tolerances and penalties.)¹³⁸ Since every one of the revisions demanded by PICGUG and recommended by the ALJ are covered by specific provisions in PGW's present tariff, prior to restructuring, the ALJ's recommendation is contrary to the statutory timeframe for restructuring.¹³⁹

Accordingly, the statute clearly contemplated that PGW would work toward full unbundling by preparing the systems and operational rules required in the time prior to its restructuring case. This was a highly sensible approach since, as the Recommended Decision acknowledges, Pennsylvania's investor owned natural gas utilities took some 20 years to evolve a system in which most of its commercial and industrial customers had a transportation option available to them. The Gas Competition Act merely completed the last part of the transition, requiring that the transportation option be available to the small commercial and residential customers.

In contrast, the ALJ's recommendations would force PGW to attempt to unbundle virtually its entire system at once, a transition that would be enormously difficult and complicated for any company, let alone one that is continuing to strive to improve its service and increase efficiency on

¹³⁸ PGW Tariff Pa. PUC No. 1, Original pages 113-127 (attached hereto as Appendix "A").

¹³⁹ The ALJ dismissed the clear statutory prohibition in Section 2212(d) by accepting PICGUG's argument that PGW's transportation rules constituted "inadequate service" barred by section 1501 of the Code, 66 Pa. C. S. § 1501. But the rules, terms and conditions associated with the provision of gas transportation are not "service" as defined in the Code, Section 102, because PICGUG's complaints do not have anything to do with the quality of the thing being "furnished or supplied," but rather the "rules regulations [and] practices having to do with any rate ...," which is the Code's definition of the term "tariff." A rate includes all the "rules and regulations [or] practices" affecting such [rate]. 66 Pa. C.S. § 102. Even if "service" were at issue, such a requirement cannot override Section 2212(d)'s explicit commandment that PGW's tariff, policies and programs remain in effect.

many fronts. In response to the Commission's order, PGW would have to plan, construct, implement and maintain at least the following systems and operational rules:

- revisions to PGW's billing system to permit PGW to keep track of and bill transportation charges to all eligible customers (including the ability to consolidate accounts and locations and to keep track of "pools");
- establishment of transportation rates for all customer classes that would be eligible to transport (i.e., all customers);
- creation of supplier rules and tariffs including detailed balancing rules, security provisions and rules to accommodate supplier market exit;
- creation of systems to maintain daily and seasonable reliability including detailed intraday nominations rules to accommodate a greatly increased level of customers; and¹⁴⁰
- real time data dissemination including the creation of an electronic bulletin board.¹⁴¹

But, as Company witness White explained, PGW does not presently have the infrastructure to perform many of the tasks that PICGUG's demands would require. They are virtually technologically impossible for PGW to implement presently.¹⁴²

Supplier balancing is a specific example. Under PICGUG's proposal, PGW would be required to provide, in the upcoming months, daily imbalance information to transportation customers through the Internet, an electronic bulletin board or some other method. However, the

¹⁴⁰ The Company has always agreed to provide this service on a best efforts basis to its existing transportation customers. Without guidelines for scheduling nomination and confirmation timelines in place, the company cannot reasonably be expected to adopt a requirement that it must comply with this request in any manner other than a best efforts basis.

¹⁴¹ It takes months to develop business plans, evaluate and implement systems, hire and train PGW personnel, and train the customers and suppliers on the scheduling timelines and process. There are no systems, policies or procedures currently in place to accommodate pooling or aggregation. There are presently no bulletin boards, nor are there any funds budgeted to make such a technological feat available prior to the anticipated date stipulated in the Gas Choice Act.

¹⁴² See PGW St. 4.1 (White) at 18-19; Tr. 677 - 80.

record shows that the Company lacks the personnel and systems necessary to receive, process and disseminate the type and volume of information that PICGUG requests.¹⁴³

Another example is billing. Mr. White explained that:

PGW is simply not equipped from a billing standpoint to successfully implement the proposed tariff changes, and, if forced to do so, risks creating problems where none currently exist including the release of inaccurate information which could undermine the reliability of PGW's system and harm its transportation customers.¹⁴⁴

Considering the disasters that PGW and its customers experienced as a result of the meltdown of its billing system in 1999 and 2000, from which the Company is only now recovering, it would be extremely unwise to order changes that would require PGW to affect major billing changes in such a haphazard and hurried manner.

The reality is that if PGW were to be ordered prematurely to attempt to undertake such massive changes in such a rushed manner, system reliability would be threatened, thus causing potential harm to the very customers the changes are intended to benefit. As Mr White explained:

Operationally, [PICGUG's] suggestions would result in a serious shock to PGW's business systems as large numbers of new transportation customers would come on line. PGW is concerned that its present ability to coordinate and balance a large amount of transportation load is inadequate.¹⁴⁵

PGW is committed to implementing the unbundling requirements of the Gas Competition Act as part of its restructuring and it is presently hard at work planning that transition. While it is understandable that customers are frustrated that the full unbundling available from Pennsylvania's investor owned gas utilities is not immediately available from PGW, the fact is that such a

¹⁴³ PGW St. 4.1 (White) at 18-19.

¹⁴⁴ *Id.* at 18.

¹⁴⁵ *Id.*

transition does not happen overnight. The General Assembly plainly recognized this by mandating that PGW's existing tariff should stay in place until restructuring.¹⁴⁶

In lieu of the massive revisions to PGW's present tariff recommended by the ALJ, PGW proposes that the Commission order the initiation of a collaborative process to assist in the planning and development of PGW's unbundling plan to be implemented at restructuring. The directive can include a request for periodic progress reports to the Commission. Otherwise, the ALJ's suggestions must not be adopted.

M. EXCEPTION NO. 13 -- The ALJ Erred by Accepting OTS' Revenue Requirement Allocation Recommendations and, Specifically, the Proposed Increase In Rates to LBS Large Direct, TriGen Direct and NGV Direct Customer Classes and Decrease In Rates for the GTS Trans Customer Class.¹⁴⁷

The ALJ accepted the OTS' proposal to reduce the rates for the GTS Trans customer class and increase rates for the LBS Large Direct, TriGen Direct and NGV Direct classes, purportedly so that these classes rates will recover the costs allocated to them.¹⁴⁸ The ALJ and OTS appear to misunderstand the nature of these classes' rates.

The rates for these classes are not cost of service based, but rather are either interruptible or heavily negotiated rates.¹⁴⁹ Thus, they are pegged to alternative fuel costs. The GTS Trans rates are negotiated rates under which PGW is bound by contract to provide service to the customers at

¹⁴⁶ In the meantime, PGW has a transportation rate for larger customers, and interruptible rates for most large, industrial and commercial customers that is competitive with alternative fuels. In addition, the ALJ recommended that the PUC accept PGW's proposal for greater pricing flexibility for interruptible service (R.D. at 112, ¶ 17), a development that will provide even greater pricing options for PICGUG members.

¹⁴⁷ This Exception excepts to the following portions of the Recommended Decision: Ordering Paragraphs Nos. 13-14; Section III.C.2.

¹⁴⁸ R.D. at 75-76, 111, ¶13, and 112, ¶14.

¹⁴⁹ PGW St. 4.1 (White) at 12.

the negotiated price and the present arrangement is reflected in its tariff (which cannot be changed). The LBS and NGV Direct classes are not firm customers. Therefore, as identified in PGW's tariff, their rates are not cost of service based, but rather are based on the price of natural gas and the price of alternative fuels.

Moreover, as detailed above in regard to the recommended transportation tariff changes, the Commission is legally constrained by Section 2212(d) of the Code from requiring tariff changes that were not initiated by PGW. Accordingly, the Commission should reject the ALJ's recommendation and adopt PGW's proposal for allocating the revenue requirement to all classes, other than those priced on a competitive fuel basis.¹⁵⁰

N. EXCEPTION NO. 14 -- The ALJ Erred by Accepting OTS' Customer Charges.¹⁵¹

PGW proposed to increase its present customer charges for all classes. The increases in the customer charge would generate approximately \$44.5 million of the requested \$65 million rate increase.¹⁵² The "present" (pre-interim), interim and proposed customer charges are set forth in the Recommended Decision, including PGW's proposed customer charges of \$15, \$25, and \$50 for residential, commercial and industrial customer classes, respectively.¹⁵³ It is important for the Commission to note that for every customer class, the proposed monthly customer charges are

¹⁵⁰ See, PGW St. 4.0 (White) at 4-7.

¹⁵¹ This Exception excepts to the following portions of the Recommended Decision: Ordering Paragraph No. 3; Section III.C.2 and 3.a.

¹⁵² PGW St. 4.0 (White) at 5; PGW Exh. HSG-1, Sch. 2.

¹⁵³ R.D. at 78; see PGW St. 4.0 (White) at 6-7; PGW Exh. HSG-1, Sch. 2; Tr. 674; PGW M.B. at 36.

lower than the customer related costs on a per customer-month basis as set forth in the Company's COSS.¹⁵⁴

ALJ Fordham accepted OTS' proposed charges of: \$12 (residential class); \$18 (commercial class); \$50 (industrial class).¹⁵⁵ The ALJ makes no recommendation for classes Municipal GS, Municipal MS, PHA-GS or PHA-PHA. PGW excepts to the ALJ's recommendation. Even at the Company's proposed \$15.00 level for the residential class, PGW is recovering less than 50% of the fixed costs incurred by it to serve the residential customers. Moreover, PGW's proposed customer charges should be accepted for all classes because the additional revenues will help to mitigate PGW's current (and substantial) reliance on cold winter weather to generate sufficient annual revenues. Currently, PGW's load is heavily weighted toward weather-sensitive customers (residential and commercial).

The Company's proposed customer charges bring rates closer to costs while honoring the concept of gradualism, and reduce PGW's sensitivity to weather swings. Accordingly, the Commission should accept PGW's proposed increases in customer charges, and reject the ALJ's recommended amounts.

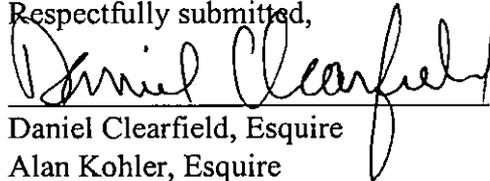
¹⁵⁴ PGW St. 5.0 (Gorman) at 5; PGW Exh. HSG-1, Sch. 2. The customer related costs include: \$39.94 (residential); \$106.41 (commercial); and \$280.85 (industrial).

¹⁵⁵ R.D. at 78.

III. CONCLUSION

WHEREFORE, PGW respectfully requests that the Pennsylvania Public Utility Commission enter an Order which authorizes PGW to increase its rates by \$65 million annually (over and above pre-interim increase levels), and to otherwise grant the exceptions set forth herein.

Respectfully submitted,



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