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August 10, 2007

VIA HAND DELIVERY

James McNulty, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
2nd Fl., 400 North Street
P.O. Box 3265
Harrisburg, PA 17105-3265

SECRETARY'S BUREAU
2007 AUG 10 PM 1:45

Re: PA PUC v. PGW, Docket No. R-00061931

Dear Secretary McNulty:

On behalf of Philadelphia Gas Works, enclosed for filing please find an original and three copies of its Petition for Waiver of Exceptions Page Limit with regard to the above-referenced matter. A copy has been served in accordance with the attached Certificate of Service.

Very truly yours,



Daniel Clearfield

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

DC/lww
Enclosure

cc: Hon. Cynthia Fordham w/enc.
Hon. Angela Jones w/enc.
Cheryl Davis, w/enc.
Kathryn Sophy, w/enc.
Cert. of Service w/enc.

DOCUMENT FOLDER

HAR:74907.1/PHI211-236005

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-00061931
 :
 Philadelphia Gas Works :

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2007 AUG 10 PM 1:45
SECRETARY'S BUREAU

**PHILADELPHIA GAS WORKS' PETITION FOR
WAIVER OF EXCEPTIONS PAGE LIMIT**

Pursuant to 52 Pa. Code § 5.43, Philadelphia Gas Works ("PGW") hereby requests the Pennsylvania Public Utility Commission ("PUC" or "Commission") grant a 20 page expansion of the 40 page limit for all exceptions, due Monday, August 20, in the above proceeding. As some parties have indicated that they will not oppose this request so long as the page limit for all reply exceptions is also expanded, PGW is requesting that the 25 page limit for all reply exceptions be expanded by 15 pages. In support of this motion PGW states as follows:

1. On July 30, 2007 the Recommended Decision ("RD") in the PUC's Investigation of PGW's request for a \$100 million, 9.6% base rate increase was filed. As noted, Exceptions are due August 20, 2007. The RD was 136 pages and contained several appendices. The RD resolved scores of issues presented by some eleven parties.

2. The letter accompanying the RD affirmed that the general page limit for exceptions and reply exceptions (40 pages and 25 pages respectively) as set forth at 52 Pa. Code §§ 5.533 and 5.535 applied to the submissions in this proceeding.

3. Due to the number and complexity of the issues that must be addressed in its Exceptions, PGW is concerned that it will not be able to cogently explain its position for the benefit of the Commission within the existing 40 page limit in what is an extremely important proceeding for the Company

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DOCKETED
AUG 14 2007

4. PGW believes that a general limitation of 60 pages – 20 pages greater than the current limitation – would permit PGW to better present its rationale for its Exceptions while not burdening the PUC or Staff.

5. PGW has contacted the parties to the proceeding to seek their non-opposition to this request. Several parties indicated that they will not oppose PGW's request if the page limit for reply exceptions is also expanded. Accordingly, PGW is requesting that the page limit for all reply exceptions be expanded by 15 pages or a 40 page limit.

WHEREFORE, Philadelphia Gas Works respectfully requests that the Commission revise the page limitation for all exceptions to 60 pages and the limit for all reply exceptions to 40 pages.

Respectfully submitted,



Daniel Clearfield, Esq.
Wolf, Block, Schorr and Solis-Cohen LLP
213 Market Street, 9th Floor
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Harrisburg, PA 17108-0865
(717) 237-7173

Of Counsel:
Gregory J. Stunder, Esq.
Philadelphia Gas Works
800 West Montgomery Ave
Philadelphia, PA 19122

Dated: August 10, 2007

RECEIVED
2007 AUG 10 PM 1:45
SECRETARY'S BUREAU

CERTIFICATE OF SERVICE

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

VIA E-MAIL & FIRST CLASS MAIL

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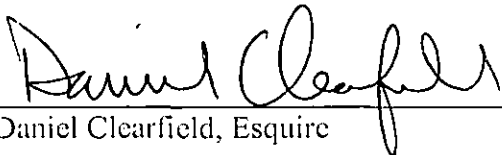
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Dated: August 10, 2007

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12:50 PM
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COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

August 14, 2007

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

ORIGINAL

Re: Pennsylvania Public Utility Commission v.
Philadelphia Gas Works

Docket No. R-00061931

Dear Secretary McNulty:

In accordance with your Secretarial Letter dated August 13, 2007, regarding the Petition for Waiver of Exceptions Page Limit filed on behalf of PGW in the above-referenced case, the Office of Trial is hereby filing this letter indicating our office non-opposition to PGW's request if the page limit for reply exceptions is also expanded.

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

Sincerely,

Johnnie E. Simms
Chief Prosecutor
Office of Trial Staff
PA Attorney I.D. #33911

DOCKETED
SEPT
AUG 27 2007

2007 AUG 14 11:00:00
SECRETARY'S OFFICE

Enclosure
JES/clp

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :

v. :

Docket No. R-00061931

Philadelphia Gas Works :

20071213 14:00
S. J. ...
11/10:00

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Correspondence**, dated August 14, 2007, either personally, by first class mail, electronic mail, express mail and/or by fax upon the persons listed below, in accordance with the requirements of § 1.54 (relating to service by a party):

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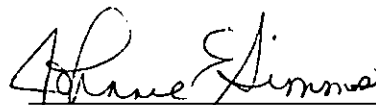
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Katherine Guerry
Hess Corporation
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Johnnie E. Simms
Chief Prosecutor
Office of Trial Staff
PA Attorney I.D. #33911

Dated: August 14, 2007
Docket No. R-00061931



COMMUNITY LEGAL SERVICES
OF PHILADELPHIA

August 14, 2007

ORIGINAL

Via Fed Ex Overnight

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

RECEIVED

AUG 14 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Re: PA PUC v. Philadelphia Gas Works
Docket No. R-00061931

Dear Secretary McNulty:

Enclosed please find for filing the original and three copies of the Answer of Action Alliance of Senior Citizens of Greater Philadelphia and Tenant Union Representative Network to Philadelphia Gas Works' Petition for Waiver of Exceptions Page Limit, in the above-captioned proceeding. This Answer was served electronically prior to 12:00 noon this date upon on the Office of Special Assistants (cwalkerday@state.pa.us, ksophy@state.pa.us, rmarinko@state.pa.us, tmaher@state.pa.us) and upon all parties of record as set forth in the Certificate of Service.

Very truly yours,

Philip A. Bertocci

Philip A. Bertocci, Esquire
Thu B. Tran, Esquire

DOCUMENT
FOLDER

Attorneys for Action Alliance et al.

KJR

Enclosures

cc: Certificate of Service

48

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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AUG 14 2007

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

v.

Docket No. R-00061931

PHILADELPHIA GAS WORKS

ANSWER OF ACTION ALLIANCE et al.
TO PHILADELPHIA GAS WORKS' PETITION FOR WAIVER
OF EXCEPTIONS PAGE LIMIT

Pursuant to 52 Pa.Code § 5.61, Action Alliance of Senior Citizens of Greater Philadelphia and the Tenant Union Representative Network (hereinafter "Action Alliance") hereby file this answer in support of the Philadelphia Gas Works' Petition for Waiver of Exceptions Page Limit, as follows:

- 1. Admitted.
- 2. Admitted.

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FOLDER

DOCKETED
AUG 16 2007

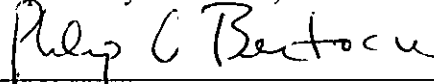
3.-4. As an active party in this proceeding, Action Alliance admits that the proceeding presents many issues that PGW is likely to address in Exceptions, in its efforts to overturn longstanding Commission ratemaking principles and methodologies. While Action Alliance strongly questions whether PGW is likely to prevail in its Exceptions, Action Alliance does not oppose allowing PGW the requested additional pages in which to set forth those Exceptions in a more extended manner. Whether allowing such additional pages for PGW's Exceptions would burden the PUC or Staff, Action Alliance is without sufficient knowledge to affirm or deny that

part of the allegation.

5. If the Commission grants the instant Petition, the Commission should also allow parties which file Reply Exceptions an additional fifteen (15) pages, in which to respond to PGW's Exceptions as extended. It would be inequitable to allow PGW an extended number of pages for its Exceptions, without allowing those who might wish to reply to these extended Exceptions with a proportionately greater additional number of pages.

WHEREFORE, Action Alliance respectfully informs the Commission that it does not oppose PGW's Petition for a waiver of existing page limitation on Exceptions, subject to the condition that the Commission extend the page limitation for Reply Exceptions by fifteen (15) pages.

Respectfully submitted,



PHILIP A. BERTOCCHI, ESQUIRE
THU B. TRAN, ESQUIRE

Attorneys for Action Alliance of Senior Citizens
and the Tenant Union Representative Network

August 14, 2007

Pennsylvania Public Utility Commission :
 v. : Docket Nos. R-00061931
 Philadelphia Gas Works :

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the Answer to PGW's Petition for Waiver of Exceptions Page Limit, upon the 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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Hess Corporation



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Attorneys for Action Alliance, et al.

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August 14, 2007

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August 14, 2007

VIA HAND DELIVERY

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Harrisburg, Pennsylvania 17120

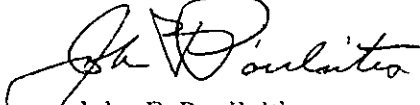
2007 AUG 14 11:12
SECRET

Re: Pennsylvania Public Utility Commission
v.
Philadelphia Gas Works, Docket No. R-00061931

Dear Secretary McNulty:

Enclosed are an original and three (3) copies of the Answer of Hess Corporation to Philadelphia Gas Works' Petition for Waiver of Exceptions Page Limit in the above-captioned proceeding. Copies have been served in accordance with the attached Certificate of Service.

Very truly yours,


John F. Povilaitis

DOCUMENT
FOLDER

Enclosure
JFP:ck

c. Certificate of Service

KJR

ORIGINAL

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

2007 AUG 14 10:11:12
REGISTRATION BUREAU

Pennsylvania Public Utility Commission :
v. : Docket No. R-00061931
Philadelphia Gas Works :

**ANSWER OF HESS CORPORATION TO PHILADELPHIA GAS WORKS'
PETITION FOR WAIVER OF EXCEPTIONS PAGE LIMIT**

Hess Corporation ("Hess"), pursuant to Section 5.61(e) of the Pennsylvania Public Utility Commission ("Commission") regulations, 52 Pa. Code § 5.61(e), submits the following Answer to Philadelphia Gas Works' ("PGW") Petition for Waiver of Exceptions Page Limit and states the following:

1. On August 10, 2007, PGW petitioned the Commission to revise and expand the page limit for Exceptions in the above-captioned proceeding from 40 pages to 60 pages. PGW indicated in this Petition that several parties indicated non-opposition to this request, provided the page limit for Replies to Exceptions was also expanded from 25 pages to 40 pages. PGW's request therefore also includes expansion of the Reply to Exceptions page limit from 25 to 40 pages.

2. Hess indicated non-opposition to PGW's request to increase the Exceptions page limit, as conditioned on an increase in the page length of Replies to Exceptions.

**DOCUMENT
FOLDER**


DOCKETED
AUG 14 2007

3. By Secretarial Letter of August 13, 2007 the Commission requested Answers to PGW's Petition electronically by noon, August 14, 2007 and in hard copy by close of business that same day.

4. Hess does not oppose the Commission granting PGW's request to enlarge the Exceptions page limit to 60 pages and to enlarge the page limit for Replies to Exceptions to 40 pages in this proceeding.

WHEREFORE, Hess does not oppose the granting of PGW's Petition for Waiver of Exceptions Page Limit.

Date: August 14, 2007



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Counsel for Hess Corporation

COMMONWEALTH OF PENNSYLVANIA

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

2007 JUN 14 11:12
SECURITY

Pennsylvania Public Utility Commission :
 :
v. : Docket No. R-00061931
 :
Philadelphia Gas Works :

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the attached documents in accordance with the requirements of 52 Pa. Code § 1.54 et seq. (relating to service by a participant).

VIA FIRST CLASS AND ELECTRONIC MAIL

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Date: August 14, 2007



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Counsel for Hess Corporation



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William R. Lloyd, Jr.
Small Business Advocate

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August 14, 2007

HAND DELIVERED

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
P. O. Box 3265
Harrisburg, PA 17105-3265

ORIGINAL

**Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00061931**

DOCUMENT
FOLDER

Dear Secretary McNulty:

I am delivering for filing today the original plus three copies of the Answer to the Petition of PGW for a Waiver of Exceptions Page Limit, on behalf of the Office of Small Business Advocate, in the above-captioned matter.

Electronic copies have been served today on all known parties in this proceeding. A Certificate of Service to that effect is enclosed.

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

Sincerely,

Sharon E. Webb
Assistant Small Business Advocate
Attorney ID No. 73995

Enclosures

cc: Parties of Record

KJR

2007 AUG 24 PM 3:21
SECRETARY'S OFFICE

24

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

Pennsylvania Public Utility Commission :
v. : Docket No. P-00061931
Philadelphia Gas Works :

**DOCUMENT
FOLDER**

DOCKETED
AUG 16 2007

2007 AUG 21 11:31:22
SECRETARY'S BUREAU

**ANSWER OF THE
OFFICE OF SMALL BUSINESS ADVOCATE**

On or about August 10, 2007, the Philadelphia Gas Works ("PGW") filed with the Pennsylvania Public Utility Commission ("Commission") the Petition of PGW for a Waiver of Exceptions Page Limit. Subsequently, on August 13, 2007, the Commission issued a Secretarial Letter directing parties of record to file answers electronically by or before 12:00 Noon, on Tuesday, August 14, 2007, with a hard copy filed with the Secretary's Bureau by close of business on August 14, 2007. This answer is filed in accordance with the directive set forth in the Commission's August 13, 2007, Secretarial Letter. The act of December 21, 1988 (P.L. 1871, No. 181), authorizes the Office of Small Business Advocate ("OSBA") to represent the interest of small business consumers before the Commission. Therefore, pursuant to 52 Pa. Code §5.61, the OSBA answers the Petition as follows:

Answer to Introductory Paragraph

Unnumbered Paragraph 1. The averments of unnumbered paragraph 1 are a summary of the relief requested to which no response is required. If, and to the extent

that, a response may be required, it is admitted that PGW is seeking approval of a waiver of the page limit for exceptions and reply exceptions to the Recommended Decision issued on July 30, 2007.

Answer to Numbered Paragraphs

Paragraph Number 1. Admitted.

Paragraph Number 2. Admitted.

Paragraph Number 3. The averments of paragraph number 3 are a summary of the request for relief to which no response is required. If, and to the extent that, a response may be required, the OSBA is without sufficient knowledge or information to form a belief as to the truth of the averment that PGW will not be able to explain its position cogently for the benefit of the Commission within the existing 40 page limit.

Paragraph Number 4. The averments of paragraph number 4 are a summary of the request for relief to which no response is required. If, and to the extent that, a response may be required, the OSBA is without sufficient knowledge or information to form a belief as to the truth of the averment that PGW will be better able to present the rationale for its exceptions without burdening the Commission with the increased page limit of 60 pages, which is 20 more than the current limit.

Paragraph Number 5. The averments of paragraph number 5 are a summary of the request for relief to which no response is required. If, and to the extent that, a response may be required, it is admitted that counsel for PGW communicated to the parties of record PGW's desire to request a waiver for the current 40 page limit set for exceptions. It is further admitted that, in response, the OSBA indicated that it would not

oppose PGW's request as long as the waiver applied to all parties and as long as a corresponding page limit waiver were requested, and granted, for reply exceptions to allow the OSBA and other parties sufficient room to respond to the Company's arguments.

WHEREFORE, the OSBA respectfully requests that if the Commission grants the Company's request for a waiver of the page limit for exceptions, that it only do so with a waiver applicable to all parties of record and with a corresponding waiver to the page limit for reply exceptions.

Respectfully submitted,



Sharon E. Webb
Assistant Small Business Advocate
Attorney I.D. No. 73995

For: William R. Lloyd, Jr.
Small Business Advocate
Attorney I.D. No. 16452

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Harrisburg, PA 17101
(717) 783-2525

Dated: August 14, 2007

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

DOCKET NO. R-00061931

STATE OF PENNSYLVANIA
PUBLIC UTILITY COMMISSION

2007 APR 24 11:31:22

CERTIFICATE OF SERVICE

I certify that I am serving electronic copies of the Answer to the Petition of PGW for a Waiver of Exceptions Page Limit, on behalf of the Office of Small Business Advocate, by e-mail, upon the persons addressed below:

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Date: August 14, 2007



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August 14, 2007

VIA HAND DELIVERY

James J. McNulty, Secretary
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Harrisburg, PA 17105-3265

ORIGINAL

RECEIVED
AUG 16 2007

RE: Pennsylvania Public Utility Commission v. Philadelphia Gas Works; Docket No. R-00061931, et al.; **NON-OPPOSITION TO PETITION FOR WAIVER OF EXCEPTION LIMIT**

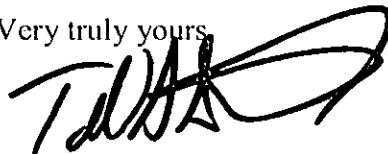
Dear Secretary McNulty:

Please consider this letter formal notice that Interstate Gas Supply, Inc., (“IGS”) does not oppose the request of the Philadelphia Gas Works (“PGW”) filed August 10, 2007, for a Waiver of Exceptions Page Limit with regard to the above-captioned matter. IGS does not oppose PGW’s request so long as the Commission also extends the page limitation for replies to exceptions.

If you have any questions regarding this response, please do not hesitate to contact the undersigned.

**DOCUMENT
FOLDER**

Very truly yours,



Todd S. Stewart
Counsel for Interstate Gas Supply, Inc.

DOCKETED
AUG 16 2007

TSS/bks

cc: Office of Special Assistants: cwalkerdav@state.pa.us; ksophy@state.pa.us; rmarinko@state.pa.us; tmaher@state.pa.us

KJR

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document upon the parties, listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party).

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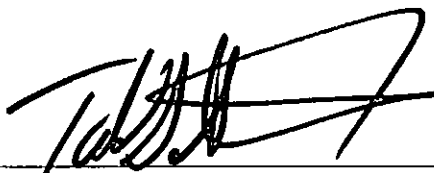
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Todd S. Stewart

Dated this 14th day of August, 2007.



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August 14, 2007

VIA HAND DELIVERY

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
The Commonwealth Keystone Building
400 North Street, 2nd Floor
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ORIGINAL

**Re: Pennsylvania Public Utility Commission, et al. v. Philadelphia Gas Works;
Docket No. R-00061931**


Dear Secretary McNulty:

The Philadelphia Industrial and Commercial Gas Users Group does not oppose Philadelphia Gas Works' Petition for Waiver filed on August 10, 2007.

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

Very truly yours,

McNEES WALLACE & NURICK LLC

By 
Charis Mincavage

Counsel to the Philadelphia Industrial and
Commercial Gas Users Group

2007 AUG 16 11:34:17
SERIALIZED

DOCKETED
AUG 16 2007

CM/lhi
Enclosures

- c: Ms. Cheryl Walker Davis, Office of Special Assistants (via e-mail)
- Ms. Kathryn Sophy, Office of Special Assistants (via e-mail)
- Mr. Robert Marinko, Office of Special Assistants (via e-mail)
- Certificate of Service

KJR

23

CERTIFICATE OF SERVICE

I hereby certify that I am this day serving a true copy of the foregoing document upon the participants listed below in accordance with the requirements of Section 1.54 (relating to service by a participant).

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PENN. PUBLIC UTILITY COM. STAFF

Certificate of Service
Docket No. R-00061931
Page 2

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Charis Mincavage

Dated this 14th day of August, 2007, in Harrisburg, Pennsylvania.



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August 14, 2007

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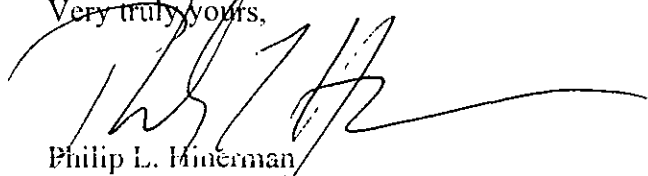
**DOCUMENT
FOLDER**

Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00061931

Dear Secretary:

The Philadelphia Housing Authority does not oppose Philadelphia Gas Works' Petition for Waiver of the Page Limit for Exceptions and Reply Exceptions. A copy of this letter has been served pursuant to the attached Certificate of Services.

Very truly yours,



Philip L. Hinerman

DOCKETED
AUG 17 2007

PLH/mn

cc: All Parties of Record
Cheryl Walker Davis, Office of Special Assistants
Kathryn G. Sophy, Office of Special Assistants
Robert Marinko, Office of Special Assistants
Thomas J. Maher, Office of Special Assistants

KJR



A Pennsylvania Limited Liability Partnership

California Delaware Florida Nevada New Jersey New York Pennsylvania

CERTIFICATE OF SERVICE

I hereby certify that I am serving a true and correct copy of the foregoing Philadelphia Housing Authority's Letter Not Opposing Philadelphia Gas Works' Petition for Waiver of the Page Limit for Exceptions and reply Exceptions, in accordance with the requirements of 52 Pa.Code §1.54 has been served upon the following person(s) via First Class Mail, postage prepaid:

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2007 AUG 17 AM 8:28

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PHILIP L. HINERMAN

Dated: August 14, 2007



ORIGINAL

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IRWINA. POPOWSKY
Consumer Advocate

FAX (717) 783-7152
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August 14, 2007

James McNulty
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
2nd Floor, 400 North Street
PO Box 3265
Harrisburg, PA 17105-3265

DOCUMENT
FOLDER

2007 AUG 14 PM 3:59

RE: Pennsylvania Public Utility Commission v. PGW
Docket No. R-00061931

Dear Secretary McNulty:

The Office of Consumer Advocate does not oppose Philadelphia Gas Works' Petition for Waiver of the Page Limit for Exceptions and Reply Exceptions. A copy of this letter has been served pursuant to the attached Certificate of Service.

DOCKETED
AUG 16 2007

Sincerely,

Christy M. Appleby
Assistant Consumer Advocate
Pa. Attorney ID No. 85824
E-mail: cappleby@paoca.org

cc: All parties of record
Cheryl Walker Davis, Office of Special Assistants
Kathryn G. Sophy, Office of Special Assistants
Robert Marinko, Office of Special Assistants
Thomas J. Maher, Office of Special Assistants

KJR

72

CERTIFICATE OF SERVICE

ORIGINAL

Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

:
:
:
:
:

Docket No. R-00061931

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

Dated this 14th day of August 2007.

SERVICE BY E-MAIL and INTEROFFICE MAIL

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2007 AUG 14 PM 3:59
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COMMONWEALTH OF PENNSYLVANIA

DATE: August 14, 2007

SUBJECT: R-00061931

TO: Office of Special Assistants

FROM: James J. McNulty, Secretary

KJR

Pennsylvania Public Utility Commission
v.
Philadelphia Gas Works

Attached is a copy of a Petition for Waiver of Exceptions Page Limit, filed by Philadelphia Gas Works in connection with the above docketed proceeding.

This matter is assigned to your Office for appropriate action.

Attachment

ksb

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DOCKETED
AUG 14 2007



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August 20, 2007

VIA HAND DELIVERY

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

DOCUMENT
FOLDER

**Re: Pennsylvania Public Utility Commission, et al. v. Philadelphia Gas Works;
Docket No. R-00061931**

Dear Secretary McNulty:

Please find enclosed the original and nine (9) copies of the Exceptions of the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG"), in the above-referenced proceeding. In addition, please find an electronic version of the Exceptions on diskette in Word Format.

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

Very truly yours,

KJR

McNEES WALLACE & NURICK LLC

By 
Charis Mincavage

Counsel to the Philadelphia Industrial and
Commercial Gas Users Group

CM/lhi

Enclosures

- c: Ms. Cheryl Walker Davis, Esq., Office of Special Assistants (via hand delivery w/ diskette in Word Format)
- Administrative Law Judge Cynthia Fordham (via First Class Mail)
- Administrative Law Judge Angela Jones (via First Class Mail)
- Certificate of Service



BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

:
:
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:
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:

DOCKET NO. R-00061931

EXCEPTIONS OF
THE PHILADELPHIA INDUSTRIAL AND COMMERCIAL
GAS USERS GROUP

Building Owners' and Managers'
Association of Philadelphia
Philadelphia College of Osteopathic Medicine
Temple University
Thomas Jefferson University/Jefferson Health System

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Dated: August 20, 2007

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I. INTRODUCTION

On December 22, 2006, Philadelphia Gas Works ("PGW" or "Company") filed with the Pennsylvania Public Utility Commission ("PUC" or "Commission") Supplement No. 16 to Tariff Gas – Pa. P.U.C. No. 2, requesting approval of proposed changes in rates designed to produce over approximately \$100 million in additional annual revenues. On February 5, 2007, the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG") filed a Complaint in this proceeding. Shortly thereafter, the PUC assigned this proceeding to Administrative Law Judges ("ALJs") Cynthia Williams Fordham and Angela T. Jones, who developed a procedural schedule, which included the submission of Main Briefs ("M.B.") and Reply Briefs ("R.B."). On July 30, 2007, the PUC issued the *Recommended Decision* ("R.D.") of the ALJs.

PICGUG commends the ALJs on a well-reasoned and thorough R.D., which appropriately finds that PGW has presented evidence in this proceeding warranting nothing more than a \$25 million rate increase. Similarly, the ALJs reasonably recommend that PGW be required to immediately implement cost-based interruptible transportation rates, as precedent requires that transportation rates be set on a cost-to-serve basis.

Although the ALJs appropriately address the majority of the issues in this proceeding, the R.D. contains one recommendation that would inappropriately allow the Company to collect rates without accounting for cost-causation requirements and PUC precedent. PICGUG files these *Exceptions* in order to except to the ALJs' recommendation that PGW be permitted to continue to allocate its Universal Service and Energy Conservation ("USC") surcharge to all firm service customs, even though only the residential customer class benefits from the programs funded by this surcharge. As addressed more fully in these *Exceptions*, the PUC must reject the ALJs' recommendation on this one very narrow, but important, issue.

II. EXCEPTIONS

1. **Exception No. 1: The Administrative Law Judges Erred in Recommending that Philadelphia Gas Works Should Continue to Allocate the Universal Service and Energy Conservation Surcharge to All Firm Service Customers.**

In reviewing various rate design issues, the ALJs address the fact that, while PGW has historically allocated its USC surcharge to all firm service customers, the Commission previously indicated in PGW's Restructuring Proceeding that the issue of this allocation would be appropriately reviewed in a base rate case. R.D. at 73-77. In addition, the ALJs note that, as part of the PUC's recent investigation regarding universal service and energy conservation policies, the Commission indicated that movement should be made with respect to assigning the costs of universal service programs to only the residential customer class. *Id.* at 77-79.

Unfortunately, the ALJs fail to implement the aforementioned Commission policies by unreasonably determining that the shifting of costs that would result from reallocating PGW's USC surcharge to only the residential customer class would result in rate shock. *Id.* at 80-81. In actuality, any concerns regarding "rate shock" are obviated through the Office of Small Business Advocate's ("OSBA") proposal to gradually phase-out the non-residential allocation over a three-year period. PICGUG M.B., p. 24. Accordingly, the ALJs' recommendation to continue to maintain the current unjust and unreasonable USC allocation must not be adopted by this Commission.

As discussed in detail in PICGUG's Main and Reply Briefs, the Commission has had a long-standing policy of declining to allocate USC costs to non-residential rate classes, as universal service programs only benefit the residential class and therefore should be funded by only the residential class. *Id.* at 22-24; PICGUG R.B., p. 13. Moreover, the Commission recently declared, as part of its investigation of Customer Assistance Programs (*i.e.*, the "CAP

Investigation") that cost causation policies require USC costs be allocated only to the customer class whose members are eligible for such programs (i.e., the residential class). PICGUG M.B., pp. 23-24.

In addition, the PUC has indicated that this issue is ripe for review with respect to PGW. Id. at 22-23. During PGW's Restructuring Proceeding, the PUC suggested that a base rate proceeding would provide a more reasonable venue for such discussion, as a base rate case would contain a Cost of Service Study that would allow for further analysis regarding USC cost reassignment. Id. As part of the PUC's CAP Investigation, the Commission recognized that PGW's USC allocation was determined prior to the PUC's oversight of the Company; however, the CAP investigation did not prohibit modifying PGW's inappropriate USC allocation on a going-forward basis. Rather, the results of the CAP investigation indicated an assumption by the PUC that this issue would be address at a later time (i.e., PGW's current base rate proceeding). Id. at 23-24; PICGUG R.B., p. 13. In other words, as correctly noted by the ALJs, the Commission is clearly "moving to have the costs of universal service programs assigned to the residential customers." R.D. at 80.

Unfortunately, while the ALJs recognize that Commission precedent, including cost-causation principles, require PGW to modify its USC allocation, the ALJs suggest that such a modification would be inappropriate at this time. Id. at 80-81. According to the ALJs, reallocation of USC costs over a three-year period, as proposed by the OSBA, would result in "rate shock" for residential customers. Id. In actuality, a gradual phase-out of this allocation to non-residential customers would mitigate against any rate shock for the residential customer class while also ensuring implementation of the Commission's directive to move towards a more appropriate USC allocation. PICGUG M.B., pp. 24-25; PICGUG R.B., pp. 13-14.

In this proceeding, the OSBA proposed a three-year phase-out of the current USC allocation, thereby revising PGW's current (and inappropriate) allocation while still addressing any concerns of "rate shock" and "gradualism." PICGUG M.B., pp. 24-25. Under this approach, the responsibility of non-residential customers for the USC would be reduced by one-third during PGW's 2008 Gas Cost Rate ("GCR") proceeding. A second one-third reduction would take place in PGW's 2009 GCR proceeding, with the final phase-out occurring in PGW's 2010 proceeding. *Id.* at 24. This proposal would result in a residential customer class increase of approximately 1.3% per year for the next three years for a total increase of 3.8%. R.D. at 80. Conversely, commercial customers would receive a rate decrease of approximately 3.9% per year for the next three years for a total rate decrease of 11.7%. R.D. at 80.

Regrettably, the ALJs fail to recognize that the OSBA's plan ensures against rate shock by allowing for a gradual (and minimal) rate increase of slightly over 1% per year for the residential customer class over the next three years. *Id.* at 81. Obviously, reassigning USC costs will result in modifications to customers' rates; however, the OSBA's proposal exemplifies gradualism by phasing-out the USC allocation from non-residential customers over a three-year period. Moreover, this proposal virtually eliminates rate shock by resulting in a slightly more than 1% increase per year for the residential customer class. PICGUG M.B., pp. 24-25.

The ALJs also claim that modifying the USC allocation in this proceeding would not be prudent because the R.D. suggests assigning the majority of the proposed \$25 million rate increase to the residential customer class. R.D. at 81. Importantly, the reason for this recommended allocation stems from the fact that commercial and industrial customers are currently and significantly subsidizing the residential customer class. *Id.* at 72. Due to this unreasonable subsidization, the ALJs appropriately recommend that the majority of any rate

increase be allocated to the residential customer class. Id. Unfortunately, the ALJs' unwillingness to modify the USC allocation would diminish any progress made with respect to decreasing this current subsidization.


The ALJs reasonably recognize that it "is clear that the Commission is moving to have the costs of universal service programs assigned to the residential customers." Id. at 80. The OSBA's phase-out proposal exemplifies the Commission's directive by providing a gradual basis upon which to modify the allocation of USC costs while also preventing rate shock by providing for a minimal rate increase of slightly over 1% per year for three years to the residential customer class. Only by implementing the OSBA's phase-out proposal can the PUC ensure that its mandate of moving towards the assignment of USC costs to residential customers is implemented while still being cognizant of the overall impact of this modification on all customer classes. For this reason, the PUC must reject the ALJs' recommendation and adopt the OSBA's proposal.

III. CONCLUSION

WHEREFORE, the Philadelphia Industrial and Commercial Gas Users Group respectfully requests that the Pennsylvania Public Utility Commission adopt a three-year phase out of any Universal Service and Energy Conservation Costs so that these costs are no longer allocated to non-residential customers.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I am this day serving a true copy of the foregoing document upon the participants listed below in accordance with the requirements of Section 1.54 (relating to service by a participant).

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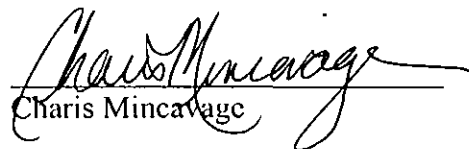
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RE: Pennsylvania Public Utility Commission
v.
Philadelphia Gas Works
Docket No. R-00061931

Dear Secretary McNulty:

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

Copies have been served on the parties of record as indicated on the enclosed Certificate of Service.

Sincerely,

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KJR

Enclosures

cc: Hon. Cynthia W. Fordham, ALJ
Hon. Angela T. Jones, ALJ

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

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Docket No. R-00061931

EXCEPTIONS OF THE
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I. INTRODUCTION

On July 24, 2007, the Office of Administrative Law Judge issued the Recommended Decision (R.D.) of Administrative Law Judges (ALJs) Cynthia Williams Fordham and Angela T. Jones in the above-captioned case. In the R.D., the ALJs recommended that Philadelphia Gas Works (PGW or the Company) be permitted to increase its annual natural gas base distribution operating revenues by \$25 million. R.D. at 55.

The ALJs also ruled on numerous issues including expense adjustments, cost of service methodologies, the revenue allocation between the different rate classes, rate design, Tariff revisions, universal service collection, and proposals to enact electronic funds transfer and mandatory budget billing programs, as proposed by the various parties to the proceeding. In most regards, the OCA supports the Recommended Decision, finding the ALJs' resolution of the many issues in this case to be reasonable and well-supported. Of particular note, the ALJs' recommended annual revenue increase of \$25 million is solidly based on the Commission's determinations in prior PGW proceedings and sound ratemaking principles that give full effect to the future test year concept used to establish just and reasonable rates. The ALJs also properly recognized that PGW's recovery of its universal service costs and its senior discount costs should continue to be collected from all firm service customers, as PGW has always done.

As to the allocation of the \$25 million rate increase among the various customer classes, the ALJs recommended adoption of a First Dollar Relief proposal sponsored by the Office of Trial Staff and the Office of Small Business Advocate. Under this methodology, approximately \$24.3 million of the \$25 million rate increase allowed by the ALJs will be collected from the residential customer classes. A similarly disproportionate burden would result at any rate increase level under the First Dollar Relief proposal adopted by the ALJs. The

OCA submits that the ALJs' determination to require the residential customer class to almost exclusively bear the burden of this rate increase does not square with the facts of record in this proceeding regarding the cost to serve the residential class or with other factors, such as the principles of gradualism, avoidance of rate shock and rate stability that the Commission must consider when establishing just and reasonable rates. When using an appropriate cost of service study, as proposed by the OCA, it is clear that residential customers should not receive such a disproportionate increase under cost of service principles. Moreover, as the Commission is aware, PGW has a unique service territory among Pennsylvania natural gas companies. Nearly 32% of PGW's residential customers have incomes that are at or below 150% of the Federal Poverty Level and 50% have incomes at or below 250% of the Federal Poverty level, an income level that has been found to be needed to meet the basic necessities of life. Further burdening these customers with virtually all of the rate increase awarded is simply not reasonable.

As such, the OCA respectfully excepts to certain portions of the ALJs' Recommended Decision. Specifically, the OCA excepts to the ALJs' failure to utilize the OCA's cost of service study to effectuate their recommendation regarding the allocation of distribution mains and to guide the rate setting process. The OCA also excepts to the ALJs' adoption of the First Dollar Relief Method for allocating the revenue increase as it disproportionately burdens the residential customer classes with over 97% of the rate increase. Finally, the OCA excepts to the ALJs' determination that there was not substantial evidence in support of the OCA's recommended budget billing program directed to payment troubled customers.

As set forth in the OCA Briefs and below, the OCA submits that the OCA's Peak and Average cost of service study, which the ALJs found most accurately reflects the cost to

serve the respective classes, should be used as a guide to set rates in this proceeding. When the OCA's cost of service study is used as a guide, it can be seen that the residential class is providing a return at or near the system average, *i.e.*, it is meeting its cost to serve the class. See, OCA M.B. at 55, 57. Based on this determination, the OCA submits that the OCA's *proportional scale back method* should be used to allocate the revenue increase to the various classes if less than the full requested amount is granted. See, OCA M.B. at 77-79. The OCA also submits that PGW should be ordered to consider, and work with the interested parties, to develop an expanded budget billing program to assist payment troubled customers. See, OCA M.B. at 98-101.

II. EXCEPTIONS

OCA Exception No. 1: The ALJs Erred in Finding That the OCA's Cost of Service Study Could Not Be Used to Effectuate the Recommendations in the R.D. and Guide the ALJs in Allocating the Awarded Revenue Increase.
(R.D. at 56-63; OCA M.B. at 45-63; OCA R.B. at 25-34).

In the Recommended Decision, the ALJs agreed with OCA and OTS that PGW's Cost of Service Study (COSS) does not properly classify or allocate the cost of distribution mains. R.D. at 63. In particular, the ALJs agreed with OCA that the Company's study, which allocates distribution mains based on a demand and customer component, was flawed in that there should be no customer component in the allocation of distribution mains. The ALJs found that distribution mains should be allocated based on demand. R.D. at 63. The OCA submits that, as the ALJs recognized, the OCA's Peak and Average demand method accurately allocates these costs in accord with the principles of cost-causality. R.D. at 63. The OCA Peak and Average COSS in this proceeding allocates the cost of distribution mains 80% to average demands and 20% to peak demands. OCA M.B. at 46-47.

In the R.D., the ALJs agreed in principle with OCA witness Galligan's Peak and Average COSS and provided the following conclusions:

PGW's proposal to allocate 75% of the costs of distribution mains investment based on purely peak demands should be rejected. Mr. Galligan's Peak and Average COSS accurately allocates such costs based on the way PGW actually incurs costs to serve its customers, as the principle of cost-causality requires.

...
The OCA and OTS arguments relating to distribution mains are persuasive. PGW has not presented evidence to show that it is correctly classifying and allocating the cost of the distribution mains. Therefore, PGW should make the proper classification and allocation. Although OCA prepared a COSS to rebut PGW's, we do not recommend that OCA's COSS should be substituted. Once the corrections are made to the current PGW COSS, it can be used as a guide for revenue allocation. In fact, the original COSS was

bundled and PGW submitted an unbundled version in response to discovery from OSBA. Therefore, PGW can use the unbundled COSS with the correct classification and allocation for distribution mains as a guide for revenue allocation.

R.D. at 63 (emphasis added). The OCA submits that the ALJs' adoption of the OCA's COSS for classification and allocation of distribution mains was correct and should be affirmed. Unfortunately, however, the ALJs did not take the next necessary step and utilize the OCA's cost allocation methodology as a guide in establishing the revenue allocation. The ALJs incorrectly concluded that the OCA's COSS could not be substituted for the Company's COSS to guide the rate setting and revenue allocation process.

The OCA's reading of the ALJs' decision is that the OCA's COSS could not be substituted for the Company's study because it did not incorporate the other modifications to PGW's COSS recommended by the ALJs, particularly the unbundling recommended by the OSBA.¹ OSBA recommended that PGW's original COSS should only be used if it was unbundled to remove the gas costs and revenues so that it only showed the distribution costs and revenues. R.D. at 59. OSBA asked PGW for an unbundled COSS during the discovery process, and PGW supplied the study using PGW's cost of service methodology. OSBA argued that since PGW's rates were unbundled, it was not proper in this proceeding to rely on a bundled COSS. R.D. at 59-60.

While the OCA agrees that going forward, PGW should provide unbundled costs of service studies and incorporate the other adjustments recommended by the ALJs, including the use of the OCA's Peak and Average methodology in its next base rate proceeding, the

¹ The ALJs also recommended adoption of an OTS adjustment to correct the allocation of measuring and regulating station equipment. R.D. at 58-59. OTS found that 77% of the costs of measuring and regulating station equipment, primarily used to serve industrial customers, was allocated to the Residential class. R.D. at 58. OTS suggested a reallocation whereby those costs would be assigned to the industrial and interruptible classes. R.D. at 58.

modifications recommended by the ALJs in this case should not lead to the conclusion that the OCA's COSS cannot be substituted for PGW's COSS as a guide to set rates in this proceeding. Importantly, the OCA's COSS is based on the Company's study, but then modifies the allocation of distribution mains in the manner found appropriate by the ALJs. Indeed, this is the exact modification to the Company's study that the ALJs ordered.

The OCA recognizes that OSBA's unbundling recommendation would not have been carried through when the Company ran the OCA's Peak and Average study.² The OCA submits, however, that in this proceeding, the unbundling of the COSS did not impact the results of the OCA COSS to such a degree as to make it unusable as a guide for setting rates in this proceeding. OCA witness Richard Galligan provided information regarding the effect of OSBA's unbundling recommendation in the cost of service studies. Mr. Galligan testified that the returns for the Residential class were virtually unchanged under the Company's bundled study as compared to the unbundled study. Specifically, Mr. Galligan found that:

The combined residential customers' return goes up slightly (from \$45.3 million to \$45.7 million) under the cost study which includes no GCR costs, while the residential rate base goes down slightly (from) \$1.109 billion to \$1.031 billion).

OCA St. 3R at 14. Thus, the unbundled COSS in this proceeding would not significantly impact the study results and would even show that the Residential class is closer to cost-based rates than the bundled cost of service study.³

² The OCA and the other Parties had to rely on the Company to run studies because PGW witness Gorman claimed the COSS program used in this proceeding was proprietary.

³ The OTS adjustment to measuring and regulating station equipment has a similar impact of showing the residential class closer to cost of service. The OTS adjustment reduces costs to the Residential class by \$1,043,000, and then allocates those costs to other rate classes. R.D. at 58. This adjustment would move the Residential class's return closer to unity in this proceeding than that shown in OCA's COSS. Again, the impact would not alter the usefulness of the OCA's COSS in guiding the rate setting process.

Moreover, no party is proposing to adjust class revenues in such a manner that would result in each class paying precisely cost-based rates as indicated by any of the cost of service studies available in this record. Small differences in resulting class rates of return comparing bundled results from unbundled results do not impact the usefulness of the OCA's COSS as a guide in the allocation of any authorized rate increase.

The OCA submits that any concerns of the ALJs with substituting the OCA's COSS for the Company's COSS in this proceeding as a means to guide the rate setting process are unfounded. While the unbundling was not reflected when the Company ran the OCA's COSS using the Peak and Average method for allocating distribution mains, this does not impair the usefulness of the OCA's COSS as a guide in setting rates in this proceeding. Indeed, the further modifications that the ALJs recommend would only show that the OCA's study on the record of this proceeding is conservative as to the results shown for the Residential class.

The OCA submits that on the record of this proceeding, OCA's Peak and Average COSS most accurately reflects the costs to serve the different rate classes, and also most accurately reflects the classes' different returns. The OCA's COSS conforms with the ALJs' recommendations regarding the allocation of distribution mains. The OCA's COSS can and should be substituted for PGW's COSS as a guide to set rates in this proceeding.

As the ALJs found:

PGW's proposal to allocate 75% of the costs of distribution mains investment based on purely peak demands should be rejected. Mr. Galligan's Peak and Average COSS accurately allocates such costs based on the way PGW actually incurs costs to serve its customers, as the principle of cost-causality requires.

R.D. at 63. The allocation of distribution mains costs has the most significant impact on costs in this proceeding. When these costs are properly allocated, as OCA's COSS does, an accurate depiction of the different classes' rates of return can be seen.

When viewed under a COSS that implements the ALJs' recommendations, the Residential heating class's index rate of return at present rates is 93% of the system average return. OCA St. 3, Exh. RAG-1, pp. 5, line 22. The misallocation of costs for distribution mains in PGW's COSS improperly burdens the Residential class with excess costs, and thus misrepresents the returns being provided by the residential heating class as the ALJs found. It is critical to start from this more accurate depiction of returns in determining a reasonable revenue allocation, as discussed in the next section.

The OCA fully agrees with the ALJs in their analysis and decision as to the proper allocation of distribution mains costs – the use of the OCA's proposed Peak and Average method. Where the OCA takes exception with the R.D. is the decision to not use the OCA's Peak and Average COSS as a guide in revenue allocation even though it contains the methodology for cost allocation that the ALJs approved. The OCA submits that its COSS accurately captures the cost and allocation factors that the ALJs found critical in this matter and it should be used as a guide to set rates in this proceeding.

OCA Exception No. 2: The ALJs Erred In Allocating Virtually The Entire Rate Increase To The Residential Customer Class.
(R.D. at 56-63; OCA M.B. at 45-63; OCA R.B. at 25-34)

A. Introduction.

In this case, the Company proposed a two-step process to move the various customer classes toward cost-based distribution rates. OCA witness Galligan explained the Company's approach as follows:

In a two-step process, PGW first determined its progress toward cost-based distribution rates that it deemed reasonable in this proceeding. Next, PGW developed rates for subject groups that would retain historic rate relationships between heating and non-heating customers. For example, in step-one of its process, PGW determined that a twenty percent movement toward cost-based rates as measured by its indexed rate of return for its residential heating customers, using its proposed cost of service study results as the standard, would reasonably balance the concepts of costs and gradualism. PGW then combined the residential heating customers with residential non-heating customers and with Housing Authority customers to determine a common delivery rate. The resulting proposed increased revenues for residential heating customers in step-two would be such that residential heating customers would actually make thirty-two percent progress in reducing this difference between their rate of return compared to system average rate of return.

OCA St. 3 at 22. Under the Company's two step approach, residential customers would move 32% of the way toward the system average rate of return based on the Company's cost of service study at the Company's proposed rates. OCA St. 3 at 23. OCA witness Galligan evaluated the Company's revenue allocation proposal in light of the results of the OCA's cost of service study. While the OCA's cost of service study showed that the residential class was already near the system average rate of return, Mr. Galligan concluded that the Company's revenue allocation was reasonable and continued to move the residential class to essentially cost-based rates. OCA St. 3 at 25. Mr. Galligan recommended that the Company's proposed spread of any rate increase

to the classes be adopted, and that such increases be proportionally scaled back if less than the full revenue increase was allowed.

The ALJs rejected the use of a proportional scale-back method to allocate the recommended rate increase of \$25 million to the customer classes. Instead, the ALJs recommended the use of the First Dollar Relief method advanced by the OTS and OSBA. The ALJs expressed concern that, based on the Company's cost of service study, the residential rate of return was far below the system average rate of return and that under the Company's proposed revenue allocation, the residential class did not make enough progress toward the system average rate of return.

Based on this analysis, the ALJs determined that the benefit of their recommendation of a lower rate increase amount than the Company requested should flow to the Commercial, Industrial and Housing GS customers. R.D. at 73. The result of this recommendation is to burden the residential class with \$24.3 million of the \$25 million rate increase.⁴ The OCA respectfully submits that the ALJs' analysis of this issue is flawed in several respects. When the evidence of record is properly analyzed, the OCA submits that there is no basis to disproportionately burden residential customers with nearly the full amount of this rate increase.

The ALJs' analysis of this issue is incorrect. First, the ALJs primarily analyzed the proposed revenue allocation by using PGW's flawed COSS which the ALJs had rejected for use in this proceeding. Second, even in using PGW's study, the ALJs incorrectly concluded that the residential class was making only minimal progress toward unity as a result of PGW's

⁴ PGW has circulated certain revised COSS results that purport to effectuate the ALJs' recommendations as to the modifications to PGW's COSS and the effect of using First Dollar Relief. These revised COSS pages show that of the \$25 million dollar revenue increase, the Residential class will be allocated approximately \$24.3 million.

proposed revenue allocation. R.D. at 72. Third, the ALJs failed to recognize the significantly disproportionate and inequitable result that obtains from the First Dollar Relief method that requires the residential heating customers to pay an increase that is 1.39x the distribution system average increase, but assigns no responsibility for any of this rate increase to the Commercial, Industrial and Housing GS classes.

The OCA submits that when the evidence of record is examined, particularly the results of the OCA's Peak and Average COSS which the ALJs endorsed, it can be seen that the ALJs' adoption of a First Dollar Relief method that significantly and disproportionately burdens one customer class with nearly the entire rate increase cannot be supported. The OCA submits that a more proportional and reasonable allocation of the rate increase to the customer classes must be adopted.

B. When Viewed In Light of the OCA's COSS, Consistent With the ALJs' Recommended COSS Finding, There is No Basis to Conclude That the Company's Original Revenue Allocation Was Unreasonable.

While the ALJs correctly found that PGW's COSS was flawed and would need certain modifications before it could be used as a guide to set rates in this proceeding, the ALJs then went on to use PGW's flawed COSS in their analyses and recommendations as to the issue of revenue allocation among the different rate classes. The ALJs particularly focused on a *portion* of Table 2-R presented by the OCA that showed the impact on the return of certain customer classes of various revenue allocation methods under PGW's COSS. R.D. at 67, 72. As the OCA stated in its Main Brief in regard to this chart "[t]his chart uses PGW's COSS and revenue allocations" and was intended to show that even using the Company's COSS, which the OCA showed was in error because it incorrectly assigned too much cost to the Residential class,

the Residential class was still making substantial progress toward cost-based rates under the Company's revenue allocation.⁵

From Table 2-R, however, the ALJs concluded that the residential class was not making enough progress toward the system average rate of return finding that the movement reflected on Table 2-R was "less than double digit percentage toward 100%." R.D. at 72. The ALJs found that the residential class return only increases by 6% under the numbers shown in Table 2-R.⁶ To be clear, however, under the Company's proposed two-step revenue allocation, the residential heating class, by far the largest group of residential users, would close 32% of the gap between its return at present rates and the system average return when viewed under the Company's COSS. OCA St. 3 at 23; OCA St. 3-R at 5; OCA St. 3-S at 13. To put any movement toward the system average return in proper context, it is not the absolute movement that should be measured, but the amount of the gap that has been closed that must be measured.⁷ When the amount of the gap that has been closed by PGW's two-step revenue allocation is measured for the residential heating class under the Company's COSS, the residential heating class moves 32% of the way toward unity. Given that approximately 50% of PGW's residential customers have incomes that are at or below 250% of the Federal Poverty Level, an income level

⁵ The portion of the chart that the ALJs did not rely upon shows that under the OSBA's proposed revenue allocation, which the ALJs adopted in this case, the movement of the residential class toward system average return defied all principles of rate shock and gradualism. The chart showed that under the Company's cost of service study and the OSBA's proposed allocation, the residential class would move from 73 % of the system average return to 97.2% of the system average return in one step.

⁶ Table 2-R was provided for illustrative purposes to show that the classes were moving toward the system average return under the Company's COSS. After the second step of the PGW revenue allocation process, which determines one common rate for the residential customers and the Housing Authority, the actual progress for the residential heating class toward closing the indicated gap between current rates and cost-based rates is 32%.

⁷ Measuring the "gap" between the class indexed rate of return and unity can be analogized to a 100 mile trip. If the traveler has, so far, made it to mile 73 and the end point is mile 100, the traveler has 27 miles to go to complete the journey. If on the next leg of the trip the traveler goes from mile 73 to mile 79, the traveler has covered 6 of the 27 miles remaining, or approximately 22% of the journey that remains to be completed ($6/27 = 0.222$). Under the Company's two-step approach, even more miles were covered resulting in 32% of the remaining journey being completed in this case.

that has been found to be needed to meet the basic necessities of life, moving the residential class toward the system average rate of return as proposed by PGW is a reasonable way to proceed.

More fundamentally, however, had the ALJs fully considered the OCA's COSS, which utilizes the cost allocation methodology they found reasonable, they would have seen that the Residential class was already very far along the road to cost-based rates and, after this proceeding, would be essentially at cost based rates under the Company's proposed revenue allocation. The OCA supplied several charts and analyses to show the distinctions between the results of the Company's proposed revenue allocation based on PGW's COSS and OCA's COSS. See, e.g., OCA M.B. at 55, 57. Under the OCA's COSS, residential heating customers are already at 93% of the system average return based on PGW's present rates. OCA St. 3, Exh. RAG-1, p.5, line 22. When PGW's proposed rate increase and revenue allocation are factored in, the residential class moves even closer to the system average rate of return. OCA witness Galligan explained:

The Peak and Average study results show residential heating customers paying proposed rates that recover all of their allocated operating costs, depreciation and taxes, and providing a rate of return that is 94.3 percent of the system average rate of return. Given the fact that fully distributed cost allocation studies are not an exact science, free from controversy, the proposed residential rates are, in my opinion, essentially cost based. Whereas Mr. Knecht believes that PGW's proposed rates are not consistent with costs of service being a polestar criterion, I believe the record evidence supports the exact opposite conclusion.

OCA St. 3-S at 15.

Under the OCA's COSS -- the method recommended by the ALJs -- the Residential heating class is at or very near the system average rate of return under the Company's proposed revenue allocation. As can be seen in OCA St. 3, Exh. RAG-1, pp. 5-6,

line 23, all other classes also make progress toward cost based rates under the Company's proposed revenue allocation. The progress toward cost based rates for the customer classes ranges from 7% to 53% under the OCA's COSS and the Company's proposed revenue allocation.⁸ OCA St. 3, Exh. RAG-1, pp. 5-6, line 23.

The ALJs' proposed use of the First Dollar Relief method to allocate the rate increase is based on their use of the flawed PGW COSS and their conclusion that the Residential class was making only minimal progress toward unity. R.D. at 72-73. Relying on the Company's flawed COSS, however, provides an inaccurate picture of each class' contribution to the cost to serve, leading to an incorrect conclusion as to the appropriate revenue allocation. The OCA submits that, using the OCA's Peak and Average COSS and the Company's proposed revenue allocation, the Residential class would be at 94% of the system average rate of return. The results based on the OCA cost of service study methodology that the ALJs found reasonable therefore do not support the need for a significantly disproportionate responsibility for the rate increase to be borne by the residential class.

The OCA submits that the evidence of record does not support a significantly disproportionate allocation of the revenue increase to residential customers in this case. The First Dollar Relief proposal recommended by the ALJs unfairly burdens the Residential class with over 97% of the recommended revenue increase despite the fact that the residential class is providing nearly cost based rates.⁹ The evidence of record cannot support such a result.

C. The ALJs' Reliance on OSBA's Table IEc-2 is Misplaced.

⁸ Substantial progress toward cost based rates can also be seen under the Company's COSS on PGW Exhibit HSG-7C, page 1, line 23.

⁹ The Company's revised COSS, as referenced *infra*, provides that of the \$25 million recommended revenue increase, approximately \$24.3 million will be allocated to the residential class. Thus, $24.3 \div 25 = 97.2\%$.

The ALJs also noted in their R.D. that they found OSBA's Table IEC-2 supportive of their conclusion to award First Dollar Relief and found it compelling that neither the OCA nor the Company used Table IEC-2 to show where the OSBA's analysis regarding the Company's proposed revenue allocation was in error. R.D. at 73. The OCA notes that Table IEC-2, shown on page 70 of the R.D., shows the current rate of return for each class under the Company's COSS and the proposed percentage of revenue increase for the different classes based on PGW's proposed revenue allocation. R.D. at 70. The OSBA argued from Table IEC-2 that, under the Company's proposed allocation, class "subsidiaries" will grow.¹⁰ The OSBA's basic argument is that because the residential class has a return below the system average return and because PGW's proposed increase for the Residential class is slightly below the system average return (30% for the residential class as opposed to 33.9% overall), the Residential class has to be moving farther away from unity. OSBA M.B. at 38-39. The OCA extensively discussed the flaws in the OSBA's logic following from Table IEC-2. See, OCA St. 3-R at 2-10; OCA St. 3-S at 12-15; OCA M.B. at 72-75; OCA R.B. at 34-39.

In response to Mr. Knecht's characterizations based on Table IEC-2 that the Residential class will move further away from cost-based rates as a result of the revenue allocation chosen by PGW in this proceeding and that the class "subsidiaries" are growing, Mr. Galligan provided the following response in his Surrebuttal testimony:

Under the Peak and Average cost study at present rates, residential heating customers pay rates which provide a 5.38 percent rate of return compared to a system average rate of return of 5.79 percent, or an index rate of return of 92.9 percent. At proposed rates

¹⁰ OCA witness Galligan explained that Mr. Knecht's use of the term "subsidy" is not in the traditional manner and that at times, Mr. Knecht places the term in quotes when he utilizes the term. To determine subsidies, one must look at incremental costs under break-even conditions and not at the fully distributed costs at issue here. OCA St. 3-R at 2. In this case, residential heating revenues are enough to cover incremental costs. Residential heating revenues also cover fully allocated expenses and provide a contribution available for interest and surplus. This is not a subsidy, just a slight difference in the rate of return.

residential customers provide a rate of return of 12.15 percent compared to a system average of 12.89, or an index rate of return of 94.3 percent. This represents a closure of 21 percent of the gap between the index rate of return at present rates and the system average index rate of return of 100 percent. Residential non-heating customers would pay increased rates that close 34 percent of the gap between their index rate of return at present rates and the 100 percent system index rate of return. Using PGW's cost study, in combination with its proposed residential rate increase, shows 32 percent progress to cost-based rates for heating customers and 34 percent progress for non-heating customers. The residential heating customer index, at 94.3 percent under the Peak and Average study, shows these customers are essentially at cost of service at PGW proposed rates. I believe these results are reasonable.

OCA St. 3-S at 13. Contrary to Mr. Knecht's assertions, this discussion of the numbers by Mr. Galligan clearly shows that the Residential class is moving closer to unity, *i.e.*, closing the small gap that remains between the residential class' index rate of return and 100% of the system average rate of return, as a result of the revenue allocation in this proceeding under the cost of service study recommended by the ALJs. See also, OCA M.B. at 72-75.

The OCA would also note that the ALJs found that the Residential class is making progress toward unity under the Company's proposed revenue allocation when viewed under the Company's cost of service study as well. R.D. at 72. While the ALJs' analysis was that the progress was not significant enough, the ALJs recognized that progress was being achieved under the Company's allocation. The OCA submits that substantial evidence of record shows that progress is being made toward unity by the residential class. Additionally, whether viewed under the OCA's COSS or PGW's COSS, the record establishes that all other classes are making progress toward cost based rates under the rate increases proposed by the Company. See, OCA St. 3, Exh. RAG-1, pp. 5-6, line 23; PGW Exhibit HSG-7C, p. 1, line 23.

The OSBA's argument that PGW's revenue allocation is moving the residential class further from cost of service cannot be squared with the facts in this case, whether looking at the OCA's COSS or PGW's COSS. The OSBA's argument that a class with a below system average return cannot make progress toward unity if it receives less than the system average increase rests solely on its disagreement with the indexed rate of return to measure progress toward cost based rates.¹¹ The problem with the OSBA's analysis is that the OSBA's "simple logic" does not reflect the complex interplay between the class rate of return, the proposed expenses, the dollar amount of the proposed percentage increase for the class, the rate base, and the underlying class cost allocations. The indexed rate of return captures the necessary information to assess the progress of the rate classes toward cost based rates. See, OCA St. 3-R at 8-10. OCA M.B. at 74-75; OCA R.B. at 38-39.

Moreover, what is not revealed by Table IEC-2, and the OSBA's argument, is the higher utility income requirement proposed for the residential class under the Company's revenue allocation. OCA witness Galligan explained:

PGW witness Gorman's Exhibit HSG-7C, revised March 30, shows a current total residential income available for interest and surplus of \$45.310 million. This would increase to \$114.707 million at proposed rates, a \$69.397 million, or a 1.53 times increase. The total proposed commercial income available for interest and surplus at current rates of \$24.808 million would increase to \$49.561 million. This is a proposed commercial income increase of \$24.753 million, or a 1.00 times increase.

¹¹ The use of the Indexed rate of return method to gauge whether the different rate classes are making progress toward unity in relation to the proposed revenue allocation is not new. The Commission has a long history of using the indexed rate of return to evaluate the appropriateness of a particular revenue allocation proposal. See, Pa. P.U.C. v. UGI Utilities, Inc., 1994 Pa. PUC LEXIS 137, *159-*167 (July 27, 1994); Pa. P.U.C. v. West Penn Power Co., 1993 Pa. PUC LEXIS 62, *249-*299 (May 14, 1993); Pa. P.U.C. v. Philadelphia Suburban Water Co., 1991 Pa. PUC LEXIS 206, *184-*192 (Oct. 18, 1991); Pa. P.U.C. v. West Penn Power Co., 1990 Pa. PUC LEXIS 142, 73 Pa. PUC 454, *194-*212, 119 P.U.R.4th 110 (Dec. 13, 1990); Pa. P.U.C. v. National Fuel Gas Distribution Corp., 1989 Pa. PUC LEXIS 225, *167-*182, 72 Pa. PUC 1 (Dec. 29, 1989). The Commission's use of the indexed rate of return is well-grounded and reasonable. Indeed, the ALJs used the index rate of return measure in this case to measure progress towards cost based rates.

OCA St. 3-R at 9-10.

The OCA submits that the ALJs' conclusion as to the compelling nature of OSBA's Table 1Ec-2 is not supported by the record evidence. There is no basis to conclude that such a significant and disproportionate increase for the residential class, *i.e.*, a \$24.3 million increase out of a total Company increase of \$25 million, is needed or reasonable in this case. The residential class is making substantial progress toward unity under the Company's proposed revenue allocation, and would make substantial progress under a proportional scale back of the Company's allocation.

D. A Proportional Scale Back Of The Company's Proposed Revenue Allocation Or Other Equitable Spread Of Any Rate Increase Is Required.

The cost of service studies available in this case show that under PGW's proposed spread of its requested rate increase, substantial movement toward rates based on allocated costs is made. OCA witness Galligan explained what the studies show at PGW's proposed rates:

These cost studies show that class revenues are sufficient to cover all allocated expenses and provide a contribution to income available for interest and surplus. At PGW's proposed rates for residential heating customers, for example, when class income available for interest and surplus is related to the investment which gives rise to the income and surplus cost (*i.e.*, the traditional measure of the adequacy of rates), the residential rates provide an 11.02 percent rate of return (PGW Study). This represents substantial movement toward rates based on allocated costs. A greater movement toward costs is indicated under the OCA study, since PGW's proposed rates provide a 12.15 percent rate of return for residential heating customers. Both of these rates of return compare to a requested 12.89 percent system rate of return.

OCA St. 3-R at 8.

The OCA submits that the record does not support the use of the First Dollar Relief method recommended by the ALJ which significantly, and disproportionately, assigns the responsibility for any rate increase to the residential class. As noted, under the ALJs'

recommended rate increase of \$25 million, the residential class would be responsible for paying \$24.3 million of the increase. While the distribution system average increase would be about 5.2% at a rate increase level of \$25 million, the residential heating distribution rates would increase by 7.2%, or 1.39x the distribution system average and the residential non-heat distribution rates would increase by 6.9%, or 1.32x the distribution system average. On the other hand, the Commercial Heat, Commercial Non-Heat, Industrial Heat and Industrial Non-Heat rates would see no rate increase at all.

Rather than gradually moving the residential class toward the system average return, the First Dollar Relief seeks to move the residential class average return far more than the 32% indicated progress under PGW's proposed rates in one rate case. Such a result fails to recognize the other factors that the Commission must consider, particularly gradualism, the avoidance of rate shock, and rate stability. See, e.g., Peoples Natural Gas Company v. Pa. Pub. Util. Comm'n., 47 Pa. Commw. 512, 537, 409 A.2d 446, 458 (1979).

The First Dollar Relief method recommended by the ALJs cannot be supported by the evidence of record or by sound ratemaking principles. The OCA submits that PGW's original revenue allocation was fair and reasonable, moves all classes toward the system average return, and provides an appropriate starting point for revenue allocation purposes. A proportional scale back from PGW's proposed revenue allocation to reflect any reduction in the claimed revenue requirement would ensure that all customer classes are provided some relief from the Company's full request if the Commission determines that less than the full request should be awarded. In not case, however, should residential customers receive more than the average percentage increase imposed on an overall basis on customers as a whole.

E. Conclusion.

The ALJs' sole reliance on PGW's flawed COSS to apparently conclude that not enough movement toward unity would result from the Company's revenue allocation, led to the recommendation by the ALJs that any rate increase less than what the Company requested should be allocated to the customer classes through the First Dollar Relief method. This analysis and recommendation should not be accepted by the Commission. The ALJs' analysis rests on the results of a cost of service study that significantly overstates the cost to serve the residential customer class and thus produces a result that does not accurately reflect the contribution of the residential class to the Company's overall return. Based on this incorrect information, the ALJs erroneously concluded that an extremely disproportionate rate increase had to be imposed on the residential class to make substantial progress toward cost based rates.

When viewed through the proper lens of the OCA's COSS – which the ALJs found accurately allocates the costs to serve the classes – it can be seen that the residential class is already providing sufficient revenue to meet the costs to serve the class and is providing 93% of the system average return at present rates and 94% at proposed rates. Based on these facts, there is no need to impose a significantly disproportionate rate increase on the residential class to make substantial movement toward cost based rates. The residential class is there. As such, the OCA submits that the disproportionate First Dollar Relief method must be rejected and a more equitable allocation of the rate increase should be ordered. A proportional scale back of the Company's proposed revenue allocation or other equitable means is called for, and supported, by the record and sound ratemaking principles. In no instance should the average percentage increase to residential customers exceed the system average percentage increase awarded to PGW.

OCA Exception No. 3: The ALJs' Conclusion That The OCA Did Not Provide Substantial Evidence To Support Its Budget Billing Program Is In Error And The ALJs Should Have At A Minimum Adopted The Company's Alternative Proposal To Further Study And Consider The Program.
(R.D. at 122-124; OCA M.B. at 98-101; OCA R.B. at 55-58)

PGW's residential budget billing enrollment has been steadily declining over the years and has reached a three-year low. OCA St. 4 at 22; OCA M.B. at 98. To address this issue, the OCA proposed a program to automatically enroll customers in a budget billing program when they evidence payment trouble during the winter heating season. OCA witness Colton described the program as follows:

For customers in good standing as of November 1 of each winter heating season who fall behind in the winter months, the billing methodology should be adjusted to a levelized monthly budget billing plan. That plan should include both the arrears and the bill for current usage. The budget billing methodology will continue until October 1 of the next heating season. A customer may opt out of the billing methodology by bringing his or her account current. To the extent that the customer defaults on any payments, normal collection processes would apply.

OCA St. 4 at 7; OCA M.B. at 98-99. The Company objected to this program raising several concerns regarding the potential impact of the program on Company operations and customers. The Company also raised concerns about their computer system readiness to implement such a program.

In oral Rejoinder testimony and Briefs, the Company proposed to further analyze the program through its upcoming customer segmentation study and to provide a report to the Commission and to the OCA regarding those efforts. Tr. 946; PGW R.B. at 69; OCA M.B. at 101. While the OCA appreciated this alternative, the OCA argued that the record was sufficiently developed for the Commission to direct the Company to proceed with the

development of such a program, working with the interested parties to address the concerns raised by the Company as the details of the program were worked out.

The ALJs recommended that the OCA's budget billing program be rejected on the basis that the OCA did not provide substantial evidence to support approving the program. R.D. at 124. The OCA disagrees with the ALJs' determination that it did not provide substantial evidence to support such a program. OCA witness Roger Colton's testimony discussed the successes of similar budget billing programs for the Tennessee natural gas utilities and the Coalition to Keep Indiana Warm and the potential benefits to PGW and its customers. OCA St. 4 at 24-25; OCA St. 4-S at 7. Mr. Colton described how the program in Tennessee upon which he based his model program yielded substantial bill payment improvement even during a time of spiraling natural gas prices. OCA St. 4-S at 6. The OCA detailed this evidence in its Main Brief at pages 98-101. The OCA also noted that the concept of budget billing has been broadly supported by the Commission. R.D. at 124; In re: Insuring Consistent Equal Monthly Billing, Docket No. M-00051925, 2006 Pa. P.U.C. LEXIS 21 (Order Entered June 2, 2006).

While rejecting the OCA's proposal, the ALJs did not recommend that the Company's alternative proposal to further study the proposed program to increase the use of budget billing be adopted. The OCA submits that PGW and its customers could benefit from greater participation in budget billing and that PGW's alternative to further study the proposal should be specifically adopted. The OCA submits that there is a sound empirical basis in both PGW data and data from other jurisdictions to warrant such further consideration of means to increase enrollment in budget billing at PGW. OCA M.B. at 101.

The OCA requests that the Commission adopt PGW's Rejoinder proposal to further study and report on the OCA's proposed budget billing program and that the Company

be directed to work with the interested parties to see if its concerns can be addressed and an appropriate program implemented.

III. CONCLUSION

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief and Reply Brief, the OCA respectfully submits that the ALJs erred in their recommendations with respect to the above issues. The ALJs recommendation on those issues should be rejected in favor of the positions advocated by the OCA in this proceeding as discussed above.

Respectfully Submitted,



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DATED: August 20, 2007
95234

CERTIFICATE OF SERVICE

Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-00061931
 :
 Philadelphia Gas Works :

I hereby certify that I have this day served a true copy of the foregoing document, the 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:

Dated this 20th day of August 2007.

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August 20, 2007

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FOLDER

HAND DELIVERED

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Pennsylvania Public Utility Commission
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400 North Street
Harrisburg, PA 17120

ORIGINAL

**Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00061931**

KJR

Dear Secretary McNulty:

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

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

Sincerely,

Sharon E. Webb
Assistant Small Business Advocate
Attorney ID No. 73995

2007 AUG 20 PM 3:58
SECRET

Enclosures

cc: Cheryl Walker Davis
Office of Special Assistants

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC
UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

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DOCKET NOS. R-00061931
R-00061931C0001

EXCEPTIONS
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

ORIGINAL

DOCUMENT
FOLDER

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I. INTRODUCTION-PROCEDURAL HISTORY

On December 22, 2006, Philadelphia Gas Works (“PGW” or the “Company”) filed Tariff Supplement 16 to Gas Service Tariff – Pa. P.U.C. No. 2 (“Supplement No. 16”) to become effective February 20, 2007. The PGW filing proposed an increase in its distribution revenues of \$100 million per year.

The Office of Small Business Advocate (“OSBA”) filed a Complaint on January 18, 2007.

On February 8, 2007, the Pennsylvania Public Utility Commission (“Commission” or “PUC”) suspended Supplement No. 16 until September 20, 2007, in order to conduct an investigation into the lawfulness, justness and reasonableness of PGW’s proposed rate increase. In addition, the Commission ordered that the investigation include consideration of the lawfulness, justness and reasonableness of PGW’s existing rates. The matter was assigned to Administrative Law Judges (“ALJs”) Cynthia Williams Fordham and Angela T. Jones.

On February 23, 2007, a prehearing conference was held before ALJ Fordham and ALJ Jones. A second prehearing conference was held on March 2, 2007.

The following are the known active parties involved with PGW’s base rate filing: the OSBA; the Office of Consumer Advocate (“OCA”); the Office of Trial Staff (“OTS”); Action Alliance of Senior Citizens of Greater Philadelphia (“Action Alliance”) and Tenant Union Representative Network (“TURN”); the Philadelphia Industrial and Commercial Users Group (“PICGUG”); PECO Energy Company (“PECO”); Interstate

Gas Supply Inc. ("IGS"); the Philadelphia Housing Authority ("PHA"); the School District of Philadelphia ("SDP"); and Hess Corporation ("Hess").¹

Public input hearings were held on March 26, 2007; March 28, 2007; and April 9, 2007.

The OSBA submitted the direct, rebuttal and surrebuttal testimony of its witness, Robert D. Knecht.

Evidentiary hearings were held before ALJ Fordham and ALJ Jones from May 21, 2007, through May 24, 2007.

The OSBA and other parties to the proceeding submitted main and reply briefs pursuant to the procedural schedule set forth in the ALJs' March 9, 2007, Prehearing Conference Order #3.

ALJs Jones and Williams Fordham issued a Recommended Decision ("R.D.") on July 30, 2007.

The OSBA respectfully submits this exception to the ALJs' R.D.

¹ The Archdiocese of Philadelphia ("Archdiocese") was an active party in this proceeding. However, because counsel for the Archdiocese was not present during the evidentiary hearings, the ALJs denied the Archdiocese intervenor status.

II. EXCEPTION

The ALJs erred in concluding that PGW's current allocation of universal service costs, which includes recovery from the commercial and industrial classes, should be retained. (R.D. at 80-81)

A. OSBA's Proposal

When PGW became subject to the Commission's jurisdiction, the Company was allocating the costs of its universal service programs to all customer classes. Without deciding the merits of that allocation, the Commission has allowed PGW to continue to charge non-residential customers for universal service costs even though only residential customers are eligible for the Company's universal service programs.

In this proceeding, the OSBA proposed that non-residential customers be relieved of having to contribute toward PGW's universal service costs. Specifically, the OSBA proposed that the current requirement on non-residential customers be reduced by one-third in PGW's 2008 proceeding under Section 1307(f) of the Public Utility Code, 66 Pa. C.S. §1307(f); be reduced by one-half of the remaining revenue requirement in the 2009 proceeding; and be eliminated entirely in the 2010 proceeding.²

B. The Recommended Decision

Although seemingly in agreement with the reasoning presented by the OSBA, the ALJs rejected the recommendation of the OSBA to phase out the allocation of universal

² OSBA Main Brief at 8

service costs to non-residential customers.³ As their rationale for rejecting the OSBA's proposal, the ALJs stated:

It is clear that the Commission is moving to have the costs of universal service programs assigned to the residential customers. In the previous proceedings, a cost of service study was not available. Therefore, the issue can be addressed in this proceeding [because there is a cost of service study].

Nevertheless, based on the amount of the increase and the revenue allocation that we are proposing, OSBA's proposal would be overwhelming to the residential customers. Although that the entire cost would not be reassigned at one time, when we look at the final year, the increase of 3.8% in addition to the current base rate increase and any increases in the GCR result in rate shock. This is not gradualism. It should be noted that we are recommending First Dollar Relief which means that the residential customers will be assigned the majority of the rate increase. We cannot burden these customers with an increase in universal service costs also. Consequently, we are recommending that PGW's current allocation of universal service costs be retained and OSBA's proposal be rejected.⁴

C. Rate Impact on Residential Customers

Contrary to the ALJs' implication, the increase to PGW's residential customers in the third year of the OSBA's suggested phase-out would be 1.3% and not 3.8%.⁵ Admittedly, residential rates would go up by 3.9% on a total-bill basis under the OSBA's proposal, but that increase would be spread across three years and would not begin until November of 2008. That three-year phase-out of costs allocated to non-residential customers would amount to a 1.3% increase per year for residential customers.

³ R.D. at 81

⁴ R.D. at 80-81

⁵ OSBA Main Brief at 18; *See also* OSBA Statement No. 1, Exhibit IEC-7.

As OSBA witness Robert Knecht testified:

PGW's annual reconciliation of the USEC [universal service and energy conservation charge] affords the Commission with an opportunity to phase out the USEC charges to non-residential customers on a regular and gradual basis over a number of years. In light of the revenue allocation that I propose in the previous section for base rates, I recommend that the adjustment to the USEC not begin until PGW's 2008 GCR proceeding. At that time, I recommend that the responsibility of the non-residential customers for the USEC be reduced by one-third. A second one-third reduction would then take place in PGW's 2009 GCR proceeding, and the phase-out would be complete in PGW's 2010 GCR proceeding.⁶

Mr. Knecht also testified to the magnitude of the rate impact the OSBA's proposal would have on PGW's residential and commercial customers in the 2008 GCR proceeding:

Table IEc-4 below shows the impact of my proposed change for 2008, assuming that 2008 GCR and USEC Surcharge costs are equal to those in PGW's 2007 GCR filing. For the purpose of this exhibit, I assume that PGW's proposal for base rates revenue allocation is adopted.

⁶ OSBA Statement No. 1 at 31.

Table IEc-4				
Impact of One-Third Phase-Out of Non-Residential USEC				
	<i>Residential</i>		<i>Commercial</i>	
	<i>Current</i>	<i>Proposed</i>	<i>Current</i>	<i>Proposed</i>
GCR	\$10.1812	\$10.1812	\$10.1812	\$10.1812
USEC Surcharge	2.2985	2.5650	2.2985	1.5323
Sub-Total GCR	12.4797	12.7462	12.4797	11.7135
<i>Percent Change</i>		<i>2.1%</i>		<i>-6.1%</i>
Base Rates	7.8230	7.8230	7.3244	7.3244
Total Bill	20.3027	20.5693	19.8041	19.0379
<i>Percent Change</i>		<i>1.3%</i>		<i>-3.9%</i>
Notes:				
As proposed by PGW, base rates include the Restructuring and Consumer Education Surcharge. Also included are average customer charge revenues per Mcf.				
Details of the calculations are shown in Exhibit IEc-7.				

Table IEc-4 demolishes a popular misconception. I have observed in previous PGW proceedings that many parties believe that PGW's USEC Surcharge costs are so enormous that it would be impossible to eliminate or even contemplate phasing out the business class's responsibility for these costs without putting an enormous burden on residential customers. Table IEc-4 demonstrates that 'it just ain't so.' While PGW's CAP costs are indeed very high, the amount of those costs that are currently recovered from non-residential customers is relatively low. That occurs because (a) residential firm sales volumes are nearly three times as large as the total non-residential firm sales volumes, and (b) none of PGW's interruptible or GTS transportation customers currently contribute to the recovery of these costs. Thus, a one-third phase-out of the USEC Surcharge for non-residential customers would result in only a 2.1 percent impact on the residential rates at issue in next year's GCR, and only a 1.3 percent impact on a total bill basis. Continuing the phase-out in 2009 and 2010 would have impacts of similar magnitude in each of those years.

For those reasons, I conclude that bringing PGW's CAP funding into compliance with the rest of the NGDCs in Pennsylvania does not constitute an insurmountable

problem, and it can reasonably be achieved in a three-year period without violating the principle of gradualism.⁷

PGW requested an annual distribution rate increase of \$100 million. PGW proposed that residential customers bear more than \$69 million of that rate increase.⁸ Under PGW's current universal service program, the residential customers are presently paying a little more than \$97 million for the universal service and energy conservation costs.⁹ About \$34 million of the universal service and energy conservation costs are paid by the non-residential class.¹⁰ The ALJs recommended that PGW receive a \$25 million annual distribution rate increase.¹¹ If the Commission were to award PGW a \$25 million increase, were to assign *all* of that increase to the residential class, and were to shift *all* of the cost of universal service to the residential class in *one* year, residential customers would receive a maximum total rate increase of \$59 million. A \$59 million rate increase would be a significantly smaller increase for the residential class than the \$69 million rate increase that the Company proposed for that class.

D. Commission Precedent

PGW is a municipal natural gas distribution company ("NGDC"), which was previously regulated by the Philadelphia Gas Commission, a local agency of the City of

⁷ OSBA Statement No. 1 at 32-33

⁸ Exhibit IEC-4:Table 4-A

⁹ Exhibit HSG-7A, page 1

¹⁰ Exhibit HSG-7A, page 1. Note that PGW's filing contains a significant mismatch between USEC costs of \$108.5 million (Exhibit HSG-1, page 1, line 17) and USEC revenues of \$131.6 million (Exhibit HSG-1A, page 1, line 27), due to the inclusion of prior period under-collections in revenues. To be conservative, this Exception relies on the revenue figures rather than the cost figures for evaluating customer impact. If the cost figures were used, the impact of the OSBA's proposal on residential customers would be considerably smaller.

¹¹ R.D. at 55

Philadelphia.¹² On June 22, 1999, the Natural Gas Choice and Competition Act (“Gas Choice Act”), 66 Pa. C.S. §§2201-2212, was enacted to provide a competitive and non-discriminatory market for natural gas supply services within the Commonwealth.¹³ Pursuant to the Act, the Commission assumed jurisdiction over the natural gas services provided by PGW on July 1, 2000.¹⁴ On July 1, 2002, PGW filed its Restructuring Petition in order to meet the requirements of the Gas Choice Act.¹⁵

Prior to becoming subject to the Commission’s jurisdiction, PGW allocated its universal service costs to all firm sales service rate classes.¹⁶ PGW did *not* allocate any universal service costs to either PGW’s interruptible sales service rate classes or to PGW’s large volume transportation service rate classes (“GTS/IT”).¹⁷

During PGW’s Restructuring Proceeding, the Company proposed to continue to collect universal service costs from all firm sales service customer classes.¹⁸ The Commission agreed that universal service costs should continue to be allocated to all firm

¹² OSBA Main Brief at 8, citing *Pennsylvania Public Utility Commission v. Philadelphia Gas Works*, Docket Nos. M-00021612, M-00021612C0001, M-00021612C002, and M-00021612C000 (Order entered March 31, 2003) at 5 (“Restructuring Order”)

¹³ OSBA Main Brief at 8; *See also* Restructuring Order at 2

¹⁴ OSBA Main Brief at 8; *See also* Restructuring Order at 5

¹⁵ OSBA Main Brief at 8; *See also* Restructuring Order at 2

¹⁶ OSBA Main Brief at 9; citing Restructuring Order at 64 and *Customer Assistance Programs: Funding Levels and Cost Recovery Mechanisms Final Investigatory Order*, Docket No. M-00051923 (Order entered December 18, 2006) at 31

¹⁷ If PGW had any smaller retail “Choice” customers who took gas supply service from an alternative natural gas supplier (“NGS”), these customers would also be assigned universal service costs. PGW Exhibit HSG-6T indicates that all retail customers take gas supply service from PGW. For convenience, this brief refers to PGW’s policy as allocating universal service costs to all firm sales service customers.

¹⁸ OSBA Main Brief at 9; *See also* Restructuring Order at 62

sales service rate classes.¹⁹ Specifically, the Commission stated, “These [universal service] costs have traditionally been included in PGW’s gas cost rate (‘GCR’) and that such a cost allocation [to the residential classes only] would involve massive cost shifting between classes prohibited by Sections 2211(e) and (h) of the Act. This is a restructuring proceeding and not a base rate case. Therefore, the record does not contain a cost study that would support a shift in rate design.”²⁰

The issue of how PGW’s universal service costs should be allocated among rate classes arose again in *Investigation into Financial and Collections Issues Regarding the Philadelphia Gas Works*, Docket Nos. P-00042090, R-00049157, M-00021612, P-00032061, and P-00042117 (Order entered October 27, 2004) at 23-24. However, the Commission stated in that proceeding that it did not “intend to address [universal service] cost allocation. Cost allocation is an issue best left to a base rate proceeding. At PGW’s next base rate proceeding, the OSBA will have sufficient opportunity to raise the issue of the proper size of PGW’s CRP [Customer Responsibility Program] and argue its position regarding the proper cost allocation for Universal Service Programs.”

Because the Commission has consistently deferred making a decision regarding how PGW’s universal service costs should be allocated, PGW continues to allocate its customer assistance program (“CAP”) costs to all firm service sales rate classes. As OSBA witness Knecht testified:

The vast majority of the program costs associated with PGW’s CAP costs are allocated to all firm service sales customers on a volumetric basis, and are recovered from those classes using a constant dollar per Mcf Universal Service and Energy Conservation Surcharge (‘USEC

¹⁹ OSBA Main Brief at 9; *See also* Restructuring Order at 64

²⁰ OSBA Main Brief at 9; *See also* Restructuring Order at 64

Surcharge'). The costs consist of the Customer Responsibility Program ('CRP') of \$90.1 million, the Senior Citizen Discount ('SCD') of \$16.4 million, the Customer Weatherization Program ('CWP') of \$2.0 million, and prior period undercollections of \$23.1 million.

Because both the CRP and SCD costs are relatively large, and because they vary with the market price of natural gas, PGW is permitted to reconcile the costs and revenues associated with these programs on an annual basis. This reconciliation takes place as part of PGW's annual 1307(f) GCR process.²¹

The Commission should reject the Companies' current methodology for allocating PGW's CAP costs and setting rates for recovering those costs because that methodology is contrary to the Commission's established precedent on this issue. Now that PGW is under the Commission's jurisdiction, it should be subject to the Commission's generic policy. In numerous proceedings, the Commission has affirmed

²¹ OSBA Main Brief at 10; *See also* Knecht, OSBA Statement No. 1 at 28-29

that universal service cost recovery should be restricted only to the residential class.²²

The ALJs even *agree* that the Commission is moving towards having the costs of universal service programs assigned only to residential customers.²³

The ALJs also agree with the OSBA that the issue of the allocation of universal service program costs is ripe and can be addressed in the context of this case.²⁴ As set forth in greater detail in the OSBA's main brief, the Commission, in PGW's Restructuring Proceeding, did not finally resolve the issue of the proper allocation of PGW's CAP costs. Rather, the Commission simply deferred making a decision on the

²² For a generic statement of Commission policy, see *Customer Assistance Programs: Funding Levels and Cost Recovery Mechanisms Final Investigatory Order*, Docket No. M-00051923 (Order entered December 18, 2006) at 31-32. For examples of gas cases in which the Commission has allocated universal service costs only to residential customers, see *Pennsylvania Public Utility Commission v. Equitable Gas Company*, Docket No. R-901595, 73 Pa. PUC 301 (Order entered November 21, 1990) at 340; *Pennsylvania Public Utility Commission v. Valley Energy, Inc.*, Docket Nos. R-00049345 and R-00049345C0001 (Order entered April 21, 2005); *Petition by Equitable Gas Company for Authorization To Use a Portion of an Equitrans, LP Refund To Benefit Low Income Customers*, Docket No. P-00052192 (Order entered December 15, 2005); *Application of UGI Utilities, Inc., UGI Utilities Newco, Inc., and Southern Union Company for approval of: 1) the transfer by sale of all property used or useful in providing natural gas service to the public to UGI Corporation; 2) the immediate retransfer of all such property, by UGI Corporation, including gas supply and pipeline and storage capacity contracts, by UGI Corporation to UGI Newco Utilities, Inc.; 3) the initiation by UGI Utilities Newco, Inc. of natural gas service in all territory in this Commonwealth where Southern Union Company does or may provide natural gas service; 4) the abandonment by Southern Union Company of all natural gas service in this Commonwealth; and 5) transfer by UGI Corporation of all stock of UGI Utilities Newco, Inc. to UGI Utilities, Inc.*, Docket Nos. A-120011F2000, A-125146F5000, and A125146 (Order entered August 18, 2006) at 31-32 ("*UGI/PGE Merger*"); and *Pennsylvania Public Utility Commission v. PPL Gas Utilities Corporation*, Docket Nos. R-00061398, R-00061398C0001, R-00061398C0002, R-00061398C0003, and R-00061398C0004 (Order entered February 8, 2007) ("*PPL Gas*") at 116. For an example of electric cases in which the Commission has allocated universal service costs only to residential customers, see *Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation*, Docket No. R-00049255 (Order entered December 22, 2004) at 97-98; and *Pennsylvania Public Utility Commission v. Metropolitan Edison Company and Pennsylvania Electric Company, Petition of Metropolitan Edison Company for Approval of a Rate Transition Plan, Petition of Pennsylvania Electric Company for Approval of a Rate Transition Plan, and RE: Merger Savings*, Docket Nos. R-00061366, R-00061366C0001, R-00061366C0002, R-00061366C0003, R-00061366C0005, R-00061366C0013, R-00061367, R-00061367C0001, R-00061367C0002, R-00061367C0003, R-00061367C0005, R-00061367C0007, R-00061367C0008, P-00062213, P-00062214, A-110300F0095, and A-110400F0040 (Order entered January 11, 2007

²³ R.D. at 80

²⁴ R.D. at 80

issue until PGW's next base rate case.²⁵ The time has come for the Commission to address that issue.

The Commission did conclude in PGW's Restructuring Proceeding that Section 2211(e) of the Public Utility Code, 66 Pa. C.S. §2211(e), barred a change in the universal service cost allocation methodology *within that proceeding*, on the grounds that interclass and intraclass cost shifts were prohibited by Section 2211(e) within the context of a restructuring proceeding.²⁶ However, Section 2211(e) does not presently apply to PGW. Specifically, Section 2211(e) states in pertinent part:

Except as provided in section 2212, for the period from the effective date of this chapter *until January 1, 2001*, interclass or intraclass cost shifts are prohibited.

(emphasis added). Interclass and Intraclass cost shifts are now allowed for PGW since it is after *January 1, 2001*. Furthermore, the instant proceeding is PGW's first base rate case after its Restructuring Proceeding; therefore, the Commission can now determine the issue of whether PGW's CAP costs should be brought into compliance with the Commission's policy on this issue.

The Commission concluded in *Customer Assistance Programs: Funding Levels and Cost Recovery Mechanisms Final Investigatory Order*, Docket No. M-00051923 (Order entered December 18, 2006) at 31-32, that universal service costs should be borne only by the residential class. Admittedly, the Commission did not reach a determination in that proceeding about the allocation of PGW's universal service costs. The Commission recognized that there were "a few exceptions" relative to allocating CAP

²⁵ OSBA Main Brief at 15; *See also* Restructuring Order at 64 and *Investigation into Financial and Collections Issues Regarding the Philadelphia Gas Work*, Docket Nos. P-00042090, R-00049157, M-00021612, P-00032061, and P-00042117 (Order entered October 27, 2004) at 23-24.

²⁶ Restructuring Order at 64

costs exclusively to the residential class. In a footnote, the Commission specifically identified PGW as one of those exceptions, noting that “PGW’s cost allocation was determined prior to the Commission’s oversight of the Company.”²⁷ However, the Commission did *not* conclude that PGW should be a *permanent* exception to Commission policy. Rather, the Commission merely observed that PGW’s current policy represented an exception to the Commission’s generic policy. Furthermore, the Commission expressed no intention to rescind its prior decision to defer the matter to PGW’s next base rates proceeding.

E. No Basis for Treating PGW Differently

PGW should be treated like any other NGDC in Pennsylvania. Every NGDC has a universal service program. Except as otherwise provided through a settlement, the costs of those programs are paid solely by the residential class. As the Commission recognized in *Customer Assistance Programs: Funding Levels and Cost Recovery Mechanisms Final Investigatory Order*, Docket No. M-00051923 (Order entered December 18, 2006), “Universal service programs, by their nature, are narrowly tailored to the residential customers and therefore, should be funded only by the residential class.”

In this proceeding, the OCA, Action Alliance, and the Company all argue that PGW should be treated differently from other NGDCs with regard to how universal service costs should be allocated. Mr. Knecht addressed those arguments in his testimony, as follows:

²⁷*Customer Assistance Programs: Funding Levels and Cost Recovery Mechanisms Final Investigatory Order*, Docket No. M-00051923 (Order entered December 18, 2006) at 31.

I will assume that the universal service program will provide the social benefits alluded to by Messrs. Hershey [PGW witness], Geller [Action Alliance witness] and Colton [OCA witness]. Mr. Geller argues that the costs of these benefits should be distributed as widely as possible, because the benefits are widely distributed. Unfortunately, PGW's proposal represents a pretty poor effort at matching the broad benefits with broad cost recovery.

First, as Messrs. Geller, Hershey and Colton recognize, PGW's service territory is a relatively low-income service territory, and PGW's universal service program is considerably larger and more expensive than those of other NGDCs. These witnesses also generally agree that municipal ownership of PGW must be recognized in evaluating how the costs of the program should be recovered. In effect, they argue that the social welfare and tax policy of the City must be considered by the Commission in this decision. Unfortunately, recovering the costs of this social welfare program through a volumetric tax on gas consumption represents dubious tax policy at best. With respect to taxes on individuals, even if we assume that all of the citizens of Philadelphia would be subject to this tax, the burden of an energy tax tends to fall disproportionately on lower income individuals. As a percentage of household income, energy costs are higher for low-income families than for higher income families. Thus, at the start, PGW is proposing to recover these costs with what economists call a *regressive* tax.

Second, the indirect social benefits of these programs presumably accrue to all businesses and citizens of Philadelphia, and not only those that consume natural gas. However, the USEC can only apply to gas consumers. In effect, PGW's proposal allows individuals and businesses that are not gas consumers to be 'free-riders' for the social welfare benefits associated with PGW's programs.

Third, PGW proposes to continue to exempt over half of the throughput to business customers from the 'responsibility' to contribute to these costs. Of PGW's 30.5 Bcf of annual non-residential throughput, some 3.3 Bcf (11 percent) goes to interruptible sales rate classes and 13.3 Bcf (44 percent) goes to GTS/IT transportation customers. Neither the interruptible sales rate classes nor the GTS/IT customers are subject to PGW's USEC charge. While I recognize that it is unlikely that PGW could

recover universal service costs from these classes, it must be recognized that PGW's proposal allows the majority of its business load to be a free-rider for the social benefits. Also, because PGW's proposal is not consistent across the business rate classes, it is anti-competitive. PGW's proposal will have the effect of providing cost advantages to *certain businesses, particularly those that are large enough to use transportation service, at the expense of smaller business customers.*

Fourth, even within the subset of business customers that it proposes to tax, PGW offers no evidence that the social benefits of the universal service program are proportional to gas consumption. It would be more logical to assume that any such benefits would be more related to a company's revenues, profits or employment levels than they are to gas consumption. Again, PGW's proposed matching of direct costs and indirect benefits is poor.

Thus, rather than proposing a broad-based recovery mechanism, the City of Philadelphia, through its municipally-owned gas utility, proposes a narrow, regressive and anti-competitive tax burden on a subset of its gas consumers.²⁸

Even if universal service programs are of value to all members of society, it is still inappropriate to require business customers to pay for them. As Mr. Knecht testified:

Using indirect social benefits as a cost allocation criterion is an invitation to open Pandora's box to other similarly vague cost allocation proposals in regulatory proceedings. While it can perhaps be argued that the universal service programs result in indirect social benefits, it can also be argued that having a healthy and cost competitive small business community will result in indirect social benefits to individuals. As Mr. Colton recognizes, healthy small businesses provide employment for low-income individuals. Therefore, under the 'who benefits' standard for cost allocation, it can readily be argued that residential customers should provide a subsidy to small businesses.

In practice, it makes more sense for utility regulators to rely on hard cost causation principles for cost and revenue

²⁸ Knecht, OSBA Statement No. 3 at 9-10

allocation, rather than indirect social benefits. The issue of balancing social benefits with the cost responsibility for those benefits is better left to government spending and tax policymakers, who have more options and greater flexibility.²⁹

F. OSBA's Requested Relief

The ALJs agree with the OSBA that the issue of the cost allocation of universal service programs is ripe and can be addressed in the context of this case.³⁰ The ALJs also *agree* that the Commission is moving towards having the costs of universal service programs assigned only to residential customers.³¹ In rejecting the OSBA's proposal to phase out the recovery of universal service costs from business customers over three years, the ALJs did not find fault with the OSBA's reasoning. Rather, they simply said that the phase-out was too fast and that the impact on the residential customers would be too great.³²

The OSBA requests that the Commission reject the ALJs' recommendation not to phase out the allocation of universal service costs to business customers over three years. The Commission's policy is to allocate universal service costs solely to the residential class. Now that PGW has come under the jurisdiction of the Commission, PGW should adhere to the Commission's policy.

However, if the Commission is concerned with the rate impact on residential customers if the allocation of universal service costs to business customers is phased out over a three-year period, then the OSBA requests that the Commission order an

²⁹ Knecht, OSBA Statement No. 3 at 7-8

³⁰ R.D. at 80

³¹ R.D. at 80

³² R.D. at 80-81

alternative remedy. Specifically, the OSBA requests that the Commission 1) remand for an investigation and hearings to determine a more appropriate phase-out; or 2) defer determination of an appropriate phase-out for universal service cost recovery from non-residential customers until PGW's next Section 1307(f) proceeding.

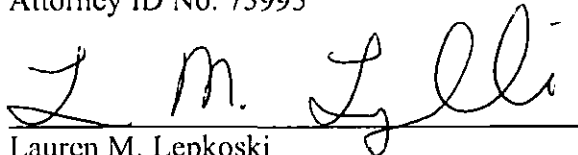
III. CONCLUSION

Wherefore, the OSBA respectfully requests that the Commission grant the OSBA's Exception and order a three-year phase-out of the allocation of universal service costs to non-residential customers. In the alternative, the OSBA respectfully requests that the Commission grant the OSBA's Exception and remand the matter for investigation and hearings to determine an appropriate phase-out of universal service cost recovery from non-residential customers. As a second alternative, the OSBA respectfully requests that the Commission grant the OSBA's Exception and defer determination of an appropriate phase-out of universal service cost recovery from non-residential customers until PGW's next Section 1307(f) proceeding.

Respectfully submitted,



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Dated: August 20, 2007

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY :
COMMISSION :

v. :

DOCKET NO. R-00061931

PHILADELPHIA GAS WORKS :

CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Exceptions, on behalf of the Office of Small Business Advocate, by e-mail and first class mail (unless otherwise noted) upon the persons addressed below:

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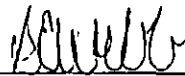
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August 20, 2007

ORIGINAL

James J. McNulty, Secretary
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Filed by Federal Express

KJR

**Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00061931**

Dear Secretary McNulty:

On behalf of Action Alliance of Senior Citizens of Greater Philadelphia and Tenant Union Representative Network (TURN), enclosed please find an original and eight (8) of the Exceptions of Action Alliance, et al. in the above-captioned matter.

Copies of this filing have been sent this date to the parties listed on the Certificate of Service by e-mail and First Class U.S. Mail, postage prepaid.

Very truly yours,

Philip A. Bertocci, Esquire
Thu B. Tran, Esquire

Attorneys for Action Alliance *et al.*

cc: Certificate of Service
PUC Office of Special Assistants

Enclosures

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FOLDER

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AUG 20 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

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Docket No. R-00061931

DOCUMENT
FOLDER

EXCEPTIONS OF ACTION ALLIANCE et al.

DOCKETED
AUG 22 2007

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August 20, 2007

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SECRETARY'S BUREAU

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I. INTRODUCTION.

Action Alliance of Senior Citizens of Greater Philadelphia and the Tenant Union Representative Network (hereinafter "Action Alliance") hereby file the following Exceptions to the Recommended Decision (hereinafter "R.D.") issued on July 30, 2007 in this case.

In these Exceptions, Action Alliance maintains that PGW has not established its entitlement to any rate increase due to its failure to comply with Public Utility Code Section 1501 that it provide "reasonably continuous service." Exceptions Nos. 1 through 6 set forth the grounds for Action Alliance's contentions that the R.D.'s conclusion that a \$25 million rate increase is justified in light of all factors (including adequacy of service) is against the weight of the evidence and contrary to law. In those Exceptions, Action Alliance contends that the R.D. errs in failing to recognize systematic violations of specific Public Utility Code provisions and Commission regulations and standards.

Exceptions Nos. 7 and 8 address the R.D.'s rejection of Action Alliance's positions concerning the sections of PGW's proposed Tariff which address residential customer service rules. In Exception No. 7, Action Alliance contends that the R.D.'s rejection of the proposal to retain existing Tariff Section 2.4.E requiring a detailed written notice of rejection is contrary to federal constitutional law and state law. In Exception No. 8, Action Alliance contends that the R.D.'s rejection of the proposal to require that PGW include a reference to "user without contract" in its Tariff to qualify its misleading references to "unauthorized use" is not reasonable.

II. EXCEPTIONS.

Exception No. 1. The R.D.'s Rejection of Action Alliance's Claim That PGW Has Failed To Provide Reasonably Continuous Service Is Contrary To the Evidence.

Action Alliance has contended on the basis of the Cold Weather Survey results for the past two years that PGW has violated the Public Utility Code Section 1501 requirement that a public utility must provide "reasonably continuous service without unreasonable delay." 66 Pa.C.S. §1501. The primary evidentiary basis for this claim is the results of the Cold Weather Survey for 2005 and 2006, which indicate that in each of those two years, 9,000 PGW residential heating customers whose service had been terminated during that calendar year, had been unable to reach payment terms with PGW in order to obtain service reconnection with the approach of cold weather. While PGW had only about 20% of the natural gas heating customers in the state, the number of PGW heating customers without service was more than 50% of natural gas heating customers without service throughout the state. Moreover, over one half of the PGW heating customers without service were low-income. Action Alliance Main Brief (hereinafter "AA M.B."), at 5-13.

On the basis of this on-the-record statistical evidence, and the supporting testimony of Harry S. Geller, Action Alliance has contended that PGW's universal service programs and its policies concerning payment agreements, reconnection agreements, budget billing practices, deposit requirements and medical certifications are not adequate. These policies, which all impact the ability of customers to maintain service, and/or to obtain service reconnection within a reasonable period of time, do not represent adequate service, when they result in the over 9,000 annual service interruptions which continue even in the face of the onset of cold weather.

The R.D. rejects Action Alliance's contention that the Cold Weather Survey results themselves, when compared to the results of other Pennsylvania gas utilities, demonstrate that PGW has failed to provide "reasonably continuous service." R.D., at 108. In addition, the R.D. concludes, on the basis of a list of measures which PGW has taken to assist low-income customers obtain and maintain utility service, that PGW's service is generally "adequate to the low-income segment of its customer base." Id.

The R.D. dismisses the probative value of the Cold Weather Survey statistics which are part of the record and the testimony of Harry S. Geller which supports those statistics.

According to the R.D.:

Action Alliance makes much of the Cold Weather Survey statistics. The numbers do not reveal whether the participants stayed in the service territory through the winter season, or had a change of circumstance to no longer qualify for CRP; and thus it is unknown whether the participants remained without heat during the winter season or remained income eligible for CRP. The statistics alone without supporting data about the participants leads to presumptions. Presumptive evidence is not enough to substantiate or support a conclusion of inadequate service.

R.D., at 108. In a footnote, the R.D. further recognizes that the Cold Weather Survey results are included in the record, but states that "Action Alliance does not provide testimony of how these issues are addressed through these exhibits." R.D., at 108, fn. 54.

The R.D.'s objections do not nullify the validity of the Cold Weather Survey results as evidence of PGW's failure to provide "reasonably continuous service." The Cold Weather Survey results are provided in the format required by the Commission itself, and provide sufficient specificity for a determination that the results do not include vacant properties. They describe, in terms of various categories, gas heating customers whose service was terminated in the Survey's calendar year, and who had not obtained service reconnection as of December 1.

Commission definitions regarding the various categories for Calendar Year 2006 were included in the record. Action Alliance Statement 1 (hereinafter "AA St.1"), at 5-8 and Exhibits HSG-1 and HSG-2.

The R.D. also objects that the numbers "do not reveal whether the participants stayed in the service territory through the winter season..." R.D., at 108. However, the Survey results specify that the statistics represent account premises which are either confirmed to be occupied or which "appear" to be occupied as of December 1. The fact that the Survey addresses premises which are occupied contradicts the R.D.'s unfounded supposition that many of the 9,000 PGW customers have moved out of the service territory. The Survey provides substantial evidence concerning the extent to which PGW heating customers terminated in the Survey year have been tragically unsuccessful in obtaining reconnection terms from PGW enabling them to have heat for the winter.

The R.D. also states that it is unclear whether CRP customers without service had a "change of circumstance to no longer qualify them for CRP." R.D., at 108. This is an unfounded supposition. If it were true, PGW would have provided such testimony in Rebuttal Testimony. Moreover, even if it were true, this consideration is not relevant to the issue of whether the terminated household was able to avail themselves of terms from PGW which would permit a household not CRP eligible to obtain service reconnection. As the legislature recognized in enacting Chapter 14, many lower income households above 150% FPL (and thus not eligible for a Customer Assistance Program) are financially vulnerable, and need access to reasonable reconnection agreements. For this reason, Chapter 14 generally barred winter termination of service for non-payment for heating customers with household incomes below 250% FPL;

although the legislature gave PGW the additional latitude to terminate customers with incomes between 150% FPL and 250% FPL, it insisted on providing numerous exemptions for households with children age 12 or under, adults age 65 or older, and customers who were making payments on at least part of their current bills. 66 Pa.C.S. § 1406(e).

Action Alliance submits that PGW's Cold Weather Survey statistics themselves, coupled with the Mr. Geller's testimony concerning how the PGW statistics compare with the Cold Weather Survey statistics for Pennsylvania's other natural gas utilities, do not require further "supporting data" to rebut PGW's generalized claims that its universal service and collection policies are reasonable and to require PGW to meet its burden of demonstrating that it provides reasonably continuous service as required by Public Utility Code Section 1501. Moreover, PGW itself does not contest that the Survey numbers are indicative of the numbers of customers who while still occupying their homes, have been unable to obtain service reconnection. In this case, Action Alliance's conclusion is further supported by the testimony of its witness Mr. Geller, who testified: "I submit that the numbers of PGW customer terminated for non-payment who once terminated, have been unable to obtain restoration of critical heat-related service at the approach of winter demonstrate that PGW's service is unreasonable." AA St.1, at 8.

The R.D. also attaches undue weight to PGW's testimony summarized in its Reply Brief concerning the measures PGW has taken to assist low-income customers. R.D., at 108, citing PGW Reply Brief (hereinafter "PGW R.B."), at 53-56. PGW like other utilities has a duty to fulfill the goals of universal services in its service territory, which admittedly contains relatively large numbers of low and lower income customers. These numbers increase the challenge, but do not reduce the scope of the duty. When 9,000 heating customers without service, terminated

within the previous 12 months, over half of them verified low-income, are unable to obtain reconnection even with the approach of cold weather, it is clear that whatever PGW has provided has not been enough to constitute reasonable service.

Exception No. 2. The R.D.'s Rejection of Action Alliance's Claim of Failure to Provide "Reasonably Continuous Service" Is Contrary to Law.

The R.D. also bases its rejection of Action Alliance claims that PGW service violates the Public Utility Code's Section 1501 requirement that residential service be "reasonably continuous and without unreasonable interruption" on the premise that to succeed on this claim, Action Alliance must show that PGW is violating Chapter 14, a provision of Chapter 56 or a PUC Guideline. In other words, the R.D. adopts the legal position advanced by PGW that in order to demonstrate that PGW fails to provide service which is "reasonably continuous and without unreasonable interruption" Action Alliance must show that PGW is not complying with specific standards set forth in Chapter 14, Chapter 56 or a PUC Guideline. R.D., at 109. In contrast, Action Alliance submits that PGW's customer service – including its universal service programs and its policies concerning payment agreements, reconnection agreements and budget billing – is inadequate when it results in the levels of denial of access to utility service reflected for the past two years in PGW's Cold Weather Survey statistics.

In this proceeding, Action Alliance has identified various PGW policies which by making service more difficult to maintain and/or reconnection more difficult to obtain, are direct causes of the widespread denial of heating service to PGW customers reflected in the 9,000 Cold Winter Survey statistic. Action Alliance submits that regardless of whether these policies violate specific

PUC customer service standards, they are not reasonable when they result in the widespread denial of residential heating service in cold weather, as has occurred in the last two winters in Philadelphia.

Some of these policies, including but not limited to the requirement that Level 1 non-CRP customers must pay deposits as a condition of service, or the requirement of payment of a \$123.23 reconnection fee or a \$372.00 excavation charge as a pre-condition of reconnection, may be legally permissible, but are unreasonable under PGW's demographic circumstances; they constitute an often insurmountable barrier to access to service, and are a misuse of the discretion provided by Chapter 14. AA M.B., at 33-37. Other policies, including but not limited to PGW's method of determining whether customers seeking reconnection have broken two or more payment agreements, are in a gray area about which the PUC has not provided guidance; under the circumstances, even if these policies are determined to be permissible under Chapter 14, they are not reasonable under PGW's demographic circumstances; these policies, even if they are determined not to be illegal, constitute at least a misuse of discretion. AA M.B., at 29-33. Yet other policies, including but not limited to those concerning PGW's failure to provide "automatic" referrals to CRP (AA M.B. at 14-16)¹, failure to incorporate a "casework" CARES function into its CAP program (AA M.B. at 16-18), failure to comply with Chapter 56.97(b) in establishing payment agreements for customers whose service is on (AA M.B. at 22-26), the requirement of a uniform minimum monthly payment on arrears and a set percentage upfront payment for customers seeking Section 1405(b) payment agreements (AA M.B. at 22-26), and failure

¹ The R.D. recognizes that in violation of PUC requirements, PGW does not "automatically" refer income eligible payment troubled customers to CRP. R.D., at 109.

automatically to allow payment of annual budget billing true-up amounts in installments (AA M.B. at 28) violate specific Commission standards of reasonableness; they therefore constitute unreasonable barriers to maintenance of service. As such, they are also contributing factors in PGW's continuing violation of the Section 1501 requirement to provide "reasonably continuous service."

Although Action Alliance submits that some of PGW's policies actually violate the Public Utility Code and/or Commission regulations and standards, even if they do not, the policies which Action Alliance has identified in this case, when viewed in terms of their tragic results, represent a misuse of the discretion provided to utilities under Chapter 14, and thereby constitute a valid legal basis for the finding that PGW has failed to satisfy the Section 1501 requirement to provide "reasonably continuous service."

Exception No. 3. The R.D.s Rejection of Action Alliance's Claim That PGW's CARES Program Fails to Provide Required "Casework" Services Is Contrary to the Evidence.

Action Alliance has contended that PGW's CARES program is inadequate because it does not assist selected, payment-troubled customers the use of a "casework approach." AA M.B., at 16-18. The R.D. concludes that "the record is devoid of a violation regarding CARES." R.D., at 111.

PGW's legal duty to provide CARES services is governed by the Gas Choice Act and regulations, at 66 Pa.C.S. § 2201 et seq. and 52 Pa. Code § 62.1 et seq. R.D., at 111. In the Gas Choice regulations, CARES (Customer Assistance and Referral Evaluations Services) is defined as a program that "helps selected, payment-troubled customers" and "provides a casework

approach to help customers secure energy assistance funds and other needed services." 52 Pa. Code § 62.2 (emphasis added). The substantial weight of the evidence shows that PGW does not provide a casework approach.

In PGW's own words, the "full extent of the [CARES] program" is as follows:

PGW does not have staff dedicated and/or assigned specifically to CARES. The CARES program entails referrals to customers. Referrals are made by all customer service representatives (CSR) in Customer Service. CRS (sic) may refer customers to any program available, including LIHEAP and Crisis, or to any agency outside of PGW. PGW does not track the percentage of time its representatives spent on referrals. Occasionally CSRs in the call center of customer service center will escalate the call to a universal service representative for additional discussion. In these infrequent cases, the universal service representative will call the customer back and also call a particular agency to link the parties. That is the full extent of the program.

AA St.1, at Exh. HSG-8, quoted in AA M.B., at 17. As Action Alliance witness Mr.Geller testified, PGW's CARES program is extremely limited in scope "compared to other utilities in Pennsylvania," has no designated CARES staff, and provides no "on-going case management" for selected individuals who without such assistance with the utility and other social agencies, are likely to lose service. AA St. 1, at 17. An occasional referral to a universal service representative for infrequent three-way phone calls does not a casework approach make.

Action Alliance submits that the R.D. determination with regard to CARES should be rejected, as contrary to the evidence.

Exception No. 4. The R.D.'s Rejection of Action Alliance's Claim That in Making Chapter 14 Section 1405(b) Payment Agreements, PGW Fails to Consider All the Factors Required to Be Considered under Chapter 56 Section 56.97(b) Is Against the Weight of the Evidence.

Action Alliance also claimed that in establishing payment agreements for customers whose service is on, PGW utilizes procedures which do not consider the "payment history of the

ratepayer and the length of time over which the bill accumulated,” in violation of Chapter 56 Section 56.97(b) and the first Implementation Order. AA M.B., at 22-23. In support of this contention, Action Alliance cited the expert testimony and analysis of its witness Mr. Geller, who stated that the internal guidelines utilized by PGW customer service representatives are “exclusively quantitative” and do not go beyond utilization of the household income level and the amount of the arrearage. AA St. 1, at 27. In addition, Action Alliance offered Exhibit HSG-5, consisting of the chart utilized on a daily basis by PGW customer service representatives, which sets forth the internal guidelines for payment arrangement terms, to demonstrate that PGW customer service representatives do not consider all the elements required by Section 56.97(b) in establishing payment agreements for customers currently receiving service. As Action Alliance stated in its Main Brief, examination of Exhibit HSG-5 shows:

...contrary to the requirements of Chapter 56.97(b), the so-called Guidelines do not incorporate any consideration of the customer’s payment history to determine whether the customer appears to be making a good faith effort to pay the gas bill. Nor does it consider the period of time over which the bill accumulated, to determine the utility’s share of responsibility for the level of the unpaid balance due to inattentive collections practices.

AA M.B., at 23-24. The Payment Arrangement Guidelines are stronger evidence than any anecdotal evidence that Action Alliance might have provided, because that document addresses policy dictated to all Customer Service Representatives, not merely the actions of a particular PGW customer service representative.

In response, PGW only cited the general testimony of its Vice President for Customer Affairs that the Payment Arrangement Guidelines do not reflect all the elements included in the PGW trainings of customer service representatives and offered the conclusory assertion by its Vice President for Customer Affairs that the “record” shows that PGW observes the “good faith”

requirement. PGW R.B., at 60-63. This testimony was supported by no documentary evidence indicating training concerning how Customer Service Representatives were to comply with the “good faith” requirement under Section 56.97(b).

The R.D. accepted PGW’s arguments, criticizing Action Alliance for not presenting testimony concerning individual instances of Customer Service Representatives failing to comply with Chapter 56 Section 56.97(b). R.D. at 113. Action Alliance submits that PGW’s evidence can not stand up against the hard evidence contained in the Payment Arrangement Guidelines. The R.D.’s conclusion in support of PGW’s position concerning violation of Section 56.97(b) is against the weight of the evidence and should be reversed.

Exception No. 5. The R.D.’s Rejection of Action Alliance’s Contentions that in Making Chapter 14 Section 1405(b) Payment Agreements, PGW Fails to Comply with Chapter 56 Section 56.97(b) When It Imposes Uniform Minimum Monthly Payments on Arrears and Uniform Upfront Payments According to Income Level, Is Against the Weight of the Evidence and Contrary to Law.

Action Alliance also contended that PGW’s Payment Arrangement Guidelines reflect an inflexible policy concerning minimum monthly payments on arrears from customers seeking a payment agreement in order to avoid termination. In addition, PGW’s Payment Arrangement Guidelines dictate an inflexible upfront percentage payment which is required from customers without consideration of all the Section 56.97(b) factors. Action Alliance contended that the use of an inflexible system of minimum monthly payments on arrears and of set percentage upfront payments according to income level is not authorized by Chapter 14, which did not abrogate the requirements of Chapter 56 Section 56.97(b). Under Chapter 14, the amount of the monthly payments on arrears must be determined by the application of Section 56.97(b), not the

application of an inflexible schedule of minimum monthly payments. AA M.B., at 24-26.

The R.D. states that Action Alliance provided “no record evidence that the Company does not apply [sic] good faith standard to its payment arrangements.” R.D., at 113. However, in this respect, the R.D. is plainly mistaken, because the Payment Arrangement Guidelines themselves reflect a policy which contrary to the Chapter 56 Section 56.97(b) requirements, does not take into account a customer’s past efforts to make payments and the length of time over which the arrearages accumulated. And, as a matter of law, the Section 56.97(b) good faith standard does not allow the rigid system of minimum monthly payments and minimum upfront payments that PGW utilizes. AA M.B., at 22-26.

Action Alliance finds further support in the Commission’s Chapter 14 Second Implementation Order for its position that a utility payment agreement policy for customers receiving service which requires fixed minimum payments on arrears and fixed upfront payments according to household income level without consideration of other factors is not permissible. In the Second Implementation Order, the Commission indicated that while it did not believe that an upfront payment was always barred by Chapter 14, upfront payments were not appropriate in all situations. Flexibility provided by Chapter 14, the Commission states, “translates into ability on the part of utilities to require up-front payments if a utility, after considering all appropriate factors, believes an up-front payment is appropriate.”² Moreover, the Commission also stated that in its view, the payment schedule limitations set forth in Chapter 14 Section 1405(b) could result in payment arrangements well in excess of generally accepted affordability standards, even when

² Re: Chapter 14 Implementation, PUC Docket No. M – 00041802 F0002 (Order entered June 2, 2005), at 10-13; Re: Chapter 14 Implementation, PUC Docket No. M – 00041802 F0002 (Second Implementation Order, entered September 12, 2005), at 36.

the customer was allowed the maximum length of time provided for Commission established agreements. The Commission observed that the payment schedules limiting the length of payment Commission established payment agreements would result in

some customers paying as much as 20% of their gross monthly income each month to keep the terms of a § 1405(b) agreement. By comparison, the US Department of Housing and Urban Development (HUD) in its *Energy Desk Book of HUD Programs* reports on page 3 that a median income household has an average energy burden of 4% of gross monthly income Clearly, the payment terms that must be established pursuant to application of § 1405(b)(2) will, in most instances, be well beyond the 4% average reported by HUD, and will be difficult enough for the customer to maintain without imposing any additional requirements such as up-front payments. (Emphasis added).³

In concluding that PGW's policy as set forth in the Payment Arrangement Guidelines was not inconsistent with Chapter 14 and Chapter 56, the R.D. has substituted PGW's narrow and rigid standards for the individualized flexibility which the Commission has determined that the General Assembly intended to preserve in the establishment of Section 1405(b) payment agreements. The Commission should reject the R.D.'s conclusion on this issue as contrary to law.

Exception No. 6. The R.D.'s Rejection of Action Alliance's Claim That No Commission Standard of Reasonableness Requires PGW to Automatically Provide for Payment in Installments of Budget Billing True-up Amounts Constitutes an Error of Law.

The R.D. declines to find any violation of a PUC standard, interpretative order or regulation with regard to PGW's policy concerning "true-up" bills for customers on PGW's budget billing plan. R.D., at 110. In uncontroverted testimony, Action Alliance demonstrated that substantial numbers of customers on budget billing in July 2006 received a true-up bill that was equal or greater than the customer's monthly bill. AA St.1, at 35-36. PGW does not automatically

³ Re: Chapter 14 Implementation, PUC Docket No. M – 00041802 F0002 (Second Implementation Order, entered September 12, 2005), at 36.

provide for customers with a true-up amount to pay the true-up in installments. AA St. 1, at 35-36. According to Mr. Geller's unchallenged testimony, this policy results in customers receiving an "unpleasant surprise" which deters other customers from enrolling in budget billing. AA St. 1, at 37.

Action Alliance contends that this policy violates the standards set forth by the Commission in its recent Final Interpretative Order concerning budget billing. In that Interpretative Order, the Commission determined that it was not reasonable for utilities to require lump sum payment of "true-up" amounts from participants in budget billing programs, and stated that it expected utilities to exercise "good judgment" in these situations.⁴ Accordingly, the Commission established a schedule for installment payments linked to whether or not the "true-up" amount was greater or less than one average monthly bill.

In rejecting Action Alliance's claim that PGW's policies regarding budget billing "true-ups" violate a Commission standard of reasonableness, the R.D. refers to the Commission's Order entered November 14, 2006 which modified the previous Final Interpretive Order eliminating the original Interpretative Order's required schedule, which prescribed that budget billing customers be provided three to six months to pay a "true-up" amount which was less than one monthly budget bill, and twelve months to pay a "true-up" amount which was equal or greater than one monthly bill. R.D., at 110. However, the R.D. has read the November 14, 2006 Order too broadly. Although the November 14, 2006 Order no longer prescribes a specific schedule of payments deemed reasonable, it nevertheless continues to require that utilities exercise "good

⁴ In re: Insuring Consistent Application of 52 Pa.Code § 56.12(7) Equal Monthly Billing, PUC Docket No. M – 00051925 (Final Interpretive Order, dated June 2, 2006).

judgment” regarding billing of “true-up” amounts. In addition, the Commission clearly states that although bullet number 6 and 7 providing for a schedule of payments are deleted from the guidelines, “the use of ‘should’ for bullet numbers 4-7 is intended to communicate what the Commission would like to see practiced by utilities.”⁵ Plainly, the Commission does not consider “good judgment” to be PGW’s current practice, which provides no system-wide accommodation establishing a payment schedule for the substantial number of its budget billing customers who must pay a “true-up” amount.

Exception No. 7. The R.D.’s Rejection of Action Alliance’s Claim That PGW Is Legally Required to Retain Its Existing Tariff Requirement Providing Detailed Written Notice of Service Denial Is Contrary to Law.

Action Alliance has contended that PGW must retain its current Tariff Section 2.4.E, rather than eliminate it in favor of the proposed Section 2.4.C. Section 2.4.E provides that PGW’s written notice of service denial (Notification of Rejection) must contain a detailed statement of the reasons for the rejection, conditions that must be met to obtain service, and appeal rights. PGW’s current Tariff Section 2.4.E provides:

2.4.E. Notification of Rejection. Where PGW rejects an application for Gas Service, PGW shall inform the Applicant in writing of: (1) the specific reason(s) why service is not being provided, (2) any conditions that must be met in order to obtain service, (3) an itemization of the amount for any charges that must be paid in order to obtain service, (4) a description of the process by which the Applicant can dispute PGW’s decision.⁶

In contrast, PGW proposes to replace current Tariff Section 2.4.E with Section 2.4.C which only

⁵ In re: Insuring Consistent Application of 52 Pa.Code § 56.12(7) Equal Monthly Billing, PUC Docket No. M – 00051925 (Order entered November 14, 2006).

⁶ PGW St.6, Exh. RG-2, Section 2.4.C. This red-lined version contains current Section 2.4.E (stricken) and the language which PGW proposes to substitute for that current provision.

states that PGW will “inform the Applicant as required by Applicable Law.” The state law, Commission regulation or guideline addressing written notice requirements in connection with a denial of utility service is contained at Chapter 56 Section 56.36, which requires a written notice containing reasons for rejection only when there is a “denial of credit” (and requirement of a deposit). Nothing in Section 56.36 requires a utility to provide an applicant with a full and complete itemized statement of all sums to be paid and any other conditions which must be met in order to obtain service. Nor does Section 56.36 require written notification of appeal rights. AA M.B., at 44-45.

As Action Alliance has explained, the reason that Section 2.4.E must be retained is that it is a reasonable requirement that continues an important consumer protection which PGW has historically provided to customers. Moreover, as a matter of federal constitutional due process law, PGW as a municipally owned utility is a governmental unit which is required to provide such notice. AA M.B., at 45-46.

The R.D. rejects Action Alliance’s request that Section 2.4.E be retained on the grounds that (1) the “Commission cannot hold a utility to a policy above that which is required by Commission statute or regulation”; (2) that Action Alliance’s constitutional argument based on Memphis Light and Gas is not applicable; (3) that Chapter 56 Section 56.36 provides an “adequate and reasonable statement for denial of service”and; (4) that retention of Section 2.4.E is not required by Public Utility Code Sections 1501, 1502 or 2203(7). R.D., at 89. These conclusions are contrary to law.

In Memphis Light, Gas & Water Div. v. Craft, 436 U.S.1, 98 S.Ct. 1554 (1978), the U.S. Supreme Court expressly recognized that municipally owned utilities are subject to federal due

process requirements which do not necessarily apply to investor owned utilities. In that case, the court had granted certiorari "to consider this constitutional [due process] question of importance in the operation of municipal utilities throughout the Nation." Memphis Light, 98 S.Ct. at 1557. The Court squarely held that a municipally owned utility must comply with federal due process requirements when it denies service to persons whom it has an obligation to serve. Written notice is fundamental to due process. The purpose of notice under the due process clause is to apprise an applicant of, and permit adequate preparation for, an impending "hearing" on a disputed termination of service. Id., at 1563. Procedural due process requirements equally attach at the application stage. Kelly v. Railroad Retirement Board, 625 F.2d 486, 490 (3d Cir. 1980) ("Due process must attach to the process of determining eligibility, whether at the outset or after receipt of benefits.").

As discussed in Memphis Light, the Supreme Court framework of analysis for the "specific dictates of due process" is provided in Mathews v. Eldridge, 424 U.S. 319, 96 S.Ct. 893 (1976), which requires a Court to consider three distinct factors:

First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.

Id., at 334-45, 96 S.Ct. at 903.

Applying these principles to the issue whether PGW must provide a detailed Notice of Rejection, as required by its current Tariff, it is clear that this current Section 2.4.E is not merely "voluntary," but expresses a constitutionally based obligation that PGW has to all customers and applicants within its service territory.

First, since provision of natural gas service to qualified persons is mandatory and not discretionary, persons seeking to obtain or restore PGW service possess a sufficient property interest to warrant due process protection. 66 Pa.C.S. §§ 1501 and 1502; AA Main Brief at 46. Memphis Light, 98 S.Ct. at 1560. Moreover, there can be no dispute that customers and applicants have an important interest in maintaining or obtaining utility service. As the Memphis Light court squarely recognized: “[t]he customer’s interest is self-evident. Utility service is a necessity of modern life.” Id., at 1565.

Second, if PGW were allowed to reject applications for service, without providing a detailed rejection notice as required by Tariff Section 2.4.E, there is a high risk of erroneous deprivation of service. Applicants would be deprived of necessary information concerning access to a vital service. Without such notice, applicants may not succeed in obtaining service, and/or suffer delays in obtaining service. AA St. 1, at 43; AA M.B., at 45-46. The harm suffered from delay in receiving utility service can be irreparable. Memphis Light, 98 S.Ct. at 1565 (“indeed, the discontinuance of water or heating for even short periods of time may threaten health and safety”).

There is therefore great value to customers for a utility providing detailed rejection notices. In order to be constitutionally adequate, notice of benefits determinations must provide claimants with enough information to understand the reasons for the agency's action. Kapps v. Wing, 404 F.3d 105, 123-124 (2nd Cir. 2005). This requirement, like the right to fair hearing, is a basic requirement of procedural due process. Claimants cannot know whether a challenge to an agency's action is warranted, much less formulate an effective challenge, if they are not provided with sufficient information to understand the basis for the agency's action. Id. Thus, in the absence of effective notice, the other due process rights afforded a benefits claimant - such as the right to a

timely hearing - are rendered fundamentally hollow. Id.

Third, the cost to PGW of providing detailed rejection notices is not significant, and has been a standard cost which PGW has borne since long before it came under PUC jurisdiction. PGW has not raised cost as a factor in its proposal, and has stated that even if Section 2.4.E is removed from the Tariff, it intends to continue to provide detailed notices of rejection. PGW St. 6R, at 18. There is no incremental cost to maintaining its current practice. In any event, PGW would be required under Chapter 56 to provide applicants with dispute and appeal rights, and to bear any costs associated with the exercise of these rights. 52 Pa.Code §§ 56.2 (Disputes), 56.151 et seq.

For these constitutional reasons, the R.D.'s conclusion that the Tariff Section 2.4.E need not be retained must be rejected.

The R.D. is also incorrect when it states that Chapter 56 Section 56.36 provides for a "reasonable and adequate statement for denial of service." Section 56.36 only applies to denial of "credit," i.e., the provision of service without requirement of a deposit. Section 56.36 does not require a written notice of rejection for any other reason than failure to qualify for service without posting a deposit.

The R.D. is also incorrect when it states that retention of Tariff Section 2.4.E is not required by Sections 1501, 1502 or 2203(7) of the Public Utility Code. Section 2.4.E is a consumer protection which was contained in PGW's historical Tariff prior to the transfer of jurisdiction over PGW to the Commission. To abrogate this provision violates Public Utility Code Section 2203(7), because it diminishes the "consumer protections, policies and services" existing as of the date of the Natural Gas Choice and Competition Act to "assist low-income retail natural

gas customers to afford natural gas services.” AA M.B., at 45-46.

For all these reasons, the R.D.’s denial of Action Alliance’s claim that Tariff Section 2.4.E must be retained is contrary to law.

Exception No. 8. The R.D.’s Rejection of Action Alliance’s Request That PGW Be Required to Correct Its Omission from Its Tariff of Any Reference to “User Without Contract” Is Not Reasonable in Light of the Tariff’s Multiple References to “Unauthorized Use.”

Action Alliance contends that references to forbidden “unauthorized use” of gas in the part of PGW’s proposed Tariff containing residential customer service regulations are misleading for customers. The provisions uniformly equate “unauthorized use” with theft of service.⁷ However, under the Public Utility Code and Commission regulations governing customer service, “unauthorized use” is a term of art, which has a specialized meaning. Under the Public Utility Code and Commission regulations, “unauthorized use” refers to the use of gas obtained in association with physical interference with company meters and piping, such as self-turn on, meter tampering, and meter by-pass. AA M.B., at 43. In contrast, the Commission has long recognized that “unauthorized use” does not include “user without contract,” a person who has not engaged in self-turn on, meter tampering or meter by-pass, but who nonetheless is receiving gas service without the knowledge of the utility.⁸ As Action Alliance pointed out in its Main Brief, “[o]ccupants become users without contract in many situations, some actively fostered by the

⁷ See the reference in PGW’s proposed Tariff to “unauthorized use” as contained in “unauthorized usage” (Section 2.1.B), “unauthorized use” (Sections 6.1, 6.1.B), “unauthorized ...use” (Section 8.3.A, 8.3.B) and “used Gas Service without PGW authorization” (Section 2.4.B). PGW St. 6, Exh. RG-2.

⁸ Re Chapter 14 Implementation, PUC Docket No. M – 0004-802 F0002 (Order entered March 4, 2005), at 8-10; Re: Chapter 14 Implementation, PUC Docket No. M – 00048802 F0002 (Order entered June 2, 2005), at 10-13.

utility policies of utilizing a “soft-off” to terminate service to a tenant/customer pending the replacement of that tenant customer by a successor tenant customer.” AA M.B., at 43.

From a customer standpoint, the distinction between “unauthorized use” and “user without contract” is a material distinction. The customer’s ability to avoid interruption of an essential service can often turn upon this distinction. As Action Alliance witness Mr. Geller testified, in contrast with “unauthorized users,” “users without contract” are not “subject to ‘immediate’ termination without prior written notice and may not be required to pay upfront the total amount that they owe and give assurances of no further unauthorized use as a condition of receiving service.” AA St. 1, at 42. In the absence of a recognition of this distinction in PGW’s proposed Tariff, the proposed Tariff is misleading on this important issue. For that reason, Action Alliance proposed that the Commission require that PGW include in its Tariff a provision which tracks the Chapter 56 Section 56.91 provision which contains the “user without contract” exception. Action Alliance therefore proposed that the Commission should require that PGW include in its Tariff a provision which states that “a residential occupant who has taken or accepted utility service without the knowledge or approval of the utility (without self-turn-on, a meter bypass or meter tampering) is not a person who has committed “unauthorized use” or “used Gas Service without PGW authorization” within the meaning of this Tariff.” AA M.B., at 44.

The R.D. decision rejected this request, accepting PGW’s assertion that “regardless of how the unauthorized use occurs, a person who lacks permission to use gas service is an unauthorized user.” R.D., at 87. This position misstates the law. It fails to recognize well settled law that the term “unauthorized use” under the Public Utility Code and Commission regulations is a term of art, which does not include “user without contract.”

The R.D. further claims that PGW argues that Action Alliance's proposed Tariff language "could mislead and confuse users without a contract to believe that they are without consumer protections." R.D., at 87. However, PGW makes no such argument, and there is no support in the record for such an argument. In addition, Action Alliance's proposed Tariff language tracks language which has long existed in Chapter 56 Section 56.91. That language is not confusing, and is a significant improvement over the misleading language concerning "unauthorized use" in PGW's current and proposed Tariff.

For these reasons, Action Alliance requests that the Commission reverse the R.D. on this issue, and accept Action Alliance's proposed Tariff language clarifying the meaning of "unauthorized use" to exclude "user without contract."

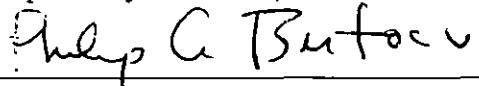
III. CONCLUSION.

For all the foregoing reasons, Action Alliance respectfully requests that the Commission grant Exceptions 1 through 6 concerning the inadequacy of PGW's customer service, and accordingly, on the basis of these determinations, deny PGW's rate increase request or, in the alternative, condition granting any increase upon adoption by PGW of procedures to correct the inadequacies which have been identified.

In addition, Action Alliance respectfully requests that the Commission grant Exceptions 7

and 8, and require PGW to make the appropriate amendments to its proposed Tariff.

Respectfully submitted,



Philip A. Bertocci, Esquire
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August 20, 2007

Attorneys for Action Alliance of Senior Citizens
and Tenant Union Representative Network

Pennsylvania Public Utility Commission :
v. : Docket Nos. R-00061931
Philadelphia Gas Works :

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the Main Brief upon the presiding officers and the active parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (service by a participant) and § 1.59 (number of copies to be served), in the manner and upon the persons listed below:

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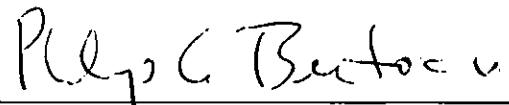
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August 20, 2007

VIA FEDERAL EXPRESS

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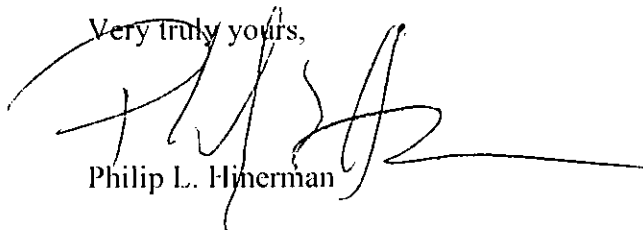
Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00061931

Dear Secretary:

Enclosed is an original and nine (9) copies of Exceptions of Philadelphia Housing Authority to Recommended Decision of Administrative Law Judges Cynthia Williams Fordham and Angela T. Jones. A copy of this document has been served pursuant to the attached Certificate of Service.

**DOCUMENT
FOLDER**

Very truly yours,



Philip L. Hinerman

PLH/mn

cc: All Parties of Record
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Kathryn G. Sophy, Office of Special Assistants (via hand-delivery)
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BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

PENNSYLVANIA PUBLIC UTILITY
COMMISSION :

v. :

PHILADELPHIA GAS WORKS :

Docket Nos. R-00061931,
R-00061931-C0001, et al.

**EXCEPTIONS OF PHILADELPHIA HOUSING AUTHORITY
TO RECOMMENDED DECISION OF ADMINISTRATIVE LAW
JUDGES CYNTHIA WILLIAMS FORDHAM AND ANGELA T. JONES**

I. INTRODUCTION

This proceeding involves the Philadelphia Gas Works ("PGW") filing of Supplement No. 16 to Tariff Gas-Pa.P.U.C. No. 2, which proposes changes in rules, regulations and rates calculated to produce additional revenues for PGW. In this proceeding, PGW presented direct testimony of eight witnesses. Additionally, witnesses and exhibits were presented by the Office of Trial Staff ("OTS"), Office of Consumer Advocate ("OCA"), Office of Small Business Advocate ("OSBA"), Action Alliance of Senior Citizens of Greater Philadelphia ("Action Alliance"), Tenant Union Representative Network ("TURN"), the Philadelphia Industrial & Commercial Gas Users Group ("PICGUG") and a number of other parties, including the Philadelphia Housing Authority ("PHA").

Evidentiary hearings were held from May 21 through May 24, 2007 in Philadelphia. PHA and others presented testimony and exhibits at these hearings.

Administrative Law Judges Cynthia Williams Fordham and Angela T. Jones, ("ALJs") filed a Recommended Decision on July 30, 2007 (the "Recommended Decision" or "R.D."). The 136- page Recommended Decision includes eight conclusions of law and twenty-three ordering paragraphs in the Order section. The Recommended Decision correctly excludes PHA's

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conventional site properties, which are served at the PHA rate, from PGW's proposed increase. However, PHA is requesting that the Commission modify proposed Order paragraph 14 which discusses classification, an issue that solely affects PHA and its rates.

Further, in an effort to avoid potential disputes in ancillary proceedings, PHA also requests that the Commission modify portions of two substantive areas of the ALJs' discussion that apply solely to PHA positions advanced in the proceedings – applicable rates to PHA and future classification of PHA residents billed directly by PGW. The ALJs' discussion of PHA's direct issues is contained at pages 82 and 83 of the Recommended Decision. PHA requests that the Commission make minor modifications to the recitations on these pages and include additional provisions in the Order section to effectuate the decisions of the ALJs.

II. EXCEPTIONS

1. PHA excepts to the ALJs' denial of its request to reclassify rates for certain of its properties insofar as the Recommended Decision does not state clearly whether or not Scattered Sites and/or Housing Choice properties qualify for the PHA or MS service rate. R.D. pages 82-83 and 135 (Ordering Paragraph 14).
2. PHA excepts to the ALJs' ordering paragraph 14 insofar as it is unclear under that paragraph whether PHA is entitled in the future to the lowest available rate for service to Conventional Sites, Scattered Sites and Housing Choice Sites on a going forward basis. R.D. pp. 82-83 and 135; PHA Main Brief at p. 8.
3. PHA excepts to the ALJs' discussion that it requested that all Scattered Sites PHA housing be placed under the Customer Responsibility Program ("CRP") on the grounds that PHA did not request this. R.D. p. 83; PHA st. 1 at 9.

III. DISCUSSION OF EXCEPTIONS

Exception Number 1 – Applicable Rate

Although not specifically enumerated as findings of fact, the Administrative Law Judges (“ALJs”) in the Recommended Decision, at pages 82 and 83, address issues raised by PHA in this proceeding. The ALJs make factual determinations in that section of the Recommended Decision which should be clarified.

At page 82 of the Recommended Decision, the ALJs correctly noted that the PHA and its residents are currently being charged under two different rates. The Recommended Decision recites the different charges for Conventional Sites and for Scattered Sites. “Conventional Sites” are PHA properties at which there is a single meter serving multiple residents. Conventional Sites are billed directly to PHA under the PHA Rate. The other type of housing is referred to by the ALJs as “Scattered Sites” housing. Scattered Sites are locations in which a single meter serves a single residence and the property is a PHA-managed facility. In reality, there are two types of sites metered this way - Scattered Sites and “Housing Choice” sites. The Housing Choice sites are those properties in which PHA qualified residents use a voucher to lease privately owned residential properties. See PHA Reply Brief, footnote 2. The Recommended Decision does not note that there are also Housing Choice properties.

There is no articulated reason for concluding that residents at PHA housing should be different for billing purposes. The residents in the Scattered Sites, the Housing Choice Sites and the Conventional Sites all must meet the same PHA eligibility requirements with regard to financial need. However, in the past, the Conventional Sites were billed at the higher PHA Rate and the Scattered and Housing Choice sites were billed at the General Service Rate (the “GS Rate”).

At page 83, the Recommended Decision correctly notes that the PHA Rate, charged to the Conventional Sites, had the largest proposed increase in the December PGW Tariff filing. As the ALJs interpreted the Tariff, however, PHA could suffer disproportionately as a result of the proposed residential rate increase.

Portions of both the current and proposed tariff schedules employ the same wording when setting out the GS Rate. The GS Rate provision applies a customer charge to “Public Housing Authority Customers”. In turn, the GS Rate imposes the Gas Cost Rate (the “GCR Rate”) for residential and “Public Housing”. It should be undisputed that PHA is “Public Housing” and that Scattered Sites residents are in Public Housing. Similarly, the PHA Rate provides that both groups of residents – Scattered Sites and Housing Choice - may be charged the PHA Rate when gas is used for cooling and heating as set out in the PHA Rate section of the Tariff.

Finally, PHA argued it could also be billed under the Municipal Rate (the “MS Rate”) for all of its properties if that is the lowest rate. The ALJs noted that PGW did not oppose PHA’s rate being changed to MS Rate on a going-forward basis. See Recommended Decision at page 83.

PHA is in the difficult position of not knowing which of the three applicable rates will apply in the future. The ALJs’ findings with respect to the eligibility of all PHA’s properties for a common rate, and wording with regarding the MS Rate, makes it unclear what rate will be charged to PHA and its residents in the future.

Exception Number 2 – Lowest Available Rate

When a customer is eligible for more than one rate, PGW is obligated to provided service at the most advantageous rate to the customer. Here, there are three possible rates applicable to the PHA residents. Section 1303 of the Public Utility Code states as follows:

Any public utility, having more than one rate applicable to service rendered to a patron, shall, after notice of service conditions, compute bills under the rate most advantageous to the patron.

66 Pa.C.S. §1303.

Under Section 1303 of the Code, PGW should compute the applicable rate and bill all PHA tenants and PHA at the most favorable rate, whether it be the GS Rate, the MS Rate, or the PHA Rate.

First, PHA suggests that the third full paragraph at page 83 be deleted and replaced with the following:

PHA residents, whether Convention Sites, Housing Choice Sites or Scattered Sites, may qualify for one of three rates, whichever is lower. All sites can be billed at the PHA Rate, the GS Rate or the MS Rate. Under Section 1303 of the Public Utilitiy Code, PGW should calculate the current rates for each of the three classes in accordance with PUC orders. Promptly upon completion of the recalculation, PGW shall institute the lowest rate for PHA and its tenants.

PHA also suggests that Ordering Paragraph 14 be deleted and replaced with the following Suggested Ordering Paragraphs:

14. PHA and its residents qualify for the lowest possible rate among the PHA Rate, the GS Rate or the MS Rate.
15. PGW shall, promptly upon it's recalculation of the applicable rates in accordance with the Order of this Commission, assign PHA and its residents the lowest of the three rates in accordance with Pennsylvania Utility Code Section 1303.

Exception No. 3 – CRP Program

The Recommended Decision states at Page 83, numbered paragraph 2, that PHA had requested that “[a]ll of its clients residing in Scattered Site PHA Housing be placed on the CRP rate, since they are low-income.” The ALJs cited PHA St. 1 at 9 to support their conclusion. The cited statement, however, contains no such request. It reads, in pertinent part:

Because PHA residents have limited incomes, the majority of PHA residents qualify for PGW’s CRP or CAP programs, although few residents choose to enroll in them.

...

In short, PGW derives more income from the PHA tenants’ utility allowance than if the residents were enrolled in the CAP program.
PHA St. 1 at 8-9

To the extent that the statement in the Recommended Decision constitutes a factual finding, it is incorrect, especially because it appears to have been taken from an incorrect characterization at Page 101 of OCA’s main brief. PHA has never made this request as it has not participated with any of its residents requesting classification under the CRP Rate. Further, PGW does not have a CAP program.

PGW, in its Main Brief at page 87, states that PHA, in an earlier agreement with PGW under the “direct vendor program”, pays utilities for some of its residents. PGW states in its brief that none of these residents are included in the CRP program.

PHA cannot and does not monitor its direct pay residents to determine which, if any, of those residents participate in the CRP program. PHA Reply Brief at 9-10. Prior to this proceeding, PGW had declined to provide PHA with this information based on confidentiality issues.

Additionally, PHA could not have made a request to place Scattered Site residents in CRP/CAP programs even had it wished to do so in view of ongoing federal court proceedings impacting residents and their financial contribution to utilities. As discussed in PHA's Main Brief at pages 11 to 13, there is an action regarding payments under the direct vendor program pending before the United States District Court for the Eastern District of Pennsylvania a lawsuit entitled *McDowell, et al. v. PHA*, Civil Action No. 97-2302. There are court -ordered payments to residents involved in that action that effectively prevent PHA from making direct vendor payments for Scattered Site properties.

OCA had requested that PHA make direct vendor payments for the entire amount of residents' utility allowances, irrespective of whether the allowance met or exceeded an individual resident's actual bill. OCA M.B. at 101. The ALJs concluded that by denying PHA's "request," OCA's request for direct vendor payment was moot. R.D. at 83. It is important to realize that the issue would also be moot in light of the federal proceedings set forth above, without regard to CRP/CAP.

In order to clarify the record and the ALJs' position on this issue, PHA respectfully requests the entry of an additional ordering paragraph denying OCA's request for expansion of the direct vendor program to all PHA Scattered Sites properties.

IV. CONCLUSION

This is a very trying time for PHA. HUD had imposed budget cuts in PHA's budget of 18% in year 2007, and has proposed further reduction to 20% in 2008. It was widely reported that PHA was forced to layoff 355 employees, or about 22% of the work force, due to these budget cuts. In fact, Carl Greene, PHA's Executive Director, testified that PHA's gas costs would rise over 15% while its overall budget will decrease by 20%. See Greene Statement, PHA

Statement 1, p.8. In light of the budget cuts, and the fact that PHA has the highest revenue to actual cost percentage, as noted in Recommended Decision Table IEC-1 at page 69, adjustments to PHA's rate are long overdue. By clarifying the Recommended Decision with respect to the applicable rate for PHA and its "residents", PHA would be in a much better position to manage the utility cost portion of its budget.

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Dated: August 20, 2007

AUG 20 2007

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SECRETARY'S BUREAU

I hereby certify that I am serving a true and correct copy of the foregoing Exceptions of Philadelphia Housing Authority to Recommended Decision of Administrative Law Judges Cynthia Williams Fordham and Angela T. Jones, in accordance with the requirements of 52 Pa.Code §1.54, has been served upon the following person(s) via electronic mail and First Class Mail, postage prepaid:

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Dated: August 20, 2007



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IN REPLY PLEASE
REFER TO OUR FILE

August 20, 2007

James J. McNulty, Secretary
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P.O. Box 3265
Harrisburg, PA 17105-3265

ORIGINAL

Re: Pennsylvania Public Utility Commission v.
Philadelphia Gas Works

Docket No. R-00061931

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Dear Mr. McNulty:

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

As evidenced by the enclosed Certificate of Service, copies are being served on all active parties of record.

Sincerely,

Richard A. Kanaskie
Prosecutor
Office of Trial Staff
PA Attorney I.D. #80409

Enclosure
RAK/clp

KJR

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

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Docket No. R-00061931

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EXCEPTIONS
OF THE
OFFICE OF TRIAL STAFF

ORIGINAL

DOCKETED
AUG 21 2007

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Motion

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Docket No. A-212285F0136 (Public Meeting of July 25, 2007)5

I. INTRODUCTION

On December 22, 2006, Philadelphia Gas Works (PGW or Company) filed Supplement No. 16 to Tariff Gas-Pa. P.U.C. No. 2 to become effective February 20, 2007, containing proposed changes in rates, rules, and regulations calculated to produce \$107 million (11.0%) in additional annual revenues.

On February 8, 2007, the Commission issued an Order suspending the filing pursuant to 66 Pa. C.S. §1308(d). This suspension will remain in effect from February 20, 2007, until September 20, 2007, unless permitted by Commission Order to become effective at an earlier date. The Commission directed that an investigation be instituted to determine the lawfulness, justness and reasonableness of the Company's proposed tariff. Furthermore, this investigation was ordered to include a review of the Company's existing rates, rules and regulations.

The Office of Trial Staff filed its Notice of Appearance on December 28, 2006, and complaints were filed by the following parties: Office of Consumer Advocate (OCA), Office of Small Business Advocate (OSBA), Action Alliance, Philadelphia Industrial and Commercial Gas Users Group. Moreover, PECO Energy Company, Interstate Gas Supply, Philadelphia Housing Authority, the School District of Philadelphia, and Hess Corporation filed Petitions to Intervene.

This filing was assigned to Administrative Law Judges Cynthia W. Fordham and Angela T. Jones (ALJs) for the prompt scheduling of hearings to result in the issuance of a Recommended Decision. An Initial Prehearing Conference was held on February 23, 2007 followed by a Second Prehearing Conference on March 2, 2007.

Public Input Hearings were held on March 26, 2007 at the Dorothy Emanuel Recreation Center; March 28, 2007 at George Washington High School; and afternoon and evening sessions were held on April 9, 2007 at the Community College of Philadelphia. Evidentiary Hearings were held in Philadelphia beginning on May 21, 2007 and concluded on May 24, 2007. The Evidentiary Hearings completed the 984 pages of transcript generated in this proceeding. Main Briefs were submitted on June 12, 2007 followed by the submission of Reply Briefs on June 21, 2007.

ALJs Fordham and Jones issued their Recommended Decision (“RD”) on July 30, 2007. OTS maintains that, with the exception of the two issues discussed herein, the detailed and insightful RD appropriately recognized the nature of PGW’s operations and its service territory. OTS submits that the recommendations contained in these Exceptions further promote the public interest and must be adopted by the Commission.

II. EXCEPTIONS

1. The ALJs Have Misapplied The Basis For The OTS Summary Tables In Their Recommended Decision.

OTS Main Brief, Appendix D
Recommended Decision, p. 45

The ALJ's have misinterpreted the basis for the inclusion of Summary Tables in the OTS recommended revenue allowance in this proceeding. The mechanics of the tables are consistent with OTS procedures and represent the proper approach in a traditional rate case analysis. However, this proceeding involves a municipal utility with somewhat unique circumstances being evaluated on the basis of cash flow and debt service coverage. The data used by OTS is appropriate and is based on the Company's filing. Adjustments to the Company's filing are recognized in the appropriate areas of the OTS Summary Tables. The Company's revised *pro forma* test year claim reflects adjustments to its original claim as does the OTS Summary Table. The semantics of the tables and their layouts must not obfuscate the purpose of their inclusion. They are presented for illustrative purposes and do not form the basis for the OTS recommendation in this proceeding.

OTS has consistently maintained that its recommended revenue allowance not be disturbed based on the adjustments presented throughout this proceeding. As will be discussed later in these Exceptions, the adjustments presented illustrate operating efficiencies that can be realized by the Company in order to produce additional revenue to satisfy its outstanding debt. The tables presented in the OTS Main Brief must be read

in the context of the related impact on the Company's debt service coverage requirements.

As has been presented in this proceeding, the Company's existing debt service coverage well exceeds the obligations set forth in the City Ordinance.¹ The purpose of the OTS Summary Table was merely to illustrate the resulting increases in the mandated debt service coverage's that will occur when the Company properly applies the savings that result from implementing the operating efficiencies in conjunction with the revenue allowance identified in the OTS recommendation.² Using the OTS Summary Table for anything other than the purpose of showing the impact of operating efficiencies on the Company's debt service coverage obligations is improper and will result in a distorted recommendation. A walk through of the tables is a needless exercise as the OTS recommendation does not advocate any adjustments to its revenue allowance.

Given this explanation, OTS acknowledges that its Summary Table begins with the Company's filed data. To the extent that adjustments to the recommended revenue allowance are warranted after Commission review, the OTS tables are not the best source for effectuating these changes.

2. The ALJs Erred By Not Recommending That Revenue Resulting From Expense Adjustments Should Be Applied To The Company's Debt.

OTS Main Brief, pp. 16-27.

OTS Reply Brief, pp. 5-14.

Recommended Decision, pp. 46-47.

¹ OTS Main Brief, p. 31, OTS Reply Brief, p. 17. See also, Company Exhibit JRB-1, p. 3.

² OTS Main Brief, p. 31.

The ALJs erred by not recommending that the Company be required to apply the identified operating efficiencies to its outstanding debt as a means of addressing its capital structure. The statutory authorities cited by the presiding officers in this proceeding were decided well before this utility came under the jurisdiction of the Commission. Recent actions by the Commission have demonstrated a willingness to expand its authority with well placed recommendations that address utility management decisions affecting the public interest. In a Joint Motion by Chairman Wendell F. Holland and Vice Chairman James H. Cawley it was moved that:

as a condition of approval of its proposed Initial Public Offering (IPO), PAWC or its parent company commit that it or they will not diminish, reduce, terminate, or otherwise adversely affect the pension, health care, welfare, or life insurance benefits of PAWC's retired employees or their dependants, including employees who were designated as management employees, as of the date of their retirement.³

These comments clearly indicate that the Commission is not willing to allow traditional management matters that impact the public interest to go unaddressed. Pensions and benefits are under the purview of utility management, yet the Commission exercised its broad reaching authority in this Joint Motion. In this proceeding, the application of identified savings to the Company's outstanding debt impacts the public interest and must be addressed. A constant argument in the Company's presentation was its debt level. It is appropriate to address the operating efficiencies identified by OTS and have the revenue associated with these expenses applied to the debt level. Allowing continued

³ Application of Pennsylvania-American Water Company for approval of a change of control to be effected through a public offering of the common stock of American Water Works Company, Inc., Docket No. A-212285F0136, Public Meeting of July 25, 2007.

recovery of these imprudent expenses without a strong recommendation as to how they should be applied allows the Company too much discretion. Ratepayers will continue to pay for these expenses under the OTS recommendation and they should receive assurances that the revenue will be applied to lower the Company's outstanding debt, not to continue the funding of imprudent activities.

Furthermore, the Commission has indicated its willingness to offer the Company guidance in its debt reduction efforts when it ordered:

[t]hat the Philadelphia Gas Works will project the amount of annual short term debt pay down (commercial paper) that the revenue requirement will permit, will provide the basis for its projections, and will agree to meet those projections or explain why it cannot in a yearly report to the Joint Petitioners.⁴

Clearly, similar guidance is necessary in this proceeding. The record indicates that the Company's debt level continues to increase despite past Commission efforts directing the PGW to control, or explain, its level of commercial paper. Allowing the Company complete discretion over the use of traditional ratemaking expense claim adjustments is counterproductive and not in the public interest. The Company's continued claim of inordinately high debt levels and its impact on operations must be addressed in this proceeding.

The examples cited above show that the Commission may, and more importantly must, provide guidance to this utility to assist in the alleviation of its outstanding debt.

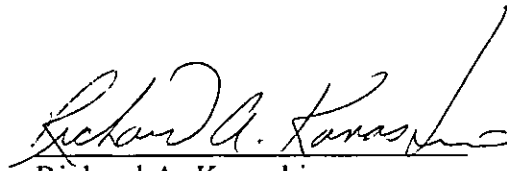
⁴ Pennsylvania Public Utility Commission v. Philadelphia Gas Works, Docket No. R-00017034, Order Adopted and Entered August 8, 2002.

The failure of the ALJs to recommend Commission involvement as to the use of revenues generated as a result of this proceeding is misguided and must be corrected.

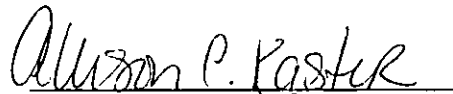
III. CONCLUSION

For the reasons stated herein, the Office of Trial Staff respectfully requests that the Administrative Law Judges and the Commission adopt its recommendations in this proceeding.

Respectfully submitted,



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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :

v. :

Philadelphia Gas Works :

Docket No. R-00061931

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I hereby certify that I am serving the foregoing **Exceptions**, dated August 20, 2007, either personally, by first class mail, electronic mail, express mail and/or by fax upon the persons listed below, in accordance with the requirements of § 1.54 (relating to service by a party):

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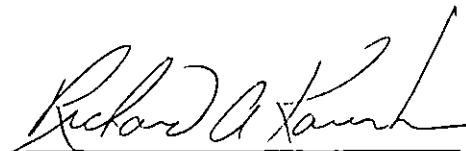
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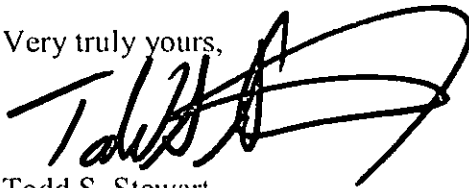
RE: Pennsylvania Public Utility Commission v. Philadelphia Gas Works; Docket No. R-00061931, et al.; **EXCEPTIONS OF INTERSTATE GAS SUPPLY, INC.**

Dear Secretary McNulty:

Enclosed please find the original and nine (9) copies of Exceptions of Interstate Gas Supply, Inc., to Initial Decision in the above-captioned matter.

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

Very truly yours,



Todd S. Stewart
Counsel for Interstate Gas Supply, Inc.

TSS/bks
Enclosure

cc: The Honorable Cynthia Fordham, ALJ (via Federal Express-Overnight)
The Honorable Angela Jones, ALJ (via Federal Express-Overnight)
Per Certificate of Service

KJR

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

PENNSYLVANIA PUBLIC UTILITY
COMMISSION, ET AL.,
Complainant

Docket No. R-00061931

v.

THE PHILADELPHIA GAS WORKS,
Respondent

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**EXCEPTIONS OF
INTERSTATE GAS SUPPLY, INC.**

NOW COMES, Interstate Gas Supply, Inc. ("IGS"), by and through its counsel in the above-captioned matter, Hawke McKoon & Sniscak LLP, and hereby Excepts to the Recommended Decision ("RD") of Administrative Law Judges' Cynthia Williams Fordham and Angela T. Jones ("ALJs") issued July 30, 2007, in the above-captioned matter. These Exceptions are provided pursuant to 52 Pa. Code. § 5.533, *et seq.*

In particular, IGS takes exception with the RD's recommended disposition of the issues raised by the competitive suppliers in the case--IGS and Hess--with regard to improvements to PGW's requirements and procedures that would facilitate competition. The RD rejects recommendations made by IGS' witness Mr. Parisi on how to jump-start residential competition in PGW's service territory without imposing additional costs upon residential customers or PGW. Ironically, the ALJs dismissed IGS's recommendation on the premise that IGS had failed to provide information regarding the potential costs of its program, so as to allow for a cost benefit analysis, despite Mr. Parisi's testimony that his proposal would not impose additional

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costs on PGW. Accordingly, the ALJs' conclusion clearly is in error and must be reversed on both factual and policy grounds. IGS's specific exceptions follow:

Exception No. 1: The ALJs' Erred in Rejecting IGS's Proposal for Bringing Retail Competition to PGW's Service Territory (R.D. 102-103).

a. Mr. Parisi's testimony regarding his proposal was clear.

Vincent Parisi testified on behalf of IGS that some sort of program to "jump-start" competition may be necessary in PGW's service territory, above and beyond changing the delivery rules and upgrading PGW's billing system, to allow competitive suppliers an actual opportunity to compete on PGW's system. (IGS St. No. 1, pp. 4:19-5:12; IGS Reply Brief, p. 9.)¹ Mr. Parisi proposed a three-year pilot program that would allow the migration of a significant percentage of PGW's customers to willing and able choice suppliers at a *discount* to PGW's current PGC rates. (IGS St. No. 1, pp. 7:7-8:11.)

Mr. Parisi testified that a three-year pilot program not only would bring benefits to individual customers in the form of savings from the PGC rate, but that it also would bring benefits to the PGW system as a whole by reducing the costs of PGW's natural gas procurement. (IGS St. No. 1, p. 8:1.) OCA's witness, Mr. Lelash confirmed the view that competition would result in savings to the gas procurement function. (Tr. at 884:16.) Mr. Parisi testified further that a 30% migration would allow for a thorough examination of the efficacy of competition on the PGW system and would provide significant benefits through the shared discount to fund improvements to PGW's billing system **without the need to spend additional PGW dollars.** (IGS St. No. 1, pp. 7-9.) In short, Mr. Parisi made it clear that IGS's program would not impose new costs on PGW. Rather, it would provide a funding source for PGW to use to implement an

¹ The RD disregarded completely the un-refuted contentions that PGW's billing system is grossly inadequate from an NGS perspective and that the Natural Gas Choice and Competition Act requires that the Company be able to bill supplier's charges, which PGW cannot reasonably do.

updated billing system. Moreover, IGS's proposal would save customer's money by providing actual savings from the PGC rate.

The RD erred as a matter of fact by concluding that "costs are not sufficiently explained to us as whether the pilot program is in the public interest" (RD at 103), because there would be no costs to PGW or the customers.

b. The RD adopted PGW's mischaracterization of IGS's proposal.

On pages 72 and 73 of its Reply Brief, PGW addresses Mr. Parisi's proposal by claiming that IGS failed to carry its burden of persuasion. It appears that the RD erroneously adopted this incorrect view as the basis for its conclusion regarding IGS's proposed MST program.

Mr. Parisi made it clear, contrary to PGW's assertions, that IGS's proposal would not produce additional costs to the company that would be unrecoverable or nonproductive, because the revenue stream generated by part of the discount provided by market share threshold participants would provide the funds necessary to upgrade the billing system. (IGS Statement No. 1, pp. 7-8.) PGW's claim that the testimony does not explain how this would occur or quantify the alleged savings is simply incorrect. Rather, the record is clear that the savings provided to customers would be guaranteed. Since those savings would be determined as part of the development of the program and would require the input from various parties, not the least of which would be the suppliers agreeing to serve at the discount, there simply is no way that Mr. Parisi could project those savings now. However, suggesting that IGS's proposal is therefore flawed simply makes no sense. It is quite reasonable to expect that the Commission would refrain from final approval over such a program until those, and other specific details are developed. The point is that something must be done, and PGW's consistent approach to competition is to throw up roadblocks to any change, despite the understanding that competition would benefit PGW.

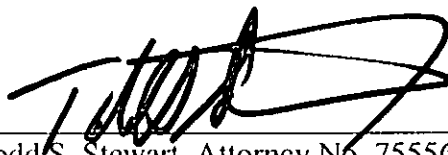
In short, the company's bald statement that IGS failed to carry its burden of proof is not substantiated by even a cursory review of the record, and the RD should have rejected PGW's position, but instead adopted it. Accordingly, the RD is in error and should be reversed.

Conclusion

It is clear that the RD adopted the view expressed by PGW in its Reply Brief that IGS has failed to provide sufficient cost data to allow the ALJs to make a decision in this case. As the record demonstrates, and as detailed in IGS's Main Brief, Mr. Parisi's proposal clearly does not propose additional costs to PGW or its customers. Those costs would be born by the MST participants.

Accordingly, for the reasons stated herein, and in IGS' Main Brief, the RD erred in dismissing IGS's proposed three-year MST pilot program and in disregarding the significant benefits that such a program could bring to PGW, and its customers. Accordingly, IGS excepts to the conclusions of the RD and requests that the Commission reverse the RD on that point and immediately convene discussions between interested natural gas suppliers, PGW and the Commission for the purpose of determining the parameters for such a program.

Respectfully submitted,



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Dated: August 20, 2007

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document upon the parties, listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party).

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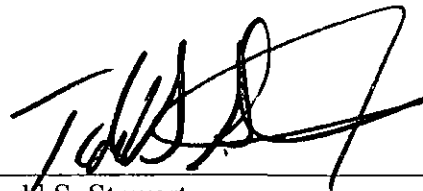
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Dated this 20th day of August, 2007.

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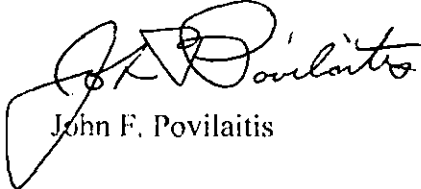
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Re: Pennsylvania Public Utility Commission
v.
Philadelphia Gas Works, Docket No. R-00061931

Dear Secretary McNulty:

Enclosed are an original and nine (9) copies of the Exceptions of Hess Corporation in the above-captioned proceeding. Copies have been served in accordance with the attached Certificate of Service.

Very truly yours,


John F. Povilaitis

Enclosure
JFP:ck

c. Certificate of Service

KJR

The Honorable Angela T. Jones
The Honorable Cynthia W. Fordham

The Honorable Wendell F. Holland, Chairman
The Honorable James H. Cawley, Vice-Chairman
The Honorable Terrance J. Fitzpatrick, Commissioner
The Honorable Kim Pizzingrilli, Commissioner
The Honorable Tyrone J. Christy, Commissioner

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

Pennsylvania Public Utility Commission :

v. :

Philadelphia Gas Works :

Docket No. R-00061931

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EXCEPTIONS OF HESS CORPORATION

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The generic proceeding referenced by the ALJs is the October 6, 2005, order adopted and entered by the Commission with respect to its investigation into Pennsylvania's natural gas supply market and its Report to the General Assembly on Competition in Pennsylvania's Retail Natural Gas Supply Market.³ The objective of this investigation was to assess "the effectiveness of competition in the [Pennsylvania] natural gas industry."⁴ The Commission's order concluding this investigation stated as follows:

It is the Commission's judgment that the existence of "effective competition" in the retail natural gas supply market in Pennsylvania would be demonstrated by participation in the market by many buyers and sellers, the lack of substantial barriers to market entry for suppliers, the lack of substantial barriers that would discourage customer participation, and the presence of sellers offering buyers a variety of products and services. Based on this standard and the record in this proceeding, there is not "effective competition" in the retail natural gas supply market on a statewide basis at this time.⁵

This determination that effective competition is lacking in the Pennsylvania natural gas supply market was supported by a number of specific Commission findings, several of which are directly relevant to the issues Hess brings before the Commission in this proceeding. Hess has raised issues involving gas supply nominations, imbalance tolerances and penalties and respectfully urges the Commission to adopt improvements in these practices in the PGW service territory via the instant proceeding to counter the

customer information flow offered by PGW. However, the only way to harmonize the ALJs' directive that the PGW counterproposals be implemented "promptly", but consistent with the *Gas Supply Competition* proceeding which has not yet generated specific Commission proposals, is to interpret the R.D. as directing that the counterproposal changes be implemented immediately, subject to modification based on future Commission directives.

³ *Investigation into the Natural Gas Supply Market: Report to the General Assembly On Competition In Pennsylvania's Retail Natural Gas Supply Market*, Docket No. 1-00040103 (October 6, 2005) ("Competition Report Order and associated "Report on Competition").

⁴ Section 2204(g), 66 Pa. C.S. § 2204(g) of the Public Utility Code ("Code") required the Commission to investigate and evaluate the level of competition five years after the 1999 effective date of the Natural Gas Choice and Competition Act.

⁵ *Competition Report Order* at 4.

negative trends in natural gas competition it documented in to Report to the General Assembly.⁶ The Commission's overall conclusion that effective competition was lacking was bolstered by the following specific findings:

The record demonstrates a lack of participation by natural gas suppliers and buyers in the retail natural gas supply services market on a statewide basis.

According to suppliers, substantial barriers to supplier participation in the retail natural gas supply market exist because of penalties placed on suppliers that vary among natural gas distribution company systems and that are not cost-based.⁷

Since the enactment of the Competition Act, there has been little to no change in the throughput of competition volumes. In 1999, approximately 50% of the gas flowing in Pennsylvania was under a competitive tariff. In 2004, the volume was approximately 47.5%.

Penalties for non-delivery or under delivery of natural gas by a NGS ["Natural Gas Supplier"] vary by NGDC ["Natural Gas Distribution Company"] and for the most part, these penalties are not cost-based.

According to suppliers, the differing penalties among natural gas distribution companies act as a substantial barrier to NGS entry and continued participation in marketing retail natural gas supply service in multiple NGDC service territories.⁸

Remedial action on these issues in this proceeding will allow more NGSs to become active on PGW's system and acquire customers. The more successful NGSs are in acquiring customers, the less PGW is required to obtain the funds needed to meet its enormous gas procurement expenses. PGW itself has identified its gas expenses and the cash flow needed to meet these expenses on a timely basis, as a major challenge to

⁶ The Commission noted that not only is the average number of NGSs per NGDC decreasing, but the total number of NGSs licensed in Pennsylvania has decreased. *Competition Report Order* at 5-6; *Report on Competition* p. 32.

⁷ *Competition Report Order* at 4.

⁸ *Competition Report Order* at 5-6; *Report on Competition*, pp. 64-65.

getting its finances on a proper footing.⁹ Essentially, NGS success on the PGW system benefits PGW. Despite this financial reality, PGW appears disinterested in expanding the number of NGSs operating on their system. In response to a Hess discovery request PGW confirmed that until 2006 there were no suppliers operating on its system, and there are currently only two suppliers assisting PGW with its merchant function.¹⁰ Moreover, PGW has no plans at the present to implement any process or incur any expenditures to increase the current level of customer information available to NGSs.¹¹

Witness Craig White for PGW, has indicated that PGW's system has already been opened to suppliers, and therefore it need not be concerned about soliciting suppliers to become active on its system.¹² This acceptance of the status quo is completely at odds with the Commission's documented goal of enhancing gas competition on all NGDC systems as detailed in its *Competition Report Order* and *Report on Competition*. The Commission should adopt Hess' proposals on nominations, delivery tolerances, penalties, supply trading and customer information to take supplier participation on the PGW system to a much needed higher level.

⁹ PGW St. 1R p. 4, lines 5-11; PGW St. 2R pp. 8-10.

¹⁰ Hess Corporation Hearing Exhibit No. 1. In contrast the *Report on Competition* states that Peoples had 20 NGSs active during the second quarter of 2004. *Report on Competition*, p. 31.

¹¹ Hess Corporation Hearing Exhibit No. 2.

¹² PGW St. 5R p. 21, lines 10-12.

II. Exceptions

Hess Exception No. 1: The ALJs erred in recommending that the issues litigated in the PGW proceeding by Hess be considered for resolution as part of the Commission's Gas Supply Competition Docket. R.D. at 101-102; Hess Main Brief pp. 3-4, 26-28; Hess Reply Brief, p. 7.

The ALJs have recommended, with one minor exception, that the issues raised by Hess should be considered in the Commission's ongoing investigation docket into competition in Pennsylvania's retail natural gas supply market.¹³ There is an inference in this recommendation that the referral of these issues to another docket is due to the ALJs perception that with additional evidence, Hess' proposals would be sustained. That is because the ALJs, in addition to the recommendation that the issues be considered in the Gas Supply Competition docket, found that Hess did not satisfy its "burden of persuasion" on several issues.¹⁴

Hess will explain in the Exception that follows precisely how it met its burden of production and persuasion on all its issues, that PGW did not sustain its burden of proof and why the preponderance of the evidence in this record supports its positions. However, the Commission should not succumb to the temptation raised by the ALJs to defer resolution of Hess' issues to another docket for resolution at some uncertain time in

¹³ R.D. at 101-102 ("Regarding the remaining issues raised by Hess, we recommend that it is more appropriate and administratively efficient to consider these issues in concert with the *Gas Supply Competition* proceeding [I-00040103] to be consistent in treating NGDCs and NGS's and to achieve the goal of uniformity within the gas industry. Alternatively, we do find that the remaining counterproposals by PGW are reasonable and in the public interest."). The ALJs did require PGW to revise its tariff language on firm transportation to make it clear that no annual cash out is required and to clearly delineate supplier responsibilities and costs associated with annual over and under deliveries, as requested by Hess. Hess Main Brief, pp. 20-21. The ALJs also required PGW to update and provide marketing files monthly and run customer enrollment processing jobs at 10:00a.m. and noon to correct enrollment mistakes. R.D. at 95.

¹⁴ R.D. at 101.

the future, because to do so would deny Hess due process and constitute an arbitrary action given the procedural approach the Commission has taken to resolve competitive supplier issues.

Under Pennsylvania law, a party before an administrative agency is entitled to a timely adjudication on the merits of a proceeding. See *Morganelli v. Casey*, 646 A.2d 744 (Pa. Cmwlth. 1994). Although no specific date is set by law for Commission action in a fully litigated matter, the Commission must still act in a reasonable period of time, even where no specific statutory deadline is set. Otherwise, it is subject to mandamus:

[A]lthough the laws normally do not specify a time limit within which an adjudicative agency or a court must issue a decision after hearing a case, the failure to decide within a reasonable time is subject to correction by a mandamus order commanding that the case shall be decided. Although no statute sets any specific time limit within which a trial court must hear and dispose of cases before it, the Supreme Court in *Commonwealth ex. rel. Duff v. Keenan*, 347 Pa. 574, 33 A.2d 244 (1943) directed a common pleas court judge to hear and decide 28 civil cases which had been pending for periods ranging from one year to four years, and to do so within 60 days.¹⁵

Furthermore, a delay in the administrative process can constitute a violation of due process. See *Cleveland Bd. of Education v. Loudermill*, 470 U.S. 532, 546-47 (1985). In evaluating whether proper due process has been provided, the Court considers the governmental interest involved and the impact of the agency's action on a party.¹⁶ Here, the governmental interest involved is the duty to adjudicate the competitive issues raised by Hess in this proceeding, an adjudication that will have a significant impact on Hess' ability and the ability of other suppliers to meaningfully compete in the PGW service territory. Hess clearly has a right under Pennsylvania law to a timely adjudication of the issues that it raised in this proceeding.

¹⁵ *Morganelli*, 646 A.2d 744.

¹⁶ *Id.*

The pending generic consideration of competition issues at the Gas Supply Competition docket should not impede the important task of examining nomination, delivery requirements and penalties, and customer information issues as part of this rate case. The Commission's continuing industry-wide examination of these issues signals the importance of these issues. It would be short-sighted to defer consideration of competitive improvements specific to PGW's practices, and Hess' efforts to be competitive on this system, because the Commission may be considering further rulemakings or orders on the issue of gas competition. Given the Commission's finding that competition is not currently effective, measures must be taken as soon as possible to remedy this situation. This case represents an opportunity to start bringing effective competition to Pennsylvania's largest city, which will benefit not only suppliers and customers,¹⁷ but also PGW.

Hess understands that the generic Gas Supply Competition docket is intended to improve on the company-by-company approach the Commission had taken with respect to tariff rules governing supplier issues. But, the Commission's Gas Supply Competition docket is weeks, if not months, from issuing any specific, concrete proposals that are intended to improve competition in the gas supply markets.¹⁸ And once those proposals are issued for comments, it is not clear when they will be finalized. Nor is it clear whether the means of adopting new provisions governing supplier issues will be policy

¹⁷ In its testimony, the School District of Philadelphia, which is a large customer in the PGW service territory, agrees that natural gas competition in PGW's service territory is lacking and declares that PGW should be more aggressive in advancing competition. SDPHL St. No. 3 (Mondre) p. 9, lines 12-21; SDPHL St. No. 4 (Mondre SR) pp. 17-18.

¹⁸ The schedule referenced is the Commission's own schedule for this docket, of which it may take administrative notice.

statements, formal rulemakings or other means of effecting change in natural gas distribution companies tariffs ("NGDC").

Regardless of the format of initiatives, individual NGDCs will be required to file tariffs implementing changes in the rules impacting competitive suppliers. If issues arise regarding compliance, further proceedings involving specific NGDCs could be necessary. The ALJs' recommendation has the potential to take gas suppliers full circle in getting rulings on their issues and effecting pro-competitive improvements in NGDC rules. The first generation of supplier tariff rules were implemented on a company-by-company basis, resulting in a patchwork of different rules that made competing in Pennsylvania and unfair to suppliers. The generic initiative represented by the Gas Supply Competition docket should achieve more uniformity, but in the end, specific tariff filings that could spawn company-by-company litigation may be necessary.

In comparison, Hess has presented a compelling case for making swift and immediate improvements in PGW's tariff rules in the record of this proceeding. Those improvements should be implemented now and not deferred for the months or years it may take to finalize and fully implement the outcome of the Commission's generic proceeding. Hess has invested its time and resources in this case and is entitled to rulings on the merits of the issues it has raised. To do otherwise violates Hess' rights to a decision and discourages intervenors from developing their issues on the record in litigated cases for the benefit of the Commission and the public interest.

To the extent the ALJs refrained from full analysis of Hess' issues due to the Commission's generic Gas Supply Competition docket, that error should be corrected and a decision on the merits of Hess' issues should be rendered at this time, in this docket.

Hess Exception No. 2: The ALJs erred by tacitly ruling that PGW is the party that bears the burden of proof on the reasonableness of their existing tariff rules, but in practice, assigning the burden of proof to Hess. R.D. at 92-93, 98-99, 101; Hess Main Brief, pp. 6-9.

PGW attempted to shift to Hess the burden of proof on the reasonableness of its existing tariff provisions and rules. PGW attempted this even though the Commission's Order opening this rate investigation clearly specified that all provisions of PGW's existing tariffs were under investigation, and the law is clear that the burden of proof is on the utility in any proceeding initiated on the Commission's own motion.¹⁹ The ALJs correctly discerned that "PGW is the party that bears the burden of proof."²⁰ The ALJs also, correctly, agreed with Hess that PGW has the burden to show that its existing tariff rates are reasonable and comply with 66 Pa. C.S. § 2212(j).²¹ In one portion of the R.D., the ALJs correctly stated the law on burden of proof in a rate case:

The Commission and the courts have clearly held that the burden of proof does not shift to the party challenging a requested rate increase. While the burden of going forward may shift, the burden of establishing the justness and reasonableness of every component of a requested rate increase remains on the utility. The opposing parties have no such burden.²²

However, in analyzing and weighing the evidence, the ALJs in effect erroneously reversed their ruling on burden of proof. The ALJs concluded that "compliance with its existing tariff is substantial evidence satisfying PGW's burden of proof," and further concluded, that "Hess must demonstrate that the existing tariff is unreasonable or that the

¹⁹ *PaPUC v. Philadelphia Gas Works*, Docket No. R-00061931 (February 8, 2007) at 2; 66 Pa. C.S. § 315(a).

²⁰ R.D. at 93.

²¹ *Id.*

²² R.D. at 11.

use of the existing tariff impedes competition.”²³ Such conclusions do not comport with long-standing Pennsylvania law, which is clear that burden of proof in this proceeding is on PGW.

The practical effect of the ALJs’ misapplication of their ruling on burden of proof is that they assigned the burden of persuasion and the burden of going forward (i.e., burden of production) permanently to Hess. Such a misapplication is contrary to the rule that the burden of persuasion always rests with PGW. This error is further magnified by the failure of the ALJs to shift the burden of production, the burden of going forward, back to PGW, even after Hess met that burden with its presentation of evidence.²⁴

In response to the Direct Testimony, Surrebuttal Testimony and Hearing Exhibits introduced by Hess that detailed the need to make improvements to PGW’s tariff in the areas of gas supply nominations, balancing tolerances, penalties, cash outs and supplier trading, PGW responded with only vague, unsubstantial and unspecified concerns about operational problems and additional costs. As explained in Hess’ Main Brief, PGW did not meet its burden of persuasion on either argument.²⁵ Therefore, no further response from Hess was required to prevail on these issues.

Hess will explain in the Exceptions which follow why the preponderance of evidence supports each of its proposals to improve competition on the PGW system. However, as an example of how the ALJs misapplied their ruling that PGW had the burden of proof on the reasonableness of its tariff rules, Hess refers the Commission to the R.D.’s discussion of Hess’ recommendations on PGW’s daily/monthly balance

²³ R.D. at 93. The ALJ also erred by equating the “burden of persuasion” (which never shifts from PGW as it has the burden of proof) with the “burden of going forward”, which can shift back and forth between the parties based on the evidence they bring forward.

²⁴ *Id.*

²⁵ Hess Main Brief, pp. 8-11, 16, 22.

tolerances and the cash out terms for excess gas sold to PGW or purchased from PGW in the event of a shortage.²⁶ Hess explained in its testimony how PGW's tariff imposes higher operational tolerances than PGW itself can attain and that the tolerances cannot be met so that they are not deterrents to change the behavior of natural gas suppliers ("NGSs"), but are punishment for punishment sake.²⁷

Despite this evidence, the ALJs noted that Hess did not present evidence quantifying the percentage of time PGW's balancing tolerances were missed by Hess and that evidence showing the tolerances were repeatedly missed would have been substantial evidence the tolerances were unreasonable.²⁸ However, Hess presented evidence that the tolerances could not be met, which shifted the burden to PGW to show the tolerances could be met and were routinely met by Hess. In fact, Hess presented evidence that the tolerances were "often" missed.²⁹ Had the ALJs correctly applied their principle that PGW had the burden of proof, they would have found that PGW did not rebut Hess' evidence that daily/monthly balancing tolerances were often not met with evidence that suppliers **did** meet their tariff balancing tolerances, and found in favor of Hess. Stated another way, Hess clearly presented evidence that it often could not meet PGW's balancing tolerances and PGW never presented facts showing it did meet those tolerances. This is the type of evidence one would expect PGW to bring forward if indeed it could meet its burden to show its existing tariff rules were reasonable. The correct inference, which the ALJs did not draw, is that evidence showing Hess can comply with PGW's balancing tolerances does not exist.

²⁶ R.D. at 96-98.

²⁷ Hess Main Brief, pp. 14-20.

²⁸ R.D. at 98.

²⁹ Hess Hearing Exhibit No. 4.

The Commission should sustain the ALJs' conclusion that PGW had the burden of proof, but apply it correctly by rejecting the ALJs' erroneous statements that compliance with its current tariff satisfies PGW's burden of proof, that the burden of persuasion and burden of going forward are the same and that Hess had the burden of showing the existing tariff was unreasonable in a rate investigation where the burden of proving the reasonableness of existing tariff provisions was on PGW.³⁰

Exception No. 3: The ALJs erred by not adopting Hess' request that the deadline for nominating deliveries to PGW's city gate occur after its deadline for upstream interstate pipeline nominations, and by not ruling on Hess' request that retroactive nominations be permitted to conform record keeping to the reality of how much gas is actually delivered. R.D. 94-96, 102. Hess Main Brief, pp. 10-13; Hess Reply Brief, p. 6.

Incredibly, PGW has a 12:00 p.m. deadline for gas supply nominations that precedes the 12:30 p.m. deadline for nominations of its interstate gas pipeline suppliers. Faced with this anomaly, the ALJs recommended consideration of this issue in the Gas Supply Competition docket, and in the alternative, acceptance of PGW's "counterproposal" of moving its deadline from noon to 12:30 so that the deadlines were simultaneous.³¹ The ALJs provided no explanation of why a simultaneous deadline was a reasonable resolution of this issue. Moreover, the ALJs did not address Hess' separate, but related, request that retroactive nominations be permitted to allow record keeping to conform to actual deliveries.

³⁰ R.D. at 93.

³¹ R.D. at 95, 102.

Hess Witness Magnani explained that “nominations” are the means by which NGSs notify PGW of the physical quantity of gas scheduled on the interstate pipelines for delivery to PGW’s city gate under current purchase, sale and transposition agreements. There is an interstate pipeline nomination deadline of 12:30 p.m. PGW’s tariff requires NGSs to submit a nomination prior to that deadline at 12:00 p.m.³² The earlier 12:00 p.m. deadline of PGW requires Hess to submit PGW nominations prior to the pipeline deadline where upstream contracts may still be provided to NGSs for nomination. A 2:00 p.m. nomination deadline for PGW is beneficial because, as Mr. Magnani stated:

This will benefit NGSs, PGW and consumers because it will reduce the potential for errors and the need for nomination adjustments. Reducing errors will have a favorable impact on price. Errors, especially those that are not permitted to be corrected, result in penalties to NGSs, which can be reflected in higher customer prices. Reducing errors will also reduce PGW’s risks associated with having to cover short supply imbalances on its system.³³

In response, PGW witness Mr. Muntzer conceded that PGW could move its nomination deadline to 12:30 p.m., but testified that any later deadline may jeopardize the safety and reliability of the system.³⁴ However, notably absent from Mr. Muntzer’s testimony is any explanation of how that would occur. Mr. Muntzer added that PGW allows intra day nominations which should address NGS concerns.³⁵ In oral rejoinder, witness Muntzer added that a later nomination deadline would be an administrative

³² Hess St. No. 1, pp. 3-4.

³³ Hess St. No. 1, p. 4.

³⁴ OCA stated it was understandable for NGSs to seek nomination flexibility, but also saw it reasonable to have operational requirements. OCA St. No. 1-R, p., 7, lines 4-6. In response, Hess noted that it sought this deadline change for concrete reasons involving the pipeline deadline and the availability of contracts. The change is sought for “feasibility” and not mere “flexibility” as OCA witness LeLash erroneously concluded. Hess St. No. SR-1, p. 8, lines 20-28.

³⁵ PGW St. No. 11, p. 3.

burden, but did not specify the scope or magnitude of the burden.³⁶ Witness Muntzer assumed that Hess was requesting additional time to submit nominations to PGW to get its calculations in order.³⁷ It is PGW's preference to consider later nominations on a completely discretionary case-by-case "best efforts" basis.³⁸

On Surrebuttal, Mr. Magnani clarified that Hess was not seeking additional time to get calculations in order, but rather to allow for the finalization of gas contracts on upstream pipelines at 12:30 p.m. and to allow time for those results to be communicated between Hess and its trading partners, and finally transmitted to PGW via an electronic bulletin board.³⁹ Mr. Magnani added that a simultaneous 12:30 p.m. PGW/pipeline nomination deadline does not allow NGSs to utilize the full breadth of gas contracts being traded on the pipeline, many of which are not finalized until 12:30 p.m., and still have time to provide timely nominations to PGW.⁴⁰ A later deadline is beneficial to all concerned because it would reduce clerical errors, reduce penalties to NGSs and reduce the need for PGW to balance its system when imbalances are caused by nomination errors.⁴¹

Hess also requested that PGW be ordered to modify its current practice of denying retroactive nominations, unless in its sole judgment it decides to permit one.⁴² The ALJs erroneously did not even address this separate but related issue in their R.D.

Hess pointed out that PGW does not permit NGSs to submit retroactive nominations, even where a pipeline allows a retroactive nomination. Mr. Magnani

³⁶ PGW St. No. 11-RJ, p. 2

³⁷ PGW St. No. 11, p. 3

³⁸ PGW St. No. 11, p. 4; PGW St. No. 11, p. 2.

³⁹ Hess St. No. SR-1, p. 1, lines 16-31, p. 2, lines 1-5.

⁴⁰ Hess St. No. SR-1, p. 1, lines 23-30.

⁴¹ Hess St. No. SR-1, p. 2, lines 1-5.

⁴² Hess Main Brief, pp. 12-13.

testified that PGW should accept retroactive nominations when a pipeline has confirmed it has issued one, and the retroactive nomination is caused by a simple unintentional error or a disruption in gas supply beyond the NGS's control.⁴³ He added that retroactive corrective nominations ensure the delivery of gas and relieve PGW of bearing the risk and financial burden of covering supply shortfalls that could be prevented.⁴⁴ Mr. Magnani explained that PGW's policy of denying retroactive nominations, unless in its sole judgment it decides to permit one, completely frustrates the benefit NGSs receive from retroactive pipeline nominations and destroys the symmetry between a competitive suppliers' pipeline and NGDC nominations.⁴⁵

In response to this request, PGW argued that retroactive nominations should not be permitted for essentially the same reasons it opposed a later-in-the-day nomination deadline. Mr. Muntzer added that in his view, permitting nomination error corrections placed PGW in the position of making subjective judgments and its actions could be perceived as arbitrary or depicted as favoritism.⁴⁶ In Rejoinder Testimony, Mr. Muntzer pointed out that PGW allows nomination adjustments for errors, but these are on a case-by-case discretionary basis where operations will not be affected.⁴⁷ He added that if retroactive nominations were permitted, PGW would have to revise spread sheets and the Company's administrative work would increase if more suppliers were involved. Witness Muntzer dismissed the fact that interstate pipelines permit retroactive nominations, and argued for retroactive nominations being on a discretionary basis when

⁴³ Hess St. No. 1, p. 4, lines 14-18.

⁴⁴ Hess St. No. 1, p. 4, lines 18-22.

⁴⁵ Hess St. No. SR-1, p. 2, lines 5-11.

⁴⁶ PGW St. No. 11, p. 3, lines 21-23, p. 4, lines 1-4.

⁴⁷ PGW St. No. 11-RJ, p. 2.

in PGW's sole judgment, operations would not be adversely affected.⁴⁸ In fact, operations could not possibly be adversely affected because the retroactive nominations would be conforming record keeping to the actual flow of gas.

PGW's concerns in these regards are unfounded. Mr. Magnani responded to PGW's concerns regarding retroactive nominations by explaining that such a provision would not place PGW in the position of favoring specific NGSs. Most NGDCs allow NGSs latitude for nomination correction, particularly when clearly innocent mistakes have been made, such as the transposition of two numbers in a lengthy contract number, which must be manually entered each day and when the gas was in fact delivered to the city gate under the correct contract numbers.⁴⁹ This would not be some extraordinarily subjective exercise, as PGW suggests. Moreover, because PGW prefers to consider nomination changes on a purely discretionary basis, it already employs a subjective process. PGW would be free to decline accepting a retroactive nomination when there is evidence an NGS is abusing this flexibility.⁵⁰

Hess has presented evidence showing that changes in nomination deadlines will benefit PGW and its customers.⁵¹ Allowing a later nomination deadline will reduce nomination errors which will benefit PGW by reducing its need to balance its system when imbalances are caused by nomination errors.⁵² PGW's position that new rules and standards for suppliers will create operational problems is merely speculation, driven by a

⁴⁸ PGW St. No. 11-RJ, pp. 2-3.

⁴⁹ Hess St. No. SR-1, p. 2, lines 15-27.

⁵⁰ Hess St. No. SR-1, p. 2, lines 17-22.

⁵¹ Hess St. No. SR-1, p. 1, lines 22-31.

⁵² Hess St. No. SR-1, p. 2, lines 1-5.

preference not to revisit the supplier tariff rules and practices established in its restructuring case.⁵³

The ALJs did not take into account on this issue, a fundamental fact that runs throughout all of Hess' recommendations and weighs in favor of approving those recommendations. To the extent these improvements in PGW's tariff rules attract more competitive suppliers, the greater the opportunities customers will have to minimize gas costs using NGSs, and the more customers can offset rate increases they must absorb from rate case increases as requested in this proceeding. Moreover, the goal of increasing gas competition in PGW's service territory is directly related to the core financial requirements of PGW that compelled the filing of this rate case.⁵⁴ As the R.D. noted, debt service is a large component of this rate increase request and borrowings are driven by the need to pay for gas supply, particularly when gas prices increase.⁵⁵ To the extent supplier success relieves PGW of the financial obligation to pay for gas supply, borrowings are reduced and debt service is reduced.

The Commission should order that PGW's tariff reflect a 2:00 p.m. deadline for NGS nominations on its system and that the tariff should be amended to allow retroactive nominations as they are permitted by interstate pipelines and other NGDCs. In addition, rather than a completely discretionary action by PGW, retroactive nominations should be allowed as a normal business practice that corrects errors and conforms record keeping to the reality of how much gas is actually delivered.

⁵³ Hess Main Brief, pp. 8-9.

⁵⁴ Hess St. No. 1, p. 10, lines 2-12.

⁵⁵ R.D. at 18.

Exception No. 4: The ALJs erred by denying Hess' request to update PGW's rules on daily/monthly imbalance tolerances, penalties and cash outs when the record showed by a preponderance of the evidence that the tolerances were unreasonably tight and the penalties/cash out rates are unreasonably high. R.D. 96-98. Hess Main Brief 14-20; Hess Reply Brief, pp. 3-4, 6-8.

The R.D. provides an abbreviated version of the evidence, recommendations and arguments submitted by Hess on the issue of daily/monthly imbalance tolerance bands, penalties and cash outs.⁵⁶ Hess' full argument and summary of the entire evidentiary record on this issue is contained in its Main Brief and Reply Brief.⁵⁷

After a review of major points made by Hess, PGW and OCA, the ALJs declined to order any changes in PGW's tariff because the record did not contain a specification of the number of times the imbalance tolerances were missed by Hess.⁵⁸

In fact, the record does contain evidence on the frequency with which tolerances were missed. In a Hearing Exhibit, Witness Magnani indicated the imbalance tolerances were so tight, NGSs "often" were unable to avoid daily penalties and monthly cash outs.⁵⁹ Moreover, as Hess explained in Exception No. 2, the ALJs' rationale represents an erroneous application of the burden of proof and Hess' recommendations should have been adopted.⁶⁰

No element of PGW's "counterproposal" referenced in the R.D. relates to the issue of daily/monthly tolerance imbalances, penalties and cash outs.⁶¹ Therefore if the

⁵⁶ R.D. at 96-98

⁵⁷ Hess Main Brief, pp. 14-20; Hess Reply Brief, pp. 3-4, 6-8.

⁵⁸ R.D. at 98.

⁵⁹ Hess Hearing Exhibit No. 4.

⁶⁰ Hess incorporates this portion of Exception No. 2 at pages 9 to 13 into this Exception.

⁶¹ R.D. at 95.

Commission does not sustain Hess' position in this proceeding no improvement in PGW's rules will occur. The ALJs' suggestion that this issue could be considered in the Gas Supply Competition docket is particularly inappropriate because in PGW's restructuring case the Commission clearly indicated its intention of revising the issue of penalties on PGW's system as customer choice evolved on that system. In the course of rejecting the argument that a collaborative be convened to further evaluate the imbalance and penalty issue, the Commission stated:

This process is not necessary as the penalty issue will be reevaluated as customer choice evolves on PGW's system.⁶²

This proceeding represents the reevaluation opportunity the Commission envisioned and the next step in the evolution of these rules calls for an increase in imbalance tolerance bands and a reduction in penalties imposed on suppliers.

Hess Witness Magnani explained in his testimony that PGW's tariff sets rules for the daily and monthly balancing of customers' gas usage and NGS gas deliveries. Daily balancing refers to the tolerance level set by the NGDC for the difference between the quantity of gas an NGS customer uses and the quantity of gas delivered by an NGS. Daily penalties are those based on the quantity by which the NGS is out of balance each day. Monthly cash out penalties are assessed on the degree of imbalance for the month as a whole.⁶³ At the end of a month, any excess gas is cashed out, or sold, to the LDC, while any short gas positions are cashed out, or purchased from the LDC. Both transactions are intended to eliminate any imbalance remaining at month-end.

⁶² *PaPUC v. Philadelphia Gas Works*, Docket No. M-00021612 (March 31, 2003) at 35.

⁶³ Hess St. No. 1, p. 4, lines 26-31, p. 5, lines 1-8.

A supplier operating on the PGW system faces a daily balancing tolerance level, with associated daily penalties, and a separate monthly balancing tolerance level with a further monthly penalty in the form of a cash-out. As Mr. Magnani explained:

PGW allows a daily tolerance level of 5%. Therefore, if an NGS's customer uses more than 105% of the quantity delivered by the NGS, then the NGS is out of balance and must pay a penalty of \$.50 per Dth outside the 5% range. At month's end, NGSs may carry over within 2.5% of their deliveries for the month, but beyond that tolerance, are cashed out at unreasonably low or high percentages of the market value of the gas, dependent on whether it was an over or under delivery, respectively.⁶⁴

The problem with PGW's balancing rules is that its tariffed operational tolerance standards for being in balance impose higher levels of performance on NGSs than PGW itself could attain. These unreasonable performance standards are then coupled with a penalty of unreasonably high or low percentages of the market value of the gas. In combination, these performance standards and penalties are overly punitive rather than reasonable standards that would encourage NGS operation on the PGW system, while still protecting PGW's supplier of last resort customers.⁶⁵

Hess proposed that continued daily balancing was unnecessary and that reconciliation between delivered and consumed volumes occur only at the end of the month. But if daily and monthly imbalance tolerances and penalties were maintained, the tolerance and cash out levels should be amended to more reasonable, market-based levels so that the tolerance bands do not go beyond deterrent and become punishment for punishment's sake.⁶⁶

⁶⁴ Hess St. No. 1, p. 5, lines 16-22.

⁶⁵ Hess St. No. 1, p. 5, line 31, p. 6, line 1.

⁶⁶ Hess St. No. 1, p. 5, lines 1-4.

Hess documented the unfairness of the current tolerance bands and cash out rates. On over deliveries outside the 2.5% tolerance band, NGSs are paid only 75% of an already low cash-out rate. On under-deliveries, NGSs must pay PGW 150% of an already high cash out rate. This is in addition to the payment of daily penalties.⁶⁷

For over-deliveries, PGW only pays NGSs a cash-out rate of the average of the lowest daily prices for the month for its interstate pipelines, Transco and Tetco. For under-deliveries, PGW charges Hess the cash out rate of the average of the highest daily prices for the month for Transco Zone 6, Non-New York and Tetco M3. Again, these rates are further worsened by the multipliers of 75% and 150% on over-and under-deliveries respectively.⁶⁸

Hess proposes the following reasonable tolerance levels, penalties and cash out rates for monthly imbalances, and also for daily imbalances as an alternative to the complete elimination of daily balancing:

- A wider tolerance band of 10% for the month for over and under-deliveries to interruptible customers should be set.
- Outside this tolerance band reasonable multipliers should be used; a 90% payout to NGSs for over-deliveries outside + 10% and a 110% charge to NGSs for under-deliveries outside -10%.
- The cash out for both firm and interruptible customers for over/under deliveries should be set at a market index such as the Gas Daily Average ("GDA") for the month for Transco and Tetco based on some blend of these pipelines' prices.⁶⁹

PGW defended its daily balancing requirements and penalties as necessary for PGW to control its system and to avoid unnecessary LNG withdrawals and excessive

⁶⁷ Hess Corporation Hearing Exhibit No. 4.

⁶⁸ *Id.*

⁶⁹ *Id.*

storage injections and withdrawals.⁷⁰ PGW Witness Muntzer believes these tight levels of tolerances and high penalties are necessary to create incentives for NGSs to accurately nominate and deliver gas supply and protect PGW's supplier of last resort responsibility.⁷¹ Mr. LeLash for OCA also expressed concern that additional delivery latitude would shift costs to "incumbent ratepayers."⁷²

However, Mr. Magnani successfully refutes these concerns by pointing out that the volume of deliveries involved in the expanded tolerance band sought by Hess is so small as to have no meaningful impact on sales customers. Meanwhile, the prime effect of current tolerance bands is to increase NGS costs, which increases cost pressure on transportation customers, while failing to avoid any negative impact to PGW.⁷³ PGW is reluctant to use what it views as its limited storage capacity to cope with system imbalances.⁷⁴ In PGW's view, daily swings in load threaten its control of its system and it argues that if given the chance, NGSs will engage in gaming-type conduct such as delivering no gas at all on Day 1 and doubling its daily delivery on Day 2.⁷⁵

PGW's example of a supplier gaming the rules by delivering no gas on a peak cold day doesn't really demonstrate the prudence of their current balancing rules and cash out penalties. When the market price is sufficiently high on a peak cold day, the supplier could fail to deliver on such a day, sell the gas elsewhere and still profit after paying the penalty. A zero NGS delivery on a peak cold day, absent an exculpatory operational problem, is gaming. If there was evidence documenting NGSs have

⁷⁰ PGW St. No. 11, p. 5, lines 5-7.

⁷¹ PGW St. No. 11, p. 5, lines 8-13.

⁷² OCA St. No. 1-R, p. 7, lines 10-19.

⁷³ Hess St. No. SR-1, p. 9, lines 3-24.

⁷⁴ PGW St. No. 11, p. 6, lines 3-17.

⁷⁵ PGW St. No. 11, p. 7, lines 1-16.

engaged in that behavior it would warrant a gaming penalty tailored to that type of behavior. PGW's balancing tolerances and penalties are unreasonable because they do not prevent gaming and financially punish suppliers who are not engaging in gaming, but are confronted with standards and rules that make penalties unavoidable.

Mr. Magnani rejected PGW's fundamental argument that PGW's tight tolerance band and severe penalties act as a disincentive to NGS gaming misbehavior. He also explains that when an NGS forecasts customer usage and the weather forecast is only 5 degrees off from actual temperatures, usage will be vastly different than predicted.⁷⁶ NGSs cannot be expected to perform better than professional meteorologists. Therefore PGW's penalties fail to produce more efficient service from NGSs, but only place unreasonable costs on NGSs, and as a byproduct, their customers, purportedly to control behavior that cannot be appreciably improved.⁷⁷ PGW's theory that reduced tolerances and penalties will allow NGSs to shift their gas assets to service territories where they will be more economically valuable assumes an NGS forecasting ability that does not exist. If NGSs could forecast that accurately to arbitrage better business opportunities, they would also be able to meet PGW's tolerances and avoid penalties – which they cannot. Therefore PGW's tariff rules constitute punishment rather than a deterrent.⁷⁸

Mr. Magnani provided an illustration of how PGW's concerns about delivery swings jeopardizing its control of its system and increasing costs to firm customers is grossly exaggerated. If an NGS serves a daily load of 5,000 dekatherms ("dth"), and a 5% tolerance level equates to 250 dth, an expanded tolerance level of 10% (Hess' recommended level) only allows a swing of 500 dth per day. This amount of swing

⁷⁶ Hess St. No. SR-1, p. 3, lines 28-31, p. 4, line 1.

⁷⁷ Hess St. No. SR-1, p. 4, lines 3-13.

⁷⁸ Hess St. No. SR-1, p. 4, lines 13-21.

cannot have any appreciable impact on a system such as PGW's where hundreds of thousands of dths are flowing daily.⁷⁹ Mr. Magnani's point is that it would take an extremely large volume of gas being transported on the PGW system before there could possibly be any significant impact. Rather than harm customers, Hess' proposal of a 10% tolerance would reduce NGS's costs and thus, reduce costs for transportation customers.⁸⁰

PGW argued that because its current tariff rules were the product of a settled restructuring proceeding they should not be examined. However, Mr. Magnani pointed out, it is the Commission's right and duty to examine its prior decision in light of new conditions. Just as the Commission was not deterred from reviewing these issues in the statewide gas investigation it launched after its Section 2204(g) report to the General Assembly, PGW's restructuring-era rules should be re-examined based on Hess' real world experience on the PGW system as well as many other systems, which allows Hess to explain what is not working and how existing requirements can be improved.⁸¹

Furthermore, as previously noted, the Commission committed to a re-examination of suspect penalty provisions in PGW's restructuring proceeding as the competitive market evolved. Hess has committed its resources in this proceeding to inform the Commission's judgment on needed improvements in PGW's tariff.

The Commission should remove PGW's daily imbalance tolerances and penalties and the monthly imbalance tolerances, penalties and cash outs should be updated as proposed by Hess. If daily requirements are continued, their tolerances, penalties and cash outs should be updated to the new monthly requirements that Hess requests.

⁷⁹ Hess St. No. SR-1, p. 4, lines 27-31, p. 5, lines 1-7.

⁸⁰ *Id.*

⁸¹ Hess St. No. SR-1, p. 5, lines 17-28.

Exception No. 5: The ALJs erred in applying the burden of proof and weighing the evidence in their rejection of Hess' recommendation that NGSs be allowed to "trade" their imbalances to avoid penalties and reduce costs. R.D. at 99; Hess Main Brief, 21-23.

Under PGW's tariff, each NGS is responsible for being in daily, monthly and annual balance. In addition, the NGS may have separate "pools" of gas, e.g. firm and interruptible, that must meet balancing requirements. One tool that NGSs have on many LDC systems is the ability to trade with each other to resolve imbalances. This makes sense because if one NGS has under-delivered and another has over-delivered by the same amount, the overall system is in balance, but each NGS still faces penalties for being out of balance individually.⁸² Allowing these NGSs to "trade" their imbalances would allow each supplier to avoid a penalty, which reduces their costs, and is appropriate since PGW did not suffer an actual imbalance on its system. Absent trading, a double charging of penalties would occur while PGW's system was completely unaffected.⁸³ Trading within the same NGS's pools is also feasible, and similarly would reduce penalty exposure to the supplier and reflect actual gas deliveries.

This trading does not affect actual deliveries – those have already occurred. PGW is not required to expend any effort on the transaction. It must merely adjust NGS volumes in its records.⁸⁴

The R.D. acknowledges that Hess presented evidence showing its proposal that NGS's be allowed to trade their imbalances between and among themselves to reduce penalties and achieve customer savings benefits NGSs and ratepayers. However the

⁸² Hess St. No. 1, p. 6, lines 19-25.

⁸³ Hess St. No. 1, p. 6, lines 25-30.

⁸⁴ Hess St. No. 1, p. 7, lines 6-13.

ALJs failed to recommend that PGW be directed to modify its tariff to permit trading between NGSs, and between an NGSs' pools, because Hess did not present evidence on the cost of implementing this proposal and therefore failed to satisfy its "burden of persuasion."⁸⁵

This holding is a misapplication of the burden of proof. It is important to analyze the presentation of evidence on this issue between Hess and PGW because it leads to the conclusion that any costs associated with Hess' trading proposal are non-material.

In response to Hess' trading proposal, PGW contended that it has no systems in place to track trading and made the general assertion that such systems would cost several hundred thousand dollars.⁸⁶ However Hess did not agree that extensive "systems" were necessary to track trading. The actual trading is handled outside the PGW system by the NGSs and PGW need only change each NGS's imbalance to reflect the traded volume. A simple Excel electronic file would suffice, which PGW already uses to provide imbalance reports to NGSs.⁸⁷

In rejoinder, PGW finally provided details on the record keeping required to incorporate trading transactions.⁸⁸ However, again, the rejoinder failed to provide a cost estimate of these record keeping changes, therefore the record does not substantiate that these costs are material or significant. The inference therefore, is that they are not unduly costly.

A complete assessment of the "cost" issue related to Hess' trading request demonstrates that PGW did not refute Hess's assertion that the costs associated with

⁸⁵ R.D. at 99.

⁸⁶ PGW St. No. 11, p. 10, lines 8-14.

⁸⁷ Hess St. No. SR-1, p. 6, lines 3-16.

⁸⁸ PGW St. No. 11-RJ, p. 4.

implementing trading between and among NGSs are non-material. It was Hess that prevailed in the burden of going forward because PGW did not meet its burden of proof to show there were specific, material costs associated with implementation that outweighed the benefits of trading.

PGW indicated that if trading is ordered by the Commission, it should be limited to similar pools of gas, e.g. firm pool to firm pool, interruptible pool to interruptible pool.⁸⁹ It qualifies that position further by stating that trading should be limited to interruptible service only.⁹⁰ PGW also hypothesizes that a trading program would require it to act as arbitrator on NGS disputes among themselves and fail to benefit customers.⁹¹ In Surrebuttal, Mr. Magnani explained that trading does not implicate PGW acting as an arbitrator or incurring any significant administrative costs.

OCA noted that if PGW accepts imbalance trading it should be allowed to terminate such trading if NGSs fail to coordinate and document offsets.⁹² Hess agrees that if NGS misconduct occurs after trading is permitted, a termination right for specifically delineated misconduct is appropriate. A termination of trading at PGW's sole discretion however, would not be reasonable. Hess agrees, however, that trading within an NGS's own pools should be allowed only from the interruptible pool to the firm pool.

Witness Magnani noted also that, once again, in its cost equation used to analyze this proposal PGW has ignored the fact that trading only reduces penalties to NGSs when the PGW system was not, in fact, out of balance. Trading therefore would impose no

⁸⁹ PGW St. No. 11, p. 10, lines 15-18.

⁹⁰ PGW St. No. 11, p. 10, lines 21-23, p. 11, lines 1-2.

⁹¹ PGW St. No. 11, p 11, lines 3-7.

⁹² OCA St. No. 1-R, p. 8, lines 13-15.

harm on PGW, but would reduce costs to suppliers, which in turn reduces costs to transportation customers.⁹³


In addition to not showing the costs of implementing Hess' trading proposed was material, the ALJs did not take into account the reduction in costs to NGSs from reduced penalties or the reduction in costs to transportation customers that occurs when supplier costs decrease. In addition, the R.D. did not acknowledge the general savings to PGW from a reduced gas supply role as NGSs, attracted by improved tariff rules, assume the gas supplier role on the PGW system.

PGW should be required to modify its tariff to permit trading between NGSs and between pools of an NGS to reduce unwarranted NGS penalties and produce customer savings at a non-material cost to PGW.

III. Conclusion

Hess respectfully requests that the Commission grant the foregoing Exceptions and correct the R.D's erroneous rejection of Hess' pro-competitive recommendations.

Dated: August 20, 2007



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⁹³ Hess St. No. SR-1, p. 6, lines 28-31, p. 7, lines 1-6.

COMMONWEALTH OF PENNSYLVANIA

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-00061931
 :
 Philadelphia Gas Works :

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the attached documents in accordance with the requirements of 52 Pa. Code § 1.54 et seq. (relating to service by a participant).

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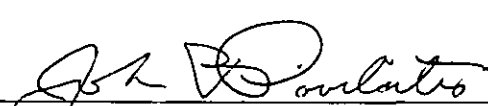
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Re: PA PUC v. PGW, Docket No. R-00061931

Dear Secretary McNulty:

Enclosed are the original and nine copies of Philadelphia Gas Works' Exceptions in the above-referenced matter. As evidenced by the attached Certificate of Service, all parties of record have been served in the manner indicated.

Very truly yours,



Daniel Clearfield
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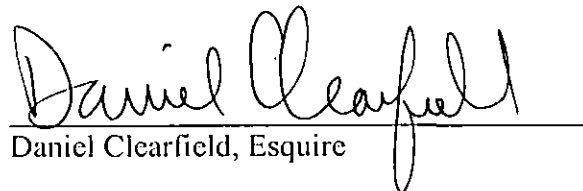
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :

v. :

Philadelphia Gas Works :

Docket No. R-00061931

ORIGINAL

EXCEPTIONS OF PHILADELPHIA GAS WORKS

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INTRODUCTION AND SUMMARY OF EXCEPTIONS

Philadelphia Gas Works ("PGW" or "the Company") respectfully submits that the Recommended Decision ("RD") must be set aside because adopting its rate increase recommendations would leave PGW at serious risk of a major financial crisis which could lead to the Company being downgraded to junk bond status and unable to make critical infrastructure investments, essential to providing safe, adequate and reliable service to its customers.

While the RD made a sincere attempt to deal with the complex financial issues presented by PGW's present financial circumstances, it made a serious error by assuming that PGW was no different than the investor-owned utilities regulated by the PUC and should be regulated in the same way. On this basis, the RD erroneously adopted the myopic, narrowly focused positions of some of the parties and looked only to a few immediate financial indicators to conclude that the Company needed just a minimal – \$25 million – rate increase. Specifically, the RD asserted that PGW met its test year coverage requirements and had some cash on hand at test year end. But the RD not only overlooked key test year data, it also refused to look beyond this immediate period to the period of impact of any rate change, a perspective essential with a Cash Flow Method regulated company.

What the RD failed to consider – or even mention – were a host of alarming financial indicators of serious and deepening financial difficulty for PGW. Most importantly: (1) the Company currently has no internal cash generation and hasn't for fourteen years;¹ (2) PGW must borrow all of the funds it requires to finance an approximate \$70 million annual capital budget needed to make essential infrastructure improvements; and (3) for the last eight years, the Company has had to borrow funds just to have cash in the bank to operate during the critical

¹ PGW St. 1 at 2.

winter heating season. As a result, PGW and its customers are drowning in debt; the Company's level of long term debt in its capital structure will reach almost 90% of its total capitalization by 2012 – where the average for municipal utilities is actually below 40%.² This long-term debt interest burden alone is almost \$60 million annually³ and is well over \$100 million when interest expense and debt service coverage obligations are considered together.⁴ This level of debt creates tremendous risk that the Company will be downgraded to "junk bond" status. Were the Company downgraded, PGW's cost of borrowing would rise to unconscionable levels for a municipal utility, and could in fact make it virtually impossible for the Company to access the public bond market. In such an event, PGW could not continue its present construction program – vital to the preservation of a safe, adequate and reliable natural gas distribution system.⁵ The present tightening in the credit markets due to the "sub-prime mortgage" crisis, unfortunately, makes that possibility all the more real for the foreseeable future.

With respect to PGW's liquidity situation – or lack thereof – the RD ignored the fact that this \$1 billion company has no – zero – non-borrowed cash working capital (*i.e.*, no cash working capital being produced from rates) and instead has to rely entirely on short-term borrowing allowed by a consortium of banks.⁶ In addition to being very expensive (over \$13 million annually),⁷ the availability of these funds is limited and could be pulled at any time. The result is that PGW actually has significant **negative** cash working capital in the test year, a

² PGW Exh. BB-3, BB-4. The average for Pennsylvania investor-owned utilities is 44%. *Id.*

³ PGW MB at 43.

⁴ For every dollar of debt, PGW ratepayers must cover 150% of the debt service in rates, making borrowing more expensive in the long run than funding projects through internal generation. PGW's total debt service (principal and interest) for its three bond series is \$96.2 million in total; *See* PGW Main Brief ("MB") App. A, p. 3 (Debt Service Coverage). *See also*, PGW MB at 43.

⁵ PGW St. 3R at 12; PGW St. 4 at 5-6.

⁶ PGW MB at 41.

⁷ PGW MB, App. A, Interest, Other.

condition that only becomes worse over time. Indeed, the RD failed to consider how its recommendation squares with the fact that, on one day last winter, the Company was just \$4 million away from having literally no cash or borrowing ability to pay further bills,⁸ nor the evidence that, with just a \$25 million rate increase, such a situation could easily be repeated or, in fact, be much worse.⁹ For a Company with no investors and no other sources of emergency bailout, such a liquidity crunch is another way the Company could be plunged into crisis. It is unimaginable that any other major utility would be refused a rate increase that would do nothing more than allow it to be assured that it will be able to pay its bills on time.

Just as important, these problems are not one-time or short term phenomena. PGW's five-year projections show that the Company's financial predicament progressively goes from bad to worse:

Table 1
PGW Key Statistics
Current Rates

	Net Income	Non-Borrowed Cash Working Capital	Available Short Term Borrowing (\$150M line)	1998 Coverages (1.5x Mandatory)	Debt-to-Equity Ratio	Internally General Funds
FY 2007 (TY) ¹⁰	\$14.0M	(\$101.4M)	\$42M	1.99x	83%	0
FY 2008 ¹¹	\$711T	(\$94.7M)	\$5M	1.52x	82%	0
FY 2009 ¹¹	(\$7.3M)	(\$108.6M)	0	1.44x*	84%	0
FY 2010 ¹¹	(\$11.3M)	(\$128.4M)	0	1.21x*	84%	0
FY 2011 ¹¹	(\$19.3M)	(\$1.67.1M)	0	.94x*	87%	0
FY 2012 ¹¹	(\$23.0M)	(\$222.9M)	0	.81x*	89%	0

* bond ordinance default

Unfortunately, the RD dealt with these grim statistics by ignoring them, focusing instead only on the fact that PGW's debt service coverage levels are projected to exceed minimum levels

⁸ PGW MB at 39-42.

⁹ *Id.* at 50.

¹⁰ PGW MB, App. A, pp. 1, 2, 3, 5.

¹¹ PGW MB, App. A; PGW Exh. JRB 10.

for the test year to conclude that a minimal, \$25 million increase was all that was needed. But, as the record evidence plainly demonstrates, a \$25 million increase will do nothing to improve PGW's crushing debt burden or provide sufficient cash working capital so that the Company could stave off a cash emergency that could occur if natural gas prices returned to pre-Katrina levels:

Table 2
PGW \$25M Rate Increase
Key Financial Statistics

FY (TY)	Net Income	Non-Borrowed Cash Working Capital	Available Short Term Borrowing (\$150M line)	1998 Coverages (1.5 x mandatory)	Debt-to-Equity Ratio	Internally Generated Funds
2007	40.3M ¹²	(\$55.1) ¹²	\$82.5M ¹²	2.44x ¹²	82%/83 ¹³	0
2008	25.7M ¹⁴	(\$46)	\$54M	1.88x	80%/81% ¹³	0
2009	17.7M	(\$34.9)	\$65M	1.79x	80%/82% ¹³	0
2010	13.7M	(\$29.7)	\$70M	1.51x	79%/81% ¹³	0
2011	5.7M	(\$43.3)	\$56M	1.24x*	81%/83% ¹³	0
2012	2.0M	(\$74.2)	\$26M	1.08x*	81%/83% ¹³	0

* bond ordinance default

These data show beyond cavil that a \$25 million rate increase is woefully inadequate. It's debt service coverages are extremely close to the 1.5x minimums in FY 2008 and 2009. Indeed, a \$25 million rate increase will mean that the Company would be forced to almost immediately return to the PUC for additional rate relief, in order to be assured it will not fail to meet its bond ordinance covenants in FY 2009 or 2010 and thus suffer a default, again with devastating

¹² RD, App. A, Tables 1, 2, 3.

¹³ The RD did not even calculate a debt-to-equity ratio for its recommended increase. The first ratios listed for each year are from PGW (MB, App. C, p. 5), PGW's calculation of the income effect of a \$25 million rate increase in the test year. PGW MB, App. C is not materially different than the calculation in the RD; *pro forma* test year (FY 2007) net earnings differs by just \$2,555,000. The second debt-to-equity ratios are from PGW Exh. JRB-10 and are calculated on the realistic assumption that PGW will not receive any rate relief until FY 2008. The data on JRB-10 differs from App. C in the MB because of this timing difference.

¹⁴ PGW MB, App. C. As noted, there is a slight (\$2.5 million) difference between PGW's projected financials assuming a \$25 million increase and the ALJs' calculation due to the effect of a handful of adjustments that the ALJs made (incorrectly) to PGW's *pro forma*, test year income statement. This additional \$2.5 million will not have a material effect on any of these key financial indicators in the five year forecast.

consequences. Moreover, at \$25 million, PGW will still have no non-borrowed cash working capital and will continue to have negative cash working capital; its debt-to-equity ratio will barely change and still be far higher than any prudent level, or the level of any comparable utility. PGW will still have no internal generation and be forced to continue to fund all of its construction through external borrowing. PGW will still be adding to its already excessive debt burden over the next five years, increasing ratepayer costs by over \$1 billion, and creating even more risk of a financial collapse.¹⁵

One way to judge the inadequacy of the RD is to consider the fact that, since PGW's last base rate case, the Company's expenses have increased some \$35 million, with most of the increase coming in expenses outside of management control.¹⁶ Over that same period, PGW's net contribution margins have gone down by \$35 million due to reduced sales from conservation and load losses. Thus, PGW needs an increase of some \$70.1 million just to put the Company in the same financial status that it was in after its last rate case – five years ago!¹⁷ If PGW's total expenses alone have increased by \$35 million since its base rates were last set, and its contributions from sales have decreased by the same amount, how could a \$25 million increase be adequate?

It is important to recall that PGW is unique among the utilities regulated by the PUC. It is a municipal utility owned by the City of Philadelphia so that its ratepayers are, in effect, its owners. It is not regulated on the basis of an allowed rate of return on its rate base, but by a statutorily mandated formula – the Cash Flow Method – that is different from the method used to

¹⁵ PGW MB at 53 (a \$25 million rate increase now, and even additional future rate increases that do not permit PGW to start producing internal generation, will result in customers incurring some \$50 million in additional debt service and coverage requirements in FY 2012, and for the next 27 years after that).

¹⁶ The principal areas that have increased are debt service costs (\$16 million), healthcare costs (\$11.5 million), and pension costs (\$13.7 million). *See*, Section II(A)(2) *infra*.

¹⁷ *Id.*

regulate any other Commonwealth utility, even other municipals. The formula requires that, beyond the amount that it may prudently borrow, all of the Company's financial needs, including amounts to finance construction or pay down debt, as well as to produce sufficient cash working capital, must come from rates.

PGW has done all that it can to reduce its need for a rate increase. It did not ask for all that it believed it could have justified and chose not to file earlier than last December so as to demonstrate that: (1) it could collect the funds it was owed; and (2) its controllable costs were declining.¹⁸ The City of Philadelphia has already granted back or loaned the Company over \$140 million, with a commitment for over \$50 million more, by continuing to suspend the statutorily mandated \$18 million City Payment going forward.¹⁹ The Company has made real progress in increasing its collections and decreasing its bad debt expense. However, the Company is very close to the limit of what it can borrow to finance its capital and operating budgets. The hard truth is that the Company simply has no place to turn other than its customers in order to alleviate its financial problems.

The Company's request for a \$100 million base rate increase, 9.6% overall, and permission to use the proceeds from natural gas off-system sales and capacity release transactions to fund construction projects would not alleviate all of PGW's problems immediately. As the following data show, the request – which would be the first base rate increase since 2002 (and only the third since 1992) – was designed to address these problems over time.

¹⁸ PGW St. 2 at 13-14.

¹⁹ PGW MB at 55.

Table 3
PGW Key Statistics
\$100M rate increase (plus \$10M/yr off-system sales)

	Net Income	Non-Borrowed Cash Working Capital	Available Short Term Borrowing (\$150M line)	1998 Coverages (1.50x Mandatory)	Debt-to-Equity Ratio	Internally General Funds
FY 2007 (TY) ²⁰	\$123.0M	(\$22.2M)	\$122M	3.84x	77%/83% ²¹	0
FY 2008	\$103.2M	\$42.4M	\$140M	2.99x	72%/77% ²¹	\$18.6M
FY 2009	\$103M	\$50.8M	\$150M	3.01x	66%/71% ²¹	\$62.8M
FY 2010	\$104.9M	\$49.1M	\$150M	2.97x	61%/65% ²¹	\$60.8M
FY 2011	\$106.4M	\$48.6M	\$150M	2.78x	57%/61% ²¹	\$59.1M
FY 2012	\$105.2M	\$53.8M	\$150M	3.35x	47%/54% ²¹	\$59.9M

The Company's request was structured to answer the demand of public officials in Philadelphia and Harrisburg to "fix" PGW – over time – and put the Company on the road to financial stability. Management has done what it has been asked to do. With reluctance, it now asks the customers, through the PUC, to make an additional effort to assure the continued safe and reliable delivery of natural gas in Philadelphia. As the calculation attached to these Exceptions as Appendix A, show, even the full rate increase will result in only modest hikes for any customer class, especially considering that the last increase was almost five years ago.

In contrast, the minimal increase offered by the RD will leave PGW "on the knife's edge," with virtually no margin or surplus to weather any crisis and even put its bonds in jeopardy of being downgraded to junk bond status. The fact is that the investor community is looking to the outcome of this case to determine whether the Commission understands PGW's problems and is prepared to help it deal with them. A minimal increase, such as \$25 million, will send the exact opposite signal.²² In today's environment, being downgraded to junk could well make it financially prohibitive for PGW to obtain the capital it needs to continue to

²⁰ PGW MB App A, p. 6.

²¹ The second figure is Debt-to-Equity Ratio calculated on the realistic assumption that PGW will not receive rate relief until FYE 2008. PGW Exh. JRB-10, p. 2.

²² PGW St. 3R at 2-3, 10-11.

function. At the very least, the Company's ability to continue the progress that all the parties have acknowledged PGW has made in the last several years will be in serious jeopardy. As these exceptions will show, even to take the Company out of "crisis" mode would require an increase of at least \$50-60 million.²³ And PGW's rates need to be increased by \$70.1 million just to put the Company in the same relative financial position it was in five years ago after the PUC's last base rate decision.²⁴ Indeed, as can be seen from the data above, a material increase would not produce improvement overnight. But it would clearly signal that this Commission is committed, with the Company, to seriously addressing PGW's chronic problems for the long-term benefit of the Company, its customers and the City of Philadelphia as well as the Commonwealth as a whole.

In addition to these errors, PGW also will show that the Commission erred in rejecting the Company's proposal to retain the proceeds it receives from natural gas off-system sales and capacity release transactions to be used exclusively to fund construction projects. While these funds – projected to be about \$10 million each year over the five year planning period – now go to reducing the Company's purchased gas cost rate (GCR), it makes far more sense to use them as a source of internally generated funds to fund construction. PGW showed that customers would save tens of millions of dollars in borrowing costs if PGW could reduce its long-term borrowing by using these funds instead. Thus, PGW's internal generation problem could be addressed without increasing rates to customers. Most Pennsylvania natural gas companies have some type of sharing arrangement where some portion of these proceeds go to shareholders. PGW is only suggesting that ratepayers, receive the benefit of these sales in a different way, making its proposal extremely reasonable. At the very least, the Commission should direct that

²³ See, Section II(A)(4)&(5), *infra*.

²⁴ See, Section II(A)(2), *infra*.

at least some portion of these funds be reallocated to fund construction and order that the exact percentage should be determined in PGW's next GCR proceeding.

PGW also excepts to a series of *pro forma* expense adjustments that should not have been made by the ALJs. While the financial impact of these adjustments is small, the RD's recommendations that PGW's test year income be adjusted for these items are either not consistent with the clear evidence or are otherwise erroneous.

In addition, PGW excepts to the RD's recommendation that the Company create a "bad debt tracker" to account for the alleged effect on bad debt expense of new CRP customers. PGW will show that such a clause is barred by the Public Utility Code, would single out only one of many reasons PGW's bad debt expense may change prospectively, and was soundly rejected as "single issue ratemaking" when PGW proposed a similar clause several years ago.

With respect to cost of service and allocation of the proposed rate increase, PGW continues to submit that its proposed cost of service study and allocation of proposed allocation of increase makes the most sense, all facts considered. The summary results of the RD's recommendations, as PGW interprets them, are attached as Appendix "A" to these Exceptions. This Appendix also shows for each general customer class the effect of rate increases of \$50, \$70 and \$100 million. PGW also excepts to the RD's recommendation that it immediately reduce its interruptible transportation rates to "cost" rather than continuing the present practice of pricing them in relation to the customer's alternative fuel source, producing contributions to help keep the rates of firm sales customers lower.

PGW also urges revision to the RD's call that the Company "immediately" implement an EFT option for late paying customers as an alternative to remitting a deposit. In fact, the record shows the Company cannot implement such a program until the next calendar year. With one

exception, the Company also supports the RD's recommendation that the Commission adopt PGW's proposed rules and regulations in its tariff in order to streamline and update those provisions.²⁵

EXCEPTIONS

1. The RD Erred in Recommending Only a \$25 Million Rate Increase For PGW.

The RD rejected PGW's extensive evidence of test year revenue requirement in two sentences.

The record shows that PGW has adequate income to satisfy its bond covenants in the test year and that PGW will have cash on hand at the end of the test year. PGW has failed to prove that it needs a rate increase in the test year. The five year planning period is rejected because it is not appropriate for ratemaking.

After reviewing the evidence in the record, we accept the recommendation from the OTS to grant an increase of \$25 million and deny the request to retain the revenues associated with off-system sales and capacity releases. In addition, the expenses that were disallowed will not be deducted from the rate increase.²⁶

The ALJs' recommendations reflect several critical errors, as described in the next pages. First, they failed to even consider that PGW justified at least a \$70.2 million rate increase simply by comparing the Company's *pro forma* revenues, expenses and income to the levels granted by the Commission in the Company's last two base rate proceedings in 2001 and 2002. Second, the RD erred by refusing to examine any of PGW's five-year planning period data and by mistakenly concluding that PGW's revenue requirement justification was based on "out-of-period" claims when, in fact, PGW used the forecasted data to show the extent of its financial problems and how various levels of rate increase would address those issues. Further, the RD

²⁵ PGW also excepts to the RD's proposal that PGW be required to supply data regarding a historical dispute with the School District of Philadelphia, as the tariff provision that the ALJs stated should be complied with was not enacted until 2003.

²⁶ RD at 55; *see also*, Conclusion of Law 7, Ordering ¶ 1.

failed to consider that a \$25 million rate increase would do virtually nothing to ameliorate PGW's massive amount of debt in its capital structure, a level that is imposing enormous costs on customers and is creating a risk of further downgrade if left unchecked. Finally, the RD failed to take account of the fact that the Company is not producing any cash working capital from the rates it charges customers, a fact that will not change even if it receives a \$25 million rate increase. PGW's legally mandated rate-making methodology – the Cash Flow Method – requires that PGW's rates be set to produce a "reasonable" level of cash working capital. PGW requires a significantly greater increase if it is to even have year end cash equal to its outstanding commercial paper.

2. The RD Erred by Completely Ignoring the Evidence of Record Showing That PGW Needs a Rate Increase of \$70.1 Million to be in the Same Financial Position as After the PUC's Last Two Base Rate Determinations.

The RD does not even mention PGW's evidence which showed that comparing its more or less undisputed test year *pro forma* revenues and expenses to the level that was permitted in PGW's last PUC base rate cases, **the Company's expenses and interest costs had risen by \$35 million** from the levels authorized in the 2001 case; and its net **contribution margin had decreased by \$35 million** from the 2001 and 2002 cases.²⁷ PGW submits that the RD erred in not finding that the Company needs a minimum rate increase of \$70.1 million just to maintain the status quo from the Company's last two rate cases.

As noted PGW last increased its base rates in April 2002, when the Commission granted its request for a \$36 million extraordinary rate increase.²⁸ That same \$36 million increase was made permanent when, in August 2002, the Commission approved a settlement of PGW's \$60

²⁷ PGW MB at 30-37.

²⁸ *Petition of PGW For Extraordinary Rate Relief Pursuant to 66 Pa. C. S. § 1308(e)*, R-00017034F0002, April 12, 2002 ("Extraordinary Rate Order").

million base rate request.²⁹ The 2002 rate increase followed a \$33.6 million base rate hike, that had been authorized by the Commission in the Fall of 2001, after a fully litigated proceeding.³⁰ The subsequent extraordinary rate increase rescued the Company from a likely downgrade to junk bond status that would have created a financial crisis of significant proportions.

After the *2002 Base Rate Order*, PGW hoped that the two base rate increases and the implementation of a Weather Normalization Clause would stabilize PGW's earnings and cash flow and permit it to reduce its outstanding short and long-term debt by financing a portion of its capital construction program from internal sources – key financial problems that had not been addressed adequately for many years. Unfortunately, this did not occur. Even before the increase was finalized, in August 2002, historically high natural gas prices significantly reduced PGW's revenues.³¹ For example, in FY 2003, the Company's collections dropped to a historically low 86.60% (compared to its longer-term historic rate of approximately 92%), resulting in a loss of more than \$40 million in revenues.³² The Company responded immediately and was able to slowly improve its collections (its collection percentage is now close to 96%).³³ But these drops in collections, combined with the over \$200 million increase in natural gas expense since the FY 2001 period (the test year used in PGW's last, fully litigated base rate proceeding), eliminated all of the cash working capital generated by the base rate increases,

²⁹ *Pa. PUC v. PGW*, R-00017034, August 8, 2002 ("*2002 Base Rate Order*"); PGW St. 2 at 2-3. The settlement was a "black box" settlement in which there was agreement only on the overall increase. *See, Joint Petition for Settlement of PGW Base Rate Proceeding*, R-00017034, June 28, 2002, ¶ III(2). The settlement also permitted PGW to implement a "Weather Normalization Clause" which protects the Company from losses caused by warmer than normal weather, and protects the customer from additional payments when the weather is colder than normal, but does not address lost sales from conservation or load loss.

³⁰ *Pa. PUC v. PGW*, R-00006042, October 4, 2001 ("*PGW 2001 Base Rate Order*").

³¹ PGW St. 2 at 3.

³² *Id.*

³³ PGW St. 6 at 2; PGW Exh. RG-1.

significantly increased bad debt expense³⁴ and reducing sales. To make matters worse, the losses in sales were heightened by reduced population and slowing industrial growth in Philadelphia as well as the generally improved energy efficiency of customer appliances.³⁵ As a result, PGW's current test year net sales margin – the net difference between the total customer charges and the cost of natural gas included in the rate – is some \$35 million less than the margins authorized in the 2001 and 2002 rate cases.³⁶ Sales margin is the portion of PGW's charge from which PGW must recover all non-gas expenses and obtain debt service coverage, cash working capital and internally generated funds.

Additionally, PGW has suffered a continued material increase in several expenses which were beyond the control of management to control in a material way, including interest expense (an increase of \$16 million), healthcare costs (\$11.5 million), and pension costs (\$13.7 million increase).³⁷ Overall, PGW's operating and maintenance expenses, depreciation and interest expenses have increased approximately \$35.2 million since its last fully litigated case in 2001,³⁸ and its profits on gas sales – from which it obtains all of the funds it needs to meet the bond debt service coverages and cash working capital – has dropped by around \$40 million!³⁹ The following table shows the net affect, in comparison to PGW's final test year claim, with all disputed expense adjustments included:

³⁴ See, PGW Exh. JRB-16. PGW's allowance for Bad Debt expense in the 2001 rate proceeding was \$55.6 million. *PGW 2001 Base Rate Order, Order on Reconsideration, Schedule 1 (Income Statement)*. Since that time, its actual Bad Debt Expense has ranged from \$51.5 million to \$85, \$71 and \$80 million. FY 2006 Bad Debt Expense, reflecting the significant improvement in collections, was \$40.1 million. PGW Exh. JRB-16.

³⁵ PGW St. 2 at 4-6.

³⁶ See, PGW Exh. JRB-3; PGW Exh. JRB-11. The total margin loss is \$40 million offset by approximately \$5 million gain in Other Income. See, Table 4.

³⁷ PGW St. 2 at 4; PGW Exh. JRB-3.

³⁸ PGW St. 2 at 4.

³⁹ *Id.* at 4.

Table 4
Comparison of Prior PGW Rate Awards⁴⁰

	2001/2002	2007	Difference
Total Non-Fuel Operating Expenses	\$239.3	\$255.5	\$16.2
Interest Expense	\$57.8	\$76.7	\$18.9
Non-Fuel Operating Expenses + Interest			\$35.1
Contribution Margin	\$379.2	\$339.0	\$40.2
Less: Other income	\$6.1	\$11.3	(\$5.2)
Net Contribution Margin Loss			\$35.0
Total Net Contribution Margin & Expense Loss			<u>\$70.1M</u>

The derivation of the above figures, which are fully set forth and supported in the record,⁴¹ shows that even accepting all of the RD's *pro forma* adjustments, a \$25 million rate increase does not even start to address PGW's deficiencies. While the OTS and OCA raised arguments against this comparison approach, all of which PGW completely rebutted below,⁴²

⁴⁰ PGW MB, App. B, p. 2. This comparison includes all disputed *pro forma* test year adjustments and calculates bad debt expense on total gas revenues (as the RD recommended) rather than on total revenues.

⁴¹ PGW MB at 32-37.

⁴² OTS first claimed that it was simply impossible to compare the PUC allowances in one case with a utility's claim in another because the test year and levels of revenues and expenses are different (OTS St. 1SR at 10-11). But the PUC was using the same ratemaking method – the Cash Flow Method – in both cases and used the same fiscal year budget approved by the Gas Commission as a test year. There have been no material changes in accounting or ratemaking policy since 2002. Thus, there is nothing to skew the results. The OTS also claimed that PGW's analysis inappropriately merged the 2001 and 2002 cases to arrive at the authorized level of income resulting from the two cases (*Id.* at 11). But PGW explained that the 2002 case had been resolved by settlement and did not include any specific findings regarding individual rate elements other than the overall level of increase – \$36 million – allowed; it is this revenue increase number that PGW used in its analysis. PGW MB at 36.

Finally, the OTS argued that PGW's comparative analysis was flawed because it overstated the level of income permitted by the PUC in the prior 2002 *Extraordinary Rate Proceeding*. They claimed that, in that decision, the Commission actually authorized PGW to earn just \$44 million and pointed to the summary income statement included with the Commission's Order as support. OTS RB at 21. But the Order they are referring to was temporary, focusing only on the level of rate relief needed to meet minimum coverage levels (*Extraordinary Rate Order* at 18, 28), and specifically indicated that "to a large extent, PGW's revenues and expenses will be fully litigated in the context of a base rate case." *Order* at 14. But, the final decision in the base rate case was the product of a settlement in which all parties, including OTS, agreed that the decision "does not reflect or constitute the recovery of any individual expense claim or revenue assumption...." PGW MB at 36, n. 93. Even if one were to look at the PUC's interim *Extraordinary Rate* decision in that case, OTS completely ignores the fact that the allowed net income – before payment of the \$18 million City Payment – was \$61.9 million, not \$44 million. Obviously, since the payment of the City Fee would be an additional obligation (which the City has provided to the Company for its benefit), the appropriate authorized income from that Order with which to compare is \$61.9 million. Compared to the ALJs' calculated net income with a \$25 million rate increase (\$40.3

none of the parties, nor the Recommended Decision, ever attempted to explain the fundamental inconsistency between their recommendations and the results of this comparative analysis. If, in 2002, the PUC determined that under PGW's "Cash Flow" ratemaking methodology a certain level of contribution and net profit, after covering legitimate expenses, was necessary to give the Company a reasonable level of debt service coverage (not the bare minimum), a reasonable level of cash working capital and a level of earnings that could permit it to reduce its dependence on external financing, how is it that, now, five years later, when PGW's expenses and interests have gone up \$35.1 million and its net contribution margin has gone down \$35 million, that only a \$25 million rate increase is justified? **The irrefutable conclusion is that the RD's recommendation does not even cover PGW's experienced changes since 2002 and the ALJs' recommendations is *per se* inadequate; thus PGW has justified a minimum increase of at least \$70.1 million.**

3. The RD Erred in Concluding that PGW's Claimed Revenue Requirement Was Based on Data Outside the Test Year and that PGW's Five-Year Financial Forecast Should Not be Considered in Setting Rates.

The RD twice rejected PGW's presentation of five-year forecast data and then rejected most of the Company's \$100 million claimed increase, apparently accepting the misstatements of OCA and OTS that PGW's rate request was based upon its projected financial results after the test year.⁴³ The RD thus reflects several errors.

First, the notion that PGW's rate increase request justification flowed from financial data outside the test year is simply wrong. The inadequacy of PGW's present rates is reflected both within the test year itself as well as by examining of planning period data.⁴⁴ As noted above,

million), PGW's rate increase would still have to be \$46.6 million in order to meet even that level of income. (\$61.9 million less \$40.3 million = \$21.6 million + \$25 million).

⁴³ See, RD at 21, 47.

⁴⁴ See, PGW RB at 21.

PGW demonstrated that its present rates are seriously deficient compared to the Commission's last rate awards; this analysis was based on test year data.⁴⁵ Moreover, the Company's analyses of its cash working capital deficiency again was based on the Company's lack of any non-borrowed cash working capital projected for the test year – in addition to data outside of the test year.⁴⁶ Finally PGW's complete reliance on the issuance of long term debt to finance 100% of its construction needs again was demonstrated by observing that PGW's test year debt-to-equity ratio is an unacceptable 83%, it only gets worse post-test year.⁴⁷

PGW did use its five-year financial forecast to provide the Commission with valuable indicators of the seriousness of its present financial difficulties, and to provide guidance on what level of rate increase will address these financial deficiencies. To the extent the RD rejected the use of these forecasts for these purposes, this was a serious error.

The forecasts submitted by PGW are regularly prepared in accordance with a rigorous process, and PGW's financial experts testified to their appropriateness as a reasonably reliable planning and projection tool.⁴⁸ Use of such future projections to assist in the determination of test year revenue requirement is not unprecedented. While the RD points out that post-test year considerations usually extend no more than 6-12 months after the end of the chosen year,⁴⁹ there is no hard and fast legal prohibition against considering a longer-term period in order to determine representative conditions.⁵⁰ In fact, the Commission has considered data well into the

⁴⁵ See, Section II(A)(2) *supra*.

⁴⁶ See, Section II(A)(5) *infra*.

⁴⁷ See, Section II(A)(4) *infra*.

⁴⁸ PGW MB at 25-29; RB at 21-23; PGW St. 2 at 14. The criticism leveled at the forecasts by OCA and OTS (and repeated by the RD (at 49)) – that they involve projections – is obviously specious. All forecasts involve projections and estimates of future costs.

⁴⁹ See, RD at 20. Indeed, in this case, both the OCA and the OTS recommended that PGW's required pay-back of its City Loan – not to occur until FY 2008 – should be recognized in rates. See, RD at 52.

⁵⁰ PGW MB at 25.

future when appropriate. For example, electric utilities' stranded costs were established using calculations of net energy costs 10-20 years into the future,⁵¹ while the used and usefulness of power plants similarly has been reviewed based upon their need beyond the test year.⁵²

Moreover, using financial forecasts is particularly appropriate for PGW because it is regulated on a Cash Flow Method basis. The Cash Flow Method requires the Company's rates to cover expenses, debt service coverage, and amounts needed to finance construction or to pay down debt (when no longer prudent to borrow), as well as an allowance for cash working capital – but provides no return on investment to shareholders.⁵³ Thus, the levels PGW needs to cover for any of these items in a particular year are related to PGW's experience in prior years. For example, PGW's complete lack of internally generated cash working capital in the test year (the cash it does have is completely borrowed) is directly related to the loss of margins and increased expenses the Company has experienced over the last five years. Similarly, the level of rate hike approved today will affect PGW's debt level, not only in the test year but over the next five years.

Frankly, while PGW's entire \$100 million rate request is justified by test year data alone, it makes little sense to ignore the indicators of a deepening financial crisis that make the need for a rate increase based on test year data even more compelling. For example, while PGW's debt service coverage requirements are met in the test year, PGW will fall below the 1.5x on its 1998 bonds required by its bond ordinance covenants by FY 2009 (12 months ending August 31,

⁵¹ *Id.* at 26.

⁵² *Id.*, at 27.

⁵³ PGW MB at 27; RB at 21-22. The RD (p. 10) did not make an explicit ruling about the elements of the Cash Flow Method, but to the extent that the decision is read to suggest that the PGW Cash Flow Method does not require the Commission to set just and reasonable levels of rates to cover all of these items, this was error and PGW excepts.

2009).⁵⁴ Even with a \$25 million rate increase, PGW's projected debt service coverage would be so low in FY 2010 (12 months ending August 31, 2010) that the Company would be required to file for another rate increase by January 2008 in order to be able to collect a full fiscal year's revenues in order to be assured that it will not violate its bond covenants and suffer a default.⁵⁵ It is respectfully submitted that these projections alone justify a significantly greater rate increase in order to remove the Company from this "knife's edge" of financial default. The five-year projections also show that granting the full increase would, once and for all, place the Company in a secure position with respect to debt service coverage by FY 2012.⁵⁶ If the Company and the Commission, as partners, are going to be successful in placing PGW on the path to financial stability, an analysis of where the Company is projected to be heading in the next several year is crucially important in the decision-making process and shows how much the Company is in need of a significant rate increase.

4. The RD Erred in Failing to Recognize That Reducing PGW's Test Year and Projected Debt-to-Equity Ratio Justified its Proposed Rate Increase.

The RD's summary dismissal of PGW's rate increase request on the ground that it appeared that the Company would meet its debt service coverage requirements in the test year and had "cash on hand" at year end completely ignored one of the most serious financial concerns facing the Company today – the enormous amount of debt in PGW's capital structure. While no explanation was given, it appears as if the ALJs incorrectly concluded that the financial concerns caused by the excessive amount of debt in the Company's capital structure either were

⁵⁴ PGW MB, App. A, p. 3. PGW's FY 2008 debt service coverage will be so low (1.52x) that it would likely have to file for emergency rate relief before the end of that fiscal year if it did not receive rate relief here.
Id.

⁵⁵ PGW MB, App. C, p. 3.

⁵⁶ PGW MB at 42-44, Table 3 *supra*.

not a test year problem or were not properly considered under the Cash Flow Method of ratemaking. Neither of these conclusions is correct.

First, PGW's Cash Flow Method as set forth in the Management Agreement Ordinance, which this Commission has stated in the past defines the ratemaking method that must be used to set rates for PGW, contains a specific provision authorizing the Company's rates to be set to produce dollars:

To provide appropriations, to the extent not otherwise provided for prepayment of debt and for capital additions which have been determined by the...Commission to be reasonable⁵⁷

The record is replete with evidence that it is not only reasonable but essential that PGW begin to fund a portion of its necessary capital additions and to retire existing debt from rates, rather than from external financing, so as to begin to reduce its heavy reliance on debt. The most important evidence is that since 1993, PGW has had no internally generated funds and is totally dependent upon the sale of bonds to finance its capital improvement program.⁵⁸ As a result, the Company is drowning in debt, with a test year debt-to-equity ratio of 83%, and this level projecting to increase to 89% by FY 2012.⁵⁹

The 83% debt level is not only wildly out of synch with other municipal gas companies and investor-owned utilities,⁶⁰ it is also adding to the Company's financial risk. It is for this reason that two different municipal finance experts testifying on behalf of PGW stated that the Company needed to begin to reduce its reliance on external financing to avoid a financial crisis.⁶¹

⁵⁷ PGW MB at 16-17, App. D; PGW Rejoinder Exh. 1 (Bogdonavage).

⁵⁸ PGW MB at 42-43, PGW St. 1 at 2.

⁵⁹ PGW MB, App. A, p. 5.

⁶⁰ PGW St. 3 at 15; PGW St. 3R at 8-12; Exhs. BB-3, 4, 5.

⁶¹ PGW St. 3 (Bisgaier) at 14; PGW St. 3R at 11-12; PGW St. 4 (Krellenstein) at 4-6. Mr. Krellenstein, the Managing Director of JP Morgan's Energy Group stated that PGW was viewed by the investment

Most importantly, this total reliance on external financing is imposing enormous long-term costs on ratepayers. Currently, just this debt load alone costs customers \$96 million a year.⁶²

Moreover, it is important to understand that for every dollar of debt that the Company incurs, it must recover in rates not only the associated debt service but also an additional 50% to cover the debt service coverage required by PGW's bond ordinance.⁶³ As a result, customers must pay \$1.50 for the cost of every dollar borrowed to pay for the capital program. In fact, PGW presented testimony showing that, due to this 1.5x coverage phenomenon, it is actually cheaper for customers to incur a rate increase to fund necessary construction rather than having to pay the costs associated with the Company's issuance of additional long-term debt.⁶⁴

The ALJs' recommendation not only fails to discuss these critical factors, it also neglects to consider how their \$25 million rate increase would affect the problem. In fact, a \$25 million rate increase would have no effect – producing virtually the same level of debt in the test year⁶⁵ and in FY 2012 (81-82%)⁶⁶ as PGW has now (83%). More troubling, because PGW would be forced to issue additional long-term debt in 2009 and again in 2011, a \$25 million rate increase (and any subsequent increases that did not allow PGW to produce internally generated funds to finance construction) would mean that the Company and its customers will incur an additional \$50 - \$52 million in annual debt service and coverage requirements by FY 2012⁶⁷ – and

community as "one of the weakest (from a financial and credit risk perspective) large municipalities in the nation." *Id.* at 3.

⁶² PGW App. A, p. 3 (total debt service on 1975, 1998 and 1998 subordinate bonds).

⁶³ PGW MB at 43-44.

⁶⁴ PGW St. 2 at 12-13; PGW St. 1R at 13-15; PGW Exh. SPH-3.

⁶⁵ App. C, p. 5. The debt-to-equity ratios on App. C and JRB-10 differ because JRB-10 was calculated on a realistic basis, *i.e.*, that PGW would not receive a rate increase until FY (ending) 2008.

⁶⁶ PGW RB at 40.

⁶⁷ PGW MB at 53; Tr. at 745-46.

ratepayers would be forced to pay this additional amount for the next 27 years.⁶⁸ It is hard to understand how the ratepayers' best interests are served by forcing them to incur rate increases of some \$1.4 billion (\$50- \$52 million over 27 years) in order to avoid some \$375 million in rate increases over the next five.

PGW's \$100 million rate increase was designed to give the Company the ability to internally fund a large portion of its annual capital program and to retire a portion of its existing debt. The Company projected that with the full rate increase (plus retention of off-system sales proceeds), the Company's debt-to-equity ratio will be reduced close to 50%/50% (54%) by FY 2012, a level deemed acceptable by PGW's municipal finance experts.⁶⁹ This level would finally put the Company on a financially secure position and assure PGW's ability to provide safe adequate and reliable service on an ongoing basis.⁷⁰

The opposing parties had little to say about this crushing problem, other than to claim that it should be ignored.⁷¹ Interestingly, OCA's overall accounting witness, Mr. Lelash, while disputing the need for PGW to achieve a 50%/50% debt-to-equity ratio, agreed that PGW's debt level was too high and claimed instead that a 70% debt-to-equity ratio was a more reasonable

⁶⁸ *Id.*

⁶⁹ PGW MB at 46; PGW St. 3 at 15; Exh. JRB-10. On a "*pro forma*" basis, *i.e.*, assuming PGW actually received the rate increase in FY 2007, PGW's FY (ending) 2012 debt-to-equity ratio is projected to be 47%. PGW MB App A, p. 10. Of course, PGW cannot actually receive a rate increase in FY 2007, which ends in a few days.

⁷⁰ *Id.*

⁷¹ Both also argued that if the City would simply forgive the \$45 million loan – due to be paid back in FY 2008 – a \$25 million rate increase would be sufficient to address PGW's debt problem. OTS RB at 3, 24-25; OCA RB at 10, 13-15. In fact, the testimony is that the City has provided enormous support for PGW over the last several years and will continue to do so, to the tune of \$200 million by FY 2012; to ask the City to find another \$45 million, and forego some other municipal need – such as police or fire protection – is plainly unreasonable. Moreover, PGW showed that trying to force the City to make even greater contributions to this troubled utility would not only be illegal but, just as importantly, would not solve the problem; even if the City forgave the City loan, PGW's debt ratio (with a \$25 million rate increase) would still stand at 80% in FY (ending) 2012. PGW MB at 58; RB at 39-40.

goal for the Company.⁷² However, the evidence shows that PGW needs at least a \$50-\$60 million rate increase from this case in order to be able to reduce its debt percentage to roughly 70% by FY (ending) 2012.⁷³ Indeed, the Commission needs to grant PGW at least \$50 million in order to make any material progress in reducing its debt-to-equity over the next five years. Here is PGW's projection of the debt-to-equity levels associated with various levels of rate increase, recognizing that any rate increase here granted can only take effect in FY 2008:

<u>Rate Increase</u>	<u>Projected FYE 2012 debt level %</u>
\$50 M	70% ⁷²
\$60 M	67% ⁷³
\$70 M	64% ⁷³
\$80 M	62% ⁷³
\$90M	59% ⁷³
\$100M	57% ⁷³
\$110M	54% ⁷⁴

5. The RD Erred By Concluding that a \$25 Million Rate Increase Would Provide Adequate Cash Working Capital.

As noted, the RD recommended a \$25 million rate increase apparently on the notion that PGW had sufficient cash working capital and liquidity (available cash working capital plus available short-term borrowing capability) because PGW showed "cash on hand at the end of the test year."⁷⁵ Apparently, the ALJs assumed that if PGW had year-end cash flow at present rates, it would have adequate cash working capital with a \$25 million rate increase. This conclusion could not be more incorrect. PGW's lack of sufficient cash working capital is an enormous problem that must be addressed in this case. A \$25 million increase will not remove the risk that

⁷² PGW RB at 40.

⁷³ PGW Exh. JRB-10. The rate increase to hit 70% exactly by the end of FY 2012 was extrapolated on the basis of the average reduction in debt-to-equity ratio for every \$10 million of rate increase shown on that exhibit.

⁷⁴ PGW Exh. JRB-10.

⁷⁵ RD at 55.

the Company will not be able to pay its bills if it experiences almost any significant increase in expenses, such as if natural gas prices return to post-Katrina levels. Moreover, the RD would not only leave PGW with no net cash working capital being produced from rates, the Company would actually have negative working capital! This result does not even satisfy the legal requirements of PGW's Cash Flow ratemaking method which provides that PGW has a legal right to rates that contain a "reasonable" allowance for cash working capital.

Like any operating utility, PGW has a need for cash working capital – a cash allowance to permit the Company to pay its expenses and debt service when they come due in advance of receiving the revenues from customers.⁷⁶ Unlike other companies, however, that have investors who loan the utility cash working capital – and accordingly pay investors a return on the "loan" by having a cash working capital amount added to utility's rate base (on which they earn a rate of return) – PGW has no investors and is not regulated using a rate base. Thus, it must receive its cash working capital from the rates it charges to customers.⁷⁷

To be sure, PGW is NOT looking to ratepayers as the sole source of necessary cash flow. PGW's cash flow statements⁷⁸ show that PGW already accounts for and utilizes all available sources of cash flow, including depreciation, bond proceeds to finance construction, earnings from investments and the like.⁷⁹ Moreover, to provide supplemental liquidity, PGW has a tax exempt Commercial Paper program backed by a letter of credit that has a \$150 million limit.⁸⁰ The Commercial Paper program is designed to help finance the purchase of gas inventories and

⁷⁶ PGW MB at 39-42; PGW RB at 25-36.

⁷⁷ For PGW this need is most acute at the end of its fiscal year (August) because it must have funds built up to pay for gas and other expenses prior to receiving revenues from winter sales. *Id.*

⁷⁸ *See, e.g.*, PGW Exh. JRB-13A p. 2; App. A, p. 2.

⁷⁹ Tr. at 532.

⁸⁰ PGW St. 3 at 6-8; PGW St. 3R at 5-7.

accounts receivables during periods of low collections in the year.⁸¹ There was no dispute by any of the parties that PGW needed its \$150 million Commercial Paper Program line of credit to be fully available at the end of its fiscal year in order to have sufficient liquidity to be able to finance gas purchases and other expenses during the lower collection months leading up to late-January and through January through May – when PGW collects most of its revenues.⁸² It was also undisputed that, in addition to its commercial paper, PGW needed an amount of cash working capital from its rates to supplement its short-term Commercial Paper program in order to be assured that it will be able to pay all off its bills when due.⁸³

Unfortunately, because PGW's present rates are not producing any additional cash, PGW has been forced to issue commercial paper just to be able to have any year-end cash working capital available.⁸⁴ **The result is that PGW's actual year-end cash is negative:**

Table 5
Total CWC-Present Rate

Test Year End Cash at Present Rates	Test Year Outstanding Short Term Borrowing	Total Cash Working Capital From Present Rates	Days of Liquidity (cash + short term borrowed)
\$51.6M ⁸⁵	\$153M	(\$101.4M)*	39

* (153M less \$51.6M)

It is simple mathematics that if PGW is only able to produce cash working capital by borrowing from other sources – sources that themselves are supposed to be fully available to provide short term liquidity – the Company's total liquidity (cash working capital plus short-term

⁸¹ *Id.*

⁸² PGW St. 2 at 7; PGW Cross Exam Exh. 3; Tr. 809-10 (OCA witness Lelash).

⁸³ *Id.* PGW witness Bogdonavage testified that in today's environment, PGW should have \$55-\$60 million in year end cash in addition to its entire, \$150 million Commercial Paper program available. PGW St. 2 at 7.

⁸⁴ PGW St. 1R at 2-4.

⁸⁵ PGW App. A, p.2. Calculation of TY Ending Cash Assuming TY Bad Debt Expense calculated on Basis of Total Revenues. Calculating bad debt expense on the basis of gas revenues only, PGW's end of year cash would be \$52.9 million and its non-borrowed cash working capital would be (\$100.1M).

borrowing) is deeply and seriously deficient. While PGW presented testimony that a standard "minimum level" of cash or liquidity for municipal utilities was "200 days" of expenses,⁸⁶ with most municipal utilities having far more,⁸⁷ PGW's liquidity at present rates equated to just 39 days.⁸⁸ In fact, while PGW is projecting it will have some \$53 million in (borrowed) cash, it has not been able to finish the year with that much since FY 1995!⁸⁹

No single fact could better demonstrate PGW's acute cash and liquidity shortfall than the fact that at its low point in January, 2006, PGW – a company with almost \$1 billion in annual expenses – had just \$4 million dollars of cash available and had reached its available commercial paper issuance limit.⁹⁰ If it had not been able to convince the consortium of banks that support the Commercial Paper program to increase the limit on its letter of credit by another \$50 million, PGW would not have been able to meet a January natural gas supply bill.⁹¹ The conclusion that must be drawn is that without rate relief, PGW is in perilous danger of not being able to meet its obligations in the face of an emergency.

Unfortunately, with a \$25 million rate increase the Company's circumstances are not much better. Using the RD's own calculation of year-end cash and short term borrowing, and even with a \$25 million rate increase, PGW's non-borrowed cash working capital continues to be negative and no cash working capital would be produced from rates:

⁸⁶ PGW MB at 44; RB at 26-27.

⁸⁷ PGW St. 3R, Exh. BB-3-4; Ms. Bisgaier's survey of water and mixed service municipal utilities showed that overall, these companies reported having over 2,000 days of liquidity, with mixed use companies reporting 691 days. *Id.*

⁸⁸ PGW MB at 42.

⁸⁹ RD at 49. For some reason, the OCA has offered this fact as an argument against PGW's rate request, when, in fact, it is just the opposite. PGW's inability to even produce that much cash – even with the availability of its Commercial Paper program – is a symptom of how troubled PGW's cash working capital situation really is.

⁹⁰ PGW St. 3 at 9-11; PGW St. 3R at 6-7; Tr. at 549-51.

⁹¹ *Id.*

Table 6
Total CWC - \$25M Increase

Test Year End Cash at \$25M Rate Increase (as Per RD Sum Sheets)	Test Year Outstanding Short Term Borrowing (As Per RD) ⁹²	Total Cash Working Capital from Rates*	Days of Liquidity (cash + short term borrowing)
\$57.4M ⁹³	\$112,500	(\$55.1M)	59.8 ⁹⁴

* (112.5M less \$57.4M).

Moreover, the record shows that, if natural gas prices were to return to post-Hurricane Katrina rate levels, a \$25 million rate increase would have left PGW \$2 million short of the necessary liquidity it needed (i.e., cash plus commercial paper) to pay its obligations in January 2007 (the test year) and it would be \$13.1 million short in January 2008.⁹⁵ Importantly, this cash deficiency would come at the end of January after PGW has utilized all its available short-term borrowing: in other words, in these scenarios PGW would have no source of cash working capital available to pay its bills, other than the "last ditch" alternatives, which are akin to selling one's car to pay the rent.⁹⁶ Failure to pay its bills when due is a violation of PGW's bond ordinance covenants.⁹⁷ Plainly, the RD's \$25 million rate increase recommendation is grossly deficient from a cash working capital standpoint.

⁹² *Id.* (\$90M in outstanding commercial paper plus \$22.5M outstanding City Loan.)

⁹³ RD, App. A, Cash Flow Statement.

⁹⁴ Total RD Operating Expenses (\$893M) less depreciation expense (\$38.2M) = \$854.8M, divided by 365 = 2,342 days. Available liquidity: \$60M commercial paper, \$22.5M available City Loan and \$57.4M cash) = \$140M divided by 2,342 = 59.8 days.

⁹⁵ PGW MB at 50-51.

⁹⁶ *Id.*

⁹⁷ PGW MB at 20-21.

The RD's recommendation is also inconsistent with PGW's Cash Flow ratemaking method, the formula that the Public Utility Code requires the PUC to use to set PGW's rates.⁹⁸ As previously noted, the Commission has previously ruled that specific elements of the Cash Flow Method formula are set forth in the Management Agreement Ordinance.⁹⁹ That Agreement states that PGW is legally entitled to an allowance in its rates for "reasonable" cash working capital. Section VII(1) of the Management Agreement Ordinance states that PGW's rates "shall" be fixed so as to ensure revenues "at least sufficient to provide cash, or equivalent, for working capital in reasonable amounts."¹⁰⁰ The uncontroverted evidence in the record is that PGW's rates with a \$25 million increase will not produce any working capital – all of the cash it will have on hand will be borrowed. Thus, this legal standard plainly will not be met. The RD did not even comment on this key legal deficiency.¹⁰¹ Moreover, one must question whether any other major utility in this Commonwealth would be consigned to having to borrow its working capital allowance rather than being able to charge rates that put it on a reasonable footing from a cash working capital standpoint.

Clearly, PGW's liquidity deficiencies justify a substantial rate increase. While the RD didn't even bother to rule on the controversy, and as noted previously, PGW submitted testimony

⁹⁸ PGW MB at 15-20.

⁹⁹ *Id.*

¹⁰⁰ PGW RB at 19.

¹⁰¹ OTS tried to argue that the Management Agreement's "cash working capital in rates" requirement was met by PGW's short term commercial paper line of credit or by selling other short term assets such as accounts receivable or gas inventories. OTS MB at 41. But, the Management Agreement requires that rates reflect an allowance for "cash or equivalent," which the OTS's own witness agreed did not include the issuance by PGW of commercial paper (PGW RB at 29). And the suggestion that PGW does not need a cash working capital allowance in its rates because the Company can always sell its gas inventories or its accounts receivable is frankly ludicrous. No healthy going-concern company resorts to such methods to pay their bills and any such regular activity by PGW would clearly signal to the investment community that PGW was in even more trouble than they had believed. PGW RB at 30-34. The PUC has, in the past, considered – and rejected – a "balance sheet approach" to calculating a utility's cash working capital need. *See cases cited at PGW RB at 32, n. 109.*

that a "minimum standard" for municipal utilities was 200 days of cash.¹⁰² Even considering both cash and PGW's short term borrowing capability, PGW's \$100 million proposed rate increase (plus \$10 million off-system sales) would produce just 72 days of liquidity in the test year.¹⁰³

OTS and OCA, however, are likely to insist that it would be more appropriate to use a more conventional measure of cash working capital used by investor-owned utilities, the "45 day" or "1/8th" method. But even with this alternative approach, PGW's non-borrowed cash working capital would not come anywhere near meeting this standard even if PGW were granted its entire rate increase request.¹⁰⁴ In fact, even if one were to put aside the fact that PGW's end of year cash is borrowed, PGW's rate increase would still have to be \$85 million to provide the Company with 45 days of year-end cash.¹⁰⁵

PGW submits that the most conservative cash working capital allowance would be one that provided the Company with the same amount of year-end cash as its outstanding commercial paper at that point in time. With a \$25 million rate increase, the RD calculated that PGW would have \$57.4 million in year-end cash and \$90 million of outstanding commercial paper borrowing. Accordingly, PGW's rate increase would have to be \$57.6 million (in total) in order to have its year-end cash equal to its outstanding commercial paper (\$90 million).¹⁰⁶ PGW submits that the Commission should consider this amount to be the minimum level of increase that it can prudently consider for PGW under the Cash Flow Method.

¹⁰² PGW St. 3 at 10; PGW St. 3R at 8-9; Tr. 761, 771.

¹⁰³ PGW MB at 44.

¹⁰⁴ *Id.*

¹⁰⁵ PGW MB at 52; PGW RB at 35-36. As noted, the 45 day or "1/8th" method never counts borrowed funds. *Id.* at 35, n. 126.

¹⁰⁶ RD, App. A "Cash Flow Schedule"; PGW RB at 35-36.

6. The RD Erred By Rejecting PGW's Proposal to Utilize the Future Proceeds From Off-System Sales and Capacity Release Transactions to Fund Construction Projects.

PGW takes exception to the recommendation denying the Company's request for retention of off-system sales margin and capacity release credits because the grounds cited for denial directly contradict current practice in Pennsylvania. The RD's recommended rejection of this proposal is based on the following grounds: (1) PGW failed to prove that retention of this revenue is necessary; (2) PGW failed to prove that retention is not a violation of the Public Utility Code and regulatory principles; (3) the proposed construction projects which will be funded by the retained revenues are not clearly identified; and (4) all customers will benefit from the spending of the retained revenues instead of just the PGC customers.¹⁰⁷ Each of these bases is clearly erroneous.

First, the RD suggested that PGW's request was somehow unprecedented, illegal and contrary to PUC regulations. However, this is completely at odds with the fact that most major gas utilities in Pennsylvania are already permitted to retain a portion of these revenues for the benefit of shareholders.¹⁰⁸ For the most part, these sharing arrangements were established as

¹⁰⁷ RD at 23-25.

¹⁰⁸ The following provides a partial list of the sharing mechanisms in Pennsylvania:

Utility	Type of Revenue Retained	Sharing Mechanism Formula
Columbia	Off-system sales margin and capacity release	If >\$6M, 50% of amounts > \$6M. If <\$6M, 50% of \$6M minus actual annual total.
NFG	Off-system sales margin, capacity release and gas storage fill contracts savings	25% of total.
PECO	Off-system sales margin	25% up to \$3.5M. 30% of amounts > \$3.5M.
PPL	Off-system sales margin, capacity release and exchanges/swaps of natural gas supply	30% of amounts > \$600K.
UGI (Penn)	Off-system sales margin, capacity release and exchanges of natural gas	30% of amounts > \$550K.
UGI	Off-system sales margin, locational exchange revenues and storage asset management fees	1 st \$240K – 0%. \$240K to \$320K – 100%. 25% of amounts > \$320K

part of negotiated settlements of annual Section 1307(f) proceedings.¹⁰⁹ If the RD was correct that such proceeds retention was somehow illegal, none of the sharing mechanisms for other Pennsylvania gas utilities could have been lawfully approved by this Commission.

Indeed, what makes this recommendation even more difficult to understand is that PGW's revenue retention proposal benefits its customers and not shareholders.¹¹⁰ PGW's proposal is to use these funds to provide the Company with a source of non-borrowed capital to finance necessary construction in order to try to reduce PGW's extraordinarily high level of debt in its capital structure.¹¹¹ Additionally, and as discussed above, when funds are contributed from these retained revenues, ratepayers pay substantially less to fund capital projects than if these same capital projects were funded through base rates.¹¹²

Sources: Columbia Gas Tariff – Pa. P.U.C. No. 9, 6th Revised Pg. No. 159, Issued November 23, 2005, Effective November 23, 2005; NFG Gas Tariff – Pa. P.U.C. No. 9, 2nd Revised Pg. No. 154, Issued July 30, 2004, Effective August 1, 2004 & 5th Revised Pg. No. 155, Issued July 29, 2005, Effective August 1, 2005; PECO Gas Tariff – Pa. P.U.C. No. 2, 10th Revised Pg. No. 35, Issued November 28, 2006, Effective December 1, 2006; PPL Gas Tariff – Pa. P.U.C. No. 3, 3rd Revised Pg. Nos. 8 & 8.1, Issued February 28, 2007, Effective February 9, 2007; UGI Penn Natural Gas Tariff – Pa. P.U.C. No. 7, 2nd Revised Pg. No. 66, Issued December 1, 2006, Effective December 2, 2006; UGI Gas Tariff – Pa. P.U.C. No. 5, 5th Revised Pg. No. 30, Issued November 30, 2005, Effective December 1, 2005.

¹⁰⁹ *PaPUC, et.al. v. Columbia Gas of Pennsylvania, Inc.*, Docket No. R-00049234 (Recommended Decision dated July 28, 2004 at p.3) & (Order entered September 14, 2004); *PaPUC v. National Fuel Gas Distribution Corporation*, Docket No. R-00049108 (Recommended Decision dated June 3, 2004 at p.4) & (Order entered July 9, 2004); *PAPUC v. PECO Energy Company – Gas Division*, Docket No. R-00061501 (Recommended Decision dated August 16, 2006 at p.3) & (Order entered September 18, 2006); *PaPUC, et.al. v. PG Energy*, R-00061518 (Recommended Decision dated September 14, 2006 at p.7) & (Order entered October 19, 2006) [for UGI Penn Natural December 1, 2006 PGC]; *PaPUC v. UGI Utilities, Inc. – Gas Division*, Docket No. R-00050539 (Recommended Decision dated September 30, 2005 at p.6) & (Order entered October 28, 2005 at p.2).

¹¹⁰ PGW St.1 at 5-6; PGW MB at 48-49.

¹¹¹ PGW St.1 at 5-6.

¹¹² PGW St.1 at 5-6; PGW MB at 48-49. This is why the RD's suggestion that this proposal is "not necessary" is so incorrect.

In PGW's previous submissions, PGW has shown that the other concerns raised by the RD are similarly without merit.¹¹³ PGW is requesting that the Commission reject the RD's recommendation and permit PGW to retain 100% of off-system sales margins and capacity release credits until the Company's debt-to-equity ratio reaches 50%.¹¹⁴ PGW here reaffirms its commitment to place all such retained proceeds in a construction fund and to use them solely to fund construction projects that have been authorized as part of PGW's capital budget (which must be approved by the Philadelphia Gas Commission and the Philadelphia City Council).¹¹⁵ Alternatively, PGW requests that the Commission approve PGW's retention of some portion of off-system sales margins and capacity release credits, and defer the determination of the exact amount of sharing to the Company's next Section 1307(f) proceeding.

7. The RD Erred in Adjusting PGW's *Pro Forma* Income For Various Individual Expense Adjustments.

(a) Introduction

The RD's recommendation to accept a series of adjustments not otherwise accepted by PGW had relatively minor effect on PGW's *pro forma* income.¹¹⁶ While the ALJs' acceptance of these items was erroneous, their effect on PGW's core financial measures – debt service, debt-to-equity ratio and cash working capital – will not be material. Accordingly, the RD's suggestion

¹¹³ PGW showed that its proposal does not improperly provide the benefits of these sales to all customers (rather than just PGC customers) because, on PGW's system, the gas assets used to make these sales actually have been procured to provide service to both sales (*i.e.*, PGC) customers and transportation customers. PGW MB at 75-76. Moreover, PGW did not identify specific construction projects that will be funded by these proceeds; instead it clearly indicated that it would only use the funds for approved capital budget projects. *Id.* at 74. No greater specificity is needed.

¹¹⁴ See, Section II.A.4. *infra* which provides a detailed discussion as to why the Company's debt-to-equity ratio must be reduced to 50%.

¹¹⁵ PGW MB at 74.

¹¹⁶ See, RD at 28-30 (Bad Debt expense calculation), 33-36 (Management Incentive Plan), 36-37 (Marketing Promotion Expense), 38-41 (Lobbying Expense), 42-43 (Injuries and Damages Reserve), and 43-45 (Regulatory Fines). PGW also excepts to the corresponding ordering paragraphs in the RD. By the ALJs' own calculation, all of these adjustments combined will add just \$2.5 million to PGW's *pro forma* income at present rates. RD, Summary of ALJ Adjustments to *Pro Forma* Net Income.

that by not further reducing the recommended \$25 million rate increase, PGW will have additional funds to make a material impact on any of these items¹¹⁷ is simply wrong and betrays a lack of understanding of the seriousness of PGW's financial troubles. The only way to make a material improvement in PGW's current financial outlook is by granting a considerably greater increase than that recommended in the RD.

8. The RD Erred by Refusing to Apply the Agreed Upon Bad Debt Factor to Total Revenues Rather than to Natural Gas Revenues Only.

The parties were able to agree on a stipulated bad debt expense factor of 4.5%.¹¹⁸ Considering that PGW has experienced factors more than twice as high in the last several years,¹¹⁹ achieving a consensus that 4.5% is a reasonable bad debt factor for PGW is a tremendous achievement. However, one issue remains: the base to which to apply the 4.5% factor. PGW calculates its overall income and revenue requirement on the basis of total revenues and expenses. In other words, it includes as part of test year revenues, all revenues it bills, including those non-gas revenues from finance charges (which are late fees applied to natural gas bills), reconnection charges and turn-on charges as well as the revenues and expenses from PGW's "Parts and Labor" appliance repair plan.¹²⁰ By including all of these revenues in the calculation of *pro forma* revenues, the customers receive a benefit. Since PGW's revenues from these items are greater than their cost, PGW's revenue requirement is less than it would be if these revenues and costs were excluded.¹²¹ Obviously, PGW experiences uncollectibles on these revenues just as it does on all of its billings. Of course, if all revenues are credited to customers,

¹¹⁷ RD at 47.

¹¹⁸ RD at 28.

¹¹⁹ PGW Exh. JRB-16.

¹²⁰ PGW MB, App. A, "Appliance Repair & Other Revenues" and "Other Operating Revenues". The detail of these items are shown on Exh. JRB-2, pg. 8.

¹²¹ PGW MB at 63-64; PGW RB at 10-11; PGW St. 2R at 27.

all associated expenses must also be credited. Unless the *pro forma* uncollectible factor is applied to all revenues, the uncollectibles on these items will not be recognized and PGW will not be fairly compensated. Applying the agreed upon bad debt factor only to proposed gas revenues as opposed to all revenues, as the RD recommended, reduces PGW's allowance for bad debt expense (at proposed rates) by some \$1.3 million. This, in turn, artificially increases *pro forma* income by the same amount.

The ALJs appeared to agree that it would be "inequitable" to include revenues from these items in the calculation of *pro forma* income and to exclude "these same revenues when not collected as expense,"¹²² but nonetheless suggested that PGW had not properly developed the issue on the record. Moreover, it cited favorably OTS's speculation in its Reply Brief that these "non-jurisdictional" revenues were "under the control of the Company" and that PGW could somehow be accounting for bad debt expense in the pricing of these services.¹²³

In fact, the RD was wrong about the lack of record support for PGW's position. The only testimony on the record on this issue was submitted by PGW accounting witness Bogdonavage who explained in his rebuttal testimony the correctness of applying the Bad Debt expense factor to total revenues when those revenues are included in the *pro forma* income statement, as they are for PGW.¹²⁴ OTS never responded to this testimony in its surebuttal or otherwise on the record. Accordingly, the OTS's non-record speculation should not have been considered.

Moreover, this speculation is not only completely unsupported by any record cite but it is also plainly wrong. First, most of these revenues are not "non-jurisdictional;" almost three-

¹²² RD at 29.

¹²³ *Id.* at 30.

¹²⁴ PGW St. 2R at 27.

quarters arise from late payment and turn-on charges.¹²⁵ Second, the fact that a portion come from non-regulated services – PGW's appliance repair plan – is not a reason to exclude the associated bad debt from the *pro forma* expense calculation because PGW is crediting these revenues to customers. Finally, the notion that these legitimate expenses should be denied because PGW could somehow be recovering bad debt expense in the rate it charges customers is similarly specious. PGW records all of its revenues on a billed basis and all of its bad debt expense in the expense item for that purpose.¹²⁶ So long as all revenues are credited to ratepayers (which they are), then all expenses must be so credited as well.

While it is true that in a prior proceeding the PUC calculated PGW's bad debt expense by applying the approved factor to gas revenues only, the adjustment was never argued and no record was ever developed on this issue because the focus in that case was the calculation of an overall amount of bad debt. PGW's position should be accepted and its allowance for bad debt expense at both present and allowed rates should be calculated by applying the stipulated 4.5% factor to whatever authorized level of "Total Operating Revenues" the Commission determines to be appropriate.

9. The RD Erred in Removing the Cost of PGW's Management Incentive Program From *Pro Forma* Expenses.

After years of providing virtually no salary increases to top management employees,¹²⁷ PGW's Board of Directors approved a Management Incentive Plan that awarded one-time payments of between 2.5% to 18%, with an average award of less than 10% of base salary, to 55 top managers based upon their performance in contributing to various operational and financial

¹²⁵ Only about 27% of these revenues could be characterized as "non-jurisdictional." JRB-2, p. 8.

¹²⁶ See, e.g., PGW Filing Requirement III.E-15 b & c; PGW St. 2R at 27.

¹²⁷ PGW MB at 61.

improvements that the Company had experienced.¹²⁸ PGW plans to continue the program on a permanent basis. The Company's Human Resources Vice President testified that the program was a key element of its efforts to maintain existing key managers who were responsible for the Company's service and operational improvements.¹²⁹ He testified that, even with the program, PGW's managers were dramatically underpaid compared to comparable employees and that this program was a small attempt to compete with the overwhelmingly greater perks and benefits that investor-owned utilities can offer its most valued employees. Thus, the program is key to maintaining PGW's operational, service and collections successes and should have been approved under the Commission's prior rulings.¹³⁰

The ALJs rejected this modest proposal, initially on the ground that the Company had not shown it had complied with the Management Agreement standard for incentive compensation plans.¹³¹ But this is incorrect. The Management Agreement states that incentive compensation may be provided pursuant to performance standards established by the Board of Directors.¹³² The RD overlooked the evidence that the Management Incentive Program was approved by PGW's Board of Directors.¹³³ As such, the Board necessarily determined that the requirements of the Management Agreement had been satisfied.

The other basis raised by the RD for rejecting this expense was that even though PGW showed that the program "is an important part of PGW's efforts to retain its most valuable senior

¹²⁸ See, PGW St. 11 at 2.

¹²⁹ PGW St. 11 at 6-7; PGW MB at 60-63.

¹³⁰ PGW MB at 61.

¹³¹ RD at 35. The Management Agreement is an ordinance of the City of Philadelphia which sets forth operating standards and practices to be followed by PGW's Board of Directors and CEO in operating the Company.

¹³² RD at 35.

¹³³ Tr. 777-78, 797.

managers,"¹³⁴ such a finding was not the correct standard because PGW needed to show that the expense was "prudently incurred." In fact, the Commission has found management incentive plans reasonable when they are shown to be designed to foster "operational effectiveness."¹³⁵ The record here clearly demonstrates that the Management Incentive Program was designed to recognize operational improvements that PGW has been able to achieve and the contributions that the top managers had made to them.¹³⁶ Thus, this program is designed to try to hold on to these key employees who helped achieve these successes – so that they can continue to improve operations and benefit customers.¹³⁷ Thus, the program satisfies the Commission's standard for the recognition in rates of management incentive plans, and the modest cost of the program (\$500,000) should have been approved as a *pro forma* operating expense.

10. The RD Erred by Denying PGW's Market Promotion Expenses.

PGW has an ongoing program to provide incentives to customers to assist them in converting from a different fuel source to natural gas, recognizing the initial investment required for such a conversion.¹³⁸ Incentives are provided in the form of discounts to the charges imposed upon the customer for the natural gas service or the delivery service it purchases, and the benefits to PGW and its ratepayers in the past have far exceeded the amount of the incentives used to induce the customer to install natural gas fueled facilities.¹³⁹

¹³⁴ In a different context, the RD recognized that the Commission may not act as a super board of directors and "has no right to manage them." RD at 35.

¹³⁵ *See, e.g., Pa PUC v. Consumers Pennsylvania Water Company Roaring Creek Division*, R-00973869, 1997 Pa PUC LEXIS 93, Oct. 14, 1997.

¹³⁶ PGW St. 11 at 3, 6-7; PGW MB at 60-63.

¹³⁷ *Id.* PGW St. 11 at 1-2; Tr. 780, 793-96; PGW MB at 60-63.

¹³⁸ PGW MB at 71-72.

¹³⁹ *Id.*

The RD erroneously denied all but \$25,000 of these expenses on the ground that the remaining projects for which PGW had budgeted had not come to fruition.¹⁴⁰ But PGW regularly incurs these expenses designed to increase gas sales which, thus, benefits all customers. PGW fully expects that it will incur the claimed level of expense in future years. Thus it was error to deny this expense.

11. The RD Erred in Adjusting PGW's *Pro Forma* Expenses to Remove All Expenses Associated With Lobbying.

The RD recommended removal from *pro forma* expenses \$245,200 in expenses related to various forms of lobbying.¹⁴¹ This determination was error for two reasons.

First, the Commission should waive its general rule on lobbying because of PGW's very different status as a municipal utility. PGW has no shareholders and is owned by the City of Philadelphia – which has not been paid its City fee in years. In turn, the Company is "owned" by the citizens of that City who are essentially the same as PGW's ratepayers.¹⁴² The record shows that its lobbying is focused on issues that benefit customers, such as funding of LIHEAP and other low-income assistance programs, which obviously directly benefit PGW customers.¹⁴³ Accordingly, all of PGW's government relation expense should be included in its *pro forma* expenses.¹⁴⁴

¹⁴⁰ RD at 37.

¹⁴¹ RD at 41.

¹⁴² PGW MB at 65-68; PGW RB at 14-16; Tr. at 505 (Hershey). To the extent that the RD rejected this conclusion, this was based upon an apparent misunderstanding of the way in which the Company functions vis-à-vis its owner, the City of Philadelphia. All funds to operate the Company come either from rates or borrowings – which are paid by ratepayers – or the City, which in turn obtains the funds from its citizens in the form of taxes or other charges. Under such circumstances, there is no difference in the interests of the ratepayers and the owner.

¹⁴³ PGW MB at 67; PGW St. 1R at 6.

¹⁴⁴ *Id.*; PGW St. 2R at 33. To the extent that the Commission believes it is required by statute to remove lobbying expenses from rates (lobbying expenses are generally prohibited from being included in rates pursuant to Section 1316 of the Public Utility Code, 66 Pa. C.S. § 1316), the Public Utility Code authorizes the PUC to "suspend or waive" the application [to PGW] of any provision of this title" 66 Pa. C.S.

Even if the Commission declines to make an overall exception for PGW lobbying expenses, it should recognize that the RD's recommendation is overstated because PGW showed that some \$100,000 of the amount claimed related to non-lobbying government relations activities, such as interacting with the PUC and trade groups on various issues and concerns.¹⁴⁵ The Commission's policy is to permit such government relations expenses, and the RD's refusal to follow the PUC's prior decisions in this regard was clearly erroneous.

12. The RD Erred in Removing An Amount Budgeted For Regulatory Fines From the Company's *Pro Forma* Expenses.

PGW budgeted a small amount (\$50,000) for fines and penalties that may be assessed against the Company in the test year by the PUC for such things as violation of Chapter 56 regulations.¹⁴⁶ The RD accepted the position of the OCA and the OTS that allowing PGW to recover these amounts would "defeat the purpose" of regulatory penalties¹⁴⁷ and that "[r]egulatory fines are ownership expenses."¹⁴⁸

Again, the RD failed to understand that, with PGW, there is no separating between "ownership" and ratepayers. Presently, every dollar that the Company earns – after paying its legitimate expenses – goes back to customers, and every dollar that the Company needs comes from customers. Accordingly, denying the Company inclusion of items like this simply will mean that the cost will have to be recovered from ratepayers at some point in the future – in the

§ 2212(c). To the extent that including lobbying expenses in *pro forma* operating expenses for PGW is deemed generally prohibited by the Code, PGW requests that the Commission waive its application for the reasons stated above.

¹⁴⁵ PGW MB at 66-67; RB at 15. The RD appeared to reject this evidence based upon the OTS refusal to accept PGW's analysis as "not supported." RD at 41. This is untrue. PGW submitted sworn testimony reflecting the results of its analysis that a large portion (\$100,000) of the activities of one of its government relations contractors were devoted to activities that were not lobbying. PGW St. 2R at 32-33. Neither the OTS nor the RD may simply refuse to accept this sworn testimony without articulating some basis for concluding that it is unpersuasive or untrue.

¹⁴⁶ PGW MB at 69-70; RB at 16-17.

¹⁴⁷ RD at 44.

¹⁴⁸ *Id.* at 45.

form of a cash flow allowance or additional borrowing – and may very well cost ratepayers more.¹⁴⁹ Accordingly, it simply does not make sense to blindly apply to PGW's regulatory policy that was formulated for investor-owned public utilities. This expense item should be allowed.

13. The RD Erred in Refusing to Include in *Pro Forma* Expenses An Estimated Amount of Injuries and Damages Expense and Associated Legal Expense.

PGW included an amount for injuries and damages reserve to cover payments that PGW anticipates it will have to make as a result of class action lawsuits (and associated legal expenses).¹⁵⁰ Large class action lawsuits of this nature normally are experienced by companies, and PGW is no exception. During the case, PGW updated its projection of the amount that is likely to be required to be paid out: at least \$1.8 million, as well as \$2 million for injuries, damages and legal fees. In its brief, it proposed to amortize these projected expenditures over five years. Rather than increase its earlier claim, PGW proposed to maintain its test year expense inclusion at \$725,000.¹⁵¹

The RD rejected this claim on the ground that the amounts had yet to be expended.¹⁵² This position is clearly incorrect. PGW's updated evidence provided its best projection of the cost that it would incur for this item. While the resolution of the lawsuit admittedly has not yet occurred, the estimate represents PGW's best projection of what will occur by end of the future test year – which is yet to be completed.¹⁵³ If this amount is not included in *pro forma* test year expenses in this case, the OTS and OCA will surely argue in future cases that an attempt to

¹⁴⁹ PGW RB at 16-17.

¹⁵⁰ PGW MB at 70-71; PGW RB at 13-14; PGW St. 2R at 37.

¹⁵¹ PGW RB at 13-14; PGW St. 2R at 36.

¹⁵² RD at 43.

¹⁵³ PGW MB at 71.

recover the expense is "retroactive ratemaking." PGW's claim was a perfectly legitimate addition to its **future** test year expense projection and should be allowed.

14. The RD Erred in Requiring PGW to establish a "Bad Debt Expense Tracker" for CRP Customers.

The RD recommended that PGW be required to implement a separate mechanism within its Universal Service Charge (USC) to track any change in bad debt expense caused by a net change in CRP participation over the level assumed in the Company's base rate proceeding and the resulting average CRP shortfall (or CRP credits) per participant in PGW's quarterly USC reconciliation.¹⁵⁴ The recommended "Bad Debt Expense Tracker" (or "Tracker") is based upon the OCA's argument that PGW's bad debt expense will be reduced when regular customers move into the CRP program and a portion of their bill will be paid by PGW's non-CRP customer base. The "possibility" that PGW will over collect its bad debt expense, OCA claim, can be alleviated by the Tracker. For a number of reasons, the RD erred in accepting the OCA recommendation.

First, and contrary to the statements in the RD, PGW did address "whether double recovery is or is not possible when participation exceeds projections in CRP" and did show that the Tracker is unreasonable. PGW showed that it is not possible to make a definitive determination of the effect of increased CRP participation on the level of CRP shortfall collected through the Company's base rate allowance for bad debt expense.¹⁵⁵ Moreover, while CRP participation alone will likely reduce bad debt expense if new CRP participants increase on a prospective basis (and, correspondingly, bad debt likely will increase if there is a net drop in CRP customers over the amount assumed when base rates were set), these facts by no means will

¹⁵⁴ RD at 33. The Company's USC is a reconcilable surcharge that recovers the cost of the CRP program, including the CRP shortfall (or discount) and arrearage forgiveness. PGW St. 7 at 4; PGW St. 2R at 29. However, arrearage forgiveness has never been included in PGW's bad debt allowance. PGW St. 2R at 29-31.

¹⁵⁵ PGW St. 2R at 30-31.

automatically result in PGW's overall bad debt expense going down (or increasing). Changes in many factors other than CRP participation levels affect whether PGW collects more or less of its base rate allowance for bad debt expense on an overall basis.¹⁵⁶ The most obvious example is increased gas costs.¹⁵⁷ PGW's base rate allowance for bad debt expense is established on the basis of test year *pro forma* revenues. When revenues increase because, for example, the Company's Gas Cost Rate or its Weather Normalization Clause increases, PGW's bad debt expense also increases, all other things being equal. But PGW doesn't receive any additional bad debt expense allowance as a result. To track a single reason why the Company's bad debt expense might change and ignore all the other things that could impact its expense is illogical and unfair.

The only way the "tracker" could be fair is if it tracked all changes in bad debt expense – but that has been rejected by the PUC and is now barred by statute. The RD's conclusion that the Tracker is not a "cash receipts reconciliation charge or another automatic mechanism for uncollectible expenses" prohibited by the Public Utility Code, Section 1408, but rather is authorized by Section 1408 because it is "associated with" PGW's USC, is simply not correct. The USC itself is the "automatic surcharge for uncollectible expenses" grandfathered by Section 1408.¹⁵⁸ Adoption of the Tracker would sanction a separate automatic uncollectible expense adjustment clause *within* an automatic adjustment clause for recovery of universal service costs,

¹⁵⁶ PGW St. 2R at 23-27.

¹⁵⁷ PGW St. 2R at 27; *Petition of Philadelphia Gas Works to Establish a Cash Receipts Reconciliation Clause*, Docket No. P-00042090 ("*CRRC Petition*"), Order entered July 8, 2004, at 23 ("The OTS reasons that if sales were equal to those used to develop base rates and the experienced write-off percentage was unchanged, but gas costs increased above the base rate levels, the utility would be under-compensated for uncollectible accounts expense, which would negatively affect cash flow. This, OTS says, is due to the fact that the allowance for uncollectible accounts would not change from the ratemaking allowance, even though revenues would be substantially increased.").

¹⁵⁸ PGW RB at 10, n. 21.

which include related uncollectible expenses. Such an interpretation would permit any utility to include even an overall bad debt tracker within its universal service surcharge and thus read the prohibition of an "automatic mechanism for uncollectible expenses" out of Section 1408. This can't be what the General Assembly intended.

The Tracker also violates the prohibition against single issue ratemaking. The Tracker is simply another form of a single factor "cash receipts reconciliation clause" ("CRRC") which PGW had proposed before Section 1408 was enacted, the OCA vehemently opposed, and which the PUC soundly rejected as violating a host of legal rules, including the prohibition against single issue ratemaking.¹⁵⁹ Both of these mechanisms – the CRRC and the OCA-proposed Tracker – would affect, either directly or indirectly, PGW's collection of its overall bad debt expense based upon single factors.¹⁶⁰ This clearly violates the prohibition against single issue ratemaking as the PUC has articulated that rule.¹⁶¹ Adopting the Tracker in a base rate case does

¹⁵⁹ *CRRC Petition*, Order entered July 8, 2004. The CRRC proposed by PGW provided for the recovery of "revenues above PGW's approved uncollectible expense allowance and that have been billed to PGW customers but have not been collected." The CRRC adjustment was based upon increases in projected gas billings and gas receipts. The O'S proposed an alternative mechanism, which was rejected for the same reasons as the CRRC, that would "adjust the allowance for uncollectible accounts expense upward or downward with each change in the Section 1307(f) rate." *CRRC Petition*, Order at 5, 6 (emphasis added). The recommended Tracker would track only net incremental changes in CRP participation and the resulting average CRP shortfall per participant. The USC clause itself avoids this characterization because it is specifically authorized by statute, 66 Pa. C.S. § 2212(h)(2).

¹⁶⁰ The PUC described the CRRC as "a unique method of recovery for expenses normally recovered through base rates" and a departure "from adherence to Pennsylvania ratemaking law and principles." *CRRC Petition*, Order at 8, 10, 11.

¹⁶¹ "Single issue ratemaking is similar to retroactive ratemaking and, in general, is prohibited if it impacts on a matter that is normally considered in a base rate case." *Pennsylvania Industrial Energy Coalition v. Pennsylvania Public Utility Commission*, 653 A.2d 1336, 1350 (Pa. Cmwlth. 1995). This prohibition is based on the rate maker's obligation to consider all of a utility's revenues and costs in the balancing process to achieve just and reasonable rates. *CRRC Petition*, Order at 13 (emphasis added). The clear precedent against such a bad debt tracker is likely why the OCA and its witness insisted in characterizing the tracker as a "CRP shortfall double recovery." OCA MB at 81-85. This was just a way to avoid the fact that it was now arguing for a bad debt tracking mechanism to adjust rates for changes in bad debt expense alone – which was rejected by the PUC previously.

not immunize it from violating the prohibition against single issue ratemaking. All the changes will occur outside the context of a base rate case.

While the RD correctly rejected the one-sided nature of the OCA's proposed Tracker (to reduce, but not increase, collections of bad debt expense resulting from net incremental changes in average CRP shortfall per participant), the RD's "balanced" Tracker nonetheless does not include sufficient balance to overcome the prohibition against single issue ratemaking because the Tracker does *not* include consideration of other factors that will affect PGW's overall bad debt expense.¹⁶²

The Tracker also violates the prohibition against retroactive ratemaking, because it retroactively affects PGW's allowance for bad debt expense based upon subsequent changes in the base rate levels.¹⁶³ The OCA's bad debt tracker for the effects of CRP participation changes is both illegal and a bad idea and should be rejected.

15. The RD's Recommendation On The Classification And Allocation Of PGW's Distribution Mains Is Erroneous And At Odds With The Principles Of Cost Causation.

The Company's cost of service study ("COSS") is a reasonable guide for allocating the base rate increase and should be adopted by the Commission over the recommendation in the RD.¹⁶⁴ The ALJs erroneously criticized the Company's COSS for: (1) allocating a portion of its distribution mains investment as a customer cost; and (2) allocating the demand component of

¹⁶² As the Commission observed in PGW's first base rate case, bad debt expense is a prospective claim established in a rate case based upon historic data. *PaPUC v. PGW*, R-00006042, Order entered October 4, 2001, at 56.

¹⁶³ Ratemaking is prospective in nature. *Columbia Gas of Pennsylvania v. Pennsylvania Public Utility Commission*, 613 A. 2d 74, 76 (Pa.Cmwlth. 1992). The Commission may not establish rates which are calculated to retroactively recover surpluses or refund deficits created by inaccuracies in its prior rate authorizations. *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*, 487 A.2d 118, 121 (Pa.Cmwlth. 1985).

¹⁶⁴ RD at 56-63.

the distribution mains cost on a peak demand basis.¹⁶⁵ Instead, the RD recommends the adoption of the OTS position to allocate 100% of the distribution mains cost on demand basis, utilizing the average and excess ("A&E") demand method.¹⁶⁶ The Commission should decline this recommendation. However, for the benefit of the Commission, PGW has prepared an analysis of the increases and relationship to cost of service produced at various rate increase levels, with the RD's COSS revisions reflected. (See App. A *infra.*)

At the outset, it is important to remember the inherently subjective nature of cost of service studies.¹⁶⁷ Based upon the expert testimony of PGW witness Mr. Gorman, the Company's COSS plainly satisfies the PUC's standard for such studies.¹⁶⁸ In terms of the 25% customer component of the distribution mains cost, Mr. Gorman explained that the number and geographic location of customers being served by the distribution system has a causal relationship with the size, and thus cost, of that system.¹⁶⁹ As such, a customer component is appropriate and the specific allocation proposed based on expert analysis of pertinent data is supported by the record.

While the Commission has certainly accepted different cost of service studies and allocation methodologies, it has also previously accepted a customer component to distribution

¹⁶⁵ RD at 56-58, 60-63.

¹⁶⁶ RD at 63; Ordering ¶ 11.

¹⁶⁷ *Pa PUC v. Duquesne Light Co.*, 51 PUR 4th 198, 252 (1983). As the Commission has explained:

[A] cost of service study is one of the most subjective elements in any rate case. The methods used for classifying items of plant and expense between demand, customer, and energy components are far from being an exact science. Cost of service studies are more accurately characterized as engineering art. . . . This commission has historically recognized the cost of service study for what it is; a useful tool for testing the reasonableness of a proposed allocation of the revenue requirement.

¹⁶⁸ PGW Sts. 8 and 8R.

¹⁶⁹ PGW St. 8R at 8-10.

mains costs (as well as allocating the demand component on a 100% peak demand basis).¹⁷⁰ In *National Fuel*, the Commission rejected arguments by the OCA that track virtually the same positions adopted by the RD here, and found that a customer allocation reflects how distribution main costs are incurred and, thus, is consistent with cost causation.

The Commission's *National Fuel* decision, in accepting a 100% peak demand allocation and rejecting an annual-peak demand split, is also consistent with the cost causation testimony in this case. As Mr. Gorman explained in his expert testimony, the demand related cost of distribution mains are causally related only to the system's peak demand.¹⁷¹ Obviously, as the RD notes, PGW's distribution system is used to deliver gas on a daily basis.¹⁷² But, this annual demand was not a factor in designing the Company's distribution system and thus could not be causally related to the system's cost. Rather, as the Commission noted in *National Fuel* and as Mr. Gorman testified, the cost of a distribution system depends on the length and diameter of its pipe, and those determinants are designed based on (and the cost of the system is thus causally related to) the length and diameter necessary to meet the system's peak demand requirements.¹⁷³ For all of these reasons, the RD is in error on this issue, and the Commission should accept the Company's COSS for purposes of allocating the rate increase.

¹⁷⁰ *Pa. P.U.C. v. National Fuel Gas Distribution Corporation*, 1982 Pa. PUC LEXIS 132, **61-62 ("*National Fuel*").

¹⁷¹ PGW St. 8R at 15-20.

¹⁷² RD at 62-63 (citing to arguments of OCA and OTS).

¹⁷³ PGW St. 8R at 17, 19; 1982 Pa. PUC LEXIS 132, *62. Additionally, specific to OTS, Mr. Gorman explained how the A&E method it advocates, when properly applied in accordance with the *Gas Rate Fundamentals* guidebook, does not use a 50/50 weighting, but rather produces a result that is equal to the peak demand method used in PGW's COSS. PGW St. 8R at 20.

Contrary to the apparent conclusion in the RD, the ALJs' invocation of the Commission's decision in *PPL Gas*¹⁷⁴ does not require a different result.¹⁷⁵ In *PPL Gas*, PPL proposed a distribution mains allocation that was 100% demand based, using a 40%-60% A&E method allocation.¹⁷⁶ The OSBA advocated for a 28% customer cost allocation, with the 72% demand based cost being allocated on a peak demand basis.¹⁷⁷ ALJ Jones recommended that PPL's allocation be accepted and the Commission adopted the recommendation.¹⁷⁸ However, the Commission did not engage in a thorough analysis of these issues as the parties did not file exceptions to the recommended decision, and the Commission simply adopted the ALJs' decision with virtually no discussion.¹⁷⁹

Ultimately, as characterized by the Commission, the recommended decision it adopted in *PPL Gas* was fact specific to that case.¹⁸⁰ As detailed above, PGW's proposals are supported by expert testimony and do not have such record-based problems. Accordingly, the *PPL Gas* decision is fully distinguished and is not controlling. The Commission should accept PGW's cost of service study as a reasonable means by which to determine how to allocate the authorized increase in this case.

16. The RD Erred By Not Adopting The Company's Revenue Allocation, Which Is Reasonable And Makes Progress Toward Unity With Each Customer Class's Cost Of Service.

¹⁷⁴ *PaPUC v. PPL Gas Utilities Corporation* Docket No. R-00061398, February 8, 2007, at 111-114.

¹⁷⁵ RD at 57. The RD is unclear as to whether the assertion that *PPL Gas* cannot be distinguished from the present case is simply a reiteration of the OTS position in this matter, or whether it is the conclusion of the ALJs.

¹⁷⁶ *PPL Gas* at 111, 113.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at 112, 114.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

The RD erroneously endorsed the revenue allocation proposal advocated by the OSBA, as modified to incorporate the first dollar relief proposal of the OTS.¹⁸¹ Attached hereto as Appendix A is an allocation of the recommended \$25 million base rate increase which also shows the relative rate of return and the "progress towards unity" that occurs when PGW's original COSS is adjusted to reflect the RD's recommendations regarding allocation of distribution mains. On Appendix A, the same data is shown for other levels of rate increase.

Nonetheless, the Commission should not accept the recommended revenue allocation, and instead should adopt the Company's proposal which is reasonable and affords an appropriate – not excessive – level of deference to the principle of gradualism in moving each customer class toward unity with its cost of service.¹⁸² The record evidence demonstrates that, at a \$100 million increase and PGW's COSS, the relative rate of return for all customer classes will move closer to unity with the system average rate of return under the Company's proposed rates as compared to its present rates.¹⁸³ The Residential Class's relative rate of return increases toward cost by 6% and the rates of return for all other classes decrease toward cost by the substantial range of 26-62%.¹⁸⁴ In Appendix A, PGW shows the results for various customer class groupings if the Commission authorizes a rate increase greater than \$25 million. As the summary chart indicates, if the RD's allocation is adopted, the Residential Class revenue-cost relationship will move from

¹⁸¹ RD at 72-73.

¹⁸² PGW Sts. 8 and 8R; OCA MB at 63-79. Contrary to the assertion of the parties below, PGW's proposed revenue allocation is not precluded by *Lloyd v. Pa. Public Utility Com'n*, 904 A.2d 1010 (Pa.Cmwlth. 2006). The real error recognized in *Lloyd* is not adherence to gradualism, but the court's perception that the Commission had allowed it to "trump" all other ratemaking concerns. *Id.* at 1020. This occurred because the approved revenue allocation showed *no progress* toward closing the gap between the subsidizing classes' rate of return and their cost of service. *Id.* The same simply cannot be said in this case.

¹⁸³ PGW St. 8R at 5; PGW Exh. HSG-7C Revised (Mar. 30); OCA MB at 72-73 (citing Exh. 11Ec-4, Table 4-B).

¹⁸⁴ *Id.*

between 59% and 98% (of the way) towards unity in this single case. This demonstrates that if the RD's cost of service study adjustments are made, PGW's rate increase proposal would appear to be more consistent with a gradual movement to cost for residential ratepayers. It also produces relatively modest rate increases (3%, 5%, 7% and 10% at \$25 million, \$50 million, \$75 million and \$100 million increase levels).¹⁸⁵ If the RD's COSS results are adopted, PGW's proposed allocations are even more reasonable.

17. The RD's Recommendation Of A Dramatic Cut In PGW's Interruptible Transportation Rates And Subsequent Shift In Costs To Its Firm Customers Should Be Rejected.

The RD urges the Commission to impose dramatic cuts in PGW's Interruptible Transportation ("IT") rates by moving from the Company's individually negotiated, alternative fuel-based margin rates to so-called "cost-based" rates.¹⁸⁶ Initially, it is important to understand that as a result of this decision, existing interruptible transportation customers with alternative fuel capability will pay less than their alternative market price and all other ratepayers, chiefly residential customers, will be forced to pay between \$1.2-\$2 million more overall.¹⁸⁷ PGW's present market-based rates have a ceiling or "maximum rate" and permit each IT customer to negotiate a rate based upon that customer's own price of alternative fuel and individual competitive alternatives. It is in PGW's interest to agree to a rate that induces the customer to use natural gas as their fuel source. At the same time, by negotiating a rate in relation to the customer's alternative price of energy, the Company maximizes the contribution that these

¹⁸⁵ PGW MB, Appendix A.

¹⁸⁶ RD at 81-82. For the GTS rate, which is comprised of grandfathered, legacy IT contracts, the RD would actually require a rate increase. *See*, Appendix B *infra*. It is not clear whether the RD intended this result. PGW did not propose increasing these rates because they are grandfathered and because they were established via long term contracts.

¹⁸⁷ The range depends upon the COSS elements ultimately approved by the Commission. *See*, App. A hereto.

customers make to keep firm customer rates lower. This result is a "win-win" as the IT customer either accepts the negotiated competitive rate or it can utilize its alternative energy source.

The RD ordered an end to this "win-win" approach first because they believed that PGW had been ordered to "propose cost based IT rates in this proceeding, [and] PGW did not comply with that Order."¹⁸⁸ This is simply not correct. In PGW's Restructuring Proceeding, the Commission directed PGW to "develop cost based IT rates for our consideration in its next base rate filing."¹⁸⁹ Indeed, PGW did exactly what the PUC ordered, developing cost based IT rates for consideration by all the parties. The unit cost-based rate for various categories of IT service is reflected in PGW Exhibit HSG-8.¹⁹⁰ PGW did not recommend that the Commission adopt the calculated unit costs at the rate, but it is wrong to suggest that the Company did not comply with the Commission's directive and present the rates for the Commission's "consideration."

Additionally, from a macro or policy level, this recommendation should be rejected for at least three reasons. First, the record is completely devoid of any evidence that such a change is needed to open PGW's system to interruptible transportation or that the Company is not negotiating reasonable rates based on its current margin-based maximum rates.¹⁹¹ In fact, the record shows just the opposite – the amount of throughput delivered via IT service has increased by 10 times since 2002;¹⁹² there is a record of IT customers successfully transporting on PGW's system at reasonable IT rates negotiated with the Company;¹⁹³ and a record that includes

¹⁸⁸ RD at 82.

¹⁸⁹ *PGW Restructuring Proceeding Order* (M-00021612) at 31.

¹⁹⁰ A revised version of HSG-8 was submitted by Mr. Gorman along with PGW's rebuttal testimony. A copy of that exhibit – Revised Exh. HSG-8 – is attached as an Appendix B to these Exceptions. PICGUG never requested any further detailed information other than what was provided in HSG-8.

¹⁹¹ PGW St. 5R at 2-5.

¹⁹² PGW St. 5R at 5.

¹⁹³ PGW St. 5R at 2.

PICGUG's own members, as evidenced by the multi-year agreement negotiated with Jefferson Health System that it admits affords reasonable rates.¹⁹⁴

Second, PGW's current rates promote a "win-win" rate which saves the IT customer money in comparison to the amounts the customer would have to pay if it used an alternative fuel and also benefits PGW's firm customers by maximizing the contribution to fixed costs provided by the sale.¹⁹⁵ Contrary to the suggestion in the RD and the unfounded claims of PICGUG, this fact provides the Company with a considerable incentive to negotiate reasonable IT rates with dual fuel customers.¹⁹⁶ Moreover, the use of the customer's "opportunity cost" vis-à-vis the cost of alternative fuel is a market-driven basis on which to establish rates that are just and reasonable and compliant with the Public Utility Code, the Commission's regulations and prior decisions on this subject.¹⁹⁷ Indeed, today PGW could justify higher maximum rates, based upon the alternative cost of fuel (less gas costs) which is how PGW's maximum rates were originally established.¹⁹⁸

¹⁹⁴ PGW St. 5R at 2-4; PICGUG St. 1 at 4. The ALJs appear to lend credence to PICGUG's allegations that PGW would not negotiate a reasonable rate with the Philadelphia College of Osteopathic Medicine ("PCOM"). RD at 82. Erroneously, while citing PICGUG's disputed claims regarding the incomplete PCOM negotiations, the ALJs completely ignore PICGUG's admission that PGW fairly negotiated a reasonable rate with JHS. Ultimately, the record revealed PICGUG's allegations regarding PCOM to be meritless. Tr. 622-24, 638; PGW RB at 86-87.

¹⁹⁵ PGW St. 5R at 5.

¹⁹⁶ *Id.*

¹⁹⁷ PICGUG claimed below that the Commission's "goal in setting any transportation rate is to recover only the fixed costs associated with the service," citing Section 60.2(6) of the regulations. PICGUG MB at 13. However, this claim is overbroad. Section 60.2 sets forth numerous objectives for a utility's transportation program, and subsection (6) merely states that an IT contract shall impose rates that "shall recover, to the maximum extent possible, the fixed costs associated with the service." 52 Pa. Code § 60.2(6). Nowhere does the term "only" appear in the regulation, as suggested by PICGUG, and the subsection – which deals with the customer-specific IT contract – suggests a floor, not a ceiling, for the rate.

¹⁹⁸ PGW St. 5R at 6; Exh. CW-8. This exhibit shows that, in 2007, even at PGW's current maximum rates, a customer's cost of transportation and natural gas supply is less than the alternative cost of fuel, by an average of \$3.00/Dth.

Third, such a seismic change in PGW's IT rates, which currently provide a positive margin in relation to the cost of service, would violate the approved theory of gradualism and will have a negative impact on the rates paid by firm customers.¹⁹⁹ The Company's revenue requirement will remain as ordered, and thus if the ALJs' recommended IT rate cut is adopted, the rates charged to PGW's firm customers (overwhelmingly residential) will have to increase to make up the difference. Such a result will obviously harm the residential and firm customers, as well as the Company, and is contrary to a general precept behind the Commission's transportation regulations: "Transportation service should be provided under terms, conditions and rates which minimize the shifting of costs to retail customers" ²⁰⁰

Finally, nothing about the decision in *Lloyd v. Pa. Public Utility Com'n*²⁰¹ requires a different result. Beyond the fact that *Lloyd* specifically dealt with revenue allocation, the court in *Lloyd* did not hold that every rate must be cost-based and that no other ratemaking concerns or principles may be considered by the Commission. Rather, the court expressly repeated its past precedent that "while cost to serve is important, other relevant factors may also be considered."²⁰² The Commission should consider such factors and approve PGW's proposed IT rates.

18. The RD Erred By Ordering PGW To Review Old School District Contracts for Compliance With Subsequent Tariff Provisions.

¹⁹⁹ PGW St. 5R at 9-10.

²⁰⁰ 52 Pa. Code § 60.1 (emphasis added).

²⁰¹ 904 A.2d 1010 (Pa.Cmwlth. 2006).

²⁰² *Id.* at 1016 (emphasis added).

PGW takes exception to the recommendation that, with regard to facilities contracted for in the 1990s, it must review its records in order to determine if a refund is due to the School District of Philadelphia (“SDP”) in compliance with PGW’s gas service tariff Section 10.6.²⁰³

These contracted 1990s facilities are SDP properties that were the subject of a dispute between PGW and the SDP in which the SDP did not fully fulfill its contractual obligations to PGW, especially with respect to exclusive gas usage requirements and volumetric minimums.²⁰⁴ The dispute began when PGW incurred capital costs for mains and services that PGW installed in order to connect the SDP facilities to PGW’s distribution system.²⁰⁵ In most cases, PGW did not charge the SDP for these capital costs because the SDP contractually committed to usage volumes that justified PGW’s capital contribution.²⁰⁶ However, in 1997 or 1998, PGW discovered that the SDP violated certain of its contracts for the 1990s facilities by failing to use the contracted volumes and/or, in some cases, using fuel oil in violation of exclusive use covenants.²⁰⁷ (Indeed, the dispute first surfaced when an RFP soliciting oil for certain of the 80 facilities that were to have been exclusively gas-consuming was issued on behalf of the SDP.) As a result of the SDP’s failures to honor its contracts, PGW did not recover all of its capital costs and PGW informed the SDP that it was liable for the unrecovered capital costs.²⁰⁸ The SDP objected to PGW’s findings and the dispute was never resolved after the parties attempted to do so in the late 1990s.²⁰⁹ Now, within the context of this proceeding, the SDP incorrectly

²⁰³ RD at 130-131.

²⁰⁴ PGW St. 5R at 23; Tr. at 686-7.

²⁰⁵ *Id.*

²⁰⁶ Tr. at 686-7.

²⁰⁷ Tr. at 677 and 686.

²⁰⁸ *See*, Tr. at 687.

²⁰⁹ *Id.*

created a new claim based on PGW tariff Section 10.6. However, Section 10.6 was not included in PGW's gas service tariff until September 1, 2003,²¹⁰ years after the disputes arose and five to six years after the parties last tried to resolve their differences. At the time of the 1990s contracts, PGW's gas service tariff did not contain any wording similar to the current Section 10.6.²¹¹ Thus, attempting to apply the provisions of this recent tariff provision to contracts and contractual disputes that go back between one and two decades is clearly wrong.

Alternatively, even if capital contributions made by customers prior to September 1, 2003 were viewed as somehow subject to the provisions of tariff Section 10.6, the SDP has no valid claim under the tariff. Pursuant to Section 10.6, a written request for a refund by a Customer or developer must be received by PGW no later than the end of the fourth year following the date of the original agreement for new Gas Service for situations in which: (1) the Customer paid for capital costs in order to connect the Customer to PGW's distribution system (i.e. line extensions comprised of mains and services); and (2) new Customer(s) with additional loads are added to the same line extension.²¹² In fact, the SDP made its "claim" for the first time in the testimony it submitted here. All "contracted 1990s facilities" date back to approximately 80 distinct original agreements that originated before 1997 or 1998 (when the dispute began).²¹³ Because no claim under this section was ever made, PGW has not maintained any of the load data or other

²¹⁰ PGW Gas Tariff – Pa. P.U.C. No. 2, Original Pa. No. 51, Issued August 29, 2003, Effective September 1, 2003.

²¹¹ PGW Gas Tariff – Pa. P.U.C. No. 1, Original Pg. No. 69, Issued July 3, 2000, Effective July 3, 2000 at www.pgworks.com/documents/PGW_Filed_Tariff_7-17-03.pdf. Tariff No. 1 is PGW's original tariff issued at the time PGW first came under the jurisdiction of this Commission. PGW Gas Tariff – Pa. P.U.C. No. 1, Original Pg. No. 69 shows that neither Section 10.6 nor any tariff provision similar to Section 10.6 existed in PGW's original Pa. P.U.C. tariff. Section 10.6 was not effective until September 1, 2003 – the effective date of PGW Gas Tariff – Pa. P.U.C. No. 2.

²¹² PGW Gas Tariff – Pa. P.U.C. No. 2, Original Pa. No. 51, Issued August 29, 2003, Effective September 1, 2003.

²¹³ Tr. at 677, 686.

information that would be needed to calculate any allowances under this tariff section. Thus, at this point, resolution of the SDP's claim under Section 10.6 – even if this section were applicable – will be impossible due to the lateness of the claim. Moreover, as stated above, the SDP has not provided evidence that it made any capital contribution with respect to the facilities. Therefore, the ALJs recommendation in this regard should not be accepted.

19. The RD's Recommendations With Respect to PGW's Proposed Tariff Revisions Should Be Adopted, With One Exception.

As part of this proceeding, PGW presented a streamlined tariff designed to remove extraneous and redundant rules and language while not changing or altering any rights otherwise granted by law or PUC regulation.²¹⁴ Only Action Alliance raised any concerns regarding the proposed tariff. Of the six proposed changes still in dispute between PGW and Action Alliance at the time of the RD,²¹⁵ the RD rejected PGW's position on three on them: (1) including "company policy" in definition of applicable law;²¹⁶ (2) adding language in Section 8.3.B. that PGW has "sole discretion" to determine whether "satisfactory assurance" has been given that the customer will not present a safety risk;²¹⁷ and (3) eliminating Section 8.3.D which protects persons tangentially associated with unauthorized users of gas service from being denied gas service.²¹⁸ As indicated throughout this case, all of PGW's proposed tariff revisions were intended to clarify the applicable standards, conform to existing law and create a tariff more in

²¹⁴ PGW MB at 98-99.

²¹⁵ Prior to submitting briefs, PGW had already agreed with Action Alliance's seventh tariff recommendation that the references to USTRA in the leased premises sections of the tariff be replaced with reference to 66 Pa. C.S. § 1521. PGW St. 6R at 18.

²¹⁶ RD at 84.

²¹⁷ RD at 85-87.

²¹⁸ RD at 89-90.

line with the format used by most other regulated utilities.²¹⁹ To the extent that the Commission agrees with the RD that the inclusion of "company policy" and "sole discretion" in PGW's tariff create more confusion, PGW is willing to accept the RD's recommendation on these issues.

However, PGW excepts to the RD's recommendation that PGW be required to maintain Section 8.3.D of its tariff based on the reasoning that removing it will "eliminate the protection" afforded to those who are not responsible for damage to, or unauthorized usage of, gas service.²²⁰ This is simply not true. PGW has been clear that its tariff revisions are not intended to remove any protections to which its customers are entitled and to assume otherwise is unreasonable. Further, to accept the RD's position is to assume that PGW intends to hold non-responsible persons liable for the misdeeds of associates. The record in this matter does not support the need for the Commission to take such a position with respect to PGW and, therefore, the ALJs' recommendation on this issue should be rejected.

20. The RD Incorrectly Found that PGW was Providing Inadequate Service Based on an Alleged Violation of the CAP Policy Statement.

After wading through the plethora of assertions made by Action Alliance attempting to show that PGW provides "inadequate service" necessary to justify the rejection of its rate increase request pursuant to 66 Pa. C.S. § 526(b), the RD properly found that PGW had not violated any statute, regulation or Commission order.²²¹ The only issue which "troubled" the ALJs was Action Alliance's allegation that PGW "violated" Section 69.265(6)(1) of the Commission's CAP Policy Statement²²² by allegedly not making CRP referrals "automatic" for low income customers when they call PGW for payment arrangements.

²¹⁹ PGW RB at 91.

²²⁰ RD at 89.

²²¹ RD at 109-116.

²²² RD at 107-109.

PGW excepts to the conclusion for a number of reasons. First, Section 69.265(b)(i) is a policy statement which, according to the Commission, is intended to "encourage" the implementation of CAPs and to provide "guidelines for those who voluntarily implement CAPs."²²³ Guidelines, by definition, are not mandatory requirements but rather suggested courses of action. Second, a policy statement does not establish a binding norm but "announces the agency's tentative future intentions, and provides the agency with the flexibility to follow the announced policy or modify it if the circumstances are appropriate."²²⁴ Therefore, holding a utility rigidly responsible for complying with a matter that the agency has indicated it wants flexibility to address is inappropriate. Third, the text of Section 69.265(b)(i) shows the Commission's intent to grant a utility flexibility by stating that "[t]he utility *should* make automatic referrals to CAP when a low-income customer calls to make payment arrangements."²²⁵

Finally, the ALJs' evidentiary conclusion that nothing in the record demonstrates that PGW gives "priority to making automatic referrals" to eligible customers is inaccurate.²²⁶ PGW Witness Gyory testified that when a low-income customer calls PGW for a payment arrangement, the customer service representative ("CSR") will initially establish income and occupancy. Once the CSR determines that the customer is qualified for CRP, then the CSR will seek from the customer the information necessary to register for the CRP program.²²⁷ As the evidentiary record shows, PGW is acting in a reasonable manner to "automatically" enroll

²²³ *Customer Assistance Program*, Docket No. M-991232, 29 Pa.B. 2495 (May 8, 1999).

²²⁴ *The Mid-Atlantic Power Supply Association v. Pennsylvania Public Utility Commission*, 746 A.2d 1196, 1201 (Pa.Cmwlth. 2000).

²²⁵ 52 Pa. Code § 69.265(b)(i) (emphasis added).

²²⁶ RD at 107.

²²⁷ Tr. 961-962.

eligible customers in CRP when they inquire about payment arrangement – once the CSR obtains information that justifies such a referral. For all of these reasons, the ALJs' recommendation that PGW has violated 52 Pa. Code 69.265(6)(1) must be rejected.

21. The RD Erred by Ordering PGW to Implement Immediately its Planned Late Payer Deposit/EFT Program.

OCA had proposed that delinquent customers with an income level at or above 250% of the FPL be automatically placed on an Electronic Funds Transfer ("EFT") arrangement to pay their arrearage. PGW opposed an automatic EFT program and ultimately gained OCA's support for a late payer deposit/Electric Funds Transfer ("LPD/EFT") program as an alternative. The LPD/EFT program will offer to selected customers, who otherwise would be asked to provide a deposit because he/she had been delinquent in paying PGW's bill, the alternative of paying their bills via EFT.²²⁸ While the RD recognized the reasonableness of this approach, it incorrectly stated that "there are no explicit timeframes for implementing and reporting analysis of the program contained in the record."²²⁹ Based on this finding, the RD recommended that PGW begin the LPD/EFT program "no later than a week after the Commission Order is entered in this matter" and that, within six months, PGW submit a report and analysis of its experience with the program.²³⁰

PGW excepts to this time requirement. As the record shows, the earliest possible timeframe PGW will be able to implement the LPD/EFT program is some time after January 1, 2008.²³¹ As PGW Witness Gyory explained, successful implementation of the LPD/EFT program requires PGW to identify the appropriate customers for inclusion in the program.

²²⁸ PGW MB at 92-93.

²²⁹ RD at 122.

²³⁰ RD at 122.

²³¹ Tr. 875-976.

Otherwise, PGW would be forced to rely on some overly broad criteria that could result in enrolling customers in the program who would not benefit from the EFT opportunity. This would result in unnecessary administrative burdens and costs.²³² Currently, PGW is not able to identify the specific customers who would benefit from enrollment in the LPD/EFT program. However, PGW is in the process of gathering this information. As explained by Mr. Gyory, PGW is in the process of awarding a contract to a vendor who will develop the analytical collection tool necessary to assess PGW's customer base and identify the customers most appropriate to include in the LPD/EFT. Once PGW has a better understanding of the customers who may benefit from this program, it can tailor the program as appropriate to ensure that it is implemented in the most effective manner.²³³

PGW is committed to moving forward with the LPD/EFT program and to working with OCA on these issues to ensure the most effective, cost-efficient implementation possible, but PGW cannot implement the program in the timeframe suggested by the RD.²³⁴ Upon further review of this program, PGW has concluded that the earliest it can commit to implementation is March 31, 2008. To require implementation of the LPD/EFT program any sooner would create a whole host of logistical and administrative problems that could be avoided entirely with a more reasonable timeframe. Therefore, PGW respectfully requests that the Commission reject the ALJs recommendation on this issue.

²³² As an example, Mr. Gyory testified that using an arbitrary criteria such as people failing to pay two consecutive bills could result in many customers who would not benefit from the LPD/EFT because they do not have an established checking account. Tr. 968.

²³³ Tr. 968-969.

²³⁴ PGW RB at 69.

CONCLUSION

PGW respectfully requests that the ALJs' Recommended Decision be revised in accordance with these Exceptions.

Respectfully submitted,



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Of Counsel:

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Date: August 20, 2007

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APPENDIX A

1. 2007 AUG 20

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Calculated Revenue/Cost Relationships & Percent Increases

Increase in Residential		Residential Rates of Return		Residential Relative Rates of Return		Residential Progress Toward Unity		Residential Increase % Total Bill		GTS	IT	Total GTS / IT	
Total Increase	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	Over (Under) Collection		
25,000	24,359	19,623	6.6%	7.0%	0.88	0.85	59%	21%	3%	3%	(2,437)	2,091	(346)
50,000	47,103	37,287	8.7%	8.6%	0.93	0.86	77%	26%	6%	5%	(2,973)	1,837	(1,136)
70,000	65,298	51,414	10.3%	9.9%	0.96	0.78	87%	18%	9%	7%	(3,402)	1,634	(1,768)
100,000	92,591	72,608	12.8%	11.8%	0.99	0.78	98%	20%	12%	10%	(4,045)	1,329	(2,716)
Increase in Commercial		Commercial Rates of Return		Commercial Relative Rates of Return		Commercial Progress Toward Unity		Commercial Increase % Total Bill					
Total Increase	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation			
25,000	0	4,344	10.9%	13.7%	1.43	1.65	63%	14%	0%	2%			
50,000	1,805	10,069	11.8%	16.6%	1.26	1.65	78%	14%	1%	5%			
70,000	3,249	14,649	12.5%	18.9%	1.16	1.49	86%	17%	2%	8%			
100,000	5,416	21,518	13.6%	22.4%	1.06	1.49	95%	17%	3%	11%			
Increase in Industrial		Industrial Rates of Return		Industrial Relative Rates of Return		Industrial Progress Toward Unity		Industrial Increase % Total Bill					
Total Increase	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation			
25,000	0	253	12.9%	14.5%	1.70	1.75	53%	25%	0%	1%			
50,000	141	790	13.7%	17.6%	1.47	1.75	69%	25%	1%	4%			
70,000	254	1,220	14.4%	20.1%	1.33	1.58	78%	28%	1%	6%			
100,000	423	1,865	15.3%	23.8%	1.19	1.58	87%	28%	2%	9%			
Increase in Municipal		Municipal Rates of Return		Municipal Relative Rates of Return		Municipal Progress Toward Unity		Municipal Increase % Total Bill					
Total Increase	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation	RecDec Allocation	PGW Allocation			
25,000	579	413	11.9%	11.5%	1.58	1.38	9%	17%	3%	2%			
50,000	766	932	12.8%	14.0%	1.37	1.38	41%	17%	4%	4%			
70,000	914	1,346	13.5%	15.9%	1.26	1.25	60%	22%	4%	6%			
100,000	1,138	1,968	14.6%	18.9%	1.13	1.25	79%	22%	5%	9%			

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NOTE: Based on COS studies that classify / allocate Mains using Average and Excess method in accordance with Recommended Decision.

Total Bill Present Rates

Residential	751,246
Commercial	187,837
Industrial	19,825
Municipal	21,416
Total	1,044,127

APPENDIX B

SECRET
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1 Philadelphia Gas Works
 2 Class COS Study - 2006- REVISED (Mar30)
 3 Future Test Year Ended August 31, 2007 (\$000s)
 4 Interruptible Transportation Cost of Service Analysis
 5

REVISED (Mar30)
 Exhibit HSG-8
 Page 1 of 1

	Source	GTS	IT-3	IT-5/ IT-6 / IT-8	Others	Total	
6 Sales, Revenue and Customer Data							
8	Thruput mcf	Company provided	9,065,383	1,431,189	2,716,315	110,401	13,323,287
9	Revenue	Company provided	2,224	2,524	2,317	191	7,256
10	Meters	Company provided	8	86	55	14	163
11 Unit Margins							
13	Average rate per mcf Thruput	Line 9 / Line 8	\$ 0.2454	\$ 1.7633	\$ 0.8530	\$ 1.7268	\$ 0.5446
14	Unit Costs per mcf	Line 42 / Line 8	\$ 0.4042	\$ 0.7190	\$ 0.4361	\$ 1.1928	\$ 0.4511
15	Unit Margin (Loss) per mcf		\$ (0.1589)	\$ 1.0443	\$ 0.4169	\$ 0.5340	\$ 0.0935
16	Total Margin (Loss)		(1,440)	1,495	1,132	59	1,246
17	Margin		(65%)	59%	49%	31%	17%
19 Allocation of Rate Base and Revenue Requirement							
20 Allocation Basis							
21 Rate Base:							
22	Mains- Direct Assignment, net	Direct	2,861				2,861
24	Mains- Customer Component, net	Meters	149	1,605	1,027	261	3,042
25	Mains- Demand Component, net	Thruput	6,210	980	1,861	76	9,127
26	Services and Meters, net	Meters	72	775	496	126	1,469
27	Rate Base excluding Direct		6,432	3,361	3,383	463	13,639
29	Balance of Rate Base	Rate Base excl. Direct	598	313	315	43	1,269
30	Total Rate Base		9,892	3,674	3,698	506	17,769
32 Revenue Requirement:							
33	Depreciation expense- Direct	Direct	589				589
34	Depreciation expense- Other	Rate Base excl. Direct	359	188	189	26	762
36	Demand-related operating expenses	Thruput	1,141	180	342	14	1,676
37	Customer-related operating expenses	Meters	11	114	73	19	215
38	Operating costs		1,151	294	414	32	1,892
40	Administrative & General expenses	Operating Costs	290	74	104	8	477
41	Interest and Surplus; Rate increase	Rate Base	1,275	474	477	65	2,290
42	Total Revenue Requirement		3,665	1,029	1,185	132	6,010
44 Allocation Bases							
45	Thruput mcf %	Line 8	68.04%	10.74%	20.39%	0.83%	100.00%
46	Meters %	Line 10	4.91%	52.76%	33.74%	8.59%	100.00%
47	Rate Base excluding Direct %	Line 27	47.16%	24.64%	24.81%	3.40%	100.00%
48	Total Rate Base %	Line 30	55.67%	20.67%	20.81%	2.85%	100.00%
49	Operating Costs	Line 38	60.85%	15.53%	21.91%	1.71%	100.00%

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 SECTION 5 BUREAU

ORIGINAL



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August 22, 2007

2007 AUG 22 PM 3:59
SECRETARY OF PUBLIC UTILITY

James J. McNulty
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265

RE: Pennsylvania Public Utility Commission
v.
Philadelphia Gas Works
Docket No. R-00061931

Dear Secretary McNulty:

The Office of Consumer Advocate (OCA) issues this letter to address a possible misunderstanding that could occur as to the OCA's Exceptions, filed in this docket on August 20, 2007. It has come to the OCA's attention, after reading the Company's Exceptions, that the Administrative Law Judges' (ALJs) determination of the appropriate Cost of Service Study (COSS) for use in this proceeding could be subject to differing interpretations. The OCA's Exceptions, and position on this issue, reflect the ALJs' discussion on page 63 of the Recommended Decision (R.D.), wherein the ALJs stated:

PGW's proposal to allocate 75% of the costs of distribution mains investment based on purely peak demands should be rejected. Mr. Galligan's Peak and Average COSS accurately allocates such costs based on the way PGW actually incurs costs to serve its customers, as the principle of cost-causality requires.

R.D. at 63. The Company focused on the ALJs' proposed ordering paragraph 11, which provides:

11. That the Company's revised unbundled cost of service study as modified by the Office of Trial Staff's distribution mains is adopted.

R.D. at 135.

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Page 2

The discussion herein is presented to clarify the source of any possible misunderstanding, and does not change the OCA's position as stated in its Exceptions.

The OCA apologizes for any confusion that this issue might have generated.

Sincerely,



Darryl A. Lawrence
Assistant Consumer Advocate
PA Attorney I.D. # 93682

Enclosures

cc: Hon. Cynthia W. Fordham, ALJ
Hon. Angela T. Jones, ALJ
Office of Special Assistants

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CERTIFICATE OF SERVICE

Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-00061931
 :
 Philadelphia Gas Works :

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

Dated this 22nd day of August 2007.

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2007/08/22 PM 3:59
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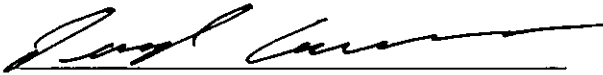
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THE SCHOOL DISTRICT OF PHILADELPHIA
SCHOOL REFORM COMMISSION
440 N. BROAD STREET, SUITE 313
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August 29, 2007

Via UPS

DOCUMENT
FOLDER

Pennsylvania Public Utility Commission
Secretary's Bureau
Commonwealth Keystone Building
2nd Floor, Room N-201
400 North Street
Harrisburg, PA 17120-3265

Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00061931

Dear Secretary:

I represent The School District of Philadelphia, Intervenor. Enclosed for filing are the original and nine copies of the Reply of The School District to Exceptions of Philadelphia Gas Works with Certificate of Service. Kindly time-stamp the enclosed extra copy and return it to me in the enclosed envelope.

Thank you very much.

KJR

Very truly yours,

Miles H. Shore

Miles H. Shore
Assistant General Counsel

MHS/jmc
Enclosures

cc: Administrative Law Judges
Service List of Active Parties

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AUG 29 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

411

INTRODUCTION

The School District of Philadelphia (the “School District”) submits this reply to Exception No. 18 filed by the Philadelphia Gas Works (“PGW”),¹ in which PGW takes exception to the Recommended Decision requiring PGW to perform an accounting for any capital contribution refunds due the School District for certain School District accounts for which service contracts were entered into during the 1990s. For such contracts, the ALJs found that “the School District provided substantial evidence to support that PGW should be directed to comply with its tariff section 10.6, both subparts 10.6(a) and 10.6(b)” and “recommend that PGW review its records to determine if a refund is due the [School District] within 30 days of the date a final Order is entered in this matter . . . and comply with 10.6(b) within 120 days of the date of a final Order is entered in this matter.”² For the reasons stated below, the Commission should deny PGW’s exception and adopt the ALJs’ recommendation.³

ARGUMENT

The record clearly establishes that: (a) the School District and PGW have been in a decade-long, unresolved dispute over certain, primarily dual-fuel accounts for which the School District may or may not have met its contractually-based gas volume obligations for service extensions installed in the 1990s;⁴ and (b) PGW has moved seven School District accounts to rate classes with greater delivery charges and also subjected any and all subsequent, new service extensions requested by the School District to a

¹ PGW Exceptions, at 51-54.

² RD at 130-131.

³ RD at 125-131.

⁴ RD at 125-126. As the ALJs have properly identified, the number of contracts in dispute is unresolved (RD at 125, fn 55), notwithstanding PGW’s continuing claim that 80 of such contracts are in dispute. PGW Exceptions, at 53.

policy of up-front capital contributions as a result of the dispute over these earlier accounts.⁵ However, PGW has stated that it is willing to provide the School District with any capital contribution refunds to which it may be entitled pursuant to Section 10 of the Tariff if and when the School District meets its contractual volume commitments.⁶

The School District submits that the ALJs' recommendation is a reasonable step toward resolving the long-standing dispute between the School District and PGW gas volume usage at the accounts established in the 1990's and, thus, will serve as a basis to determine whether the School District is entitled to refunds for any of those prior accounts as well as subsequent accounts under Section 10 of the Tariff. As the School District stated in its Main Brief, it is well time for PGW to stop holding all School District accounts "hostage" with respect to any refunds that may be due under Section 10 because of the ongoing, unresolved dispute over gas usage at accounts for which contracts were entered into during the 1990s.⁷

PGW supports its exception by claiming the School District has "created a new claim based on PGW tariff Section 10.6," which PGW states, for the first in this proceeding,⁸ that the provisions in that Section did not exist at the time the disputed contracts were entered into, thus should not apply to such contracts.⁹ This argument should be rejected. It is PGW itself that has tied School District capital contribution refunds for any and all School District accounts to whether the School District has met its

⁵ RD at 126 and 129.

⁶ RD at 129.

⁷ School District M.B. at 10.

⁸ The Commission should not consider any extra-record information contained in PGW's exceptions. *See, G. Denny French v. Verizon Pennsylvania Inc.*, Docket No. F02998923, 2007 WL1772000, Opinion and Order entered May 31, 2007, at 3.

⁹ PGW Exceptions, at 52-53.

contractual volume commitments under the disputed 1990s contracts. Thus, as the ALJs properly determined, PGW must be required to produce an accounting of the School District's status under the 1990s contracts with respect to meeting contractual gas volume commitments in order to resolve not only the dispute involving those contracts, but also whether refunds may be due the School District under Section 10 of PGW's Tariff for any subsequent School District contracts.

PGW also claims that it cannot comply with the ALJs' recommendation because it "has not maintained any of the load data or other information that would be needed to calculate any allowances" under Section 10.6 of the Tariff.¹⁰ This claim, also made for the first time on exceptions, appears specious. PGW's witness Craig White referred in his testimony to an "extensive review" prepared by PGW in 1998 listing each of the contracts in dispute, which review is PGW's basis in this proceeding for its claim of the number of 1990s contracts in dispute.¹¹ Thus, the Commission should reject PGW's claim that it cannot produce an accounting of the School District's gas volume usage under the disputed 1990s contracts as it is unsupported by evidence in the record and, in fact, conflicts with PGW's own, uncontroverted evidence in the record.

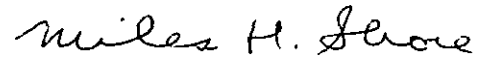
¹⁰ PGW Exceptions, at 53-54.

¹¹ Tr. at 689-690.

CONCLUSION

For the foregoing reasons, the Commission should deny PGW's Exception No. 18 to the Recommended Decision of the ALJs.

Respectfully submitted,



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BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

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:
:
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:

Docket No. R-0006193

CERTIFICATE OF SERVICE

I hereby certify that I am serving a true copy of the attached Reply of The School District to Exceptions of Philadelphia Gas Works, in accordance with the requirements of 52 Pa. Code §1.54, upon the following persons by electronic mail on August 30, 2007, with a hard copy by First Class Mail, postage prepaid:

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AUG 29 2007

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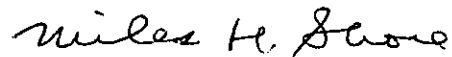
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Dated: August 29, 2007

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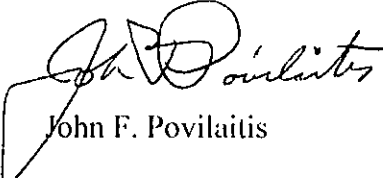
Re: Pennsylvania Public Utility Commission
v.
Philadelphia Gas Works, Docket No. R-00061931

KJR

Dear Secretary McNulty:

Please be advised that Hess Corporation will not be filing Replies to Exceptions in the above-captioned proceeding. Copies of this correspondence have been served in accordance with the attached Certificate of Service.

Very truly yours,


John F. Povilaitis

DOCKETED
AUG 31 2007

Enclosure
JFP:ck

c. Certificate of Service

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COMMONWEALTH OF PENNSYLVANIA

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

2007-11-30 P13:35
SECRET

Pennsylvania Public Utility Commission :
:
v. : Docket No. R-00061931
:
Philadelphia Gas Works :

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the attached documents in accordance with the requirements of 52 Pa. Code § 1.54 et seq. (relating to service by a participant).

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Date: August 31, 2007



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August 30, 2007

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RE: Pennsylvania Public Utility Commission
v.
Philadelphia Gas Works
Docket No. R-00061931

Dear Secretary McNulty:

Enclosed for filing, please find an original and nine (9) copies of the Exceptions of the Office of Consumer Advocate to Philadelphia Gas Works' Proposed Compliance Filing, filed on October 18, 2007, in the above-referenced proceeding.

Copies have been served on the parties of record as indicated on the enclosed Certificate of Service.

Sincerely,

Darryl A. Lawrence
Assistant Consumer Advocate
PA Attorney I.D. # 93682

Enclosures

cc: Hon. Cynthia W. Fordham, ALJ
Hon. Angela T. Jones, ALJ

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

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Docket No. R-00061931

ORIGINAL

EXCEPTION OF THE OFFICE OF CONSUMER ADVOCATE
TO THE OCTOBER 18, 2007 COMPLIANCE FILING
MADE BY PHILADELPHIA GAS WORKS

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DOCKETED
OCT 30 2007

Dated: October 29, 2007

**DOCUMENT
FOLDER**

Pursuant to 52 Pa. Code, Section 5.592(c) of the regulations of the Pennsylvania Public Utility Commission (Commission), the Pennsylvania Office of Consumer Advocate (OCA) files this Exception to the Compliance Filing made by Philadelphia Gas Works (PGW or Company) on October 18, 2007.

The OCA understands that PGW seeks to have new rates to go into effect on November 8, 2007. The OCA does not oppose PGW's proposed new rates going into effect on one day's notice after that date, if the Commission has not acted on this Exception. If the Commission renders a decision as to this Exception *after* PGW's new rates go into effect, then the OCA submits that any modification to those rates, if needed, should be made on a prospective-only basis.

In support of its Exception, the OCA submits the following:

I. INTRODUCTION

The OCA objects to PGW's proposed treatment of the existing base rate revenue shortfall that results from the establishment of cost-based Interruptible Transportation (IT) rates, as required by the Commission's Opinion and Order (Order). Pa. PUC v. Philadelphia Gas Works, Dock. No. R-00061931 (Order entered Sept. 28, 2007). The Order directed a redesign in IT rates, from margin-based rates to cost-based rates. This redesign results in \$2.671 million less base rate revenue being collected from IT customers. This revenue shortfall in existing base rates must be collected from other customer classes, in order for the Company to be made whole. The redesign of the IT rate results in a \$2.6 million *cost shift* away from IT customers. Through its Compliance Filing, the Company proposes to shift all of these costs onto residential customers. The OCA submits that such a proposal is not in accord with the Order, prior Commission treatment of cost shifts or sound ratemaking principles.

The Commission entered its Order in the above-captioned matter on September 28, 2007. Of particular importance to this Exception, the Order directed PGW to file a tariff that, *inter alia*, (1) produces an annual increase in base rates of \$25,000,000, (2) allocates the \$25,000,000 rate increase in accordance with the First Dollar Relief proposed by the Office of Trial Staff (OTS), and (3) establishes cost-based Interruptible Transportation (IT) rates. Order at 74, 84 and 92. PGW submitted its Compliance Filing on October 18, 2007. In Attachment A of the Compliance Filing, at Final Order Attachment 6 pages 1 and 2, PGW shows the rate increase for each class on line 20. The total rate increase is \$24,999,000. Also on line 20, the existing base rate revenue shortfall, created by the implementation of cost-based IT rates, is shown as \$2,671,000.

The OCA is not contesting the Company's implementation of the Order, which directed that the \$25 million rate increase be allocated to the customer classes using the OTS's First Dollar Relief method.¹ The OCA does object, however, to the treatment of the \$2.6 million cost shift that results from the redesign of the IT rates. The OCA submits that there is no reasonable basis to shift 100% of this \$2.6 million cost to the residential ratepayers as the Company has done in its Compliance Filing. This cost shift, related to the redesign of the existing IT rates, should be borne by all firm service customer classes. The OCA respectfully requests that the Company's treatment of this cost shift in the Compliance Filing not be adopted and that a filing be required that is consistent with the discussion herein.

The OCA understands, however, that PGW's approved revenue increase should go into effect without undue delay. It is the OCA's understanding that the Commission may act on PGW's Compliance Filing at its November 8, 2007 Public Meeting. If the Commission

¹ The OCA would note that line 20 of Attachment 6 shows \$24,939,000 of the authorized \$25 million rate increase is allocated to the Residential class under the Order.

requires more time to decide the issues raised by this Exception, the OCA would not object to PGW's proposed compliance rates going into effect prior to the outcome of this matter, and any modification of those rates as a result of a Commission decision on this matter could be made on a prospective-only basis.

II. ARGUMENT

When the existing IT rates are redesigned to be cost-based rates and not margin-based rates, in accordance with the Commission's Order, the IT rates will be lower. This means that PGW will receive less revenue from IT customers under the cost-based rates, in this case, about \$2.6 million less than under the existing margin-based rates. For the Company to be made whole, this existing base rate revenue shortfall must be made up, i.e., PGW must *shift* the cost of providing lower IT rates, \$2.6 million, to other customer classes. In its Compliance Filing, the Company chose to shift 100% of this \$2.6 million cost to residential customers. The issue raised in this Exception is how the \$2,671,000, created by the implementation of cost-based IT rates, should reasonably be assigned.

The problem from the OCA's perspective is that, as evidenced by Attachment 6 of PGW's Compliance Filing, the Company followed the same basic formula to treat this \$2.6 million cost shift as it used to allocate the \$25 million rate increase, that being First Dollar Relief, and essentially assigned 100% of the \$2.6 million to the residential class. As a result, residential customers will now pay \$27.6 million of a \$25 million rate increase.² The OCA submits that while the Order directed PGW to allocate the \$25 million *rate increase* in a certain manner, neither the ALJs' Recommended Decision (RD) nor the Order directed PGW to assign this entire underlying \$2.6 million *cost shift* in that same manner. These are two different issues.

² That is, residential customers will pay not just 100% of the Company's rate increase under First Dollar Relief, but 110% of the rate increase.

The OCA has no objection to making the Company whole, because this \$2.6 million is already part of PGW's existing revenue requirement. The OCA does object to making the Company whole, however, by recovering 100% of this \$2.6 million cost shift from the residential class. The OCA submits that the \$25 million authorized rate increase and the \$2.6 million existing base rate revenue shortfall are two different items, as the latter is not part of the \$25 million rate increase, but rather a *cost shift*, and should be treated accordingly.

The Commission has already recognized that the establishment of cost-based IT rates for PGW would create a revenue shortfall, in this case \$2.6 million that would have to be made up by a shift of those costs to the other firm customer classes. In PGW's restructuring proceeding, the Commission's Opinion provided the following as to cost-based IT rates:

Upon review of the record on this issue, we conclude that the issue of IT rates should be addressed in PGW's next base rate proceeding and not within the current restructuring case. We find that lowering PGW's IT rates in this proceeding may result in an impermissible *shift in costs* from interruptible customers to firm customers.

Pa. PUC v. Philadelphia Gas Works, Dock. No. M-00021612, at *45 (Order entered Mar. 31, 2003) (*emphasis added*). PGW has also recognized in this case that the establishment of cost-based IT rates would create a revenue shortfall that would have to be made up by a shift in costs to other firm customer classes. As PGW provided in its Exceptions to the RD:

Initially, it is important to understand that as a result of this decision, existing interruptible transportation customers with alternative fuel capability will pay less than their alternative market price and all other ratepayers, chiefly residential customers, will be forced to pay between \$1.2-\$2 million more overall.

At the same time, by negotiating a rate in relation to the customer's alternative price of energy, the Company maximizes the contribution that these customers make to keep *firm customer* rates lower.

Third, such a seismic change in PGW's IT rates, which currently provide a positive margin in relation to the cost of service, would violate the approved theory of gradualism and will have a negative impact on the rates paid by firm customers. The Company's revenue requirement will remain as ordered, and thus if the ALJs' recommended IT rate cut is adopted, the rates charged to PGW's firm customers (overwhelmingly residential) will have to increase to make up the difference. *Such a result will obviously harm the residential and firm customers, as well as the Company ...*

PGW Exceptions at 48, 49 and 51 (*emphasis added*). The OCA would note that in the numerous Reply Exceptions that were filed in this matter, no party disagreed with PGW's assertions that the implementation of cost-based IT rates would result in all firm service customer classes having to absorb that cost shift. There was no indication in PGW's prior pleadings that 100% of this cost shift would be borne by residential customers alone.

Sound ratemaking principles discussed in past Commission decisions holds that discounting distribution rates to customers with competitive options (close to a pipeline, having alternative fuel capabilities, etc.), generally the large industrial customers, results in keeping those customers on the system and providing some contribution to fixed costs or margin even though other customer classes will have to make up the difference between that lower level of revenue and the utility's authorized revenue requirement. Costs get shifted from the customer receiving the lower rate to other customer classes. In cases like that, there may be disagreements among the parties as to the amount of the cost shift, or the percentage allocated to the different classes, but there has not been any large-scale disagreement with the general principle that all firm customers are responsible for the existing base rate revenue shortfall.

For example, the Commission recently decided the PPL Gas case. Pa. PUC v. PPL Gas Utilities Corp., Dock. No. R-00061398 (Order entered Feb. 8, 2007). The Commission's Order provided the following description of the rate discount at issue:

PPL Gas offers a discounted rate to some LVS (large volume service) customers as a result of negotiated contracts between the Company and the customer.

...

PPL Gas reflected the difference between the actual revenues from Rate L (rate for LVS customers) and the revenue required to produce the system average rate of return. The purpose is to allocate among the other rate classes the discounted revenue received by the Company that is less than the system average rate of return. *The Company, the OSBA, and the OCA agree that under-recovery of costs that results from the rate discounts provided to Rate LVS customers should be shared among the customer classes.*

PPL Gas at *193, 194. The rate discount at issue in PPL Gas is similar to the cost-based IT rate issue here, in that under both scenarios an existing base rate revenue shortfall results that must be made up by all other firm service customers.

Moreover, the commercial and industrial classes received no rate increases in this matter. Under PGW's Compliance Filing, these classes were also not assigned any part of the \$2.6 million cost shift. Yet, these classes may reap the benefits of the new lower IT rates, should any of their members choose to transport gas on the system. Industrial and commercial customers will now have an enhanced opportunity to shop for lower cost gas supplies as a result of the cost-based, lower IT rates. The OCA submits that it is not reasonable to allocate 100% of the \$2.6 million cost shift, created by the redesign of IT rates, to the Residential class when it is obvious that other classes not only received the benefit of the contribution margin from the existing IT rates, but now may also continue to benefit from the lower IT rates.


The OCA submits that PGW's Compliance Filing does not treat this \$2.6 million cost shift, resulting from the implementation of lower IT rates, in a manner that is reasonable, consistent with Commission precedent, or consistent with PGW's own statements about the existing base rate revenue shortfall that would result from implementing cost-based IT rates. PGW's allocation has imposed a higher total revenue requirement on the Residential class, a

class that has already sustained virtually 100% of the \$25 million rate increase awarded in this matter.

III. CONCLUSION

For all of the foregoing reasons, the Office of Consumer Advocate excepts to PGW's October 18, 2007 Compliance Filing and respectfully requests that the Commission direct the Company to submit a revised compliance filing that distributes the \$2.6 million cost shift related to establishing cost-based IT rates to all firm service customers, not just to the Residential class. To the extent that the Company's original Compliance Filing goes into effect prior to a Commission ruling on this Exception, the OCA submits that any change in rates could be made on a prospective basis only.

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DATED: October 29, 2007

96067

CERTIFICATE OF SERVICE

Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-00061931
 :
 Philadelphia Gas Works :

I hereby certify that I have this day served a true copy of the foregoing document, the Exceptions of the Office of Consumer Advocate to Philadelphia Gas Works' Proposed Compliance Filing, filed on October 18, 2007, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 29th day of October 2007.

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