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June 29, 2001

HAND DELIVERED

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Pa. Public Utility Commission
Commonwealth Keystone Building
Harrisburg, PA 17105

PA.P.U.C.
SECRETARY'S BUREAU

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

Dear Mr. McNulty:

Enclosed for filing are the original and nine (9) copies of the Reply Brief on behalf of the Office of Small Business Advocate in the above-docketed proceeding. As evidenced by the enclosed certificate of service, three copies have been served on all active parties in this case.

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

Sincerely,

Steven C. Gray
Assistant Small Business Advocate

Enclosures

cc: Hon. Cynthia W. Fordham
Administrative Law Judge
(W/disk)

Parties of Record

Brian Kalcic

41

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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REPLY BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

POCKETED

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FOLDER**

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Dated: June 29, 2001

I. INTRODUCTION

On January 5, 2001, Philadelphia Gas Works (“PGW” or “Company”) filed Supplement No. 7 to Tariff Gas – Pa. P.U.C. No. 1 (“Supplement No. 7”) to become effective March 6, 2001. The PGW filing proposed an increase in rates calculated to produce an additional \$65,000,000 in annual revenues. On February 8, 2001, the Pennsylvania Public Utility Commission (“Commission”) suspended Supplement No. 7 until October 6, 2001, in order to conduct an investigation into the justness and reasonableness of PGW’s proposed rates.

The Office of Small Business Advocate (“OSBA”) filed a formal complaint in this rate proceeding on February 6, 2001. In addition, the OSBA distributed and entered into the record the direct, rebuttal, and surrebuttal testimony of Mr. Brian Kalcic, the single witness appearing on behalf of the OSBA.

Evidentiary hearings were held before Administrative Law Judge (“ALJ”) Fordham in Philadelphia on May 22, 23, and 24, 2001.

Main Briefs were to be submitted by any party to this rate proceeding on June 21, 2001. Main Briefs were filed by PGW, the Office of Trial Staff (“OTS”), the Office of Consumer Advocate (“OCA”), the OSBA, the Philadelphia Industrial and Commercial Gas Users Group (“PICGUG”), and a coalition of consumer groups (“CEPA”).

The OSBA submits this Reply Brief in response to issues raised in the PGW Main Brief, and the OCA Main Brief.

II. ARGUMENT

A. PGW – Revenue Allocation

Section five of PGW's Main Brief is entitled "Rate Structure / Cost of Service." See PGW Main Brief, at 58. PGW introduces this section with the statement that "[t]he Company's proposal to allocate the proposed \$65 million rate increase ... was designed to move the rates for each class closer to cost, keeping in mind the need for gradualism." Id. Since PGW is putting such emphasis on the concept, an examination of the Company's proposals to determine PGW's adherence to the concept of "gradualism" is clearly warranted.

As an initial comment the OSBA suggests that the Company should decide once and for all on its definition for the term "gradualism," and then use the term consistently. For example, PGW states that "[I]n an attempt to eliminate over and under recoveries, the Company proposes to distribute the \$65 million by increasing rates to the residential class by 15.65% and to all other classes by 13.44%." PGW Main Brief, at 61-62. The Company's proposal assigns a mere 0.5% of an additional revenue increase (above the system average increase of 15.1%) to the Residential class. The remaining revenue shortfall is made up by a 13.44% increase to all other firm classes. See OSBA Main Brief, at 6.

This 0.5% increase in the Residential class revenue allocation stands in sharp contrast to the Company's proposed 150% increase to the Commercial class customer charge. PGW Main Brief, at 63. Evidently PGW's adherence to the concept of "gradualism" includes any percentage increase in the 0.5% to 150% range.

The Company's adherence to the concept is quite touchy, however. PGW is evidently not going to stand for anyone questioning its choice of when an issue should or should not be excluded from the concept of "gradualism." As an example, PGW takes issue with the OTS argument that the Company's proposed customer charge increases violate the aforementioned principle of gradualism. PGW Main Brief, at 63. In response, PGW deems the Commercial customer charge increase from \$10.00 to \$25.00 "essential," and pats itself on the back by noting that the Company is "unique." *Id.* Essentially, PGW's response to the OTS gradualism argument is that the Company needs the money, the Company deserves the money, and therefore the Company should have the money. *Id.* at 64-65.

Not surprisingly, PGW tosses the "gradualism" concept overboard at its first opportunity – in this case, within roughly seven pages of their section introduction. In the alternative, the OSBA suggests that PGW's definition of "gradualism" is simply highly flexible, with wide variety of percentage increases being acceptable and useful depending upon the situation.

The question remains, however – with "gradualism" drowning in PGW's cynicism, what remains of PGW's revenue allocation argument? The Company's own cost of service study demonstrates that the Residential class is significantly under-recovering its cost of service, while the remaining firm customer classes are seriously over-recovering their cost of service. See, e.g., OSBA Statement No. 1, Schedule BK-1. The only answer that PGW provides is that its proposed "allocation is fair and clearly balances the interests of its various rate classes." PGW Main Brief, at 62. The PGW proposal is certainly not fair to its Commercial class customers, who are seriously over-

recovering their cost of service at present rates, and are provided only token relief under the Company proposal. See OSBA Statement No.1, at 6.

In addition, PGW's "fair" treatment of its firm non-Residential customer classes does nothing to change the fact that PGW's restructuring proceeding is looming on the horizon. See OSBA Main Brief, at 7. The token revenue allocation change proposed by PGW, which barely moves the firm customer classes closer to their cost of service, provides little revenue relief now while exacerbating the problem in the approaching restructuring filing. See id., at 4.

Consequently, the OSBA revenue allocation proposal provides the best balance between the goal of making revenue allocation progress in this case, and the goal of minimizing "rate shock" in this rate proceeding *and* the upcoming restructuring proceeding. See OSBA Statement No. 1, at 7. Specifically, the OSBA proposal to increase the Residential class revenue 1.25 times the system average increase of 15.1% does not instantly eliminate the Residential class under-recovery, nor does it immediately abolish the over-recovery of the other firm customer classes. Instead, it makes progress in this case towards eliminating such under- and over-recoveries, while balancing the impact upon the customer classes.

B. PGW – Customer Charge Rate Design

PGW proposes to increase the Commercial class customer charge from \$10.00 to \$25.00. See PGW Statement No. 4, at 7. However, the Company's argument to radically raise its customer charges now includes a new chart that is set forth on the top of page 63 of PGW's Main Brief. The chart is a clever attempt on the part of PGW to show that "gradualism" is well and truly underway in the PGW service territory.

In other words, PGW no doubt realizes that a jump from \$10.00 to \$25.00 in the Commercial customer charge, for example, is simply extreme and beyond the bounds of reason. Therefore, in order to mitigate the appearance of such a large increase, PGW creates a chart of customer charges that now includes a row entitled "Interim." PGW Main Brief, at 63. This chart not only includes "Present" and "Proposed" customer charges, it includes the "Interim" customer charges that are temporarily in effect until August 31, 2001 as part of the settlement of PGW's Interim Base Rate case. See Joint Petition for Full Settlement of Philadelphia Gas Works' Petition for the Establishment of Interim Rates and Related Appeal (adopted by the Commission February 22, 2001). Obviously, the implication of the PGW chart is that because the Commercial class customer charge is already at \$14.57, another move to \$25.00 is acceptable and quite palatable.

Nothing could be further from the truth. The fact is that a Commercial class customer of PGW was paying a \$10.00 customer charge prior to the implementation of the "interim" rates on March 1, 2001, and if PGW were to be successful, would be paying \$25.00 at the conclusion of this case. That would result in a 150% increase in the Commercial class customer charge in less than one year, no matter how one does the math, and notwithstanding PGW's "interim" step of increasing the Commercial class customer charge to \$14.57 until August 31, 2001. Therefore, for the purposes of demonstrating the "reasonableness" or "gradualism" of PGW's proposed increase in customer charges, the chart on page 63 of PGW's Main Brief should be given no credence.

In contrast, the OSBA proposed customer charge of \$17.50 is a realistic way of meeting the revenue stability concerns raised by PGW while mitigating the impact that a 150% increase in the customer charge would have upon the smaller Commercial customers of PGW. The \$17.50 will literally have half the impact that the PGW proposed increase will have, and will also bring PGW more in line with the Commercial customer charge of other Pennsylvania natural gas distribution companies. See OSBA Main Brief, at 8.

B. OCA - Class Revenue Responsibility

Section six of the OCA Main Brief includes a sub-section entitled “Class Revenue Responsibility.” OCA Main Brief, at 47. Under that section, the OCA states that “[t]hese witnesses [OTS Metro, OSBA Kalcic, PICGUG Baudino] base their class revenue responsibility recommendations on the PGW class cost of service study presented by Company witness Gorman.” OCA Main Brief, at 49 (explanation of reference added).

The OSBA observes that the OCA statement is correct, as far as it goes. As stated in the OSBA Main Brief, this office accepts the PGW Cost of Service Study for the purposes of allocating costs and revenue responsibility in this case. See OSBA Statement No.1. Essentially, the OSBA agrees with the sentiment expressed by PICGUG, that the PGW “COSS may be used as a reasonable guide to determine cost responsibility for PGW’s customer classes.” PICGUG Main Brief, at 28.

However, the OSBA respectfully disagrees with the OCA that its “more extreme revenue responsibility recommendations ... are not consistent with the results of Mr. Miller’s class cost of service study.” OCA Main Brief, at 50. In fact, the OSBA

would be perfectly satisfied to base all of its revenue recommendations upon Mr. Miller's cost of service study. See, e.g., OSBA Main Brief, at 5. Specifically, OSBA witness Brian Kalcic compared the results of the PGW cost of service study to the modified COSS proposed by the OCA. The comparison demonstrated that "[a]mong PGW's firm rate classes, the OCA's cost methodology has the greatest percentage impact on the Commercial class, which would see its required cost-based decrease rise from 14.71% in PGW's cost study to 20.89% in the OCA's study." OSBA Statement No. 3, at 3 (emphasis in original).

It is no doubt clear, therefore, why in this rate proceeding the OSBA might be willing to accept the OCA's statement that "Mr. Miller's COSS more accurately reflects the cost responsibility of each class and provides a more reasonable guide for determining class revenue responsibility." OCA Main Brief, at 47.

However, the OCA further asserts that in the OCA cost of service study "the residential class revenues at present rates are somewhat less than the costs allocated to the residential class, but the differences between class revenues and costs are much smaller in Mr. Miller's properly constructed COSS than the much larger disparities in the Company's COSS." OCA Main Brief, at 50. The OSBA respectfully suggests that Mr. Miller's class cost of service study shows only a slight improvement in the cost recovery of the Residential class, while once again demonstrating that the Commercial class is far over-recovering its cost of service. As pointed out by Mr. Kalcic, "[o]n net, Schedule BK-1S, page 1 of 2 does not reveal any improvement in the relative standing of the Residential class among PGW's firm rate classes. For instance, the Residential class is still the only firm class shown to require an increase, that increase is in excess of 23.5%,

and all other firm rate classes are shown to require double-digit decreases.” OSBA Statement No. 3, at 4. (Emphasis in original).

In addition, the OCA Cost of Service Study revealed nearly identical results when the CRP and Senior discount programs were re-assigned to the customer classes on a volumetric basis. As stated by Mr. Kalcic:

If one compares page 2 of Schedule BK-1 with page 2 of Schedule BK-1S, one finds that, as before, the commercial class receives the greatest percentage reduction in allocated revenue responsibility. Indeed, all of the relative changes in class revenue responsibility discussed above are “mirrored” in the scenario where CRP and Senior discounts are re-assigned on a volumetric basis.

Id., at 4-5.

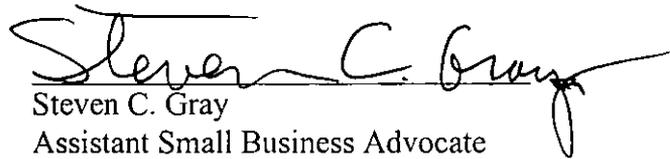
The OSBA respectfully submits, therefore, that Mr. Miller’s cost of service study does not produce the favorable results for the Residential class that the OCA suggests in their main brief. See OCA Main Brief, at 50. Instead, the OCA cost of service study agrees with the PGW COSS on two fundamental and critical points: (1) that the Residential class is drastically under-recovering its cost of service; and (2) that the Commercial customer class is severely over-recovering its cost of service.

Consequently, the OSBA’s revenue allocation recommendations are entirely consistent with the results of Mr. Miller’s cost of service study. Instead of the “extreme” nature of the OSBA recommendation as suggested by the OCA, the OSBA revenue allocation is a reasonable first step towards moving the classes closer to their cost of service revenue responsibility. OCA Main Brief, at 50.

III. CONCLUSION

For the reasons set forth in this Reply Brief and its Main Brief, the OSBA respectfully requests that the ALJ and the Commission accept the OSBA's rate design and revenue allocation recommendations as described therein.

Respectfully submitted,


Steven C. Gray
Assistant Small Business Advocate

Date: June 29, 2001

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY :
COMMISSION :
 : Docket No. R-00006042
v. :
 :
PHILADELPHIA GAS WORKS :

CERTIFICATE OF SERVICE

I certify that I am serving three copies of the Reply Brief on behalf of the Office of Small Business Advocate by first class mail (unless otherwise indicated) upon the persons addressed below:

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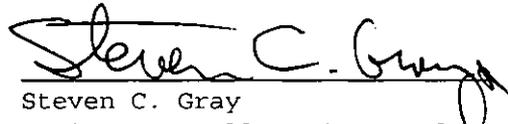
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Dated: June 29, 2001

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June 29, 2001

JUN 29 2001

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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Filed by Federal Express

KJR

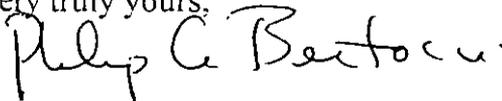
Re: CEPA et al. v. Philadelphia Gas Works, Docket No. R-00006042

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 CEPA et al.'s Reply Brief in this case.

Very truly yours,



PHILIP A. BERTOCCI

Attorney for CEPA et al.

cc: Certificate of Service
Honorable Cynthia Williams Fordham, ALJ

Enclosures

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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PENNSYLVANIA PUBLIC UTILITY :
COMMISSION :

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

v

Docket No. R-00006042

PHILADELPHIA GAS WORKS :

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JUL 6 2001

REPLY BRIEF OF CEPA ET AL.

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EDWARD A. MCCOOL, ESQUIRE

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

COMMUNITY LEGAL SERVICES INC.
1424 Chestnut Street, 4th Floor
Philadelphia, PA 19102
(215) 981-3702

Date: June 29, 2001

I. Introduction.

In its Main Brief, CEPA et al. urged the Administrative Law Judge to take the case D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission, 466 F.2d 394 (D.C. Cir. 1972), cert. denied, 409 U.S. 1086 (hereinafter "D.C. Transit") as the template for this case. There as here, a regulator confronted a request for a rate increase allegedly to refurbish a utility with an "unstable financial structure which in turn had contributed substantially to an operation presently uneconomical and inefficient and a service seriously deteriorated." D.C. Transit, at 397. This case represented substantial authority for CEPA et al.'s position that especially in a situation where there have been and are severe management deficiencies, provision of adequate service is the sine qua non for a rate increase. The Pennsylvania Public Utility Commission (PUC) has already expressly recognized that in applying the "constitutional standard of just and reasonable rates ...which governs the setting of PGW's rates," service considerations are an "essential" factor.¹

In its Main Brief in this case, PGW continues to repeat its well known theses which effectively place on ratepayers all the burdens of years of PGW mismanagement. These theses include: the supremacy of Section VII of the Management Agreement

¹ Pennsylvania Public Utility Commission, et al. v. Philadelphia Gas Works, Docket No. R -00005654, Order entered November 22, 2000, at 21. Moreover, at that time, the Commission expressly rejected PGW's oft repeated claim that Section 2212 of the Gas Choice Act, 66 Pa.C.S. §2212 and/or the Management Agreement between PGW and the Philadelphia Facilities Management Corporation justify a different standard for PGW. Id. at 21.

As a preliminary matter, CEPA et al. also take issue with PGW's statement that in this case, the PUC will be deciding for "the first time" the ratemaking requirements of Section 2212. It is simply not true that in the Interim Base Rate case, the Commission did not make a decision on the "specifics of the prior ratemaking methodology for PGW to be used in setting permanent rates." PGW Main Brief, at 2n.3. To the contrary, the Commission established that the constitutionally based "just and reasonable" standard was part of the prior ratemaking methodology, and that the adequacy of service was relevant to any consideration concerning PGW's base rates. Other issues, including how to interpret the Management Agreement's provision for "reasonable working capital" in light of overall "just and reasonable" ratemaking principles were left for the permanent rate case.

(hereinafter “Section VII Formula”) in PGW ratemaking; the absolute inviolability the \$18 million annual City payment which PGW’s must make from project revenues or borrowed funds regardless of the Company’s performance; the exclusive duties of customers to fund all PGW’s cash needs regardless of whether PGW has improvidently exhausted the TXCP short term credit program specifically provided under state law and the Management Agreement; and the total irrelevance of PGW’s quality of customer service and long history of financial mismanagement for the fixing of PGW’s rates.

In making these arguments, PGW sets forth in succession versions of most of the arguments that D.C. Transit Company raised and lost resoundingly in D.C. Transit. Just as the Court rejected those arguments there, so, here, in this case, the Administrative Law Judge should for the same reasons reject those same arguments.

II. PGW Is Not Entitled under the Management Agreement to a Rate Increase Irrespective of the Quality of its Operations and Service.

In D.C. Transit, the transit company took the position that it was entitled under the Washington Metropolitan Area Transit Regulation Compact (“Compact”) to a rate increase “irrespective of the quality of its operation and service.” D.C. Transit, at 409, 410. In this case, PGW takes the same position, insisting on its alleged right to a substantial base rate increase irrespective of the inadequacy of its customer service and its historical financial mismanagement. It claims that the PUC has been:

specifically directed to ensure, that under any circumstances, PGW must be permitted to impose rates and charges that will enable it to satisfy its bond covenants and make its annual \$18 million payment to the City. Rates set pursuant to the City Ordinance and Section 2212 of the Code are presumed to be just and reasonable.

PGW Main Brief, at 5.²

In D.C. Transit, the Court rejected the company's misinterpretation of its governing laws and regulations. In this case, the Commission should reject PGW's similar misinterpretations of the operative standards governing the prior ratemaking methodology applicable to PGW.

First, PGW insists upon interpreting Section VII of the Management Agreement as a formula not permitting "any discretion"³ which is to be applied even in isolation from the rest of the Agreement. The PUC itself recently rejected this approach, when it stated that in light of the "stated objective of the Management Agreement to 'provide quality gas services to [Philadelphia] citizens at reasonable rates'" the standard set forth in that Agreement "and followed by the Philadelphia Gas Commission in prior base rate proceedings is consistent with the 'just and reasonable' analysis."⁴

Second, PGW repeatedly misinterprets the two controlling appellate cases concerning the standards governing ratemaking for PGW in a way which makes the constitutionally based "just and reasonable" standard subordinate to the working of the Section VII Formula. Action Alliance v. Philadelphia Gas Commission, 406 A.2d 1155 (Pa.Cmwlt. 1979) and Public Advocate v. Philadelphia Gas Commission, --Pa.--, 674 A.2d 1056 (1996) were cases which arose from challenges to specific rate orders in PGW

² See also PGW's claim that the impact of rates to be imposed is irrelevant for the purposes of the "prior ratemaking methodology" utilized by the Philadelphia Gas Commission: "Neither allegations about PGW's service nor concerns about "affordability" may justify a result that does not satisfy the prior rate making method or PGW's bond covenants...." PGW Main Brief, at 7

³ PGW Main Brief, at 10 ("The Code makes clear that the PUC lacks any discretion to deviate from these terms").

⁴ See, Pennsylvania Public Utility Commission, et al. v. Philadelphia Gas Works, Docket No. R - 00005654. Order entered November 22, 2000, at 9.

rate cases for FY 1978 and FY 1992. These cases do not hold, as PGW desperately insists, that the result obtained by the non-discretionary application of the Section VII Formula is presumptively “just and reasonable.” See. e.g., PGW Main Brief, at 12-16. Nor do they mean that the “just and reasonable” standard for PGW’s rates is met, if the individual determinations building up PGW’s revenue requirement are within a zone of reasonableness. PGW Main Brief, at 14. Rather, these appellate courts upheld specific Philadelphia Gas Commission rate orders on the grounds that they met a supreme and independent “just and reasonable” standard. In reaching the conclusions in those two cases that the rate orders were “just and reasonable,” the courts undertook a balancing analysis that considered the “impact,” the “total effect” and the “consequences” of the rate order, as required by the U.S. Supreme Court in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 602, 64 S. Ct. 281, 288 (1944).

Third, as a corollary of these two misinterpretations, PGW continues to insist that the Section VII Formula has been somehow reinforced by Section 2212(e) of the Gas Choice Act. In support of this view, PGW makes reference to the fact that the so-called mandates of Section 2212(e) requiring use of the “prior ratemaking methodology” and the setting of rates sufficient to permit compliance with bond rate covenants are preceded by the phrase “[n]otwithstanding any provisions of this title to the contrary.” PGW Main Brief, at 10. According to PGW, this language means that Section 2212(e) trumps not only all provisions in the Public Utility Code, but even those provisions like the “just and reasonable” standard set forth in Section 1301 that are constitutionally based. This outlandish claim has been already rejected by the PUC in the Interim Rate case, when it stressed that “PGW rates are subject to the constitutional requirement that rates be just and reasonable.”⁵ It is hornbook law that a legislature does not have the

⁵ See. Pennsylvania Public Utility Commission, et al. v. Philadelphia Gas Works, Docket No. R - 00005654, Order entered November 22, 2000, at 9.

authority to isolate and insulate a statutory provision from constitutional limitations. The Commission, in interpreting a statute, is bound to interpret it in a manner which does not result in the violation of constitutional protections.⁶

III. The City's Owner PGW Is Not Guaranteed under the U.S. Constitution, the Gas Choice Act or the Management Agreement the Right under All Circumstances to Rates Sufficient to Permit Payment of the \$18 Million City Payment.

In D.C. Transit, the transit company put forth, as the Court described, "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." D.C. Transit, at 422. In this case, PGW takes the same position, when it asserts that the Gas Choice Act requires that the PUC, "regardless of the outcome of PGW's prior ratemaking method, ...permit PGW to charge rates that allow it to make its annual payment to the City." PGW Main Brief, at 18, 19.

Like the D.C. Transit Court, the Commission should reject this claim as meritless. As that Court recognized, under normal circumstances, a rate "confining a public utility's return from operations to an amount below the point of confiscation violates due process." D.C. Transit, at 418. In Public Advocate, the Pennsylvania Supreme Court reached an identical conclusion. However, normal circumstances did not exist in D.C. Transit and to the great misfortune of PGW's ratepayers, do not exist in this case either. As the D.C. Transit court held, adequate service is a sine qua non to constitutional protection for a utility under confiscation/due process principles. Because

⁶ PGW itself implicitly recognizes this legal principle when it argues that the "just and reasonable" standard bars the Commission from setting rates at an inadequate "confiscatory" level. PGW Main Brief, at 56.

of PGW's demonstrated customer service and historical management deficiencies, the Company is not entitled to a rate which would ensure or guarantee payment of the \$18 million City payment, notwithstanding any provisions of the Management Agreement or the Gas Choice Act to the contrary.

Although the Management Agreement and the Gas Choice Act may provide for PGW's annual payment of \$18 million to the City, provision in rates for the making of that payment is mandated only where the overall rate to be charged is "just and reasonable." Just like the provisions of Gas Choice Act Section 2212(e) concerning the use of the Section VII Formula and compliance with PGW's bond covenants, Section 2212(f) (authorizing rates which permit the \$18 million City payment) is subject to the constitutionally based "just and reasonable" standard.⁷

To further support its constitutional holding that denial of a return on investment, or even denial of sufficient rates to "break even" is not barred by the Constitution in circumstances where a utility's service and management are inadequate, the D.C. Transit Court stresses a policy argument which is also applicable to this case. If PGW is correct, that the Commission must, under "any" circumstances, no matter how abysmal the customer service and no matter how irresponsible the historical financial management, provide sufficient funds from rates to cover all PGW's costs including the \$18 million City payment, how can the PUC or any regulator exercise the necessary oversight to protect the ratepaying public from monopoly power? In rejecting the type of argument set forth in PGW's Main Brief, the D.C. Transit court observed, "if ...[the company] is correct, it may disregard its public responsibilities at will – as the Commission found that

⁷ Gas Choice Section 2212(f) states in pertinent part, "The commission shall permit ...[PGW] to impose. charge or collect rates and charges as necessary to permit ...[PGW] on an annual basis to transfer or pay to the city that is the owner ... on an annual basis such amount as may be specified from time to time in the applicable ordinances of the city or agreements of the city approved by ordinances." 66 Pa.C.S. §2212(f).

it has frequently done – and yet insist that the public respond to its demands for higher fares.” D.C. Transit, at 422. Just as the D.C. Transit court rejected the transit company’s arguments, so the Commission must reject PGW’s arguments in this case. Neither the Constitution nor the Pennsylvania General Assembly has left the Commission impotent to confront the situation presented by PGW’s inadequate service and historical financial mismanagement in a sensible manner.

IV. The Commission Must Not Disregard a Management Audit in Determining Whether PGW’s Service and Operational Deficiencies Bar Any Increase in Base Rates at This Time.

In D.C. Transit, the Washington Metropolitan Area Transit Commission (WMATC) engaged a consultant to perform a detailed analysis of the transit company’s financial condition with a “view of assessing the full implications and isolating the underlying causes of Transit’s condition.” D.C. Transit, at 398. The consultant prepared a report which was entered into the administrative record, and he appeared as an expert witness in the proceeding and presented himself for cross examination on the conclusions and recommendations contained in his report. Id. at 398. In denying consideration of the the transit company’s rate increase pending satisfaction of pre-conditions, WMATC based its order principally on the findings contained in the consultant’s report.

As in D.C. Transit, the Commission here engaged an independent consulting firm to perform a Management Audit, the “Stratified Management and Operations Audit of Philadelphia Gas Works, Administrative Counsel Exh. No. 1, Attachment 1 (hereinafter “BWG Audit”). As set forth in summary form in CEPA et al.’s Main Brief, at 12-21, the BWG Audit provided a comprehensive assessment of PGW’s management effectiveness operating efficiency, including customer service, and financial management.

Now, like the transit company in D.C. Transit, PGW claims that the Commission may not use the BWG Audit “as a basis for denying, in whole or in part, PGW’s rate increase request.” PGW Main Brief, at 74. As in D.C. Transit, this claim is not supportable. The BWG audit is competent evidence, and as explained throughout this Reply Brief, is relevant to any rate consideration under the “just and reasonable” standard.

PGW presents a number of objections to the use of the Audit’s findings and conclusions for ratemaking purposes. It claims that the purpose of the Audit was to identify “areas of improvement in service and management,” and that therefore, use of the Audit for ratemaking purposes would be a “complete misuse.” PGW Main Brief, at 74. This argument fails because the information contained in the assessment is directly relevant on the issue of whether PGW is providing adequate customer service and the role that financial and operational mismanagement has played creating PGW’s current circumstances. The fact that the BWG Audit does not make recommendations concerning PGW’s rate request does not invalidate for ratemaking purposes the assessments which the Audit contains.⁸

PGW also makes the argument that “any use of the Management Audit must be intrinsically linked and limited to the purpose and public policies for which it was conducted under the Public Utility Code –namely, promoting ‘management effectiveness and operating efficiencies’ within the Company.” PGW Brief, at 75. Use of the Audit in determining a “just and reasonable” rate, or whether any rate increase can be provided, is not in the least inconsistent with the public policy underlying the PUC conduct of

⁸ In this connection, it is perhaps noteworthy that PGW does not hesitate to attempt to use the Black & Veatch Report, which was created for the purposes of supporting a bond offering, not determining a “just and reasonable rate,” to support its contention that its \$65 million base rate increase request is reasonable. PGW Main Brief, at 35-38.

management audits. CEPA et al. submit that one of the most significant tools that the PUC has for promoting “management effectiveness and operating efficiencies” is the ratemaking process, in which owners who serve their customers well may be rewarded with a larger rate of return, and in which owners like the City, who have inflicted chronic mismanagement on their customers, are called to provide an infusion of equity capital, conscientious management and political will in support of their enterprise.

PGW also claims that because it has made it “unmistakably clear” that acceptance of the recommendations made by the BWG Audit did not imply acceptance of the Audit’s findings and conclusions, the Commission may not now rely on those findings and conclusions for ratemaking purposes. PGW Main Brief, at 72. Such a claim can not withstand examination. If PGW wanted to contest specific Audit conclusions and findings, it had the full opportunity to provide Rebuttal Testimony, cross examination and Rejoinder Testimony with regard to all elements of the Audit. It can not now be heard to say that somehow, the findings and conclusions contained in the Audit should be disregarded, because PGW while not formally contesting them, does not agree with them.

PGW also claims that the Audit may not be used to justify denial of PGW’s rate increase request, because CEPA et al. and other parties did not request an “adjustment” on the record based on the Audit. To do so, PGW claims, would violate its “due process” rights. PGW Main Brief, at 74. PGW provides no citations in support of this claim – which attempts to reduce a qualitative argument that no rate increase may be justified because of serious service and management deficiencies, to a matter of making a specific adjustment to a fundamentally unjustifiable rate increase request. Moreover, PGW had adequate notice that both CEPA et al. and the OCA considered issues of inadequate customer service and historical mismanagement to be relevant to the rate

determinations in this case. Indeed, in addition to full litigation of two discovery disputes concerning the relevance of interrogatories concerning customer service and management issues, PGW sought unsuccessfully through a Motion in Limine to impose a bar upon consideration of such issues in this case.⁹

Finally, PGW argues that whatever customer service problems and financial management problems PGW may have had are largely in the past, that PGW is committed to improvements, and that customers should be ordered to provide all the resources necessary to fund those improvements. PGW Main Brief, at 82-84. As set forth in CEPA et al.'s Main Brief, at 12-21, the record does not support this position. Despite individual measures which PGW may have taken in the last few months, the Audit identifies structural issues which have plagued PGW customers for over two years now, and will not be soon remedied. Major areas identified by the Management Audit have not been addressed, including inadequate customer service which PGW itself will not commit to improve to industry standards for yet two more years, a depleted cash position due to mismanagement which PGW seeks to replenish solely from ratepayer funds, and the need to streamline PGW's governance.

As D.C. Transit suggests, an order such as that requested by CEPA et al. denying any further base rate increase until PGW's owner, the City of Philadelphia, has demonstrated its willingness through an infusion of cash to shoulder some of the burden caused by the City's mismanagement of PGW, would normally require the strong, comprehensive evidentiary basis that only an audit of the dimensions performed by the

⁹ See Order #5 Granting in Part Motion of CEPA et al. to Dismiss Objections and to Compel Answers to Interrogatories CEPA-1 through 21, 23 through 30, 32 through 42, and CEPA-49 of CEPA et al.'s First Set of Interrogatories, April, 2001; Order # 4 Granting OCA's Motion to Dismiss Objections and to Compel Answers to Interrogatory 31 of OCA Set II, and Interrogatories 15, 23-26, 28-32, 34-37, 39-41, 45-46 and 51 of OCA Set II (April 17, 2001); Order #3 Denying PGW's Motion in Limine, April 13, 2001.

Barrington-Wellesley Group can provide. The BWG Audit provides that record foundation strong enough to withstand any appeal that PGW might bring. It is a proper foundation for a denial of a rate increase on the grounds that rates must follow service, not proceed them.

V. Conclusion.

For all the foregoing reasons, CEPA et al. respectfully request the Administrative Law Judge to recommend that the Commission:

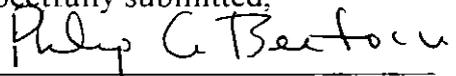
(a) declare that the requested base rate increase above the existing interim base rates are unjust and unreasonable;

(b) 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;

(c) 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).

(d) grant PGW customers such other relief as is just and reasonable.

Respectfully submitted,



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

Date: June 29, 2001

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1424 Chestnut Street, 4th Floor
Philadelphia, PA 19102
(215) 981-3702

R-00006042

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JUN 29 2001

CERTIFICATE OF SERVICE

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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

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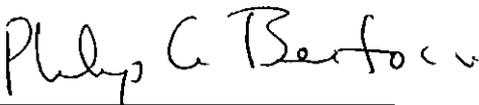
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PHILIP A. BERTOCCI

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COMMONWEALTH OF PENNSYLVANIA
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IN REPLY PLEASE
REFER TO OUR FILE

July 10, 2001

KJR

James McNulty, Secretary
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R-00006042

In Re: Docket No. ~~R-0006042~~
Pennsylvania Public Utility Commission
v.
Philadelphia Gas Works

Dear Secretary McNulty:

Enclosed for filing please find corrected pages for the Reply Brief of the Office of Trial Staff in the above-captioned proceeding.

Copies are being served on all active parties of record.

Sincerely,

Johnnie E. Simms
Senior Prosecutor

c: Parties of Record
Honorable Cynthia W. Fordham

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FOLDER

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PGW is requesting that the Commission adopt its position which is based on a forecasting computer model, without affording the Commission the independent ability to test the accuracy of the computer model, since the Company provided none of the inputs involved in the forecasts. In contrast, OTS witness Kubas has provided detailed Exhibits and Schedules to support his position that there should be an upward adjustment of approximately \$32.5 million resulting from changes to PGW's projected average annual usage per residential and commercial customers.

3. OTS' Adjustments to PGW's Promotional Activities and Rate Case Expense.

A. Legal Standard

In responding to both the Promotional Activities and Rate Case Expense adjustments, PGW argues that the adjustments are in violation of prior ratemaking method, and that its rates must cover all of the Company's expenses. With respect to prior ratemaking method, OTS submits that the Company has misinterpreted the "prior ratemaking method", because the concept "prior ratemaking method" only distinguishes between the ratemaking concepts of PGW's "cash flow method" versus the Commission traditional investor-owned "rate base/rate of return" method. Pursuant to 66 Pa. C.S. A. Section 2212(e), the Commission is only obligated to follow the PGW's prior ratemaking method of using the "cash flow method" in setting rates. The Public Utility Code does not prohibit the

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Commission from making adjustments to PGW's "claimed expenses" in order to ensure that the rates are just and reasonable.

Moreover, the Company's argument that all expenses must be covered by rates fails to recognize the reality of ratemaking. In that regard, using the Company's claimed Promotional Expenses as an example, the Company will not be in violation of Section VII of the Management Agreement as the Company will simply have less money available from ratepayers to pursue its Promotion Activities. In fact, as the Company readily admits, since the inception of the Promotion Program, PGW has only expended a total of \$558,103 and no more than \$383,193 in any one year, while budgeting \$1.6 million every year (OTS Main Brief at pages 37-39).

In addressing the rate case expense adjustment, PGW also argues that the PGC *never denied rate case expense based on the relevance of someone's testimony*. Presumably, the PGC never encountered testimony from a witness discussing the difference between a municipal owned utility from an investor owned utility, because such testimony is totally irrelevant for the purpose of setting rates for PGW using the cash flow method. While PGW argues on page 47 of its Main Brief that it should be allowed to determine what is necessary to meet its burden of proof and prove its own case, OTS submits that is correct with certain limitations. One limitation imposed is that the Commission must *determine what reasonable rate case expense will be charged to ratepayers, and*

OTS submits that total irrelevant testimony addressing a issue that is not remotely related to any issue in this proceeding is not just and reasonable.

Notably, PGW argues that "other parties, particularly the OCA and CEPA, have drawn parallels to investor-owned utilities" (PGW Main Brief at page 48). OTS respectfully submits that such an argument is nonsensical, assuming arguendo, if the Company was addressing the direct case of OCA and CEPA, then the direct testimony of Mr. Lukens would have been presented in the rebuttal phase of the proceeding not in the Company's case-in-chief. The Company's argument is even more nonsensical when one considers that CEPA did not sponsor any witnesses in this proceeding. Simply put, the Company's argument regarding the OCA and CEPA is a red herring at best, as it is simply an attempt to create some nexus between "any" remote issue in this proceeding and the direct testimony of Mr. Lukens. The problem with the Company's argument is that Mr. Lukens direct testimony was filed with the initial Filing and not in the rebuttal phase of the proceeding, if the purpose of the direct testimony as suggested by PGW was to address issues sponsored by OCA and CEPA.

Consequently, the Company's arguments are without merit and should be rejected.

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 July 10, 2001, either personally, by first class mail, electronic mail, or by fax upon the persons listed below:

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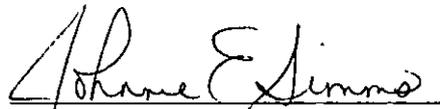
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A handwritten signature in black ink, reading "Johnnie E. Simms", written over a horizontal line.

Johnnie E. Simms
Senior Prosecutor
Office of Trial Staff

Dated: July 10, 2001
Docket No. R-00006042