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August 30, 2007

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VIA HAND DELIVERY

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Harrisburg, PA 171020-3265

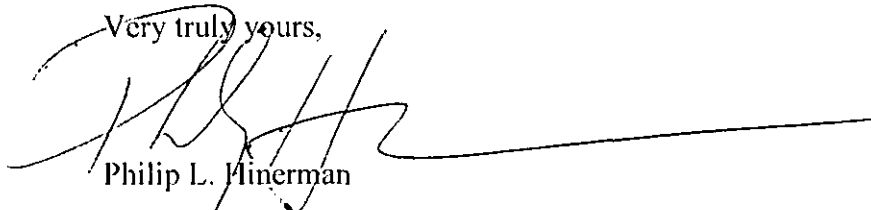
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Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00061931

Dear Secretary:

Enclosed is an original and nine (9) copies of Reply of Philadelphia Housing Authority to Exceptions 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.

Very truly yours,



Philip L. Hinerman

PLH/mn

- cc: All Parties of Record (w/encl.)
Cheryl Walker Davis, Office of Special Assistants (via hand-delivery, w/encl.)
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BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

Docket No. R-00061931

PHILADELPHIA GAS WORKS

FILED
AUG 1 2007
PHILADELPHIA

**REPLY OF PHILADELPHIA HOUSING AUTHORITY
TO EXCEPTIONS TO RECOMMENDED DECISION**

I. INTRODUCTION

On July 24, 2007, the Office of Administrative Law Judge of the Public Utility Commission issued the recommended decision of Judges Cynthia Williams Fordham and Angela T. Jones regarding the Philadelphia Gas Works' ("PGW") request for increases in its rates (the "Recommended Decision"). In the Recommended Decision, the ALJs recommended that PGW be permitted to increase its annual natural gas base distribution operating revenues by \$25 million dollars.

The ALJs' Recommended Decision contained some findings that were specific to PHA. The ALJ declined to classify all PHA accounts at the lowest of the PHA rate, MS rate or the GS Residential rate class stating that PGW had agreed to the MS rate on a go-forward basis. R.D. at 83. The ALJs also made a finding with regard to PHA's alleged argument that all its residents should receive the lower rate that PGW offers in its Customer Responsibility Program ("CRP"). Finally, the ALJs also followed the recommendations of the Office of Trial Staff and allocated the greatest share of the \$25 million increase to customers in the GS-Residential rate class – not the PHA rate class. R.D. at 71.

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In response to the recommended decision, many of the parties in the proceeding have filed exceptions. PHA's exceptions sought clarification of the ALJs' findings with respect to (a) applying the CRP rate to residents and (b) the reclassification of PHA and its tenants.

PGW's exceptions were a broad-ranging set, addressing many aspects of the Recommended Decision. Those exceptions did not seek a change in the ALJs' ruling with respect to PHA specific issues. Similarly, the Office of Consumer Advocate, whose argument regarding PHA issues was determined to be moot, did not challenge that determination, choosing to focus on the application of the bulk of the rate increase on residential users. No party, other than PHA, filed any exceptions related to the determinations in the Recommended Decision which directly impact PHA. Therefore, the outstanding issues relative to PHA are those set forth in PHA's exceptions.

With respect to several of the filed exceptions, primarily the exceptions filed by PGW and the Office of Consumer Advocate, parties assert that the recommended increase in rates should be more uniform and apply across rate classes. In its exceptions, PGW, in Appendix A, sets out pro forma increases in all rate classes except the Housing Rate (PHA rate). One would assume that no PHA rate increase is provided. That is not the end of the matter, however, for PHA as many of its residents are classified under the GS residential rate.

In this reply, PHA is only expressing its opposition to (a) any exception that may either cause an increase in the already high PHA rate or (b) cause a further burden to PHA residents who are billed at the GS rate.

II. PHA's RATE

As demonstrated by the chart in the Recommended Decision at page 67, the PHA rate has one of the highest rates of return to PGW of all rate classes. As demonstrated in the cost of

service study at Exhibit HSG-1, attached to PGW's statement 8R of the Main Brief, current PHA revenue before the proposed rate increase provides one of the highest profit margins. As summarized by the testimony of Craig White, acting Chief Operating Officer of PGW, there was no reason for that high rate of return. In his testimony, Mr. White responded:

Q. Why is (the PHA rate) higher?

A. Its been higher for many years.

Q. Why?

A. Don't know the answer to that.

* * * * *

No, I don't know the reason. I mean the rates were not done on a cost of service basis when these rates were first established. They were done many, many years ago.

Transcript p. 649; 9-23.

PHA has already been penalized by rate increases that were unjustified and not based on costs of service. The injustice should not be perpetuated by yet additional increases.

III. PHA'S BUDGET CRISIS

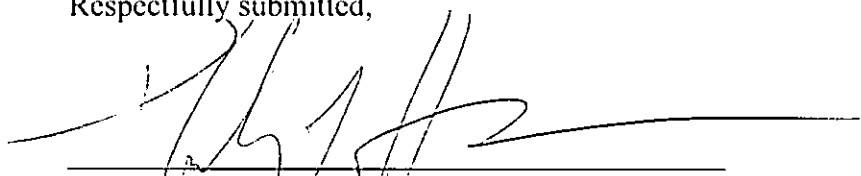
PHA is currently facing the worst budget crisis of its history. The testimony of PHA's Executive Director, Carl Greene, at PHA -1, demonstrates the difficult times that PHA faces. PHA now only receives 83% of the funds that it needs to operate. The Department of Housing and Urban Development has informed PHA that it intends to further reduce funding to 80% of the funds currently needed. To date, there has been an \$18,000,000 budget shortfall which has forced major staff reductions of 22% at a time when a number of PHA households has been increasing. As shown at http://pha.phila.gov/web_files/Accomp_2007_Report_web.pdf, in 2000,

PHA had one employee for every 7.4 households. As of March 31, 2007, PHA had one employee for every 24.6 households.

Even though approximately 22% of the PHA staff has already been cut, more cuts are likely. These cuts, combined with increasing costs and inflation, have to lead to insurance and utility costs that now comprise an all-time high of 46% of PHA's operating budget. See http://www.pha.phila.gov/web_files/issue12.pdf. See also Testimony of Carl Greene, PHA - 1. If the Commission were to impose gas rate increases on PHA, PHA will be required to have pay more utility dollars at a time when funds are being severely cut and scarce dollars could, instead, be used to provide essential services to low income tenants, such as security and maintenance, which have been severely cut back.

As is stated at <http://pha.phila.gov/press/index.asp?id=112>, PHA residential population has increased 68% in the last seven years, yet the budget for these essential services has been reduced. Accordingly, this Commission should not adopt any rate plan that increases PHA's costs. Increases will require PHA to divert its already scarce funds from critical programs into subsidizing lower rate categories.

Respectfully submitted,



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PHILADELPHIA HOUSING AUTHORITY

Dated: August 30, 2007

CERTIFICATE OF SERVICE

I hereby certify that I am serving a true and correct copy of the foregoing Reply of Philadelphia Housing Authority to Exceptions 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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VIA HAND DELIVERY

James J. McNulty, Secretary
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The Commonwealth Keystone Building
400 North Street, 2nd Floor
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**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 Reply 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 Reply 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 Reply Exceptions and kindly return it to our messenger for our filing purposes. Thank you.

Very truly yours,

KJR

McNEES WALLACE & NURICK LLC

By *Charis Mincavage*
Charis Mincavage

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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

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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

REPLY 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 30, 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. On July 30, 2007, the PUC issued the Recommended Decision ("R.D.") of Administrative Law Judges ("ALJs") Fordham and Jones.¹ Because PICGUG supports the majority of the ALJs' well-reasoned R.D., PICGUG submitted limited Exceptions ("Exc.")²

PICGUG's Reply Exceptions respond to the Exceptions of PGW and the OCA. PICGUG submits that: (1) PGW's opposition to the ALJs' recommendation to implement cost-based interruptible transportation ("IT") rates is based upon nothing more than the Company's desire to maximize the marginal revenues currently received from IT rates; (2) PGW fails to present any evidence allowing for a rate increase beyond the \$25 million recommended by the ALJs; and (3) PGW and the OCA do not provide any basis for modifying the ALJs' recommended allocation of the rate increase, especially in light of the significant subsidization of the residential customer class by other non-residential customer classes. As discussed more fully herein, none of the arguments raised by PGW and the OCA regarding these issues negate the propriety of the PUC adopting the ALJs' well-reasoned R.D. Accordingly, PICGUG respectfully requests that the Exceptions of PGW and the OCA regarding these issues be denied.

¹ PICGUG submitted both a Main Brief ("M.B.") and a Reply Brief ("R.B.") in this proceeding.

² PICGUG received Exceptions from PGW, the Office of Consumer Advocate ("OCA"), the Office of Trial Staff ("OTS"), the Office of Small Business Advocate ("OSBA"), Interstate Gas Supply ("IGS"), Action Alliance, et al. ("Action Alliance"), the Philadelphia Housing Authority ("PHA"), and Hess Corporation ("Hess").

II. REPLY EXCEPTIONS

1. Reply to PGW Exception No. 17: The Administrative Law Judges Appropriately Determine that PGW Must Implement Cost-Based Interruptible Transportation Rates.

In the R.D., the ALJs correctly conclude that, pursuant to the PUC's Order in PGW's Restructuring Proceeding, the Company had the burden of proposing cost-based IT rates in this proceeding. The ALJs further determine that PGW did not meet this obligation, as the Company failed to propose cost-based IT rates, much less prove that the current, margin-based IT rates are just, reasonable, and in compliance with PUC requirements or Commonwealth Court of Pennsylvania ("Commonwealth Court") precedent. R.D. at 81-82. For these reasons, the ALJs appropriately recommend that PGW be ordered to establish cost-based IT rates no later than twenty days after the PUC's Order in this proceeding.

Conversely, the Company's Exceptions disregard the ALJs' reasonable assessments and instead suggest that the Company be excused from the requirements of PUC regulations and Commonwealth Court precedent. PGW Exc., pp. 48-51. Not surprisingly, PGW fails to provide any support for this claim, but rather, offers a clear insight into the Company's driving factor, which is to continue to receive the revenue from the margin-based IT rates. PICGUG M.B., pp. 6-19; PICGUG R.B., pp. 3-8. Because PGW's arguments fail to withstand any type of scrutiny, PICGUG respectfully requests that the PUC reject PGW's Exceptions and affirm the ALJs' recommendation with respect to this matter.

Initially, the ALJs confirm that the Commission, as part of PGW's Restructuring Proceeding, ordered the Company to address cost-based IT rates during the current base rate

proceeding.³ R.D. at 82. While the R.D. correctly notes that "PGW did not comply with that Order," the Company suggests that merely providing a class Cost of Service Study ("COSS") fulfills this requirement. *Id.*; PGW Exc., p. 49. Obviously, PGW's offering of a COSS, as part of an overall base rate proceeding, does not equate to adhering to a mandate by the Commission for the Company to propose cost-based IT rates.⁴ Although PGW attempts to shirk its responsibilities with respect to this issue, the ALJs reasonably find that PGW has failed to meet the requirements of the PUC's Order. R.D. at 82. More importantly, the ALJs recognize that the need for cost-based IT rates must be addressed in this proceeding. *Id.*

Perhaps realizing that the issue of cost-based IT rates cannot be avoided, PGW also excepts to the ALJs' recommendation to mandate the implementation of such rates immediately following the conclusion of this proceeding. While PGW claims that several "policy" reasons exist for such exception, none of the arguments presented by the Company warrant overturning the ALJs' recommendation. Accordingly, the Commission must reject PGW's Exceptions.

First, PGW submits that the implementation of cost-based IT rates are unnecessary, as PGW's system is currently "open" for purposes of natural gas competition. PGW Exc., p. 49. Unfortunately, PGW fails to recognize that the level of competition on the Company's system is irrelevant when examining whether IT rates are just and reasonable. PICGUG M.B., pp. 11-12; PICGUG R.B., pp. 3-5. In fact, the Public Utility Code provides that the goal in setting any

³ Specifically, the Commission found that several issues raised in PGW's Restructuring Proceeding, including the potential for cost-based IT rates, should be revisited as part of PGW's first base rate proceeding after the conclusion of the Company's Restructuring Proceeding. Because the current proceeding is the first base rate filing by the Company since Restructuring, this proceeding provides the Commission with ample and appropriate opportunity to revisit PGW's current rate allocation methodology. PICGUG M.B., p. 3.

⁴ Interestingly, PGW suggests that "PICGUG never requested any further detailed information other than what was provided" in the COSS. PGW Exc., p. 49. PGW seems to completely ignore the burden of proof that the Company carries with respect to this issue. R.D. at 11-14, 82.

transportation rate is to recover the fixed costs associated with the service, as compared to providing the Natural Gas Distribution Company ("NGDC") with an accompanying margin. PICGUG M.B., pp. 12-13. While the Commission developed cost-based IT rates to ensure customers adequate opportunity to access the competitive natural gas market, these requirements are applicable to all NGDCs regardless of the level of customers transporting on the individual NGDC's system. Id.

Even assuming *arguendo* that the level of competition on an NGDC's system was relevant to the setting of transportation rates, review of the history of PGW's transportation program and a comparison of the current status of competition among other NGDCs in the Commonwealth confirm that PGW's system is sorely lacking. PICGUG R.B., pp. 3-5. In fact, PGW's exaggerated claims regarding the increase in transportation levels on the Company's system since 2002 fail to note that, prior to 2002, PGW's transportation program was fairly non-existent. Id.

Moreover, prior to PGW's Restructuring Proceeding, PGW failed to provide even a remotely viable transportation rate schedule to large industrial customers, even though most NGDCs had been allowing such customers to transport natural gas, at cost-based rates, since the mid-1980s. Id. Similarly, prior to implementation of the Natural Gas Choice and Competition Act ("Competition Act"), PGW required a customer to transport at least 75,000 Dth of natural gas per year in order to be eligible for an IT rate; comparatively, PGW's current IT rate allows a customer to transport as little as 2,500 Dth of natural gas per year for purposes of eligibility. Id. Thus, PGW's claim that margin-based IT rates have resulted in an increase in competition on PGW's system must be tempered by the fact that prior to 2002, the Company's transportation

program was virtually non-existent. Appropriately, the ALJs ignored PGW's irrelevant argument with respect to this issue.

Second, PGW argues that the Company's current margin-based IT rates provide a "win-win" situation in that the Company can "negotiate" below the maximum rate for customers based upon the customer's alternative fuel source.⁵ PGW Exc., p. 50. In actuality, this "negotiation" process provides a "win" only for PGW in that the Company maintains full and complete discretion with respect to any such negotiation, has no incentive to negotiate below the maximum rate, and has been unwilling to do so in some instances. PICGUG M.B., pp. 14-17.

As part of this proceeding, PICGUG has provided a concrete example of the unilateral nature of PGW's ability to negotiate rates with customers. One of PICGUG's members, the Philadelphia College of Osteopathic Medicine ("PCOM"), has been in discussions with PGW regarding the possibility of installing alternative fuel capability in order to obtain IT rates. *Id.* at 15. Due to the monopoly that PGW maintains over its customers, PGW's "negotiation" with PCOM resulted in PCOM being offered the maximum, margin-based transportation rate, which is 350% higher than the cost-based rate PCOM would receive if it were transporting natural gas on PECO Energy Company's ("PECO") system.⁶ *Id.* Moreover, while PGW suggests that PCOM's concerns are "meritless," in actuality, the record reveals even more problems with PGW's "negotiation" process. PGW Exc., p. 50; PICGUG M.B., pp. 15-17.

⁵ In an effort to support this otherwise meritless argument, PGW suggests that the Company could justify higher maximum rates based upon the alternative cost of fuel and that implementing cost-based IT rates would result in IT customers paying less than "their alternative market price." PGW Exc., pp. 48, 50. Once again, PGW ignores the fact that Commission precedent has determined that transportation rates, in order to be just and reasonable, must be cost-based. PICGUG M.B., pp. 12-13. Accordingly, the cost of an IT customer's alternative fuel is moot for purposes of this argument.

⁶ Considering that PECO is located across the street from PCOM's facility, such a comparison is more than appropriate. PICGUG M.B., p. 14.

For example, PGW's witness in this proceeding initially claimed that the Company never negotiated with PCOM, even though such negotiations had occurred both telephonically and in person and resulted in PGW offering PCOM nothing more than the maximum IT rate. Id. Only after conversations with other PGW employees was the Company's witness willing to admit that such negotiations had occurred; however, PGW's witness was still unable to confirm any specifics regarding these discussions. PICGUG M.B., p. 15. In addition, the witness's lack of knowledge regarding these discussions further illuminated the fact that PGW has no documented protocol with respect to such negotiations. Id. at 16. In fact, PGW's negotiations seem to occur on a random basis, with each account representative utilizing their own set of parameters to determine whether and to what extent a negotiated rate should be offered. Id. While the lack of standards employed by PGW may be beneficial for the Company, such haphazard rate negotiations can hardly be considered a "win" for PGW customers.

PGW also suggests that the troubles faced by PCOM should be overlooked because PGW has negotiated a multi-year agreement with another PICGUG member, which allows this member to currently transport on PGW's system. PGW Exc., p. 50. Although such transportation is occurring because of PGW's willingness to negotiate an IT rate, PGW fails to mention that, when the current contract expires, the customer's ability to continue to transport via a negotiated rate will be left to PGW's discretion. PICGUG R.B., pp. 5-6. Considering PGW's haphazard process for such negotiations, the customer's ability to continue to transport is not guaranteed.

While PGW touts its willingness to "negotiate" with customers as the panacea to the Company's current unjust and unreasonable margin-based rates, the haphazard way in which these negotiations occur, combined with PGW's complete discretion in permitting such

negotiated rates, confirms that customers do not have any assurances with respect to obtaining a just and reasonable transportation rate. PICGUG M.B., p. 17. Moreover, customers currently transporting on PGW's system are only able to continue to do so as long as PGW is willing to negotiate a rate that meets the customer's needs. *Id.* Justifiably, the ALJs recognize that PGW's ability to negotiate below the maximum margin-based IT rates does not provide a "win" for customers, but rather, ensures unfettered discretion for PGW in terms of maximizing revenue. For these reasons, the ALJs' recommendation to implement cost-based IT rates should be adopted by this Commission.

Third, PGW claims that the ALJs' recommendation to implement cost-based IT rates would violate the theory of gradualism and have a negative impact on firm service customers. PGW Exc., p. 51. Interestingly, in this proceeding PGW proposed a rate allocation for firm service customers that would purportedly account for gradualism by moving these customers closer to their cost to serve; however, PGW failed to offer a similar proposal for IT customers. PICGUG R.B., pp. 6-7. Accordingly, PGW's argument that gradualism must be considered in implementing cost-based IT rates rings hollow, especially in light of the Company's unwillingness to even considering moving away from maximum, margin-based rates.

Moreover, PGW's "concerns" for firm sales customers ignores the fact that IT customers are currently providing a subsidy to PGW's other customer classes. *Id.* at 7. Again, PGW's proposed rate allocation for firm sales customers at least considers the need to progress towards eliminating the subsidization of residential firm sales customers by non-residential firm sales customers; however, the Company seems to feel justified in requiring IT customers to continue such subsidization without any potential for future relief. *Id.* To suggest that PGW's IT

customers should continue to suffer the harms of unjust and unreasonable rates while firm sales customers are at least provided some form of relief is inequitable and inappropriate.

Finally, PGW argues that Commonwealth Court precedent does not require the implementation of cost-based IT rates because the Commission must consider other factors besides the cost to serve; however, PGW fails to provide a full and complete analysis with respect to Commonwealth Court precedent on this issue.⁷ PGW Exc., p. 51; Lloyd, 904 A.2d at 1020. In reviewing the basis for setting rates, the Commonwealth Court found that rates and rate structures, especially after an unbundling due to implementation of competition, must be set for each service primarily on a cost to serve basis. While PGW is correct that the Commonwealth Court found that "gradualism is but one of many factors to be considered and weighed by the Commission in determining rate designs," PGW seemed to overlook the Court's caveat that the "principles of gradualism cannot be allowed to trump all other valid ratemaking concerns and do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time." Lloyd, 904 A.2d at 1020.

By claiming that Lloyd does not require a modification to PGW's margin-based rates, the Company seems to ignore the overarching theme presented by the Commonwealth Court. Specifically, the Commonwealth Court found that the polestar of rate setting is the cost to serve, with other factors, including gradualism, playing a role in such allocation as long as these other factors do not allow inappropriate subsidization of other customer classes for an extended period of time. Under PGW's arguments, cost to serve would not be the polestar for IT rates, but rather,

⁷Recently, the Commonwealth Court examined a request by an Electric Distribution Company ("EDC") to increase its distribution and transmission rates. In establishing the parameters for this increase, the EDC set a goal of limiting the rate increase for all customers to below 10% of the total bill, which resulted in substantial differentials in the rate structure between rate classes. The PUC approved these differentials as reasonable and justified based upon the principles of gradualism and mitigation of rate shock. The Commonwealth Court found, however, that rates and rate structures must be set primarily on the cost to serve. Lloyd v. Pa. PUC, 904 A.2d 1010 (Commw. 2006).

the Company's margin would continue to form the basis for establishing IT rates. Moreover, gradualism would not be a factor in setting these rates, as PGW is unwilling to consider any movement towards cost-based rates, and, as a result, IT customers would be forced to subsidize other customer classes for an infinite period of time. For PGW to suggest that Lloyd does not require a modification to PGW's IT rates in this proceeding completely ignores Commonwealth Court precedent.

In reviewing PGW's IT rates, the ALJs reasonably recognize that the Company has failed to comport with the directives of the PUC and the Commonwealth Court, instead choosing a path that permits PGW to maximize its revenues at the expense of customers seeking competitive natural gas supply. While the Company presents numerous arguments in response to the ALJs' appropriate recommendation that PGW be required to implement cost-based rates, these arguments only provide further insight into PGW's true motive in this proceeding, which is to continue to obtain as much revenue as possible from otherwise captive IT customers. Because such a process does not ensure just and reasonable rates for IT customers, the PUC must deny PGW's Exceptions and adopt the ALJs' well-reasoned arguments on this matter.

2. Reply to PGW Exception Nos. 1-6: The Administrative Law Judges Correctly Recommend that PGW Should Receive a \$25 Million Rate Increase.

Upon reviewing all of the evidence in this proceeding, the ALJs rightfully determine 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." R.D. at 55. Moreover, the ALJs correctly find that PGW failed to prove that a rate increase was needed based upon the test year. In addition, the ALJs appropriately reject the five-year planning period because it is not appropriate for ratemaking purposes. Id. Based upon these findings, the ALJs recommend that PGW receive an increase of \$25 million.

PGW excepts to the ALJs' recommendation mainly on the basis that the ALJs focus too narrowly on immediate financial indicators provided in the test year, as compared to examining PGW's five-year plan. PGW Exc., pp. 1-18. Although PGW seeks to inappropriately expand beyond the traditional test year period in order to request additional financing, the ALJs correctly note that "proper regulation requires recognition of expenses occurring during the Company's claimed test year," especially considering that "future projections are speculative," "less reliable," and "do not form the basis for ratemaking in Pennsylvania." R.D. at 20-21; see also OCA M.B., p. 20; OTS M.B., pp. 15-16.

The crux of PGW's argument stems from the Company's claim that additional funding is required based upon PGW's five-year projections. As correctly noted by the ALJs, however, a five-year projection is inappropriate for purposes of ratemaking. Rather, utilizing the appropriate test year requirements of traditional ratemaking, PGW failed to provide any evidence warranting anything more than a \$25 million increase. R.D. at 55. Because the ALJs adequately account for these findings in the R.D., PGW's Exceptions should be denied.

3. **Reply to PGW Exception No. 16 and OCA Exception No. 2: The Administrative Law Judges Properly Conclude that the Majority of Any Rate Increase Should Be Allocated to the Residential Customer Class.**

Although PGW provided a proposed rate allocation in this proceeding, the ALJs properly conclude that there is substantial inequity among the rate classes in that the non-residential customers are subsidizing the residential customers. R.D. at 72. Because moving customers towards their cost to serve is the polestar for rate allocation purposes, the ALJs correctly determine that non-residential customers should be provided a form of first dollar relief. Id. at 73. For those reasons, the ALJs recommend that the majority of the proposed \$25 million rate increase should be allocated to the residential customer class. Id.

Conversely, PGW argues that any proposed rate allocation should move more slowly in terms of progressing the classes towards unity. PGW Exc., p. 47. Similarly, the OCA supports PGW's proposed rate allocation to ensure that residential customers are not "disproportionately burdened" with the rate increase. OCA Exc., p. 10. Contrary to the claims of PGW and OCA, however, the ALJs consider these issues and appropriately determine that a more aggressive stance must be taken in order to move towards eliminating the current, and inappropriate, subsidy occurring between the residential and non-residential classes. For these reasons, the ALJs' recommended rate allocation should be adopted by this Commission.

Specifically, the ALJs agree with the OSBA that PGW's proposed revenue allocation would move rate classes further away from rather than closer to the cost to serve. R.D. at 69. As a result, PGW's proposed rate allocation would increase the cross-subsidization by non-residential firm sales customers to residential firm sales customers. *Id.* Moreover, under PGW's proposal, the residential customer class would receive a rate increase below the system average while the non-residential rate classes would receive rate increases above the system average. Not surprisingly, the ALJs find that PGW's proposed allocation "does nothing but perpetuate the cross-subsidy that exists in the current rate structure." *Id.* at 70. For these reasons, the ALJs find that PGW's "proposal is simply not logical." *Id.*


Based upon these findings, the ALJs reasonably determine that the present rates demonstrate a substantial inequity among the rate classes, which would only be exacerbated through PGW's proposed rate allocation. *Id.* at 72. Not surprisingly, PGW and the OCA can present no sound basis for accepting a manifestly unjust and unreasonable rate allocation. For these reasons, the Exceptions of the OCA and PGW must be rejected, and the Commission should adopt the ALJs' recommendation.

III. CONCLUSION

WHEREFORE, the Philadelphia Industrial and Commercial Gas Users Group respectfully requests that the Pennsylvania Public Utility Commission deny the aforementioned Exceptions and adopt the well-reasoned Recommended Decision of Administrative Law Judges Fordham and Jones with respect to: (1) requiring PGW to implement cost-based interruptible transportation rates; (2) allowing PGW a rate increase of \$25 million; and (3) allocating the majority of this rate increase to the residential customer class.

Respectfully submitted,

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Dated: August 30, 2007

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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Dated this 30th day of August, 2007, in Harrisburg, Pennsylvania.



COMMONWEALTH OF PENNSYLVANIA
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August 30, 2007

ORIGINAL

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

**DOCUMENT
FOLDER**

Re: Pennsylvania Public Utility Commission v.
Philadelphia Gas Works

Docket No. R-00061931

Dear Mr. McNulty:

Enclosed for filing, please find an original and nine (9) copies of the **Reply 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
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RAK/nhd

cc: Chairman Holland
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Commissioner Christy
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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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Dated: August 30, 2007

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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. Exceptions to the Recommended Decision were filed by the active parties on August 20, 2007. OTS hereby files these Reply Exceptions to the matters raised in the Exceptions of PGW.

II. REPLY EXCEPTIONS

1. The Recommended Decision Applied Well Established Ratemaking Principles in Recommending That PGW Receive a \$25 Million Rate Increase.

PGW Exceptions, pp. 10-11.
Recommended Decision, pp.15-55.

The Recommended Decision thoroughly analyzed the record evidence and properly determined that PGW is entitled to a \$25 million rate increase.¹ In reaching that determination, the Recommended Decision affirmed the concept of a test year rather than PGW's proposed five year forecast, denied the Company's proposal concerning off system sales and capacity release credits, reviewed disputed operating and maintenance expenses, and held that PGW has adequate income to satisfy its bond covenants and cash on hand in the test year. OTS maintains that this thorough and complete analysis and the resulting \$25 million rate increase is supported by the record evidence and satisfies the public interest because it results in just and reasonable rates for PGW ratepayers.

Throughout this proceeding, OTS has advocated a three prong approach to address the Company's financial concerns and maintains that the recommended \$25 million increase is an appropriate level of rate relief. First, OTS recommended that PGW be granted \$25 million in rate relief to enable the Company to repay a \$45 million loan due to the City of Philadelphia (City) in 2008. The Recommended Decision correctly determined that PGW has failed to prove that it needs a rate increase in the test year; however, by collecting the money for this loan repayment through rates, PGW ratepayers

¹ Recommended Decision, p. 55.

assist the Company in reducing a known and measurable debt expense.² Moreover, this recommendation is in the public interest because it moderates the requested \$100 million rate impact on PGW ratepayers, many of whom are low-income. Second, OTS asserted that it would be appropriate for the City, as the owner of PGW, to contribute to PGW's long term financial goals by forgiving the \$45 million loan. This equity infusion would decrease PGW's debt and enable the Company to allocate the rate relief granted in this base rate proceeding to further improve its capital structure. The Company balked that the City has done its part as it has provided \$153 million in financial assistance from 2000 to 2011.³ However, PGW is requesting to collect \$660 million from ratepayers over the next five to six years.⁴ OTS maintains that it is not in the public interest to relieve the owner of PGW of any financial responsibility and shift the entire, substantial burden of reducing PGW's debt in an artificial five year time frame to ratepayers. Third, OTS identified operating efficiencies through expense reductions that were not taken into account in the \$25 million recommendation. By not reducing the \$25 million recommended increase to reflect these expense adjustments, as is traditionally done in base rate proceedings, OTS maintains that PGW can implement these efficiencies and do its part to address its debt and liquidity concerns.

The concerns raised in PGW Exception 1, which were further explained in detail in subsequent Company Exceptions, fails to provide persuasive arguments to disturb the Recommended Decision's thorough and well-reasoned analysis. The Company's \$100

² Recommended Decision, p. 55.

³ PGW Main Brief, p. 55. OTS Reply Brief, p. 24.

⁴ OTS Reply Brief, p. 24.

million rate relief plus \$10 million in off system sales and capacity release revenues is unsupported by the record evidence and was properly rejected in the Recommended Decision. As such, OTS respectfully requests that the recommended \$25 million rate increase be approved by the Commission.

2. The Company's Analysis of Requiring a \$70.1 Million Increase Based on Prior Rate Cases is Flawed and Need not be Addressed in the Recommended Decision.

PGW Exceptions, pp. 11-15.
OTS Reply Brief, pp. 19-21.

The Company erroneously faults the Recommended Decision for not addressing its argument that the Company needs a \$70.1 million increase to maintain the status quo from the Company's prior two rate proceedings.⁵

As noted in the Recommended Decision, the record consists of 984 transcript pages, ten main briefs, nine reply briefs, and a voluminous amount of written testimony submitted by the active parties.⁶ The ALJs, in the 136 page Recommended Decision, are not required to address every contention raised by PGW and the parties during the course of this litigated proceeding. It is well-established that ALJs need not consider expressly or at length every contention raised by the parties.⁷ As such, any issue that is not specifically addressed is deemed to have been considered and denied without further discussion.

⁵ PGW Exceptions, p. 11.

⁶ Recommended Decision, p. 5.

⁷ Wheeling & Lake Erie Railway Co. v. Pennsylvania Public Utility Commission, 778 A.2d 785, 794 (Pa. Cmwlth. 2001).

Denial of this issue was appropriate given that the proper determination of just and reasonable rate relief is on a case-by-case basis. The starting point for every rate case begins with the utility's filing, based on a selected test year, to determine the proper level of rate relief. The Commission does not look to the overall revenue granted in prior rate cases as a baseline for revenue in future rate cases. If that were the case, base rate review would be a meaningless exercise as the utility would be guaranteed a certain level of recovery. The rate relief granted in prior proceedings in no way sets a floor of the appropriate level of relief in this proceeding. Rather, it is the Company's burden to prove in each and every proceeding that its rate request is just and reasonable. Accordingly, PGW's attempt to use the rate increase received in its two prior rate cases as an indication of what is proper in this proceeding is not supported by sound ratemaking principles.

Moreover, throughout PGW's case it has used different scenarios, with different minimum increase requirements, to highlight its need for rate relief. For example, as previously noted, PGW claimed that a \$70-71 million increase is necessary to obtain an earnings level equal to the prior two rate cases⁸; PGW compared the 2001/2002 base rate proceedings with PGW's initial pro forma claim in this proceeding to demonstrate that \$80 million increase is necessary⁹; the Company claimed that to reach a 70% debt percentage by 2012 a \$50-60 million increase is necessary¹⁰; PGW argued that an \$85 million increase is necessary to have 45 days of year end cash from any source¹¹; and, PGW maintained that a \$57.6 million increase is the minimum level of increase prudent

⁸ PGW Main Brief, p. 29-37.

⁹ PGW Main Brief, p. 34.

¹⁰ PGW Exceptions, p. 22.

¹¹ PGW Reply Brief, p. 94.

under the cash flow method¹². This is just a sample of what are potentially many more scenarios and illustrations proposed by the Company throughout this litigated proceeding. The ALJ and the Commission are not required to address these moving targets in detail.

3. The Recommended Decision Appropriately Refused to Recognize PGW's Claimed Revenue Requirement on the Basis of a Five Year Financial Forecast.

PGW Exceptions, pp. 15-18
Recommended Decision, pp. 18-21.
OTS Reply Brief, pp. 14-25.
OTS Main Brief, pp. 29-43.

Despite the Company's protests otherwise, its \$100 million increase request was based on a five year planning horizon rather than on the basis of a test year. The Recommended Decision appropriately rejected this approach as inconsistent with regulatory principles because a basic ratemaking tenant is that rates are set based on a test year.

It is astounding that, based on the record evidence, the Company claims that its rate relief is not based on a five year forecast.¹³ The Company's testimony and briefs are riddled with scenarios of its dire liquidity and capital structure by 2012 if the \$100 million in rate relief is not granted in this proceeding. The Company's Exceptions state that the Recommended Decision's notion that PGW's rate request was outside the test year is "simply wrong", however, the remainder of PGW's discussion in that section seeks to bolster the very concept of setting rates on a five year basis.¹⁴ The Recommended Decision noted that PGW presented the information from the five year

¹² PGW Exceptions, p. 28.

¹³ PGW Exceptions, pp. 15-18.

¹⁴ PGW Exceptions, pp. 15-18.

period because the proper level of rate relief should be based over a “reasonable planning period”.¹⁵ PGW’s definition of a “reasonable planning period” is clearly not the test year given that a Company witness testified that the test year concept “is a very limiting and potentially inaccurate mechanism for cash flow companies.”¹⁶ PGW’s insistence that its rate relief is not based outside the scope of the test year, while at the same time presenting evidence and testimony doing exactly that, is disingenuous.

This issue, whether it is proper for PGW to obtain rate relief to achieve goals set in 2012, is the crux of this case. OTS has adamantly maintained throughout this proceeding that rates can only be set on a test year basis as it is the best way to accurately represent the revenue requirement of the utility during the time in which the rates will be in effect. The test year is a fundamental ratemaking principle that provides the very foundation for the calculation of just and reasonable rates. The premise is that a utility’s financial picture is more easily and accurately projected on a limited basis rather than far into the future. Therefore, while PGW would be permitted to file a base rate case five times in a five year period, it should not be permitted to obtain rate relief in this proceeding based on projections or to achieve financial goals that may or may not occur five years from now.

One needs only look to the Company’s filing to see that the \$100 million rate request for the future test year is unwarranted as the evidence illustrates that its financial position is adequate to satisfy its future test year obligations. As explained in detail in

¹⁵ Recommended Decision, p. 19. PGW Main Brief, p. 25.

¹⁶ PGW 2R, p. 21.

OTS Main Brief, the Company can satisfy its debt service coverage requirements in the future test year without a rate increase.¹⁷ There is little dispute about these findings given that PGW admits that it is able to satisfy its bond coverages and maintain an investment grade rating in the test year without an increase.¹⁸ The Company's flawed position is best illustrated in Exceptions where it states that the entire \$100 million request is justified by the test year data alone but, in the very next sentence, admits that the debt service coverage requirements are met in the test year.¹⁹ The Company goes on to predict its dire financial position in 2009 and 2010 as a basis for accepting the \$100 million request. The Company's own testimony, briefs, and Exceptions highlight its contradictory and flawed position. OTS maintains it is clear that the Company is seeking to reject the concept of a test year in order to justify its \$100 million rate relief request. The Recommended Decision properly rejected this request as it is inconsistent with well-established ratemaking principles. Allowing the Company to obtain \$100 million in rate relief in this proceeding to achieve certain financial goals in 2012 will result in unjust and unreasonable rates. As such, the Recommended Decision properly rejected the Company's flawed position in favor of a sound ratemaking approach.

4. The Recommended Decision Appropriately Rejected PGW's \$100 Million Rate Request Based on the Company's Improper Claim to Reduce its Debt in a Five Year Period.

PGW Exceptions, pp. 18-22.

Recommended Decision, pp. 15-55.

OTS Reply Brief, pp. 22-25.

OTS Main Brief, pp. 34-38.

¹⁷ OTS Main Brief, pp. 30-31.

¹⁸ PGW St. 2, p. 6; PGW Exceptions, p. 17.

¹⁹ PGW Exceptions, p. 17.

One basis for the Company's \$100 million rate request was its high level of debt, which the \$100 million in rate relief was supposed to resolve by Fiscal Year 2012. The Recommended Decision appropriately rejected the Company's five year planning period.²⁰

The Company's desire to achieve a 50%/50% capital structure in an artificially imposed five year deadline is not in the public interest. As has been previously discussed, going outside the future test year to project the Company's financial circumstances to 2012 violates basic ratemaking principles. Several unknown factors may change PGW's debt position in that time frame, such as the City's forgiveness of the \$45 million loan, continued improvement in PGW's collection efforts, or a reduction in gas costs, which make projecting the Company's debt five years out highly speculative. Moreover, the Company noted that it is requesting this level of rate relief so that "for the first time in a generation, it can be a self-sustaining, viable gas distribution enterprise"²¹. Although the Company admits that it has not been self-sustaining for a long period of time, it nevertheless insists that it must reduce a significant portion of its debt in the artificial five year time frame. This dramatic shift in capital structure over the next five years, funded through a significant rate increase for the Company's ratepayers, violates the interests of its ratepayers and was properly rejected.

The Company's debt level projections through 2012 are little more than a scare tactic used to justify its \$100 million request. The Company claims that a \$25 million

²⁰ Recommended Decision, p. 55.

²¹ PGW Main Brief, p. 5, quoting PGW St. 1, p. 3.

increase will produce 81-82% debt level by 2012 and a \$70 million increase will result in 64% debt by 2012.²² The common theme among the Company's projections is that it provides scenarios of what its financial outlook will be five years from now. What PGW has consistently failed to recognize is that it is wholly within the Company's discretion between now and 2012 to file a subsequent base rate case. PGW's perception that it must obtain revenue now to resolve the debt issue five years from now is simply not in accord with sound ratemaking concepts. The \$25 million in rate relief is a step toward reducing the Company's debt as it provides the necessary funds to repay the \$45 million loan to the City. The Company, however, is not satisfied with this step in the right direction. Rather, it demands to resolve the entirety of the debt issue, which is important to note was accumulated over a significant period of time, in five years solely through ratepayer funds. There is no justification to abide by the Company's requested five year deadline. Additionally, there is no reason to rely on the worst case predictions five years from now given that the Company has the discretion to file subsequent base rate cases before the Commission. This is precisely why the Commission relies on the test year concept and the Company's request to abandon that concept in favor of its five year planning horizon was properly rejected in the Recommended Decision.

5. The Recommended Decision Correctly Concluded That a \$25 Million Rate Increase Would Adequately Provide PGW Cash on Hand.

PGW Exceptions, pp. 22-28.

Recommended Decision, p. 15-55.

OTS Reply Brief, pp. 25-29.

OTS Main Brief, pp. 39-43.

²² PGW Exceptions, pp. 20, 22.

The ALJs properly concluded that the record evidences showed that PGW has adequate cash on hand.²³ Again, this position is proper because the Company has requested rate relief in the instant proceeding to achieve financial goals five years from now in violation of the test year. Moreover, the Company's definitions of liquidity and cash working capital are inappropriately narrow to inflate its ratemaking claim.

Throughout this proceeding, the Company has improperly defined liquidity as cash plus commercial paper.²⁴ Whereas, the appropriate definition of liquidity is broader as it includes any assets that can readily be converted into cash or cash equivalent (i.e. gas inventories, money markets, short-term treasury bonds).²⁵ PGW disputes that these additional sources of liquidity are appropriate in an effort to justify the \$100 million rate request. However, it is undeniable that the Management Agreement requires that the Company have sufficient funds "[t]o provide cash, or equivalent, for working capital in such reasonable amounts..."²⁶ These cash equivalents include a broader definition of liquidity. The record shows that a Company witness agreed that additional sources, such as accounts receivable and some gas inventories, are sources of liquidity.²⁷ Moreover, OTS noted that rating agencies accept the broader OTS definition given that Standard and Poor's views unspent proceeds of bonds for capital projects and gas storage deferral

²³ Recommended Decision, p. 55.

²⁴ PGW Main Brief, p. 40.

²⁵ OTS Main Brief, p. 40-41.

²⁶ PGW Rejoinder Exh. 1 (Bogdonavage).

²⁷ Transcript p. 585.

contracts as liquidity tools.²⁸ Because of the Company's narrow definition of liquidity, it improperly inflated its ratemaking claim and must be rejected.

Moreover, PGW's claim that it is appropriate to have at least 200 days of free cash (not cash and short term borrowings) on hand is unsupported by the record evidence. To support this claim the Company entered exhibits into the record to demonstrate that municipal utilities have over 2,000 days of liquidity.²⁹ The Company's witness who sponsored those exhibits admitted that it is unclear whether a consistent definition of liquidity was used, regardless of one that adheres to the Company's inappropriately narrow definition, because the information was self-reported by several hundred utilities. As illustrated in this proceeding, PGW and OTS have two very different definitions of liquidity so the hundreds of utilities applying their own definition of that term is of little guidance. Moreover, of the several hundred utilities identified on the exhibit, only three provided gas service and none solely provided gas service. Clearly, this evidence fell far short of supporting the Company's position. While OTS did not make a specific recommendation of appropriate level of liquid assets because the cash flow methodology does not focus on the concept of days of liquidity, OTS maintained that utilizing all sources of cash and cash equivalents under the appropriate definition of liquidity, PGW's current assets would likely exceed 200 days.

The Company, through its \$100 million rate relief request, is seeking to address problems that began long before Commission assumed jurisdiction in a five year time

²⁸ See, OTS Main Brief, p. 41; PGW St. 3, Ex. BB-2.

²⁹ PGW Exceptions, p. 25, FN 87. See PGW St. 3R, Exh. BB-3, 4.

frame at the expense of ratepayers. In merely one base rate proceeding, the Company seeks to achieve a 50/50 capital structure, internally generate funds, and dramatically increase its liquidity. This strategy is not in accord with sound ratemaking principles and is untenable when one considers that PGW has a high percentage of low-income customers in its service territory. As such, the Recommended Decision appropriately held that, based on the record evidenced, a \$25 million rate increase would result in just and reasonable rates.

6. The Recommended Decision Appropriately Rejected PGW's Proposal to use 100% of Off-System Sales and Capacity Release Revenue to Fund Construction Projects.

PGW Exceptions pp. 29-31.

Recommended Decision, pp. 23-25.

OTS Reply Brief, pp. 29-31.

OTS Main Brief, pp. 44-48.

PGW's exception to the ALJ's rejection of its proposal to fund construction projects with revenue generated from off-system sales and capacity release transactions must be rejected. The well reasoned Recommended Decision is supported by sound ratemaking principles and the record evidence.

The ALJs properly determined that the Company failed to prove that its proposal to use 100% of this revenue is consistent with the Public Utility Code and sound regulatory principals. The primary reason that OTS opposes the Company's proposal is that it violates the Public Utility Code mandate that the Company pursue a least cost fuel

procurement policy in the determination of just and reasonable rates.³⁰ PGW's proposal violates this statutory obligation because none of the revenue from these transactions will be used as a credit against purchased gas costs. It is well-settled Commission policy that an NGDC's least cost procurement obligation includes the requirement that the utility pursue capacity releases and off-system sales in order to reduce PGC costs.

The Company asserts that the Recommended Decision is at odds with the fact that several gas utilities are permitted to retain a portion of such revenues.³¹ OTS does not dispute that some investor owned utilities are permitted to retain a limited portion of the revenue derived from such transactions. However, the precedent of sharing mechanisms fails to support PGW's position given that the Company has not proposed to share the revenue from these transactions. Rather, it proposed to retain 100% of the revenue, which no utility under Commission jurisdiction is permitted to do. Permitting the Company to retain 100% of such revenue is unsupported by long standing Commission policy and the ALJs correctly denied the Company's request.

Now, for the first time in Exceptions, the Company is requesting that the Commission approve PGW's retention of some portion of the off-system sales and capacity release credits and defer the determination of the exact sharing to its next §1307(f) proceeding.³² It is well-established that the Company has the burden of proving the reasonableness of each and every element of its claim.³³ Throughout this litigated proceeding, the Company has argued that it should receive 100% of off-system sales and

³⁰ 66 Pa. C.S. § 1307(f), 1317, 1318.

³¹ PGW Exceptions, p. 29.

³² PGW Exceptions, p. 31.

³³ 66 Pa. C.S. § 315(a); 66 Pa. C.S. § 1301.

capacity release credits. Commission regulations prohibit a party from introducing evidence at the rebuttal stage that should have been included in its case in chief.³⁴ Rejection of PGW's proposal is especially appropriate in the instant proceeding given that the parties are far beyond the rebuttal phase and are now in the Exceptions phase. The active parties have not had the chance to litigate whether a sharing mechanism is proper for a municipal utility and what level, if any, of sharing is appropriate. The ALJs correctly determined that the issue presented, namely PGW's retention of 100% of off-system sales and capacity release credits, was inconsistent with regulatory principals. It is wholly improper for the Company to present an alternative in the Exceptions phase to an issue that has been extensively litigated by the active parties and decided by the ALJs.

Moreover, the Company's request to obtain preapproval of a sharing mechanism in this base rate proceeding and defer the details of that sharing mechanism until the next §1307(f) proceeding is procedurally flawed. It is wholly within the Company's discretion to request a sharing mechanism in its next 1307(f) proceeding. Through that forum, the active parties will be afforded the opportunity to review the Company's proposal, engage in discovery, and litigate the issue. By creating the necessary evidentiary record, it will allow the presiding officer to render a decision on the issue presented. Such a record does not exist in the instant proceeding and the Company should not be permitted to obtain preapproval of a proposal that was not the subject of this proceeding.

³⁴ 66 Pa. C.S. § 5.243(e).

7. The ALJs Correctly Identified And Denied Recognition of Improperly Claimed Operation And Maintenance Expenses.

PGW Exceptions, pp. 31- 40.

Recommended Decision, pp. 28 - 45

OTS Reply Brief, pp. 5 - 14.

OTS Main Brief, pp. 16 – 27.

The presiding officers in this proceeding have thoroughly and properly reviewed the Company's claimed operation and maintenance (O&M) expense claims and have recommended the appropriate regulatory treatment. Proper utility regulation requires the recognition of only the expenses that are prudently incurred and are necessary for the provision of safe and reliable service. This is precisely what has been done in this proceeding. The law is clear on the burden of proof in base rate proceedings and the ALJs have correctly identified that the Company has failed in satisfying its burden with respect to many of its claimed O&M expenses. For a company with the claimed financial position of PGW, it is imperative that imprudent expenses be identified and the revenue applied to these actions be used properly. OTS has consistently maintained that the Company's base rate filing offers no support for its staggering revenue request. In fact, absent the Company's loan repayment to its parent, the City of Philadelphia, there would be no evidentiary basis for any increase in revenue.

As has been presented throughout the entirety of this proceeding, OTS believes that the public interest is best served by implementing mechanisms to assist the Company in lowering its outstanding short term debt. This is the driving force behind the OTS recommendation that its proposed revenue allowance not be disturbed to reflect the

imprudent expenses identified by the ALJs in the Recommended Decision. Instead, as argued in previous documents, the revenue associated with the disallowed expenses should be applied to the Company's outstanding debt.

The level of savings associated with these expenses is secondary to the understanding of the proper regulatory treatment of the claims. Whether the expense claim is one dollar or one million dollars, the regulatory treatment is the same. If the expense is imprudent and not associated with the provision of safe and reliable service, it must be rejected. The Company opines that the savings will not have a material impact on its claimed financial condition.³⁵ The Company's belief that "[t]he only way to make a material improvement in [its] current financial outlook is by granting a considerably greater increase than that recommended in the RD"³⁶ is indicative of its narrowly presented, one dimensional solution. Simply requiring more revenue from its ratepayers is not a sound regulatory practice and is not in the public interest. Any improvement in the Company's debt position must be driven by the proper application of the revenue it receives and requires the participation of all stakeholders. The first step is the recognition of only prudently incurred expenses. The Recommended Decision has identified these imprudent expenses and the ruling of the ALJs should not be disturbed.

³⁵ PGW Exceptions, pp. 31–32.

³⁶ *Id.* at 32.

8. The ALJs Correctly Applied the Stipulated Bad Debt Expense Factor to Jurisdictional Revenue in Determining the Proper Bad Debt Allowance.

PGW Exceptions, pp. 32-33.

Recommended Decision, pp. 28-30.

OTS Reply Brief, pp. 8-10.

OTS Main Brief, pp. 19-21.

The Recommended Decision correctly distinguishes between jurisdictional and non-jurisdictional revenue and the appropriate regulatory treatment of each. The Commission does not regulate non-jurisdictional activities and it would be improper to include an allowance for these activities in jurisdictional rates. The ALJs correctly opined that the Company has failed to satisfy its burden of proving why this expense claim merits consideration. The Recommended Decision correctly states that “PGW has not provided substantial support to applying the 4.5% representing the collection shortfall to total operating revenue to represent its bad debt expense.”³⁷ Absent this evidence, the disallowance of this claim is appropriate. As correctly identified, non-jurisdictional activities are under the purview of the Company’s management. No detail as to the non-jurisdictional activities has been presented in the record including any irrefutable evidence that the pricing policies of the Company do not already account for an appropriate level of uncollectible accounts. The management decisions and policies associated with non-jurisdictional activities are beyond the control of this proceeding and must not be considered in the resolution of this issue in this base rate case. If the Company chooses to price its non-jurisdictional services without an appropriate level of anticipated uncollectible accounts that is within its discretion and these decisions should

³⁷ Recommended Decision, p. 30.

not be questioned in a regulatory proceeding. However, any attempt to claim recovery of expenses associated with non-jurisdictional activities within the confines of a base rate proceeding requires substantial evidence.³⁸ Merely including the revenue and the expenses in the *pro forma* income statement does not satisfy the burden of proving that a regulatory uncollectible factor must be applied to these non-jurisdictional activities. The record evidence in this proceeding does not include any level of detail as to the activities associated with the Company's non-jurisdictional actions. It is only during the Company's Exceptions do they attempt to offer some detail as to the activities included in non-gas revenues.³⁹ As argued previously, the "programs and services that generate non-jurisdictional revenues are under the total control of the Company and its owner."⁴⁰ Prudent management practice would surely include an uncollectible factor in the pricing model of the goods and services comprising the non-jurisdictional activities. As such, applying the regulatory factor to these revenues would be redundant and would improperly penalize ratepayers.

The ALJs correctly applied the bad debt factor to the Company's jurisdictional gas revenues. This recommendation is based on sound regulatory principles, protects the public interest and is consistent with the Commission's prior determination of this very issue. As identified in the OTS Main Brief, the Commission clarified this issue in its

³⁸ Burleson v. Pennsylvania Public Utility Commission, 501 Pa. 433, 461 A.2d 1234 (1983).

³⁹ PGW Exceptions, pp. 33-34.

⁴⁰ OTS Reply Brief, p. 9. See also, Recommended Decision, p. 30.

Order Entered December 6, 2001.⁴¹ In this Order, the Commission offered the following clarification as to the application of a bad debt factor:

In our October 12th Order we noted as follows:

The income statement attached to our Final Order, as Appendix A, appears to contain a computational error regarding the bad debt expense. Within that schedule, bad debt expense is reflected as \$61,128,000, representing 7.616% of the OTS recommended total gas revenues. However, it was our intention to apply the 7.616% factor to our overall determination of total gas revenues, rather than that submitted by the OTS, to arrive at the proper bad debt expense allowance level....

By this Tentative Opinion and Order, we simply propose to correct the bad debt expense allowance consistent with our adoption of the OTS methodology....⁴²

The ALJs recommendation to apply the stipulated bad debt factor to gas revenues must not be disturbed.

9. The ALJs Properly Determined That Funding PGW's Management Incentive Program is Imprudent.

PGW Exceptions, pp. 34-36.
Recommended Decision, pp. 33-35.
OTS Reply Brief, pp. 7-8.
OTS Main Brief, pp. 18-19.

The ALJs correctly determined that the Company has failed to satisfy its requisite burden of proof to substantiate the inclusion of this Management Incentive Program expense claim for recovery in rates. Vague assertions and anecdotal evidence clearly do not satisfy the evidentiary standards in Pennsylvania public utility regulation. The

⁴¹ OTS Main Brief, p.21.

⁴² Pennsylvania Public Utility Commission v. Philadelphia Gas Works, Docket No. R-00006042 (Order Entered December 6, 2001).

Recommended Decision clearly articulates the basis for the denial of this claimed expense with the crux of the discussion being the Company's inability to support its claim with substantial evidence.⁴³ Lacking this evidence, the ALJs correctly determined that the Company has not satisfied its burden of proof.

The Company has failed to provide the necessary level of detail with respect to the provisions of the program. Additionally, there has been no demonstration of the effectiveness of the program or any plausible explanation as to how ratepayers benefit from the inclusion of this expense. As the ALJs have correctly observed "PGW...has failed to produce evidence that it has complied with its own Management Agreement."⁴⁴ There are numerous examples of the Company's failure to present adequate support for this claim. The ALJs correctly recommended the dismissal of this claim based on a lack of evidentiary support. This recommendation is sound and must not be vacated.

10. Market Promotion Expenses Were Properly Denied in the Instant Proceeding.

PGW Exceptions, pp. 36-37
Recommended Decision, pp. 36-37
OTS Reply Brief, pp. 10-11.
OTS Main Brief, pp. 21-22.

The Recommended Decision properly determined that the Company's claim for recovery of expenses related to Marketing Promotions is unreasonable and should not be recognized. The record evidence in this proceeding offers no support for the inclusion of this claim. The claimed expense is clearly not going to be incurred in the Company's

⁴³ Recommended Decision, p. 35.

⁴⁴ Id.

claimed test year. As a result, the proper regulatory treatment is to not recognize this expense. The ALJs have correctly made this recommendation. PGW has offered no evidence to support this claim. In fact, the Company's Exceptions are equally evasive and lacking in credibility as it claims that it "fully expects that it will incur the claimed level of expense in future years."⁴⁵ As the evidence indicates, the Company will clearly not incur the expense in the test year, and claims beyond the test year are speculative.

The correct regulatory treatment of this erroneous claim has been suggested in the Recommended Decision offered by the ALJs in this proceeding. The ALJs' analysis is conclusive and proper and should not be disturbed.

11. Lobbying Expenses Were Appropriately Denied by the ALJs in the Recommended Decision.

PGW Exceptions, pp. 37-38.
Recommended Decision, pp. 38-41.
OTS Reply Brief, pp. 11-12.
OTS Main Brief, pp. 22-24.

The ALJs correctly denied any expense claims relating to lobbying efforts on the part of the Company. This issue has been decided by the Commission in a prior base rate case⁴⁶ involving this same utility and the Company has not presented any credible evidence as to why this decision should be reversed.⁴⁷ Its status as a municipal utility is of no consequence when evaluating the reasonableness of this expense claim. The Company clearly had the burden of proving the elements of this claim and the ALJs correctly determined that it had failed to do so. The Company's Main Brief as much as

⁴⁵ PGW Exceptions, p. 37.

⁴⁶ Pennsylvania Public Utility Commission v. Philadelphia Gas Works, Docket No. R-00006042 (Order Adopted December 5, 2001, Order Entered December 6, 2001).

⁴⁷ Recommended Decision, p. 41, OTS Reply Brief, pp. 11-12.

admitted this lack of evidence in its lament that OTS did not seek more information and further proclaiming that it would have supplied documentation and support upon request.⁴⁸ Amidst this attempt to shift the burden of proof to an intervening party is the Company's own failure to provide the type of substantial evidence that is required in supporting this expense claim. The ALJs correctly identified this failure on the Company's part. "PGW has not supported its claim by adequate evidence."⁴⁹ As such, the ALJs' recommendation must be affirmed.

12. Regulatory Fines and Penalties were Appropriately Rejected in this Proceeding.

PGW Exceptions, pp. 38-39.
Recommended Decision, pp. 43-44.
OTS Reply Brief, p. 13.
OTS Main Brief, p. 26.

The ALJs properly determined that it is not in the public interest to waive Commission statutes or Regulations and allow recovery of this improper expense claim.⁵⁰ As delineated in the Recommended Decision, allowance of this expense claim will negate the effect of fines and penalties as a means of controlling improper business practices. The Company erroneously claims that it should be allowed to recover the costs of fines and penalties from its ratepayers that are a result of its improper actions citing its status as a cash flow company. This premise is counterintuitive to the goal of fines and penalties and must be rejected. The ALJs have correctly identified the flaws in the Company's

⁴⁸ PGW Main Brief, p. 67, OTS Reply Brief, p. 11.

⁴⁹ Recommended Decision, p. 41.

⁵⁰ Id. at 45.

request and the Recommendation should not be altered. Fines and Penalties should not be recovered in rates.

13. The ALJs Properly Excluded the Expense Claim for Injuries and Damages and Associated Legal Expense.

PGW Exceptions, pp. 39-40.

Recommended Decision, pp. 42-43.

OTS Reply Brief, pp. 12-13.

OTS Main Brief, pp. 24-25.

The ALJs have properly recommended the disallowance of an expense claim that is clearly not ripe for disposition. The speculative nature as to the ultimate resolution of the lawsuit cannot be substituted for the actual incurrence of the expense. The ALJs' analysis is consistent with the evidence in the record. In lieu of evidence, the Company continues to offer projections and estimates and what it perceives is likely to happen. This type of presentation clearly does not refute the fact that the proceeding that will generate the expense claim has not yet been resolved and the resulting calculations and total penalties have not yet been determined. OTS reiterates its position that it will address the matter when it is ripe for disposition and is properly presented before the court. Until then, the speculative nature of the claim and its premature submission require that it not be recovered in rates as a result of this proceeding. The Company's opinion as to how OTS will react when the matter is ripe for disposition is equally speculative.⁵¹ When the underlying matter is resolved and the calculations are complete, the Company will be under no constraints in seeking recovery of this expense. OTS will respond appropriately when the matter is ready to be resolved in a regulatory setting.

⁵¹ PGW Exceptions, pp. 39-40.

The ALJs have correctly recommended the exclusion of the recovery of this expense claim from the Company's ratepayers.

14. The Recommended Decision Properly Classifies and Allocates the Cost of Distribution Mains.

PGW Exceptions, pp. 43-46.
Recommended Decision, pp. 56-63
OTS Reply Brief, 31-34.
OTS Main Brief, 52-57.

The ALJs correctly identified the flaws in the Company's submitted Cost of Service Study (COSS) and properly recommended that it be adjusted. As previously argued by OTS the "[p]roper allocation of costs in a COSS is necessary to enable the study to be used as a guide in assigning responsibility for rates to each of PGW's customer classes."⁵² Revenue cannot be allocated properly until the COSS is adjusted in order to serve as an accurate guide in establishing rates. OTS agrees that there is a level of subjectivity involved in the development of a Cost of Service Study. However, the basic principles of cost causation, allocation as well as recent Commission decisions cannot be ignored in selecting the appropriate method of allocating costs in a Cost of Service Study. "An accurate cost representation is necessary in order to provide assistance in designing just and reasonable rates."⁵³ The ALJs' recommendation has properly considered these factors and this finding should not be disturbed.

OTS has provided expert testimony in support of its recommendation that the entire cost of distribution mains should be allocated on a volumetric basis utilizing the

⁵² OTS Main Brief, p. 54.

⁵³ OTS Main Brief, p. 56.

average and excess (A&E) demand method.⁵⁴ “[T]he quantity and investment in mains does not change significantly if one customer joins or leaves the system. Mains were built to deliver gas, and the cost of mains cannot be assigned to one specific customer.”⁵⁵ The Company’s argument that distribution mains are in some way a customer cost is not supported by any credible evidence in the record. Furthermore, the Company’s offered position is contrary to the determination in recent Commission decisions. The Company argues that the recent PPL Gas⁵⁶ proceeding is not applicable in this case. Without indicating the characteristics that make the case distinguishable, the Company opines that it should not be controlling in this proceeding. Incredibly, the Company offers as support the notion that “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.”⁵⁷ OTS cannot offer an opinion as to the basis of the Commission’s decision in the PPL Gas proceeding, but does not subscribe to the “rubber stamp” theory as presented by the Company. OTS would speculate that the previous determination did not need to be disturbed as it was based on sound regulatory policy. This is precisely the case in this proceeding. Sound regulatory policy requires that the recommendation of the ALJs, consistent with prior Commission determinations, must be approved. The Company’s reliance on a twenty five year old

⁵⁴ OTS Statement No. 3. (See page 3 et seq.).

⁵⁵ OTS Main Brief, p. 55, quoting OTS Statement No. 3, p. 12.

⁵⁶ Pennsylvania Public Utility commission v. PPL Gas Utilities Corporation, Docket No. R-00061398 (Order Entered February 8, 2007).

⁵⁷ PGW Exceptions, p. 46.

case is misguided as it ignores the most recent findings of the Commission. As such, this argument must be ignored and the recommendation of the ALJs should be implemented.

15. The Recommended Decision Properly Corrects the Proposed Revenue Allocation to Provide First Dollar Relief to the Classes Providing Significant Subsidies to Other Classes.

PGW Exceptions, pp. 46-48.

Recommended Decision, pp. 63-73.

OTS Reply Brief, pp. 35-36.

OTS Main Brief, pp. 58-61.

The correction of the minor flaws in the COSS has resulted in an accurate basis for allocating revenue among the various classes. The resulting revenue allocation recommended by the ALJs is based on a corrected COSS and is in the public interest as it appropriately balances the interests of all parties. As such, it should be adopted without modification. The Company's proposed proportional scale back does little to address the severe subsidies evident in the Company's existing, and proposed, rate structures and, therefore, must be rejected. OTS has targeted the most egregious inequities and recommends First Dollar Relief be granted to these classes. Specifically addressing the Commercial, Industrial and Housing GS classes provides immediate relief and lessens the level of subsidy currently being provided to the other classes. The ALJs' recommendation properly acknowledges this inequity and the results should not be disturbed. Alternate proposals in this proceeding fall way short of moving the rate classes toward cost based rates.

16. The Company's Inclusion of Appendix A with its Exceptions Violates Regulatory Procedure and Should be Stricken.

PGW Exceptions, pp. 47-48, Appendix A.

In violation of accepted regulatory principles, the Company has included a new table purportedly summarizing the impact of various revenue awards on the rate classes. This blatant breach of accepted principles does not allow the parties any opportunity to test the validity of any of the claims presented in this table. The record in this proceeding has closed and all recommendations must be based on record evidence. Allowing the submission of evidence into the record at the Exceptions phase of a litigated proceeding makes a mockery of established litigation procedures and ignores accepted regulatory practices. The Commission must not encourage and endorse this practice. Violations of this longstanding prohibition against the submission of evidence in the Exceptions phase of a litigated proceeding will result in severe shifts in the litigation positions of participants as it will be more advantageous to withhold evidence until it is too late to conduct a meaningful analysis. This practice violates the public interest and cannot be approved. The Company's submission of Appendix A during the Exceptions phase of this proceeding must be rejected and any assumptions presented by this data must be ignored.

A cursory review of the data supplied in this table shows some apparent inconsistencies that must be investigated before any probative value can be attributed to this document. For example, under the ALJs' recommendation based on a \$25,000,000 increase, the residential class is allocated a \$24,359,000 increase with a 6.8% rate of

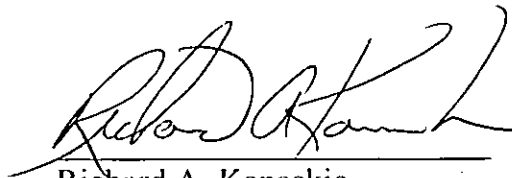
return. At the same level of increase, the Company's proposal allocates a \$19,623,000 increase to the residential class at a 7.0% rate of return. There is no logical explanation on the record as to how a lower increase in allocated revenue to the residential class would produce a higher relative rate of return. Unfortunately, this, and other questions arising from this document cannot be explored. Even if it were determined that this document retains some value in this proceeding, the data contained therein still demonstrates a severe subsidy being borne by the Industrial, Commercial and Housing GS classes.

For the reasons articulated below, the Company's Appendix A must be rejected as *it was late filed and its data has not been verified. Furthermore, the Company's proposed scale back proposal must be rejected as it does not adequately address the imbalance in the Company's rate structure.*

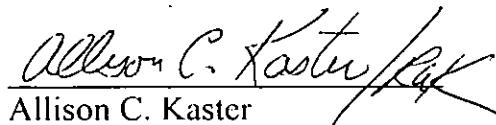
III. CONCLUSION

For the reasons stated herein, the Office of Trial Staff respectfully requests that the Recommended Decision, and the findings contained therein, be adopted by the Commission in its entirety.

Respectfully submitted,



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Pennsylvania Public Utility Commission
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Dated: August 30, 2007

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :

v. :

Philadelphia Gas Works :

Docket No. R-00061931

2007 SEP 30 PM 3:37
SEAL

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Reply Exceptions**, dated August 30, 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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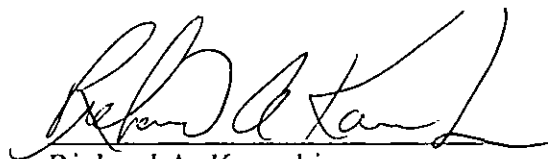
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Dated: August 30, 2007
Docket No. R-00061931

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August 30, 2007

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DOCUMENT
FOLDER

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 Reply Exceptions, 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
Office of Special Assistants

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

Docket No. R-00061931

ORIGINAL

REPLY EXCEPTIONS OF THE
OFFICE OF CONSUMER ADVOCATE

**DOCUMENT
FOLDER**

DOCKETED
AUG 31 2007

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Dated: August 30, 2007

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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 proceeding. In the R.D., the ALJs ruled on numerous issues, including the revenue requirement needed by PGW, the expense adjustments proposed by the parties, PGW's proposal to retain an annual \$10 million in off system sales and capacity release revenue, the cost of service study methodologies, the revenue allocation among the customer classes, rate design, tariff revisions, universal service cost recovery, proposals for electronic funds transfers and budget billing, proposals to change requirements for Natural Gas Suppliers (NGS) on PGW's system, and proposals to implement additional programs to increase the number of customers served by alternative suppliers. As will be explained in these Reply Exceptions, the OCA submits that in most regards, the ALJs' R.D. provides a reasonable resolution of these matters and results in an overall rate increase for PGW that is just and reasonable.

Of particular note, based on the future test year, the ALJs recommended that PGW receive an annual rate increase of \$25 million rather than the \$100 million that PGW requested. The ALJs also rejected PGW's proposal to retain the off system sales and capacity release revenues, which would have increased the annual gas cost rates charged to customers by \$10 million. The ALJs properly analyzed PGW's needed revenue requirement level based on the future test year, rejecting PGW's attempt to secure a much higher base rate increase based not on traditional test year concepts, but on PGW's five-year forecast and its overly ambitious debt reduction plan that seeks to establish a 50/50 debt ratio by 2012.

In its Exceptions, PGW takes issue with the ALJs' recommendation, arguing that its case is not based on its five-year financial forecast and that it has shown a need for more of a rate increase based on the future test year. PGW's argument does not comport with its own testimony or the facts of this case. PGW's witness Joseph Bogdonavage, after setting forth the financial goals that PGW seeks to achieve, stated the core reason for PGW's \$100 million revenue increase as follows:

To reach these goals, it is essential that the Commission authorize a revenue level that, on a projected basis, will permit PGW to realize approximately a 50/50 capital structure in the next five to six years.

PGW St. 2 at 12. PGW's proposed uses of its requested \$110 million rate increase demonstrate that the core basis for the rate increase is to achieve PGW's five-year business plan. Over the test year and the five-year forecast period used by PGW to support its revenue increase request, PGW would recover \$660 million in additional revenue from ratepayers. But of this amount, only 3.4% would cover increased operating expense, while 54.2% goes to debt reduction and 36.8% goes to capital expenditures. OCA St. 1 at 13.

An analysis of the future test year level of expenses also does not bear out PGW's arguments. Based on the FY 2007 test year with the \$25 million increase recommended by the ALJs, PGW would have \$32.3 million in net earnings, a 2.47x debt service coverage on its 1998 bonds, \$50 million of year end cash, and \$55 million available on its commercial paper line. PGW St. 2-R, Exh. JRB-8. Without reflecting any additional expense adjustments recommended by the ALJs, or any additional contributions by the City, these *pro forma* test year financial results exceed PGW's minimum required debt service coverage of 1.5x on its 1998 bonds and provide PGW with the financial means to meet its obligations. OCA St. 2-S at 5.

Perhaps recognizing that based on the future test year, it cannot justify more of a rate

increase than that awarded by the ALJs, the Company, in its Exceptions, argues for a multitude of other measures and standards to establish its rates. PGW provides no less than five rate increase requests that could result, presumably all from application by PGW of the Cash Flow Methodology. None of these rate increase calculations, however, follow traditional ratemaking principles or use the standards and benchmarks applicable to PGW. PGW's attempts to create new applications of the Cash Flow Method cannot form the basis of establishing just and reasonable rates.

The \$25 million rate increase recommended by the ALJs adheres to sound ratemaking principles and provides a reasonable, measured step to addressing PGW's financial situation. PGW's request that the Commission provide it with revenue now to try to solve all of its problems based on five year's worth of projections is an unsound basis for setting rates. As PGW acknowledges in its Exceptions, prior rate awards intended to stabilize PGW's financial circumstance and permit reduction of its long-term debt had been overcome by changes in expected natural gas prices and a substantial drop in PGW's collections rates. Representative Cherelle Parker provided important public input testimony in this regard:

In 2004 PGW urged the State Legislature and the PUC to help them improve their financial condition by tightening up customer service and collection rules which they felt were too lenient on customers. PGW told the House Consumer Affairs Committee that they would become financially self-sufficient in four years time using these stricter rules in combination with supplemental state funding for LIHEAP, additional costcutting at PGW and enrolling more low income customers on PGW's customer assistance program, CRP. ... Act 201 of 2004 provided PGW with the additional collection tools they wanted. PGW is now collecting 96 cents of every dollar billed ... Also there are more customers on CRP now than ever before ... And the state did finally appropriate about \$20 million in funds to supplement LIHEAP last year. ... But here we are three years later in 2007 facing a \$100 million rate increase request from PGW even though thousands of poor Philadelphia residents are without gas service.

Tr. at 103-104. As stated by Representative Parker, PGW predicted in 2004 that it would be self-sufficient in four years' time. *Id.* Now, PGW is asking for an annual revenue increase of \$100 million, and PGW alleges that, by 2011 to 2012, it will have successfully brought the Company to a solid financial state. The OCA submits that PGW's projection about what may or may not occur some four to five years into the future is not a reasonable basis upon which to grant a revenue increase that will cumulatively amount to almost *2/3 of a billion dollars* over this timeframe.

Despite PGW's protestations in its Exceptions that the ALJs have ignored PGW's substantial debt problems, no Party in this proceeding has ignored PGW's circumstances. What must be considered, however, is that PGW's financial situation has developed over decades and it cannot realistically be resolved by imposing an ever-increasing burden solely on its ratepayers.¹ The public input testimony was clear that PGW's ratepayers continue to struggle to pay their bills. Many customers spoke of the measures that they take to afford their bills, from turning the heat down to where the house is cold, to forgoing other necessities, to working other jobs. OCA M.B. at 16-17; OCA R.B. at 16-17. More than 30% of PGW's customers, who are currently paying the highest overall gas rates in Pennsylvania, have incomes at or below 150% of the Federal Poverty Level and 50% of PGW's residential customers have incomes at or below 250% of the Federal Poverty Level, a level found to be needed to meet the basic necessities of life. OCA St. 1 at 23.

PGW's request to achieve all of its financial goals at the expense of its already strained ratepayers was properly rejected by the ALJs. The \$25 million rate increase recommended by

¹ The OCA would also note that while PGW, in its Exceptions, argues that the City, as the owner of PGW, is giving considerably to PGW, the City's recent contributions should be kept in context. The City's agreement to grant back the \$18 million City payment through 2010 is laudable. At the same time, however, PGW will be required to return \$45 million to the City through the repayment of the City loan.

the ALJs allows the Company to repay its \$45 million loan to the City, meet all of its debt service coverage requirements, end the year with sufficient cash working capital, and continue to pay down its long term debt. If PGW wishes to reduce its debt more quickly, it should look to its owner, the City, for further capital contributions, not to its ratepayers.

II. REPLY EXCEPTIONS

A. Reply To PGW Exceptions.

OCA Reply To PGW Exception 1: The ALJs Correctly Concluded That A Revenue Increase Of \$25 Million Was Just And Reasonable. (PGW Exc. at 10-11; R.D. at 15-55; OCA M.B. at 14-32; OCA R.B. at 6-19.)

PGW attempted to support its proposed \$100 million revenue increase through the use of five-year financial forecasts and a future capital structure that is unrealistic. The ALJs correctly rejected these speculative and unrealistic proposals by PGW in reaching their conclusion that a \$25 million revenue increase was appropriate for PGW at this time. PGW filed five (5) separate Exceptions on the revenue increase issue. PGW Exc. at 10-28.

In its Exception 1, PGW summarized its arguments that the ALJs erred in awarding a revenue increase of \$25 million and in evaluating PGW's claims based on the test year data. PGW restates its arguments that, as a municipal utility regulated under a Cash Flow Method, the rules of the road must be applied differently to PGW. PGW also argues that its ratepayers must be viewed as the owners of PGW rather than the City, and its ratepayers must now bear responsibility for "fixing" PGW. The OCA addresses each PGW Exception as to the revenue increase issue in detail, but in response to Exception 1, provides the following summary.

Throughout its Exceptions, PGW presents numerous possible revenue requirement increases that it could accept, calculated in a variety of ways. None, however, are based on the test year with an evaluation of test year revenues, test year expenses and test year coverage ratios, or test year cash balances that are the basis of the cash flow methodology.² PGW now urges consideration of a host of financial indicators that it uses to construct various revenue requirement increase amounts. The OCA submits, however, that when viewed based on the test

² See PGW Exceptions: \$50.0 million on page 22, \$57.6 million on page 28, \$70.2 million on page 10, \$85.0 million on page 28 and \$100.0 million on page 17.

year, with the financial indicators that the Commission uses and investors rely on, PGW meets all the criteria under the Cash Flow Method with the \$25 million revenue increase the ALJs recommended.

So that there is no confusion about the various comparisons put forth by the Company to support its myriad of potential rate increases, the key to assessing PGW's revenue increase claims under the Cash Flow Method were succinctly provided by OTS witness Plonski as follows:

The revenue requirement for a cash flow utility is established based on the formula:

$$RR=E+DS+M$$

Where:

RR= Revenue Requirement

E= Operating Expense

DS= Debt Service

M= Margin

OCA M.B. at 14; OTS St. 1 at 5-6. When properly viewed using the test year, the ALJs' recommendation of a \$25 million increase allows PGW to meet its obligation to repay the City Loan, provide coverage on its 1998 bonds of 2.47x, have \$50 million in year-end cash and have \$55 million of available commercial paper. OCA M.B. at 30-31; OCA St. 2-S at 5.

The \$25 million revenue increase is not intended to address PGW's finances through 2012, as PGW would like. The OCA submits that it is neither realistic nor reasonable to expect that PGW's financial house can be put in order in this five-year timeframe, by relying solely on its ratepayers, many of whom are low-income. PGW's current financial situation developed over a much longer timeframe, and will take time to resolve. OCA M.B. at 19-20. If PGW requires further rate relief (based on then current test year data) to continue working on its financial concerns over the next five years, it can request it in later years. PGW's own Exceptions highlight the unreasonableness of PGW's request for a revenue increase intended to last five

years, and address all its financial concerns. PGW acknowledges on page 12 of its Exceptions, its 2002 rate award was supposed to "Reduce its outstanding short and long-term debt." However, as PGW notes, increased gas expenses and collection problems quickly overcame it and rather than paying down debt and improving its financial circumstance, it had to resort to using delayed payment gas contracts which effectively passed on the extra carrying costs to its GCR customers. The Commission has no assurance that PGW will fare any better with a large increase now that is supposed to address problems all the way through 2012.

The OCA agrees that PGW's financial situation requires continued work and attention over many years. In this case, a \$25 million increase will allow for appropriate coverages, repayment of the City Loan and sufficient working capital to meet its day-to-day needs. If PGW seeks further funding to support a more rapid debt reduction program, then it must look to the City, as the owner of PGW, to provide that capital.

OCA Reply To PGW Exception 2: The ALJs Were Correct In Disregarding PGW's Arguments As To The Proper Amount Of A Rate Increase In This Proceeding Based On Comparisons To Past PGW Base Rate Proceedings. (PGW Exc. at 11-15; R.D. at 55; OCA R.B. at 10-12.)

In its Exception No. 2, PGW argues that the ALJs erred in failing to compare its *pro forma* test year level of revenues and expenses to that permitted in PGW's last base rate case. PGW Exc. at 11-15. PGW argues that when this comparison is made, and increased expense levels are recognized, PGW would require a \$70.1 million rate increase. PGW Exc. at 11. PGW also argues that the Commission must provide for the same level of debt service coverage and earnings as in its prior rate cases. PGW Exc. at 11-15.

The OCA submits that it was reasonable and appropriate for the ALJs to ignore this comparison since such a comparison is completely flawed. The standard that must guide the Commission and the ALJs is not the novel approach of adding increased expenses to a prior case

award, but the *pro forma* test year revenues and expenses established in this case. See, OCA R.B. at 10-12. Every one of the increased expenses that PGW seeks to highlight in its comparison to prior cases was fully reflected in the *pro forma* test year level of expenses and revenues that formed the basis of the ALJs' decision in this case.

The OCA submits that the revenue requirement in each case must be based on the specific circumstances and test year data applicable to that case. The revenues, expenses and earnings in a prior rate case are not the same as in a pending case.³ Underlying factors, such as gas prices, weather variations, capital and cash requirements, all change. PGW's attempt to set up this new standard illustrates why such comparisons cannot be made. As the Company stated:

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. 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.

PGW Exc. at 12. The fact is that many things change between rate cases and results from two different cases during two very different periods of time cannot be compared.⁴

³ The Company, in its exceptions, emphasizes that, "The irrefutable conclusion is that the RD's recommendation does not even cover PGW's experienced changes since 2002 . . ." (PGW Exc. at 15). However, it is pertinent to note that covering experienced changes is exactly what the R.D.'s test year revenue requirement determination accomplishes. It takes actual current revenue and expense amounts and determines the extent of any revenue deficiency. To suggest otherwise is to imply that experienced changes are not reflected in the test year, and this is obviously incorrect. The OCA submits that there is no "irrefutable conclusion" that a \$25 million rate increase does not measure up as PGW argues.

⁴ Moreover, PGW's argument, taken to its logical conclusion, would suggest that the Commission could never authorize revenues in excess of the level awarded to PGW in 2001, or never be able to authorize a different return on equity for an investor owned utility once it establishes a return on equity in a case. Such a result has no basis in ratemaking.

What is carried forward in each case is the rate setting methodology and the regulatory principles needed to guide the Commission's decision in establishing just and reasonable rates. Here it is PGW that has sought to deviate from its prior methodologies and principles by eschewing the test year concept for a variety of comparisons to attempt to justify a rate increase that is not supported by its test year level of expenses and revenues.⁵

The ALJs reached the proper conclusion that based on the test year level of expenses, including all expense increases that PGW highlights since its last base rate case, and based on its test year level of revenues, with a \$25 million rate increase PGW has sufficient debt service coverage, working capital and year-end cash, and PGW can repay the \$45 million City loan. There is no requirement that the Commission match results from prior cases. There is only a requirement that the Commission determine what is just and reasonable based on the test year and the facts of this case.

OCA Reply To PGW Exception 3: The ALJs Were Correct In Adhering To Test Year Data And Disregarding PGW's Speculative Five-Year Forecasts In Determining The Proper Amount Of A Rate Increase. (PGW Exc. at 15-18; R.D. at 21, 55; OCA M.B. at 19-24; OCA R.B. at 6-10.)

In its Exception 3, PGW argues that the ALJs incorrectly accepted "misstatements" of the OCA and OTS that the basis of PGW's \$100 million request was its five-year forecast, designed to achieve certain financial goals by 2012. PGW Exc. at 15. Despite presenting its entire case based on the five-year forecast, and arguing in its Brief that the five-year forecast, rather than the test year concept, was the reasonable method to set rates for PGW, PGW in its Exceptions argues that it was error for the ALJs to view its presentation in that manner. PGW Exc. at 15-16. PGW

⁵ The OCA would also note that PGW's attempt to use a Settlement of its 2002 Emergency Rate Relief proceeding to establish a standard of financial results is both improper and selective. The revenue requirement in that case stemmed from a "black box" Settlement that was the result of compromise on the part of all parties. The Settlement was not to be used or considered as precedent. PGW's attempt to now use the Settlement as a financial measure is inconsistent with the Settlement's own terms.

then goes on to argue that it has shown the need for rate relief on a test year basis. PGW Exc. at 16. PGW's Exceptions do not square with the facts of this case.

As an initial matter, PGW's arguments in its Exceptions that it has shown a need for a \$100 million rate increase based on the test year data is simply unsupported by the facts in this case. PGW's own witness, Mr. Bogdonavage, confirmed that based on the test year data with a \$25 million rate increase, PGW maintains debt service coverage on its 1998 bonds of 2.47x, a \$50 million cash balance, and \$55 million of available commercial paper. PGW Exh. JRB-8; OCA St. 2-S at 5. These results reflect payback of half of the outstanding \$45 million City Loan during the future test year. These results also do not reflect any of the expense adjustments that the ALJs found to be reasonable, adjustments that would show further improvement in these major financial indicators.

Moreover, PGW's argument that it did not use its five-year financial forecast to support its \$100 million revenue request is disingenuous. PGW witness Bogdanavage testified that PGW used its five-year financial forecast to arrive at the \$100 million figure. PGW St. 2 at 14-15. Also, PGW witness Hershey in discussing the reasons for the rate increase states, "PGW will have inadequate earnings in FY 2009 to meet its debt service obligations . . ." PGW St. 1 at 2. Nowhere does witness Hershey discuss the 2007 test year results.

PGW's attempt to reach five years beyond the future test year to support its claims must be rejected. The *pro forma* test year, adjusted for known and measurable items that will shortly follow the test year, is a fundamental basis for setting just and reasonable rates. As the Commonwealth Court has stated:

In Pennsylvania, as in most other jurisdictions, rates for public utilities are set using what is known as a test year concept, which requires taking a snapshot of the utility's revenues, expenses and capital costs during a one year period.

...

Under the test year concept, revenues, expenses, and capital costs are to be simultaneously reviewed for the same period of time so that a utility may prove that its new rates are just and reasonable.

Popowsky v. Pa. PUC, 869 A.2d 1144, 1152 (Pa. Commw. Ct. 2005).

The use of the adjusted *pro forma* test year results in financial data that is representative of future periods and forms the proper basis for establishing just and reasonable rates. PGW's five-year financial forecast, on the other hand, is based on speculative assumptions about expenses, capital expenditures and revenues five years into the future, collection ratios in the future, and PGW's identified financial goals to "fix" PGW by 2012.⁶ Relying on speculative future assumptions that are not known and definite by any measure, however, is not the way to proceed to set rates. As OCA witness LeLash testified:

Requiring ratepayers to pay higher rates now for revenue requirements that might be justified in two or three years is not an accepted rate setting procedure, nor is it prudent. As stated previously, the Company has the ability to file another rate request anytime in the future when events and changes become known and measurable.

OCA St. 1-S at 14.

The test year concept does not ignore PGW's financial situation and it does not ignore the "deepening financial crisis" that PGW argues it finds itself in. PGW Exc. at 17. The test year concept, as applied by the ALJs, allows for a measured step-by-step approach to address PGW's

⁶ PGW attempts to analogize its use of its five year forecast to the determination of stranded cost under the Electric Choice Act. PGW's example actually highlights the flaw in PGW's approach. The Electric Choice Act provided specific statutory authority to the Commission to determine stranded cost over the remaining life of the assets that were at issue. 66 Pa.C.S. §2803 (definition of stranded cost). In contrast, Section 2212(e) of the Natural Gas Choice Act that brought PGW under the Commission's jurisdiction provides that PGW's revenue requirement is to be set using the methodology and requirements that were applicable to PGW at the time the Commission assumed jurisdiction. 66 Pa.C.S. §2212(e). As the Commission found in PGW's prior cases, that methodology is the cashflow method, and the Commission, as well as PGW, have consistently applied the method using a future test year to derive the revenue requirement. See, Pa. PUC. v. Philadelphia Gas Works, Docket No. R-0006042, 2001 Pa. PUC Lexis 103 (Oct. 4, 2001); Pa. PUC. v. Philadelphia Gas Works, Docket No. R-00005654, 2000 Pa. PUC Lexis 66 (Dec. 20, 2000)

financial situation – a situation that has developed over decades.⁷ As the ALJs correctly found, no basis in ratemaking principles or the law exists to provide PGW with the rate increase that it wants based on a speculative five-year business plan and forecast.

OCA Reply To PGW Exception 4: The ALJs Were Correct In Disregarding PGW's Arguments As To Its Plan To "Fix" PGW's Financial Woes, Which Developed Over Many Years, In The Context Of This One Base Rate Case. (PGW Exc. at 18-22; R.D. at 21; OCA M.B. at 24-29; OCA R.B. at 7-10.)

In Exception 4, PGW argues that the ALJs erred by ignoring the enormous amount of debt in PGW's capital structure. PGW Exc. at 18. PGW argues that it is "drowning in debt" and that it must have a rate increase to reduce its debt problems over the next five years. In essence, the major justification for PGW's rate request is that PGW has decided that now is the time to "fix" PGW and that this "fix" must be accomplished by reaching a 50/50 debt to equity ratio by 2012 and by having \$50 million in cash at each year's end. PGW St. 1 at 3.

The OCA agrees with PGW that it must work toward reducing its reliance on long-term debt and bring its debt to equity ratio to a more reasonable level. It is important to note in this regard that in the future test year, PGW will be able to retire \$36.7 million of its revenue bonds. OCA St. 2, Sch. MAB-10. Where the OCA disagrees with PGW is on a debt to equity ratio that would be reasonable for PGW, the time frame over which such levels should be achieved, and the level of responsibility for such debt reduction that PGW's ratepayers should bear.

OCA witness LeLash recommended that the Company work toward bringing its debt to equity ratio to roughly 70/30, but Mr. LeLash did not recommend that this be achieved over a

⁷ PGW also argues that without looking this far into the future and providing a rate increase to achieve its goals, PGW will have to file for another base rate increase, perhaps very soon. PGW Exc. at 18. The need to file another base rate case, even in the near term, is not a criticism of the test year method, but is one possible result as all parties work to resolve PGW's long-standing financial challenges over a reasonable time horizon. PGW's financial difficulties developed over decades and a measured step by step approach is necessary to address the multitude of problems.

five-year period or solely at the expense of ratepayers.⁸ OCA St. 1 at 20. PGW's long term debt problem has developed over many years. In 1993, about 75% of PGW's total capital was provided by long-term debt. OCA St. 1 at 13. By 2003, this level had grown to nearly 84% and by the end of 2006, the long term debt level had declined to about 82%.⁹ See, OCA St. 1, Sch. 1. As OCA witness LeLash explained, the increase in long term debt was the result of several factors, including the fact that the City has historically received dividends without making any necessary capital contributions. OCA St. 1 at 8-9.

Since 1993, for example, the Company's long-term debt has increased by \$360 million, and in the same period, the capital withdrawn by the City through its annual \$18 million payments totaled \$198 million. Had the City reinvested the \$18 million City payment in PGW between 1993 and 2006, PGW's debt ratio would have declined to about 71% by the end of 2006. OCA St. 1, Schedule 1 at Column 6. OCA witness LeLash provided a sound rationale for why the Company's stated goal of a 50/50 capital structure by 2012 should not be the basis for setting rates:

PGW's contention that a 50% debt ratio is needed and that it must be attained in the next 5-6 years is unreasonable in two regards. First, the 50% debt ratio target is overly aggressive and unwarranted given the City's own assumed industry best practice level of 70% debt and 30% equity (City of Philadelphia Five Year Financial Plan, February 22, 2007, Appendix I, Page 14). Likewise, for PGW, which has an 83% debt ratio in its test year, a 65% to 75% debt ratio target range would be far more realistic and it would still represent a dramatic improvement

⁸ In its Exceptions, PGW creates another potential revenue requirement by projecting a 70% debt percentage by 2012, implying that this was OCA witness LeLash's recommendation. Mr. LeLash recommended that the Company move toward a 70% debt percentage but did not recommend that such level be achieved by 2012 or that it be achieved solely at the expense of ratepayers.

⁹ Under the cash flow method, PGW reduces its debt by having rates reflect at least a debt service coverage rate of 1.5x and an adequate level of working capital. This provides the earnings to make annual payments to reduce the level of the bonds. As Mr. Bleiweis shows in OCA St. 2, Sch. MAB-10, in the future test year, PGW will retire \$36.7 million of its bonds. In addition to the revenue from rates, the City, as owner of PGW, can make capital contributions to PGW for debt reduction. OCA St. 1 at 10.

from the current level. Second, it is unrealistic to assume that ratepayers should, or could, provide revenue to achieve such a 50% debt level over 5-6 years.

OCA St. No. 1 at 14.

In its Exceptions, PGW argues that the City and PGW management has done all that it can, and now it is only customers who are left to pay off this debt burden – a burden PGW seeks to have ratepayers pay off by 2012. PGW Exc. at 6-7. The OCA submits that the interests of ratepayers and PGW's owners must be balanced in considering just and reasonable rates. As the Courts have held, ratepayers cannot finance all of the capital requirements of a utility. See, D.C. Transit System, Inc. v. Washington Metropolitan Transit Commission, 466 F.2d 394, 402-403 (D.C. Cir. 1972); OCA M.B. at 28; OCA St. 1-S at 4.¹⁰ Under the \$25 million revenue increase, PGW can continue to work on its debt ratio. As OCA witness LeLash noted, though:

While the City was given credit for addressing capital requirements with the loan it made in 2000, it seems paradoxical that, in the face of continued working capital concerns, it is now withdrawing \$45 million from PGW. It also seems illogical for Ms. Wilkerson to claim that the City's provision of capital to PGW would erode the City's ability to provide fundamental services. To PGW's customers, affordable natural gas service for winter heating is also a fundamental and essential service.

OCA St. 1-S at 3.

The OCA submits that the Commission must balance the interests of PGW and its ratepayers to arrive at a reasonable result. As the Commission noted in the 2001 PGW Order:

. . . we urge the City of Philadelphia, as owner of PGW, to continue to take measures to insure the financial health of PGW. It is the expectation of this Commission that the City of Philadelphia, as the owner of PGW, continue to assist PGW in its cash flow requirements so that a financial crisis does not take place.

¹⁰ As PGW's own witness Mr. Krellenstein stated: "As a general rule . . . it is not uncommon for municipalities to reduce, defer, or grant back the payments if the utility is incurring financial distress." OCA St. 1 at 15. Indeed, PGW has been in financial distress over the last ten to fifteen year time period. OCA St. 1 at 15.

Pa. P.U.C. v. Philadelphia Gas Works, Docket No. R-00006042 (Order Entered Oct. 4, 2001) at 34, 2001 Pa. PUC LEXIS 103 (October 4, 2001) (2001 PGW Base Rate Order). The Commission should insist on the same here.

OCA Reply To PGW Exception 5: The ALJs Were Correct In Determining That, Based On Test-Year Data, The \$25 Million Rate Increase Would Provide Adequate Cash Working Capital. (PGW Exc. at 22-28; R.D. at 47-55; OCA M.B. at 29-32; OCA R.B. at 12-13.)

In Exception 5, the Company argues that the ALJs' recommendation of a \$25 million rate increase would not provide PGW adequate cash working capital. PGW Exc. at 22-23. Despite the fact that under the ALJs' \$25 million rate increase recommendation, PGW will have a year end cash balance of \$50 million – a level of cash on hand that PGW has not seen since FY1995 – PGW argues that this is unreasonable. The gravaman of PGW's argument now is that it must have *non*-borrowed cash on hand to serve as cash working capital. PGW Exc. at 24-26. PGW argues that if its outstanding commercial paper exceeds its cash on hand, then it has negative cash working capital, a result it calls unreasonable.

PGW is creating negative cash working capital through a definition that PGW has not heretofore used and is not included in the PGW Management Agreement, the document that establishes the basic cash flow method for ratemaking purposes. PGW witness Bogdanavage testified that liquidity for PGW was defined as a *combination* of its year end cash and its available commercial paper. Tr. 595 (emphasis added). The Management Agreement in the segment entitled "Working capital" provides:

(iii) To provide cash, *or equivalent*, for working capital in such reasonable amounts as may be determined by Company to be necessary and as shall be approved by the Gas Commission.

PGW Rejoinder Exh. 1 (emphasis added). As can be seen, the equivalent of cash, *i.e.*, funds from short term borrowing, can and is used to fund working capital. PGW's assertion that cash

working capital requirements must be solely from *non*-borrowed cash cannot be supported.¹¹ Indeed, it is common practice in the utility industry to utilize short-term debt to fund cash working capital requirements based in large part on the fact that such requirements are seasonal in nature. To exclude commercial paper borrowings from the Company's available cash working capital merely inflates its alleged need for higher revenues.

Another major flaw in PGW's argument is that PGW's year end cash calculations are based on PGW's five-year forecast and its aggressive debt reduction program. OCA witness Bleiweis explained how this can affect any determination of PGW's year end cash:

Another major effect on cash would result if PGW were to pare down what it has termed its Debt Reduction Funding program. This funding, which totals \$205 million for the period FY2007-FY2012, is part of PGW's program to attain an approximate 50/50 debt/equity ratio at the end of the five-year forecast period. For argument's sake, if the Debt Reduction program was reduced by \$100 million over the five-year period, then an additional \$100 million in cash would be available to PGW.

OCA St. 2-S at 2-3.

When properly viewed, PGW has about \$53 million of cash on hand at the end of the future test year under the OCA's recommendation (a \$22.5 million increase compared to the ALJs' recommended \$25 million increase) and about \$60 million of available commercial paper. OCA St. 2, Schedule MAB-10. This level of working capital provides about 45 days of liquidity,

¹¹ At page 27 of its Exceptions, PGW argues that it doubts that major utilities in the Commonwealth would be consigned to having to borrow working capital rather than being able to charge rates to provide reasonable cash working capital. As PGW witness Bogdanavage acknowledged on cross-examination, and as the Commission is aware, major investor owned utilities receive their cash working capital allowance from shareholders and only the amount of that allowance is included in rate base to receive the return (interest) from ratepayers. Tr. at 599-600.

an amount that is typically seen as a standard in the industry.¹² OCA St. 2-S at 10. When PGW's liquidity is assessed, including its cash and cash equivalents, the ALJs' recommended rate increase provides a reasonable level of cash working capital for PGW.

OCA Reply To PGW Exception 6: The ALJs Were Correct In Denying The Company's Request To Retain 100% Of The Revenues Derived From Off-System Sales And Capacity Releases. (PGW Exc. at 29-31; R.D. at 23-25; OCA M.B. at 32-35; OCA R.B. at 15-18.)

PGW requested to change the treatment of its approximate \$10 million annual off-system sales and capacity release revenues. Instead of crediting these revenues to the GCR, which directly lowers the ratepayers' cost for natural gas, PGW proposed to keep 100% of these revenues for the stated purpose of funding its construction program and reducing its outstanding debt. PGW St. 1 at 5. The ALJs correctly upheld the current treatment of off-system sales and capacity release revenues. R.D. at 25. The ALJs cited numerous reasons why PGW's proposal was flawed, including that PGW failed to show that its proposal was necessary, PGW failed to show its proposal does not conflict with the Public Utility Code or regulatory principles and PGW failed to clearly identify the construction projects involved. Additionally, the ALJs noted that retaining 100% of the revenues for construction projects would benefit non-GCR customers at the expense of GCR customers, who paid for the assets used to generate the revenues. R.D. at 25. PGW filed an exception to the ALJs' decision on this issue. PGW Exc. at 29.

In its Exception number 6, PGW argues that since other Natural Gas Distribution Companies (NGDCs) have sharing mechanisms, whereby a certain percentage of these revenues are retained for the benefit of their shareholders, PGW should be allowed to keep 100% of these

¹² PGW also argues that a minimum standard of liquidity for a municipal utility is 200 days of cash. PGW Exc. at 27-28. PGW bases its argument on Exhibit BB-3 presented by PGW witness Bisgaier. As cross examination of Ms. Bisgaier showed, this Exhibit did not include companies that were comparable to PGW. Tr. 757-761. See, OTS Main Brief at 41-43 for a complete discussion of the flaws of this Exhibit. OCA witness LeLash also noted that the Exhibit showed that some utilities had between 1,000 and 100,000 days of liquidity, which should raise some red flags. OCA St. 1-S at 10. As Mr. LeLash points out, the standard in the industry is 45 days of liquidity, or what is referred to as the 1/8th method (because 45 days is approximately 1/8th of a year). OCA St. 1-S at 10.

revenues. PGW Exc. at 29-30. PGW also argues that keeping these revenues and using them for construction projects is less costly for ratepayers in the long run. PGW Exc. at 30.

The OCA submits that PGW's arguments must fail. The Commission should not entertain this speculative proposal by PGW, to perhaps someday provide greater benefits, as this proposal amounts to a gamble involving scarce resources that PGW's ratepayers can ill afford to wager. PGW ratepayers already bear the burden of the highest overall costs for gas service in Pennsylvania, and those costs should not be made \$10 million higher. OCA M.B. at 33; OCA St. 1 at 22; St. 1S at 16.

OCA witness Richard LeLash pointed out and discussed a serious flaw in the Company's reasoning – that ratepayers would be better off paying \$10 million higher gas costs:

The central issue is whether ratepayers would be better off over time losing their margins and credits and not having to pay for alternative debt or not losing their margins and credit and having to pay for any debt. Central to this question is the opportunity cost of capital for ratepayers. In my opinion, the ratepayers' cost of capital is probably well above 15% and not the 5% or 6% apparently used by the Company. Consumers' opportunity cost of capital is best reflected by credit card interest rates, and the rates of pay day lenders referenced by Mr. Hershey. Even with all of the costs associated with incremental debt, a more realistic financial analysis should indicate that ratepayers would not be better off by foregoing their capacity margins and credits.

OCA M.B. at 34; OCA St. 1 at 23-24.¹³

PGW's reference to the sharing mechanisms in place for other investor-owned NGDCs also does not provide a fair comparison. PGW Exc. at 29-30. These other investor-owned NGDCs do not have the same extraordinary level of overall gas costs as are found in PGW's service territory. Additionally, the Commission has found that NGDCs have a responsibility to

¹³ Mr. LeLash also pointed out that there is an implicit assumption in PGW's proposal that capital for construction projects has only two sources, either the capital is borrowed or PGW ratepayers supply it. OCA M.B. at 34; OCA St. 1 at 23-24. PGW chooses to ignore the fact that its owner, the City of Philadelphia, could provide an equity infusion and thereby avoid the continued borrowing and the raiding of the GCR funds. OCA M.B. at 34; OCA St. 1 at 23-24

pursue off-system sales and capacity releases as a means to reduce gas costs for GCR customers. OTS M.B. at 44-45. PGW's proposal would violate that principle, because PGW's stated purpose is to reduce borrowing for construction projects. This lessened borrowing, if in fact it came to pass, would affect base rates for all PGW customers, and thus GCR assets would be impermissibly used to provide benefits to non-GCR classes.

In addition, there is no guarantee that these alleged benefits would ever come to fruition. As PGW's Exceptions provide, in 2002, following on the heels of two base rate increases that totaled approximately \$70 million and the establishment of a weather normalization clause, PGW was planning to reduce its long and short-term debt. As the Company stated, "Unfortunately, this did not occur." PGW Exc. at 12. The OCA submits that to accept PGW's current proposal to keep 100% of these revenues for the purpose of reducing its reliance on debt, would not appear to be the sure bet that the Company portrays it to be.

PGW's GCR ratepayers currently receive a guaranteed, definite offset to the GCR that directly and immediately helps to mitigate their total gas service costs, the highest costs in Pennsylvania. OCA M.B. at 33; OCA St. 1 at 22; St. 1S at 16. As the testimony from the Public Input Hearings clearly showed, many of PGW ratepayers are already struggling to pay their gas bills at current rates. OCA M.B. at 16-17; OCA R.B. at 16-17. PGW's proposal to keep 100% of the off-system sales and capacity release revenues – about \$10 million annually – in order to perhaps be able to lower costs to ratepayers at some future, unspecified time, is not reasonable. The OCA submits that the ALJs' decision on this issue should be upheld.

OCA Reply to PGW Exception 9: The ALJs Were Correct In Disallowing PGW's Claimed Management Incentive Program Expense. (PGW Exc. at 34-36; R.D. at 33-35; OCA M.B. at 36-40; OCA R.B. at 19-22.)

In Exception 9, PGW argues that the ALJs erred in disallowing PGW's claimed \$500,000 Management Incentive Program expense. R.D. at 33-35. The ALJs disallowed this expense finding that PGW had failed to meet its burden of proving that the expense was reasonable and prudent. R.D. at 35. Specifically, the ALJs found:

Necessarily it follows that PGW has not carried its burden of proof by providing sufficient detail of the incentive program to substantiate the expense as prudent and therefore reasonable. Consequently, we recommend that the Commission disallow the expense for the incentive program.

R.D. at 35.

PGW argues that the R.D. overlooked the evidence it presented that the Management Incentive Program was allowed and approved under the Management Agreement and by PGW's Board of Directors. PGW Exceptions at 35. PGW's argument misses the point, however. As the OCA discussed in its Main Brief, PGW failed to provide any formal guidelines to define the program, any measurable performance objectives, or any plan documentation. See, OCA M.B. at 37-38; OCA St. 2 at 17; OTS St. 2 at 6-8. When the Philadelphia Gas Commission reviewed this claim, the Philadelphia Gas Commission, as the ALJs here, concluded that without "clearly articulated, well-defined, quantitative goals and criteria," the program should not be approved.¹⁴

The OCA submits that the Company has failed to show sufficient documentation to demonstrate the reasonableness of the Management Incentive Program. See also, OCA M.B. at 36-40; OCA R.B. at 19-22; OCA St. 2 at 17; OTS St. 2 at 6-8. This was the conclusion reached by the Philadelphia Gas Commission based upon the evidence provided by PGW and by the ALJs here upon review of the evidence. The ALJs' R.D. should be upheld.

¹⁴ PGW also states that the R.D. erred in stating that the correct standard for review was whether the expense was "prudently incurred." PGW Exceptions at 36; R.D. at 35. PGW argues that the Commission has found management incentive plans reasonable when they "are shown to be designed to foster 'operational effectiveness'." PGW Exceptions at 36. This is a difference without a distinction.

OCA Reply to PGW Exception 11: The ALJs Were Correct In Disallowing PGW's Claimed Lobbying Expenses. (PGW Exc. at 37-38; R.D. at 38-41; OCA M.B. at 40-42; OCA R.B. at 22.)

In the R.D., the ALJs disallowed PGW's claim for lobbying expenses. R.D. at 39. PGW excepts to this determination, arguing that the Commission should waive its general rule disallowing lobbying because PGW is a municipal utility and its owners are "essentially the same as PGW's ratepayers." PGW Exceptions at 37.¹⁵ PGW argues that its lobbying efforts benefit ratepayers. Therefore, PGW concludes the expense should be included in rates. Id.

The OCA submits that extensive Commission precedent and Section 1316 of the Public Utility Code preclude PGW's claim. R.D. at 40; 66 Pa.C.S. § 1316.¹⁶ PGW made similar arguments in its last base rate proceeding, and the Commission denied the lobbying expense. As the ALJs found:

This claim is similar to the claim presented in the Company's last base rate case which the Commission rejected. PGW has not provided any compelling reasons that the Commission should waive treatment of this claim contrary to the PUC consistently rejecting this claim in the past. Regarding the Company's attempt to equate the ratepayers to owners, we find the logic of attributing ownership qualities to the ratepayers of the Company flawed.

R.D. at 41. 2001 PGW Base Rate Order, at 63-66.

The OCA submits that the ALJs' decision on this issue should be upheld.

OCA Reply to PGW Exception 12: The ALJs Were Correct In Disallowing PGW's Expense Claim For Regulatory Fines. (PGW Exc. at 38-39; R.D. at 43-45; OCA M.B. at 43-44; OCA R.B. at 23-24.)

¹⁵ PGW attempts to shift ownership responsibilities to its ratepayers. The City, not ratepayers, owns PGW. R.D. at 41.

¹⁶ Pa. P.U.C. v. Pennsylvania-American Water Co., 79 Pa. P.U.C. 25, 66 (1993) (portion of membership dues disallowed which related to legislative advocacy functions and lobbying); Pa. P.U.C. v. Duquesne Light Co., 59 Pa. P.U.C. 67, 118 (1985) (Edison Electric Institute (EEI) dues disallowed because the legislative advocacy activities were of no benefit to ratepayers.); Pa. P.U.C. v. National Fuel Gas Distribution Corp., 84 Pa. P.U.C. 134, 196 (1995) (disallowed expenditures of the Governmental Affairs Department that related to lobbying); Pa. P.U.C. v. Metropolitan Edison Co., 60 Pa. P.U.C. 349, 382 (1985) (EEI dues eliminated for the percentage that went towards lobbying and legislative activities expenses.)

In this case, PGW sought to include \$50,000 of expense for regulatory penalties and fines. The ALJs denied this claim finding that “PGW can control its conduct and thus minimize this expense by avoiding activities that violate the Commission’s statutes and regulations.” R.D. at 44. In the R.D., the ALJs highlighted the testimony of OCA witness Bleiweis as follows:

[PGW] expects that the company will be fined by the PUC for failure to comply with the Public Utility Code and related regulations.

Regulatory fines are an ownership expense and, therefore, are not recoverable through rates. Customers cannot be expected to subsidize a utility’s failure to comply with PUC standards or reasonable and efficient service. Similarly, PGW’s Operating Budget should be based upon the assumption that PGW will provide reasonable service and avoid incurring regulatory penalties.

...[I]t is within PGW’s power and responsibility to take the necessary steps to avoid incurring regulatory penalties.

OCA St. 2 at 28; See also, R.D. at 45.

In its Exceptions, PGW argues that the R.D. failed to understand that there is no separation between the City ownership of PGW and the ratepayers. PGW states that “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.” PGW Exceptions at 37. The OCA submits that PGW has missed the point. PGW ratepayers are not the owner of PGW and including such penalties as a recoverable item in rates would not be in the public interest. Inclusion of such an expense defeats the purpose of regulatory penalties and moves responsibility for Company actions to the customers who are the injured party by violations of the regulations. Moreover, such an allocation assumes that PGW will continue to violate the Commission’s regulations. PGW’s Exception must be denied.

OCA Reply To PGW Exception 14: The ALJs Were Correct In Ordering PGW To Implement A Program To Prevent Double Recovery Of CRP Costs. (PGW Exc. at 40-43; R.D. at 30-33; OCA M.B. at 81-84; OCA R.B. at 42-44.)

PGW collects its Customer Responsibility Program (CRP) costs through a reconcilable surcharge (Universal Service Charge or USC) from all firm service customer classes. Included in the USC are the CRP credits, or CRP shortfall. The CRP credits are the difference between the CRP usage billed at the General Service Rate and the amount the customer is asked to pay under the terms of the CRP. Before a customer enters CRP, the amount the customer fails to pay is reflected in the uncollectible expense. When a customer moves into CRP, the amount that the customer does not pay is reflected in the CRP credit. As the CRP credit, it is now fully paid by all other customers through the USC.

The movement of additional customers into CRP creates the potential for double-recovery of this expense - - once as uncollectible expense in base rates and once as a CRP credit through the USC. R.D. at 30; OCA M.B. at 81; OCA St. 4 at 4. The ALJs recognized this potential for double-recovery and directed the Company to design a mechanism that would prevent this double-recovery. As the ALJs reasoned:

OCA makes a convincing argument that double recovery is a possibility and can be alleviated by implementing a mechanism for reconciliation. PGW does not provide a persuasive argument that the current practice guards against double recovery. Consequently, PGW does not support persuasively that the recommendation by OCA is unreasonable.

R.D. at 33.

PGW excepts to the ALJs' recommendation, arguing that the ALJs' R.D. establishes a "bad debt tracker" in violation of Section 1408 of the Public Utility Code.¹⁷ The mechanism recommended by the OCA, however, is not a "bad debt tracker" as PGW asserts. It is a mechanism to prevent the double-recovery of uncollectible expense - - once through base rates

¹⁷ The ALJs correctly stated that Section 1408 does not apply to universal service and energy conservation programs. As the ALJs note, the "section states it is not to affect any clause associated with universal service and energy conservation." R.D. at 32.

and once through the USC. The USC should only recover the incremental costs of CRP. When the number of customers in CRP exceeds the number of customers at the time base rates are set, there needs to be a reduction in the CRP credits to account for the uncollectibles that are already in base rates.¹⁸

The R.D. correctly ruled that such double recovery should not be permitted and that PGW should take steps to eliminate this double recovery. The R.D. should be upheld.

OCA Reply To PGW Exception 15: The ALJs Were Correct In Finding That PGW's COSS Does Not Accurately Classify Or Allocate The Cost Of Distribution Mains In This Proceeding. (PGW Exc. at 43-46; R.D. at 56-63; OCA M.B. at 45-63; OCA R.B. at 25-34.)

In the R.D., the ALJs agreed with OCA and OTS that distribution mains do not have a customer component and should be allocated based on demand. R.D. at 63.¹⁹ The ALJs directed PGW to rerun its Cost of Service Study (COSS) using a demand allocator for distribution mains. R.D. at 63. PGW filed exceptions on this issue. PGW Exc. at 43. PGW argues that its witness, Mr. Gorman, supported the use of a customer component to distribution mains in his COSS and testimony. PGW Exc. at 44. PGW also cites to a single Commission decision as support for its argument that this Commission should accept a customer component to distribution mains costs. Pa. PUC v. National Fuel Gas Corp., 1982 Pa. PUC LEXIS 132 (Mar. 26, 1982) (National Fuel). The OCA submits that the ALJs were correct in rejecting PGW's COSS.

The ALJs provided the following conclusions as to the allocation of costs for distribution mains in this proceeding:

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

¹⁸ The CAP Policy Statement requires that cost recovery for universal service programs should include both revenues and any cost off-sets. CAP Policy Statement, 52 Pa. Code § 69.266.

¹⁹ On August 22, 2007, the OCA filed a letter with the Office of Special Assistants and the other parties in this proceeding as to the OCA's Exceptions that had been filed on August 20, 2007. Therein, the OCA clarified that the ALJs' discussion in the R.D. appeared to endorse OCA's COSS, but the ordering paragraphs provided that PGW should use the OTS methodology. The OCA's position, as expressed in its Exceptions, is unchanged.

the cost of the distribution mains. Therefore, PGW should make the proper classification and allocation.

R.D. at 63. PGW's COSS allocates 25% of the cost of distribution mains as a customer component, or based on the number of customers connected to the system. PGW St. 8 at 15; OCA M.B. at 47. The remaining 75% of distribution mains costs are allocated on the basis of customer class coincident peak demands. PGW St. 8 at 15; OCA M.B. at 47.

OCA witness Richard Galligan testified as to why distribution mains have no customer component, as follows:

Mains are not sized for the number of customers served from them, but for the loads placed upon them. This is made clear in the following example: along one city block are located 10 residential customers with a coincident peak demand of one Mcf each. The main running down the street would have to be capable of delivering 10 Mcf at peak. On another city block is only a small plastics factory that exhibits a maximum demand of 10 Mcf. The main for that one customer has to be sized to deliver 10 Mcf when the plastics factory demand peaks. It is clear that the mains investment is driven by the loads placed upon it -- not by the number of customers served from it. Finally, imagine that the plastics factory is torn down to make room for five large residences, each of which exhibits a demand at time of coincident peak of 2 Mcf. Again, the main which is sized to deliver 10 Mcf is adequate. One customer, five customers, or ten customers do not determine the amount of mains investment; rather, mains investment is a function of the loads to be served.

OCA St. 3 at 9; OCA M.B. at 48-49. As can be seen by Mr. Galligan's example, the concept of a customer component of distribution mains costs is at odds with the principle of cost-causality.²⁰ In allocating the cost of distribution mains on a demand basis, the OCA submits that the Peak and Average method is in accord with the principle of cost-causality, as OCA witness Galligan describes:

²⁰ Mr. Gorman, who sponsored the Company's COSS, used both a zero-intercept and minimum-system method to assess the accuracy of the 25% customer component. OCA M.B. at 50. In addition to Mr. Galligan's example and analysis above that highlights the flaws as to the customer component of distribution mains, the Commission has rejected zero-intercept and minimum system methods as being inconsistent with the principle of cost-causation. See, Pa. P.U.C. v. National Fuel Gas Distribution Corp., 83 Pa. PUC 262 (1994)**Error! Bookmark not defined.**; Pa. P.U.C. v. National Fuel Gas Distribution Corp., 73 Pa. PUC 552 (1990). OCA M.B. at 50.

PGW's system was built and costs were incurred to deliver gas both at the time of peak system demand and generally throughout the year. Because costs are incurred to deliver gas generally throughout the year, and additional costs are incurred to meet peak demands, PGW's delivery costs must be allocated on the basis of both annual and peak demands if those costs are to be allocated in accord with the principle of cost causality. PGW's failure to recognize the importance of annual demands as well as peak demands, and PGW's allocation of 100 percent of its demand related mains investment costs on peak demands only, violates the principle of cost-causality.

OCA St. 3 at 14; OCA M.B. at 51. As the ALJs recognized, Mr. Galligan's Peak and Average COSS recognizes and allocates the cost of mains based on average use throughout the year and also during periods of peak demand, more in-line with how PGW's system actually operates. R.D. at 63; OCA M.B. at 53-54. The OCA submits that the ALJs' agreement with the OCA's and OTS's basic methodology for allocating the costs of distribution mains was correct, and the ALJs' decision to not adopt PGW's COSS should be upheld.

PGW tries to rely on the 1982 National Fuel case for support of its position, but ignores the long line of Commission decisions that accept the Peak and Average method that came after the 1982 National Fuel decision. PGW Exc. at 44-45. In the 1982 National Fuel case, the Company had presented two COSSs, one that used peak demand only and another that used peak and average, but both COSSs also allocated a portion of the costs of distribution mains based on the number of customers. PGW Exc. at 45; National Fuel at *61-62. The Commission accepted the Company's COSS, but it did not have a choice of viewing a COSS that allocated the cost of distribution mains without a customer component. National Fuel at *64. Of note though, the Commission stated:

Although we find the cost-of-service studies developed by respondent to be reasonable and therefore acceptable, we request that the company, at the time of its next rate case, prepare cost-of-service studies which allocate distribution main costs using a method similar to that employed in this proceeding, and a separate study which would allocate these costs on a demand commodity basis. This will enable the commission to evaluate both methodologies.

National Fuel at *63-64. Subsequently, in National Fuel Gas Distribution's 1994 base rate proceeding, the Commission accepted the Peak and Average methodology, stating, "The Peak and Average method that allocates mains equally is a sound and reasonable method of cost allocation and should remain intact." Pa. P.U.C. v. National Fuel Gas Distribution Co., 83 Pa. PUC 262 (1994). See also, Pa. P.U.C. v. National Fuel Gas Distribution Co., 73 Pa. PUC 552 (1990); Pa. P.U.C. v. Equitable Gas Co., 73 Pa. PUC 301 (1990); Pa. P.U.C. v. National Fuel Gas Distribution Corp., 72 Pa. PUC 1 (1989); Pa. P.U.C. v. Peoples Gas Co., 69 Pa. PUC 138 (1989). OCA M.B. at 60. This is the precise method Mr. Galligan used for his study in the present case. OCA St. 3 at 4. In the present proceeding the OCA's Peak and Average COSS, which the ALJs found to be persuasive as to allocating the costs for distribution mains, should be adopted.²¹

The OCA agrees with the ALJs on their analysis that the allocation of distribution mains costs in this proceeding be based on demand. The ALJs correctly concluded that PGW's COSS, with a customer component, was flawed. The OCA submits that the ALJs' decision to reject PGW's COSS was correct and should be upheld.

B. Reply To OSBA And PICGUG Exceptions.

OCA Reply to OSBA and PICGUG Exception 1: The ALJs Were Correct In Maintaining PGW's Current Allocation Of Universal Service Costs To All Firm Service Customers. (OSBA Exc. at 3-18; PICGUG Exc. at 2-6; R.D. at 73-81; OCA M.B. at 87-95; OCA R.B. at 45-55.)

²¹ Other jurisdictions have accepted the Peak and Average methodology as proposed by OCA witness Galligan in this proceeding. The Indiana Utility Regulatory Commission (IURC) recently issued a decision, wherein the exact peak and average methodology advocated by Mr. Galligan in the present matter was accepted and strongly endorsed. See, In re Citizens Gas & Coke Utility, IURC Cause No. 42767, (Oct. 19, 2006).²¹ "The IURC found that the peak and average method, as advanced by Mr. Galligan,²¹ was the 'equitable and realistic' method for allocating distribution mains costs." OCA M.B. at 60.

Similarly, the Illinois Commerce Commission and the Arkansas Public Service Commission have also both endorsed the use of the Peak and Average method. Central Ill. Pub. Service Co. Proposed General Increase In Natural Gas Rates, et. al., 2003 Ill. PUC Lexis 824. 231-232 (2003); In The Matter Of The Applications Of Ark. Western Gas Co. For Approval Of A General Rate Change In Rates And Tariffs, Docket No. 02-227-U; Order No. 17, 2003 Ark. PUC LEXIS 397, 69 (2003). OCA M.B. at 61-62.

The ALJs found that maintaining PGW's historic recovery of universal service costs from all firm service customers was reasonable. As such, the ALJs denied OSBA's proposed three-year phase-out of the allocation of universal service costs to non-residential firm service customers. The OSBA and PICGUG filed Exceptions. OSBA Exceptions at 3-18; PICGUG Exceptions at 2-6. OSBA and PICGUG repeat their arguments that Commission precedent requires that universal service costs be charged only to PGW's residential customers. OSBA also argues that it is inappropriate to require business customers to pay these costs. OSBA Exceptions at 13-15. The OCA submits that OSBA's and PICGUG's Exceptions must fail.

1. PGW's Existing Recovery of Universal Service Costs To All Firm Service Customers Is Not Precluded By Commission Policy or Precedent.

Historically, PGW has allocated its universal service costs to all firm service customers. The OSBA and PICGUG now argue that this existing allocation be changed based on Commission decisions in other cases and the Commission's recent CAP Policy Statement Order. OSBA Exceptions at 10-13; PICGUG Exceptions at 2-5; See also, Customer Assistance Programs: Funding Levels and Cost Recovery Mechanisms Final Investigatory Order, Docket No. M-00051923 (Order Dec. 18, 2006) (CAP Policy Statement Order). The OCA submits, however, that neither Commission cases nor the CAP Policy Statement Order provide a basis for changing PGW's collection of its universal service costs from all firm service customers.

In their Exceptions, OSBA and PICGUG primarily rely on cases where the Commission determined to retain an existing allocation of universal service costs to residential customers,

finding no basis on the record of the case to change the existing method.²² OSBA's reliance on Equitable's universal service program allocation is also misplaced. As noted in the OCA's Main Brief and Reply Brief, some portion of Equitable universal service costs *are* allocated to small business customers. The Commission specifically affirmed that the commercial class was funding the existing CAP as a result of the Equitable Gas Restructuring Settlement. OCA M.B. at 93 at Appendix C, Application of Equitable Gas Company For Approval of Natural Gas Choice and Competition Act Restructuring, Docket No. R-00994784, *slip op.* at 2-3 (Sept. 12, 2002); OCA R.B. at 47.

Here, with respect to PGW, the existing method is an allocation to all firm service customers, not just to residential customers. As the ALJs correctly concluded, there is no basis on this record to change such allocation, and in fact, a change in the allocation as proposed by OSBA would result in rate shock to residential customers. R.D. at 80-81.

The Cap Policy Statement Order also provides no basis to change PGW's existing allocation of universal service costs. As OSBA recognizes in its Exceptions, the Commission's CAP Policy Statement Order setting forth its general policy on collection of universal service costs specifically recognized that PGW had unique circumstances and a specific policy. OCA

²² Pa. P.U.C. v. Equitable Gas Company, Docket No. R-901595, 72 Pa. P.U.C. 301 (Order entered November 21, 1990) at 340 (Allocation of "pilot" program expenses to residential class customers. Commission deferred further review of issue to generic proceeding.); Petition for 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) (No allocation of the small business customer portion of Equitrans refund to \$1 Energy Fund and Equitable Gas Help Fund.); Pa. P.U.C. v. Valley Energy, Inc., Docket Nos. R-00049345, R-00049345C0001 (Order entered April 21, 2005) (Continued allocation of universal service costs to residential customers.); Application of UGI Utilities, Inc., UGI Utilities Newco, Inc. and Southern Union Company for approval of the transfer by sale of all property used or useful in providing natural gas service to the public to UGI Corporation, et al., Docket Nos. A-12011F2000, *et al.* (Order Entered August 18, 2006) (UGI/PGE Merger); Pa. P.U.C. v. PPL Gas, Docket Nos. R-00061388, *et al.* (Order entered February 8, 2007) (Collaborative would not address universal service funding issues.); Pa. P.U.C. v. PPL Electric Utilities Corporation, Docket No. R-00049255 (Order Entered December 22, 2004) (No basis to change the historic allocation of costs of universal service programs to residential customers.); Pa. P.U.C. v. Metropolitan Edison Company and Pennsylvania Electric Company, et al., Docket Nos. R-00061366, *et al.* (Order Entered January 11, 2007) (Continued allocation of universal service costs to residential customers.)

witness Colton provided testimony on the importance of PGW's policy given that it is a municipal utility:

PGW's offer of universal service programs helps to control the need to provide local government services, the cost of which is largely borne by non-residential taxpayers. The connection between the loss of home energy service and housing abandonment has been documented in Pennsylvania. In addition, there is a documented connection between utility shutoffs and an increase in homelessness, with one of the primary studies being performed in Philadelphia. There is a direct connection between unaffordable home energy bills and the costs of providing public health and nutrition services. There is a documented connection between unaffordable home energy bills and the costs of providing public health and nutrition services. There is a documented connection between unaffordable home energy bills and public safety costs. Particularly in a city such as Philadelphia, with a large low-income population, the costs of providing these city services can be tremendous. Conversely, the benefits of mitigating the need to provide these city services will redound to the benefit of all taxpayers, including commercial and industrial entities.

OCA St. 4-R at 13; OCA M.B. at 92-93.

Neither prior Commission decisions in other utility cases nor the CAP Policy Statement Order support a change in PGW's allocation of its universal service costs to all firm service customers. The continuation of PGW's policy to collect universal service costs from all firm service customers is fully in accord with the Commission's prior decision regarding PGW and is sound public policy. Pa. P.U.C. v. Philadelphia Gas Works, 2003 Pa. PUC LEXIS 13, 223 PUR 4th 412 (2003). The ALJs' decision should be upheld.

2. OSBA's Arguments Fail To Recognize The Many Benefits Of Universal Services Programs To All Customers.

OSBA also argues that asking commercial customers to pay for these programs is inappropriate because only residential customers can participate in and benefit from these programs. OSBA Exc. at 13. OSBA ignores, or discounts as indirect, the record evidence as to the many benefits that these programs provide to commercial and industrial customers. OCA

witness Colton detailed these benefits and OCA discussed these benefits at length in its Main Brief at pages 89 to 93 and Reply Brief at pages 51 to 55. By way of summary:

- Universal service programs help increase employee productivity. OCA St. 4-R at 11.
- Universal service programs help prevent employee turnover and increased absenteeism. Universal service programs also reduce forced mobility. OCA St. 4-R at 6, 10.
- Universal service program help employers by contributing to the economic stability of their workforces. These programs bolster the ability of low-income workers to meet their basic needs, in effect providing a wage supplement to employers. OCA St. 4-R at 11.
- With low-wage employees, in particular, unaffordable home energy directly contributes to lowered productivity. Increased personal illness, increased employee turnover, and increased family care responsibilities are but three of the factors contributing to lower employee productivity. Addressing unaffordable home energy helps to address these factors. OCA St. 4-R at 4, 6-11.
- Universal service programs have a substantial economic development impact in the jurisdictions in which they operate. As a significant contributor to economic development, low-income rate affordability programs help drive additional job creation, income generation, and economic activity for local businesses. OCA St. 4-R at 11-12.
- Universal service programs provide a substantial housing affordability subsidy to low-income wage workers, thus improving the work and competitive environment of the territory within which they are offered. OCA St. 4-R at 9.
- For a municipal utility such as PGW, universal service programs help control the need to provide local government services, and thereby, help to decrease and to address homelessness, public health and nutrition problems, and increase public safety. The benefits of mitigating or reducing the need for such services will redound to all taxpayers, including commercial and industrial customers. OCA St. 4-R at 13.

See also, OCA St. 4-R at 6-14. As can be seen from this summary, the benefits of these programs for commercial and industrial customers are significant. Commercial and industrial customers should not avoid responsibility for contributing to the cost of these programs.

3. The ALJs Correctly Concluded That OSBA's Proposal Would Still Violate Principles of Gradualism.

The ALJs concluded that with the base rate increase, shifting of cost responsibility to residential customers for universal service costs - - even over three years - - would constitute rate shock and would violate the principles of gradualism. R.D. at 80-81. The OSBA excepts, arguing that the suggested phase-out would only be a 1.3% increase per year for residential customers. OSBA Exc. at 4. PICGUG also argues that this would not constitute rate shock. PICGUG Exc. at 2. The OCA submits that OSBA and PICGUG do not correctly assess the impact on residential customers. Importantly, OSBA and PICGUG do not address the cumulative impact of the OSBA proposal or the fact that the increases are in addition to the base rate increases.

One crucial factor that is not contemplated in OSBA's proposal is the double-impact of the base rate increase and the assessment of the universal service costs to just residential customers. As OSBA's Exceptions acknowledge, the cumulative effect of OSBA witness Knecht's proposal would be to further increase residential customer rates on a total bill basis by an additional 3.9%, or \$.80/Mcf by the end of the three year period (assuming that there are no additional increases to the universal service charge due to other factors.) OSBA Exceptions at 4; OCA M.B. at 87; OSBA St. 3 at 13. This 3.9%, however, must be added to the base rate increase that will be imposed on residential customers. Under the ALJs' recommended rate increase and revenue allocation, the 3% increase on a total bill basis for residential customers would more than double, to a 6.9% increase, under OSBA's proposal by the third year. And this assumes that universal services costs would not increase, and that gas costs would not increase.

OSBA tries to soften its proposal by arguing that if the total increase granted to PGW is less than its full request, the impact should not be so severe for residential customers. OSBA Exceptions at 7. The OCA submits that just because an awarded rate increase is less than what the Company originally proposed does not make a proposal to shift an additional, disproportionate amount of costs onto one class reasonable. The assumption that if a class is assigned a rate increase at or below the Company's proposed level, more costs can be added to the class' responsibility is inconsistent with basic rate allocation principles.

PICGUG's argument that commercial and industrial customers are currently and significantly subsidizing the residential class is also incorrect. PICGUG Exc. at 4-5. Under the Cost of Service Study methodology supported by the ALJs, residential customers are paying their cost of service, not being subsidized by other classes. OCA St. 3-S at 13. Moreover, PICGUG's argument "puts the rabbit in the hat" by assuming that no universal service costs should have been assigned to the commercial and industrial class in the first place so that by paying any costs, the commercial and industrial classes are subsidizing the residential class. On the one hand PICGUG argues that the residential customers would not experience any hardship from the increased allocation of the costs of the program to residential customers even though it results in a 3.9% increase in rates, but on the other hand, PICGUG argues that it would provide a substantial hardship for commercial and industrial customers to continue to pay their existing share of these costs (which are already far smaller than the residential share.).²³ Id. at 5. PICGUG never attempts to reconcile its position with the fact that 32% of PGW's residential customers are at or below 150% of the Federal Poverty Level (FPL) and that 50% are at or below 250% of the FPL. Action Alliance St. 1 at Exh. HSG-4; OCA St. 1 at 5. These customers, many

²³ The lion's share of these costs are already borne by the residential customers. As OSBA notes in its Exceptions, \$97 million is paid by residential customers and \$34 million by the non-residential class. OSBA Exc. at 7.

of whom are not CRP customers, will have to absorb these costs. Action Alliance St. 1-R at 5; OCA R.B. at 50-51.

The ALJs correctly concluded that OSBA's proposal to shift all costs of universal service programs onto residential customers would result in rate shock for residential customers and would violate the principles of gradualism. OSBA's and PICGUG's arguments to the contrary must be rejected.

4. Conclusion.

The OCA submits that OSBA's and PICGUG's Exceptions must be denied. As PGW witness Hershey testified:

The Commission and the parties must recognize that PGW is unique when it comes to universal service and that force-feeding a one-size-fits-all approach to CAP programs and their cost-recovery mechanisms simply will not work for PGW. These differences were discussed at length in PGW's restructuring proceeding, just under five years ago, and they were a part of the record on which the Commission's decision to retain the Company's traditional cost allocation across all firm customers was based. The obvious differences are the size of PGW's programs (and thus their costs) and the ability of the residential customers to absorb the significant costs that would be shifted to their shoulders if the OSBA position were adopted.

Philadelphia is home to the greatest concentration of Pennsylvania's poor. As stated, PGW's CRP (not including the Senior Discount or other programs) presently has approximately 76,200 participants. Notably, as of the restructuring proceeding, 130,000 customers were at or below 150% of the federal poverty level and thus eligible for the CRP program. In terms of cost shifting, Mr. Knecht attempts to soft pedal the impact on PGW's residential customers who will be forced to pick up the tab, but his proposed phase-in of the increased cost cannot make its cumulative effect.

Ultimately, the Commission policy applied to other NGDCs that Mr. Knecht trumpets simply cannot and does not account for these dramatic differences between run-of-the-mill CAP program and PGW's CRP program. The Commission should not impose a set of standards designed for very different circumstances on PGW's customers.

PGW St. 1-R at 19-20; OCA M.B. at 94-95. The OCA submits that due to the nature of PGW and the financial circumstance of its customers, that the historic allocation of universal service costs should be maintained.

C. Reply To Hess And IGS Exceptions.

OCA Reply To Hess Exceptions 3 & 4: The ALJs Were Correct In Deciding That The Gas Supply Competition Docket Is A More Appropriate Forum For Hess's Nomination And Tolerance Issues. (Hess Exc. at 12-17; R.D. at 94-102; OCA M.B. at 107-109.)

In the R.D., the ALJs found that Hess's proposed changes to PGW's gas supply nominations, imbalance tolerances and penalties should not be adopted. R.D. at 101-102. The ALJs recommended that Hess either accept the counteroffers that PGW made as to these issues, or it could address these issues within the generic proceeding at Investigation into the Natural Gas Supply Market: Report to the General Assembly On Competition In Pennsylvania's Retail Natural Gas Supply Market, at Docket No. I-00040103, entered October 6, 2005 (Gas Supply Competition). R.D. at 101-102. Hess filed Exceptions 3 and 4 on these issues, which the OCA will address in the following section. Hess Exc. at 12, 18. The OCA submits that the ALJs' decision on this issue was correct and should be upheld.

Hess sought to change PGW's existing pipeline nomination deadline from 12:00 p.m., to 2:00 p.m. Hess Exc. at 12-13. Hess's contention is that PGW can accommodate this change, without incurring increased costs. Hess St. SR-1 at 11, 12. Hess also sought changes to PGW's tariff provisions for daily/monthly imbalance tolerances, penalties and cash outs. R.D. at 96-97. Hess witness Magnani argued that these changes are necessary to spur competition on PGW's system, but agrees that such activities should not be permitted to increase costs to incumbent ratepayers. Hess St. SR-1 at 11, 12.

The OCA agrees with Mr. Magnani that PGW's ratepayers must be held harmless from any increased costs that such proposals could generate. OCA M.B. at 108-109. The OCA is also concerned with the continued stability of the PGW system. As Mr. LeLash stated with respect to the Hess proposals:

While such changes would provide suppliers with greater flexibility, they would limit PGW's ability to 'police' its system and avoid costs associated with supplier non-compliance.

OCA St. 1R at 8.

The OCA submits that Hess failed to show how its proposals would assure that PGW would not incur substantial additional costs from these activities, costs that PGW's ratepayers would inevitably bear, and that Hess's imbalance tolerance proposal would not impair PGW's ability to safely control its system. The ALJs' recommendation to adopt PGW's counterproposals or take these issues up within the context of the Gas Supply Competition docket is reasonable and should be upheld.

OCA Reply To Hess Exception 5: The ALJs Were Correct In Rejecting Hess's Proposal To Allow Imbalance Trading Between Natural Gas Suppliers. (Hess Exc. at 25-28; R.D. at 99, 101-102; OCA M.B. at 107-109.)

The ALJs rejected Hess's proposal to allow imbalance trading between NGSs on PGW's system. R.D. at 99. The ALJs found that the costs of such activities were not quantified. R.D. at 99. Hess filed an Exception on this issue. Hess Exc. at 25. The OCA submits that the ALJs' determinations on this issue were correct, as the reasonableness of the increased costs to PGW, and ultimately its GCR ratepayers, was not supported in the record. Accordingly, the ALJs' decision should be upheld.

Hess contends that “PGW is not required to expend any effort on the transaction. It must merely adjust NGS volumes in its records.” Hess Exc. at 25. OCA witness LeLash testified, however, that:

such imbalance trades can often result in administrative problems. Over-deliveries may not be properly matched with under deliveries and there can be disputes between suppliers concerning trading status.

OCA St. 1R at 9.

The ALJs correctly identified the possible expense to PGW and its GCR ratepayers from these imbalance trading activities, and found that since the costs were not part of the record in this matter that Hess’s proposal should be rejected. R.D. at 99. The OCA submits that concerns over increased costs being passed on to PGW, and ultimately its GCR ratepayers, were considered by the ALJs in their decision to reject the Hess proposal on this issue. The ALJs’ decision should be upheld.

OCA Reply To IGS Exception 1: The ALJs Were Correct In Not Adopting IGS’s Proposal To Institute An Aggregation Pilot Program. (IGS Exc. at 2-4; R.D. at 102-103; OCA M.B. at 106-109.)

The ALJs held that the Interstate Gas Supply (IGS) proposal to initiate an aggregation pilot program on PGW’s system was not sufficiently developed, as no cost/benefit analysis was provided, and should be rejected. R.D. at 102-103. The OCA would also note that the program was insufficiently detailed, in that it is difficult to determine how actual savings from this program would result. OCA St. 1R at 2-3. IGS filed an Exception on this issue. IGS Exc. at 2. Consistent with the analysis that the OCA presented in its Main Brief on this issue, the OCA agrees that the ALJs’ decision to reject IGS’s unrefined proposal was correct and should be upheld.

IGS contends that its proposals would not impose additional costs on PGW or its customers, and that its proposals would result in a revenue stream generated by part of the discount provided by participants. IGS Exc. at 3-4. As OCA witness LeLash testified, however, IGS's proposals were not "described in sufficient detail to evaluate the proposals in full" and that the proposals "can present unique issues and risks to residential customers." OCA St. 1R at 4.

The OCA submits that the ALJs were correct in rejecting the undeveloped proposal, because IGS did not adequately support its proposal through the evidence of record in this proceeding. Accordingly, the OCA submits that the ALJs' decision on this issue was reasonable and should be upheld.

D. Reply To PHA Exceptions.

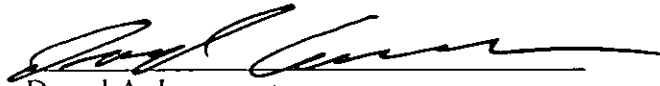
OCA Reply to PHA Exception 3: The PHA Request For Clarification About The Direct Vendor Program Should Be Denied. (R.D. at 82-83.)

In this proceeding, the Philadelphia Housing Authority (PHA) sought to have its tenants in its scattered sites placed on the CRP rate based on their income, whether or not the customer is payment-troubled. PHA St. No. 1 at 8-9; OCA St. No. 4-R at 24-28 . The ALJs properly denied this request. R.D. 83. As the ALJs correctly note, the CRP is for low-income, payment-troubled customers. R.D. at 83; See also, OCA M.B. at 101, 52 Pa. Code § 69.264. PHA tenants, who receive an allowance for payment of their utility bills, are not necessarily payment-troubled. OCA M.B. at 101. PHA now asks for a clarification to the R.D., arguing that it was not their position to have PHA tenants placed on CRP. PHA Exceptions at 6-7. The record, however, does not support PHA's request. R.D. at 82-83. The R.D. requires no clarification in this regard. As such, the PHA Exception should be denied.

III. CONCLUSION

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief, Reply Brief and Exceptions, the OCA respectfully submits that the Commission should adopt the ALJs' recommendations that are supported in these Reply Exceptions.

Respectfully Submitted,



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DATED: August 30, 2007

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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 Reply 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 30th day of August 2007.

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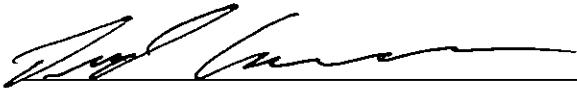
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC
UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

DOCKET NOS. R-00061931
R-00061931C0001

REPLY EXCEPTIONS
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

ORIGINAL

DOCUMENT
FOLDER

DOCKETED
AUG 31 2007

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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.

The Commission issued the ALJs' Recommended Decision ("R.D.") on July 30, 2007.

On August 20, 2007, the OSBA filed exceptions to the R.D. regarding the ALJs' recommendation that PGW's current allocation of universal service costs be retained and that OSBA's proposal to phase-out the recovery of universal service costs from business customers over three years be rejected. The Company, the OCA, the OTS, PHA, Hess, PICGUG, and Action Alliance also filed exceptions to the R.D.

The OSBA submits these Reply Exceptions in response to certain Exceptions filed by the Company and the OCA.

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. REPLY EXCEPTIONS

A. **REPLY TO PGW EXCEPTION NO. 6: The ALJs properly recommended denial of PGW's request to utilize the future proceeds from off-system sales and capacity release transactions to fund construction projects. (R.D. at 25; PGW Exception No. 1)**

PGW argues that it should be permitted to change the regulatory treatment of revenues derived from off-system sales and capacity releases. The Company currently returns 100% of that money to its purchased gas cost ("PGC") customers.² In this proceeding, PGW is proposing to reverse that practice and to begin retaining 100% of these revenues to help finance construction projects.³

The ALJs recommended the denial of PGW's request. Specifically, the ALJs stated in their R.D. as follows:

PGW failed to prove that this is necessary and that it is not a violation of the Public Utility Code and regulatory principles. The proposed construction projects are not clearly identified. All customers will benefit instead of just the PGC customers. Therefore, the Company's request to retain revenues associated with off-system sales and capacity releases is denied.⁴

The Company filed an Exception to the ALJs' recommendation that the Company's request to utilize the future proceeds from off-system sales and capacity release transactions to fund construction projects be denied.⁵ In support of their Exception, PGW makes four basic arguments.

² PGW Main Brief at 73

³ PGW Main Brief at 73

⁴ R.D. at 25

⁵ PGW Exceptions at 29

First, the Company asserts that the ALJs erred in finding that PGW's request was unprecedented, illegal, and contrary to Commission regulations.⁶ PGW argues that most major natural gas distribution companies ("NGDCs") in Pennsylvania are already permitted to retain a portion of off-system sales and capacity release revenues for the benefit of shareholders.⁷ Therefore, if retaining these proceeds were illegal, none of the sharing mechanisms for other Pennsylvania NGDCs could have been lawfully approved by the Commission.⁸

Second, PGW argues that its revenue retention proposal benefits its customers and not its shareholders.⁹

Third, PGW argues that its proposal would not improperly provide the benefits of these transactions to non-PGC customers because, on PGW's system, the gas assets used for these transactions are actually procured to provide service to both PGC customers and transportation customers.¹⁰

Fourth, PGW argues that although it did not identify specific construction projects that will be funded by these proceeds, PGW did indicate that it would use the funds for approved capital budget projects and that no more specificity is needed.¹¹

PGW Exception No. 1 should be denied.

⁶ PGW Exceptions at 29

⁷ PGW Exceptions at 29-30

⁸ PGW Exceptions at 30

⁹ PGW Exceptions at 30

¹⁰ PGW Exceptions at 31,,footnote 113

¹¹ PGW Exceptions at 31, footnote 113

PGW has estimated that, under its proposal, the Company would retain an estimated average of \$10 million in margins from off-system sales and capacity releases per year.¹² PGW would then flow the proceeds through to customers by making the estimated \$10 million per year available to fund construction projects.¹³ PGW's stated rationale for the proposed change is that the Company, by funding necessary construction projects with the credits from off-system sales and capacity releases, could avoid issuing additional long-term debt and thereby avoid the debt service that would otherwise follow the issuance of such debt.¹⁴

The proper treatment of the proceeds from off-system sales and capacity releases by an NGDC is not a new issue.¹⁵ Recently, the Commission addressed the matter in Equitable Gas Company's 2005 proceeding under Section 1307(f) of the Public Utility Code, 66 Pa. C.S. §1307(f).¹⁶ In that proceeding, the Commission approved an incentive mechanism by which ratepayers are to receive 75% of the margins from these transactions and the NGDC is to retain 25%. According to the Commission, a sharing of off-system sales and capacity release proceeds was initiated precisely to encourage NGDCs to maximize their use of excess or idle capacity and off-system opportunities in order to "recover a portion of fixed costs and *reduce the overall PGC rate.*"¹⁷ Thus, as

¹² PGW Main Brief at 74, citing PGW Statement No. 2 at 15-16

¹³ PGW Main Brief at 73

¹⁴ PGW Main Brief at 74

¹⁵ See *Pennsylvania Public Utility Commission v. National Fuel Gas Distribution*, 1980 Pa. PUC LEXIS 31, at 33-35, 54 Pa. PUC 401, at 414-415, 40 PUR4th 101 (1980).

¹⁶ *Pennsylvania Public Utility Commission v. Equitable Gas*, Docket No. R-00050272 (Order entered September 28, 2005) at 33-34

¹⁷ *Id.* (emphasis added)

OSBA witness Knecht testified in the instant proceeding, the objective of the incentive mechanisms approved by the Commission in other proceedings is to produce larger credits to PGC customers than they would obtain without a sharing mechanism.¹⁸ If none of the proceeds from capacity release and off-system sales transactions are directly shared with PGC customers, PGW's proposed approach cannot be consistent with the Commission's objective of reducing the PGC rates.

PGW's argument that it would actually be flowing through the credits to sustain construction projects and reduce the need for, and cost of, issuing long-term debt is not persuasive and should be rejected. PGW's proposal would require an improper mismatch between base rates and gas supply rates. An NGDC's gas supply rates are based on the cost of acquiring gas, pipeline capacity, and storage capacity. These costs are reviewed, and recovery is permitted or denied, in an annual proceeding under Section 1307(f). Because capacity release and off-system sales margins are earned by using the upstream capacity acquired for gas supply customers, the margins earned from those transactions are properly associated with the gas supply function. In contrast, an NGDC's distribution costs, including the costs associated with capital projects, are reviewed, and recovery is permitted or denied, on an irregular schedule in a base rates proceeding under Section 1308 of the Public Utility Code, 66 Pa. C.S. §1308. If the Commission determines that PGW is reasonably entitled to an additional \$10 million per year for capital improvements to its distribution system, the Company should recover those costs through base rates, not the gas cost rate ("GCR").

¹⁸ Knecht, OSBA Statement No. 2 at 26

As the Commission found in the 2005 Equitable Gas proceeding, Section 1307(f) does not provide a specific statutory directive for sharing of the proceeds from off-system sales and capacity releases. However, Section 1307(f) must be read in conjunction with Section 1318 of the Public Utility Code, 66 Pa. C.S. §1318, which directs that an NGDC pursue a least cost procurement policy.¹⁹ PGW's proposal, as filed, is therefore contrary to its statutory obligation under Section 1318.

In addition to advocating for its original proposal, PGW makes an alternative claim for relief on this issue, *i.e.*, 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."²⁰ If PGW can demonstrate that a sharing mechanism, such as that used by other Pennsylvania NGDCs, will result in larger credits for GCR customers than the current approach, then such a sharing mechanism would be consistent with a least-cost procurement program. While PGW has made no showing in this proceeding that a sharing mechanism would, in fact, increase the magnitude of the credits, PGW already has the opportunity to address that issue in the Company's Section 1307(f) proceedings. Consequently, there is no reason for the Commission to authorize an unspecified sharing mechanism in this proceeding.

¹⁹ *Equitable*, Docket No. R-00050272, Order at 33-34

²⁰ PGW Exceptions at 31 (emphasis in original)

B. REPLY TO PGW EXCEPTION NO. 11: The ALJs properly denied PGW's request to recover lobbying expenses. (R.D. at 41; PGW Exception No. 11)

PGW proposed a claim for operating expenses which included \$100,000 for WolfBlock Government Relations, a lobbying firm; \$130,000 for a contract government relations firm with a designated person devoted exclusively to PGW; and \$15,200 for dues and subscriptions.²¹ The ALJs recommended the denial of PGW's request.

Specifically, the ALJs stated:

We agree with the arguments supplied by the public advocates, OCA and OTS. PGW has not supported its claim by adequate evidence. This claim is similar to the claim presented in the Company's last base rate case which the Commission rejected. PGW has not provided any compelling reasons that the Commission should waive treatment of this claim contrary to the PUC consistently rejecting this claim in the past. Regarding the Company's attempt to equate the ratepayers to owners, we find the logic of attributing ownership qualities to the ratepayers of the Company flawed.

We recommend that the lobbying claim *in toto*, \$230,000 and the dues and subscription expense claim related to lobbying in the amount of \$15,200 or a sum of \$245,200 be excluded from rates.²²

In its Exception, PGW argues that the ALJs erred for two reasons. First, PGW contends that because the Company has a different status as a municipal utility, the Commission should waive the general rule against recovery of lobbying expenses.²³

²¹ PGW Main Brief at 66

²² R.D. at 41

²³ PGW Exceptions at 37

Second, PGW contends that \$100,000 of the rejected amount actually relates to non-lobbying government relations activities, such as interacting with the Commission and trade groups on various issues and concerns.²⁴

The OSBA takes no position on whether the ALJs were required to reject the entirety of PGW's claim because of the ban in Section 1316 of the Public Utility Code, 66 Pa. C.S. §1316, against the recovery of lobbying expenses. However, the OSBA objects to PGW's attempt to rely on Section 2212(c) of the Public Utility Code, 66 Pa. C.S. §2212(c), as authority for the Commission to waive the applicability of Section 1316 to the Company's claim.

Section 2212(c) states:

(c) APPLICABILITY OF OTHER CHAPTERS.-- Commencing July 1, 2000, to the extent not inconsistent with this section, the provisions of this title, other than Chapters 11 (relating to certificates of public convenience), 19 (relating to securities and obligations) and 21 (relating to relations with affiliated interests), shall apply to the public utility service of a city natural gas distribution operation with the same force as if the city natural gas distribution operation was a public utility under section 102 (relating to definitions), provided that, *upon request of a city natural gas distribution operation, the commission may suspend or waive the application to a city natural gas distribution operation of any provision of this title, including any provision of this chapter other than this section.* Chapter 11 shall apply to a city natural gas distribution operation to the extent it seeks to provide natural gas distribution services outside of its corporate or municipal limits. Chapter 19 shall apply to issuances of securities for the benefit of a city natural gas distribution operation by an issuer other than a city to the extent provided in subsection (c) but shall not apply to issuances of securities by a city. (emphasis added)

²⁴ PGW Exceptions at 38

The Company's request for a waiver of Section 1316 illustrates why PGW's overbroad reading of Section 2212(c), if accepted by the Commission, would violate the Pennsylvania Constitution.

Although Section 2212(c) authorizes PGW to request a suspension or waiver of any provision of the Public Utility Code, the Pennsylvania legislature did not articulate standards by which the Commission is to decide whether to grant or deny a specific request for suspension or waiver.

Section 1922(e) of 1 Pa. C.S. requires a statute to be construed with the presumption that the General Assembly did not intend to violate the Constitution. The effect of PGW's argument is to invite the Commission to use Section 2212(c) to write a separate Public Utility Code solely for PGW, and to do so with no standards set by the legislature. Construing Section 2212(c) to allow the waiver of major substantive provisions of the Public Utility Code, as advocated by PGW, would be contrary to the presumed legislative intent because such construction would render Section 2212(c) unconstitutional.

As set forth in *PPL Energyplus, LLC v. Commonwealth of Pennsylvania*, 814 A.2d 861 (Pa. Cmwlth. 2003), *reversed on other grounds, Delmarva Power & Light Company v. Commonwealth of Pennsylvania and Pennsylvania Public Utility Commission*, 582 Pa. 338, 870 A.2d 901 (Pa. 2005), any delegation of power or discretion to an administrative agency is unconstitutional if the legislature fails to provide the necessary standards for the exercise of that power or discretion. The Commonwealth Court decided that the delegation in *PPL Energyplus* was constitutional because the General Assembly had provided standards, *i.e.*, the Commission could exercise its

discretion to impose sections of the Public Utility Code on electric generation suppliers only “when such requirements are necessary to maintain the quality of service, to protect the public or to ensure the safety and reliability of electric service.” *PPL Energyplus*, 814 A.2d at 865.

In contrast, PGW’s interpretation would make the Commission’s discretion under 2212(c) unfettered—and, therefore, unconstitutional—because there are no comparable standards in Section 2212(c) to guide the Commission in deciding whether or not to grant a suspension or waiver of Section 1316.

C. REPLY TO PGW EXCEPTION NO. 15: The ALJs should have recommended adoption of PGW’s cost of service methodology. (R.D. at 56-63; PGW Exception No. 15)

REPLY TO OCA EXCEPTION NO. 1: The ALJs properly recommended that the Commission not rely on the OCA’s cost of service study. (R.D. at 56-63; OCA Exception No. 1)

1. Background

In its initial filing, PGW submitted a cost of service study (“COSS”) which improperly “bundled” all gas supply, transportation, load balancing, distribution, and customer assistance costs. As OSBA witness Knecht testified, using a bundled COSS to set rates for PGW would be inconsistent with the principles of cost causation because PGW has unbundled its rates.²⁵ Without an unbundled COSS, it is impossible to determine whether each component of PGW’s unbundled rates is, or is not, consistent

²⁵ Knecht, OSBA Statement No. 1 at 5

with allocated costs.²⁶ PGW unbundled its rates pursuant to its gas industry restructuring proceeding.²⁷ PGW's tariff has separate charges for gas supply (the Gas Cost Rate or "GCR"), distribution and customer services (base rates), and Universal Service and Energy Conservation ("USEC"). As Mr. Knecht pointed out, it makes little sense to continue to allocate those costs on a fully bundled basis, as PGW proposed in this proceeding.²⁸

In the R.D., the ALJs recommended that PGW use an unbundled COSS methodology. No party takes an explicit exception to that recommendation, although the OCA argues that the differences in allocated costs between bundled and unbundled COSSs are relatively small.

In response to the OSBA's discovery requests, PGW submitted unbundled corrected COSSs ("CCOSS") to reflect GCR costs, base rates costs, and USEC costs, accordingly. For purposes of this proceeding, the OSBA generally accepted PGW's unbundled *distribution* CCOSS methodology for setting *distribution* base rates. The OSBA did so with the knowledge that the CCOSS contains certain errors and methodological biases which result in the over-allocation of costs to commercial customers.²⁹

²⁶ As Mr. Knecht observed, it is not always necessary to develop separate COSSs, as long as costs within each study are segregated into categories (or "functions") that are consistent with the unbundled rates. Thus, for example, the allocation of universal service costs in PGW's COSS is generally not problematic, because the costs that are associated with universal service revenues can be readily segregated. However, PGW's COSS does not clearly segregate GCR-related costs and revenues, which are intermingled with non-GCR production and storage costs. Therefore, separate studies are required for PGW's GCR and base rates costs. Knecht, OSBA Statement No. 1 at 5-6.

²⁷ *Pennsylvania Public Utility Commission v. Philadelphia Gas Works*, Docket No. M-00021612 (Order entered March 31, 2003)

²⁸ Knecht, OSBA Statement No. 1 at 6

²⁹ Knecht, OSBA Statement No. 1 at 2

PGW's unbundled CCOSS, which includes all distribution base rates costs, was submitted as a corrected response to OSBA-I-2A (Revised).³⁰ However, that CCOSS remains partially bundled, in that it includes both distribution costs and universal service costs. With respect to the latter, both the revenues and costs associated with PGW's universal service programs are allocated on a volumetric basis and are, therefore, in balance. Mr. Knecht concluded that the universal service revenues and costs are easily segregated from base rates costs in this CCOSS. However, as set forth in the OSBA's Exception to the R.D., current Commission policy is that the recovery of universal service costs should be treated separately from base rates issues.³¹ Thus, for purposes of the OSBA's analysis of base rates cost allocation and revenue allocation issues, universal service costs and revenues have been excluded.³²

As Mr. Knecht observed, even with its errors and biases that are unfavorable to non-residential customers, PGW's CCOSS shows that non-residential firm sales customers provide revenues that are well in excess of allocated costs and that residential customers provide revenues that are below allocated costs.³³ The results of PGW's distribution cost allocation study are shown in Table IEc-1 below.

³⁰ This document refers to the full updated response to OSBA-I-2A circulated by PGW on March 30, 2007.

³¹ Knecht, OSBA Statement No. 1 at 13

³² *Id.*

³³ Table IEc-1 can be found at Knecht, OSBA Statement No. 1 at 14.

Table IEc-1 PGW Base Rates CCOSS Summary of Results for Firm Sales Customers at Present Rates \$000				
	Revenues	Total Costs	Difference	Revenue-Cost Ratio
Residential	264,747	281,203	(16,456)	94.1%
Commercial	52,317	39,766	12,551	131.6%
Industrial	5,432	3,996	1,436	135.9%
Municipal	4,417	3,275	1,142	134.9%
Housing Auth.	4,751	3,423	1,328	138.8%
Total	331,664	331,664	--	100.0%
Source: Exhibit IEc-4				

Both the OCA and the OTS objected to the Company's CCOSS for two reasons. First, the OCA and OTS objected to recognizing a "customer component" of distribution mains cost in PGW's CCOSS. In summary, they contended that a main is not sized on the basis of the number of customers to be served from that main. Second, they argued that the allocation of the commodity-related component of distribution mains costs should be based partly on an annual average demand factor rather than only on the basis of peak demand as proposed by PGW.³⁴

In addition to criticizing the Company's cost of service methodology, the OCA submitted its own COSS. Specifically, OCA's witness Richard Galligan testified that distribution mains costs should be allocated on the basis of the Peak and Average ("P&A") methodology, with 80% of the costs allocated on the basis of average demands and the remaining 20% allocated on the basis of peak demands.³⁵ The OCA contends that the allocation of mains costs should be done using both annual and peak demands

³⁴ PGW Main Brief at 77-78

³⁵ OCA Main Brief at 45

because this approach is the most closely aligned to allocating costs on the basis of cost-causality.³⁶

The OTS also submitted its own COSS. Under the Average and Excess (“A&E”) methodology, as advocated by OTS witness Joseph Kubas, 50% of the mains costs are allocated on the basis of average demands and 50% are allocated on the basis of excess demands.³⁷

The ALJs agreed with the arguments of the OCA and the OTS that there should be no customer component in the allocation of mains costs. However, the ALJs did not recommend that OCA’s COSS be used. Instead, the ALJs recommended the use of the OTS methodology as applied to the unbundled CCOSS submitted by PGW in response to the aforementioned OSBA interrogatory.³⁸ Specifically, the ALJs stated:

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 the OSBA. Therefore, PGW can use the unbundled COSS with the correct classification and allocation for distribution mains as a guide for revenue allocation.³⁹ (emphasis added)

³⁶ OCA Main Brief at 45

³⁷ OTS Main Brief at 54-56. Note that Mr. Kubas applies a non-standard version of the A&E methodology, that is not consistent with the American Gas Association’s text *Gas Rate Fundamentals*. Knecht, OSBA Statement No. 2 at 21.

³⁸ See R.D. at 135, Ordering Paragraph 11.

³⁹ R.D. at 63

Both the Company and the OCA filed Exceptions to the R.D. regarding the ALJ's recommended choice of COSS.

The Company argues that the Commission should adopt PGW's methodology. In support of its Exception, PGW argues that in *Pennsylvania Public Utility Commission v. National Fuel Gas Distribution Corporation*, 1982 Pa. PUC Lexis 132, **61-62, the Commission rejected the OCA's arguments and found that including a customer component properly reflects how distribution mains costs are incurred.⁴⁰ The Company also argues that the selection of the COSS for the instant proceeding is not dictated by the Commission's decision in *Pennsylvania Public Utility Commission v. PPL Gas Utilities Corporation*, Docket No. R-00061398 (Order entered February 8, 2007). Although the Commission approved the use of an A&E methodology in *PPL Gas*, PGW argues that the decision was fact-specific to that case and was not based on a thorough analysis of the COSS in that proceeding.⁴¹

In contrast, the OCA argues that the ALJs erred by not recommending the use of the OCA's P&A COSS. OCA opines that the ALJs did not use the OCA COSS because the OCA COSS did not incorporate the other modifications to PGW's COSS recommended by the ALJs, *i.e.*, the unbundling advocated by the OSBA.⁴² The OCA argues that the OCA COSS could still be used in this proceeding even though unbundling was not reflected in that COSS, because (according to the OCA) an unbundled COSS would not significantly impact the study results.⁴³

⁴⁰ PGW Exceptions at 45

⁴¹ PGW Exceptions at 46

⁴² OCA Exceptions at 6

⁴³ OCA Exceptions at 6

2. PGW's CCOSS

As OSBA witness Knecht testified, PGW's CCOSS uses a reasonable cost allocation methodology for allocating base rates costs.⁴⁴ The ALJs rejected PGW's CCOSS principally because it includes a customer component in the allocation of mains costs.⁴⁵ However, Mr. Knecht pointed out that "the cost of mains is significantly affected by two factors: the overall *length* of the mains needed to interconnect all of the customers and the *size* of the mains needed to meet peak demands."⁴⁶ Because it is difficult to calculate the precise length of the mains required to serve each specific customer class, Mr. Knecht explained that "many rate analysts use *number of customers* as a proxy for the length of mains."⁴⁷ PGW's witness Howard Gorman made a similar observation: "Clearly, the more customers there are on the system, the more length of distribution mains are required, and the higher the cost."⁴⁸ The underlying assumption is that because the mains needed to be lengthened as new customers were added to the distribution system, it is reasonable to assign part of the mains costs on the basis of the number of customers in each class and to assign the remainder of the mains costs on the basis of each class' demand.⁴⁹

⁴⁴ Knecht, OSBA Statement No. 2 at 9

⁴⁵ R.D. at 63

⁴⁶ Knecht, OSBA Statement No. 2 at 10 (emphasis in original)

⁴⁷ Knecht, OSBA Statement No. 2 at 10 (emphasis in original)

⁴⁸ Gorman, PGW Statement 8R at 9.

⁴⁹ Knecht, OSBA Statement No. 2 at 10-11

In addition, Mr. Knecht testified that PGW's use of a customer component is consistent with the principle of economies of scale. As an illustration, he explained as follows:

It is very likely that an NGDC will need to install many more feet of distribution main to serve 50 residential customers, each with a design day demand of 1.5 Mcf per day, than it would to serve one commercial customer with peak demand of 75 Mcf per day. Therefore, it will cost the NGDC more, per unit of peak demand, to serve the 50 residential customers than to serve the one commercial customer.⁵⁰

Mr. Knecht pointed out that PGW's use of a customer component in the allocation of mains costs is consistent with the published positions of the American Gas Association and the National Association of Regulatory Utility Commissioners.⁵¹ He also noted that PGW's use of a customer component is consistent with the methodologies used by PG Energy (now UGI Penn) and National Fuel Gas Distribution Company to allocate mains costs.⁵²

Based on expert judgment, PGW's filed COSS allocated 25% of its mains costs to customer classes on the basis of the number of customers in each class. PGW allocated the remaining 75% of the mains costs on the basis of each customer class' contribution to the systemwide peak demand. PGW subsequently prepared industry standard analyses, known as the "zero-intercept" and "minimum system" methodologies, in support of its proposed customer component of costs.⁵³ Mr. Knecht concluded that PGW's 25/75

⁵⁰ Knecht, OSBA Statement No. 2 at 11

⁵¹ Knecht, OSBA Statement No. 2 at 12-13

⁵² Knecht, OSBA Statement No. 2 at 13

⁵³ Knecht, OSBA Statement No. 1 at 11

judgmental split was a reasonable middle ground between a zero-intercept result of 21/79 to 27/73 and a minimum system result of 47/53 to 55/45.⁵⁴

Therefore, the Commission should grant PGW Exception No. 15 and adopt the PGW CCOSS methodology for allocation of distribution mains costs.

3. OCA's COSS

Unlike PGW's CCOSS, the OCA's recommended COSS does not allocate *any* of the mains costs to rate classes on the basis of the relative number of customers in each class. Although the ALJs did not recommend the use of the OCA's COSS, they did agree with the OCA that the COSS adopted for this proceeding should not include a customer component in the allocation of mains costs.⁵⁵ As set forth in the prior discussion regarding PGW's cost allocation methodology, the OSBA agrees with PGW that the ALJs erred in refusing to recognize a customer component of mains costs. For the same reasons, the absence of a customer component in the allocation of mains costs under the OCA's COSS is a fatal flaw.

However, even if the Commission agrees with the ALJs that there should be no customer component in the allocation of the mains costs, the Commission should reject the OCA's COSS and should, instead, adopt the OTS' cost of service methodology.

OTS witness Kubas advocated a variant of the A&E methodology for allocating the demand component of mains costs. As explained by Mr. Knecht, A&E is a hybrid methodology which allocates part of the demand costs to classes on the basis of each class' "average demand" relative to the system average. A&E allocates the remainder of the demand costs on the basis of each class' "excess demand" relative to the system

⁵⁴ Knecht, OSBA Statement No. 2 at 14-15

⁵⁵ R.D. at 63

average. "Excess demand" is equivalent to the "peak demand" minus the "average demand."⁵⁶

*In contrast to Mr. Kubas' approach, OCA witness Galligan advocated the use of the P&A methodology for allocating the demand component of mains costs. Under Mr. Galligan's COSS, 80% of the mains costs are allocated among the customer classes on the basis of the relative average demand of each class. The remaining 20% of the mains costs are allocated on the basis of the relative peak demand of each class.*⁵⁷

As Mr. Knecht pointed out, a major problem with the OCA's methodology is that PGW sizes its mains on the basis of the expected *peak* demand of its customers, not on the basis of the *average* demand of PGW's customers (as Mr. Galligan's approach assumes).⁵⁸ As PGW's Mr. Gorman put it, ". . . the costs of the mains are *causally related only* to peak demands, and *not* to annual demands. . . . Annual usage is not a consideration in the design of distribution mains."⁵⁹

An additional problem with the OCA COSS is that the P&A methodology double counts, in that it allocates part of the mains costs on the basis of the average demand and part on the basis of the peak demand. The peak demand *includes* the average demand. In contrast, the A&E methodology avoids double counting by allocating part of the costs on the basis of the average demand and part on the basis of the excess demand, *i.e.*, the peak demand *minus* the average demand.⁶⁰

⁵⁶ Knecht, OSBA Statement No. 2 at 19

⁵⁷ Knecht, OSBA Statement No. 2 at 19

⁵⁸ Knecht, OSBA Statement No. 2 at 23

⁵⁹ Gorman, PGW Statement No. 8R, at 16

⁶⁰ Knecht, OSBA Statement No. 2 at 19

Therefore, for the forgoing reasons, the Commission should deny OCA Exception No. 1 and reject the OCA's COSS.

4. Significance of COSS

Regardless of whether the Commission selects the PGW, OTS, or OCA COSS, the implications for allocating the revenue requirement are the same. As illustrated by Mr. Knecht in Table IEC-R1, all three COSSs show that the residential class provides less than the system average rate of return at present rates and that the commercial, industrial, municipal, and housing authority classes each provides a rate of return that is well in excess of the system average.⁶¹

Table IEC-R1 Comparison of Cost Allocation Study Results Class Rate of Return at Present Rates				
	PGW Bundled	PGW Base Rates (OSBA)	Galligan (OCA)	Kubas (OTS)
Residential	4.1%	4.4%	4.9%	4.6%
Commercial	12.6%	13.5%	11.8%	12.0%
Industrial	14.5%	16.0%	13.1%	12.4%
Municipal	9.5%	13.0%	9.3%	8.7%
Housing Authority	13.7%	15.9%	13.9%	13.3%
Firm Sales	5.6%	6.0%	6.3%	6.0%
Interruptible Sales	4.2%	11.7%	1.9%	3.3%
GTS/IT	19.9%	28.6%	-0.8%	7.9%
Total	5.8%	6.4%	5.8%	5.8%
Sources: Exhibit HSG-1 (revised), Exhibit IEC-4 Table 4A, OCA Statement No. 3, Exhibit RAG-1, OTS Exhibit 3 Schedule 4.				
Note: PGW's unbundled study has a slightly higher system average rate of return because PGW incorrectly functionalizes some rate base to the GCR, as discussed in my direct testimony.				

⁶¹ Knecht, OSBA Statement No. 2 at 4

Therefore, regardless of which COSS the Commission adopts, the residential class requires a disproportionately larger rate increase than the non-residential classes in order to eliminate—or, at least, begin to eliminate—the subsidies now provided by those non-residential classes.

D. REPLY TO PGW EXCEPTION NO. 16: The ALJs properly recommended denial of PGW's proposed revenue allocation. (R.D. at 72-73; PGW Exception No. 16)

1. Background

PGW requested an increase of \$100 million above its present distribution base rates, and proposed to allocate the increase in a manner which PGW represented would move each rate class toward unity between its relative rate of return and the system average rate of return. According to the Company, the residential heating class would move 32% toward cost, the commercial heating class would progress 17%, and the industrial heating class would progress 33%.⁶²

The OSBA argued that PGW's proposed revenue allocation would actually move class rates farther away from costs rather than closer to costs. Basically, PGW's proposed revenue allocation would give the residential class (the only underpaying class) a smaller than system average increase, while the overpaying classes would each receive a larger than system average increase.⁶³ To correct this inequity, the OSBA proposed that the underpaying residential class receive a percentage rate increase which was 1.2 times the system average and that the rate increases proposed by PGW for the overpaying non-residential classes be scaled back so that the net effect would be revenue neutral. The

⁶² PGW Main Brief at 79-80

⁶³ OSBA Main Brief at 37; Knecht, OSBA Statement No. 1 at 16

OSBA's proposal would apply if PGW receives the entire \$100 million in requested relief and would also apply as a form of first dollar relief ("FDR") if PGW receives less than \$100 million.⁶⁴

The OTS also proposed that FDR be provided to the overpaying non-residential classes. Under the OTS proposal, the rate increases for all of the non-residential classes (except the municipal class) would be scaled back to zero before any reductions were made in the increase proposed by the Company for the underpaying residential class.⁶⁵

The ALJs agreed with both the OSBA and the OTS that the overpaying non-residential classes should receive FDR. Specifically, the ALJs stated:

We find the proposals of OSBA convincing. Most compelling is the Table 2-R presented by OCA above. OCA focused on the residential rate of return and the system average for the present rates and the proposed allocation by the Company. We viewed the present rates and the proposed allocation by the Company for all customer classes. This is a substantial inequity and demonstrates the point by the OSBA that the non-residential parties are subsidizing the residential parties. However, in viewing the proposed rate allocation by PGW, while the residential class increases by 6% or 600 basis points, all but one non-residential class is approximately 200%. For present rates, the residential class is the only class below 100% while the other classes exceed 200%. For proposed rates the residential class moves less than double digit percentage toward 100%. We do not find this situation equitable. We also note that the presentation of the Company's present and proposed rates is more extreme than the presentation proposed by OSBA.

Moreover, we agree with the analysis presented by OSBA. We find that the use of the Company's COSS does not damage the analysis with the concessions that OSBA did such as excluding universal service costs and revenues from the analysis. We find that the residential class

⁶⁴ Knecht, OSBA Statement No. 1 at 23

⁶⁵ OTS Main Brief at 59; Kubas, OTS Statement No. 3 at 24-26

allocation is wanting under the Company's proposal. We find it compelling that neither OCA nor the Company used the IEc-2 table to show where that analysis erred. Additionally, we find it appropriate and reasonable to grant first dollar relief to the non-residential firm sales customers as proposed by OTS. The benefit of our recommendation of \$25 million should go to the targeted classes, Commercial, Industrial and Housing GS classes. We conclude that relief should be afforded the non-residential firm sales customers as proposed primarily by OSBA with the first dollar relief proposal by OTS.⁶⁶

The Company filed an Exception to the revenue allocation proposal recommended by the ALJs. PGW argues that the Company's proposed revenue allocation is "more 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."⁶⁷

2. Flaws in PGW's Revenue Allocation Proposal

Notwithstanding the Company's assertions, PGW's revenue allocation proposal actually moves class rates farther away from allocated costs rather than closer to those costs.⁶⁸ In other words, PGW's proposal actually increases the cross-subsidies among the rate classes rather than decreases them. As explained in greater detail by OSBA witness Knecht, a cross-subsidy represents the relationship between the revenues provided by a rate class and the costs allocated to the class. It is typically referred to as a "cross-subsidy," because a subsidy that is received by one class must be provided by other classes.⁶⁹

⁶⁶ R.D. at 72-73

⁶⁷ PGW Exceptions at 47

⁶⁸ Knecht, OSBA Statement No. 1 at 16

⁶⁹ *Id.*

As shown in Mr. Knecht's Table IEc-2, PGW's proposed revenue allocation for firm sales customers is based on a system average distribution rate increase of 33.9%. However, even though residential customers are currently underpaying based on cost of service, PGW proposes to assign the residential class a *lower* than system average increase (30.0%). At the same time, PGW assigns a *larger* than system average increase to the other classes (commercial: 49.5%, industrial: 35.3%, municipal: 51.5%, and the housing authority: 42.4%) even though those other classes are all currently *overpaying* based on cost of service. For ease of reference, Table IEc-2 is reprinted below.⁷⁰

Table IEc-2				
PGW Revenue Allocation Proposal for Firm Sales Customers				
\$000				
	Current Revenues	Allocated Total Costs	Current Rate of Return	Proposed Increase
Residential	264,747	281,203	4.4%	30.0%
Commercial	52,317	39,766	13.5%	49.5%
Industrial	5,432	3,996	16.0%	35.3%
Municipal	4,417	3,275	13.0%	51.5%
Housing Auth.	4,751	3,423	15.9%	42.4%
Total	331,664	331,664	6.0%	33.9%
Interruptible sales and transportation customers are excluded from this comparison for reasons discussed below.				
Total costs include all costs, including return on rate base and ratepayer equity contribution.				
Source: Exhibit IEc-4				

Under the Company's proposal, the current cross-subsidies would, therefore, be exacerbated. To reiterate, the residential class, which is currently the only underpaying class based on cost of service, would get a smaller than system average increase, but the overpaying classes would get a larger than system average increase.

⁷⁰ Reproduced from Knecht, OSBA Statement No. 1 at 16

Simple logic leads to the conclusion that a class which is overpaying its cost of service at present rates can not be moving closer to the cost of service if it receives a larger than system average rate increase.⁷¹

As Mr. Knecht testified, PGW's only apparent justification for its proposal is that it results in an *indexed rate of return* at proposed rates that is closer to unity than it is at current rates.⁷² PGW believes that if the class indexed rates of return move closer to unity, then the proposed rates are closer to unity than are the current rates.⁷³ However, as Mr. Knecht pointed out, the indexed rate of return metric can imply that progress is being made towards cost-based rates, when common sense (and all other metrics) say otherwise.

The OSBA respectfully submits that common sense must prevail and PGW's proposed revenue allocation must fail. As Mr. Knecht pointed out, there is a fundamental arithmetic problem with the indexed rate of return metric, in that it relies on a ratio of ratios.⁷⁴ In any event, PGW's argument is contrary to simple logic. A class which is overpaying at present rates can not be moving closer to cost of service if it receives a larger than system average increase.⁷⁵

⁷¹ See Knecht, OSBA Statement No. 1 at 18-21 and Knecht, OSBA Statement No. 2 at 19 for an analysis of various metrics for measuring progress toward cost of service.

⁷² See Knecht, OSBA Statement No. 1 at 18-21 and Exhibit IEC-5 for a detailed discussion on indexed rate of return.

⁷³ Knecht, OSBA Statement No. 1 at 18

⁷⁴ Knecht, OSBA Statement No 1 at 19

⁷⁵ OSBA Main Brief at 39

As Mr. Knecht testified, certain utilities and the Commission have relied upon the indexed rate of return *and* common sense in the past.⁷⁶ Specifically, the utilities applied judgment and common sense in the preparation of their rate filings and ultimately proposed to assign above average rate increases to classes that were receiving subsidies, *i.e.*, underpaying their cost of service. Therefore, as Mr. Knecht pointed out, the indexed rate of return has not *always* produced illogical results; however, it can produce illogical results if a utility makes an illogical proposal, *i.e.*, to assign an above-system average rate increase to a class that is already providing a subsidy to the underpaying classes.⁷⁷

In addition to defying common sense, PGW's proposed revenue allocation defies the results of the four other metrics identified by Mr. Knecht as ways to determine progress toward cost of service: dollar cross-subsidy, differential rate of return, revenue-cost ratio, and normalized revenue-cost ratio.⁷⁸

In Table IEc-3 of his direct testimony, Mr. Knecht illustrated the impact of PGW's proposal, as measured by the dollar cross-subsidy and the revenue-cost ratio metrics. For ease of reference, the table is reprinted below.⁷⁹

⁷⁶ Knecht, OSBA Statement No. 3 at 4

⁷⁷ Knecht, OSBA Statement No. 3 at 4

⁷⁸ Knecht, OSBA Statement No. 1, Exhibit IEc-5

⁷⁹ Reproduced from Knecht, OSBA Statement No. 1 at 17

Table IEC-3				
Impact of PGW Revenue Allocation Proposal for Firm Sales Customers on Interclass Cross-Subsidies				
	Dollar Values		Revenue-Cost Ratios	
	Present	PGW Proposed	Present	PGW Proposed
Residential	(16,456)	(29,887)	94.1%	91.8%
Commercial	12,551	23,737	131.6%	144.5%
Industrial	1,436	2,127	135.9%	141.3%
Municipal	1,142	2,023	134.9%	144.1%
Housing Auth.	1,328	2,001	138.8%	144.4%
Total	--	--	100.0%	100.0%
Interruptible sales and transportation customers are excluded from this comparison for reasons discussed below. Source: Exhibit IEC-4				

As shown above in Table IEC-3, the dollar value of the cross subsidies under PGW's proposal increases for each class from present to proposed rates, indicating that every class' rates are moving away from allocated costs. Similarly, the revenue-cost ratios shown in this table indicate that all of the ratios are farther away from 100 percent under proposed rates than under present rates, again indicating that rates for each class are moving away from allocated costs.⁸⁰

Mr. Knecht also provided an analysis to reflect the differential rate of return metric.⁸¹ For this metric, a negative number means that a class' rate of return is below the system average and, conversely, a positive number indicates that the class' rate of return is above the system average. Reprinted below is Table IEC-S1, which illustrates

⁸⁰ Knecht, OSBA Statement No. 1 at 18

⁸¹ Knecht, OSBA Statement No. 3 at 3

that PGW's revenue allocation proposal will result in the differential rate of return for each class moving farther away from zero, *i.e.*, farther away from the system average.⁸²

Table IEC-S1 PGW Revenue Allocation Proposal Differential Rate of Return Analysis				
	<i>Class Rate of Return</i>		<i>Differential Rate of Return</i>	
	<i>Current Rates</i>	<i>Proposed Rates</i>	<i>Current Rates</i>	<i>Proposed Rates</i>
Residential	4.4%	11.2%	-1.6%	-2.9%
Commercial	13.5%	28.1%	7.4%	14.1%
Industrial	16.0%	28.9%	10.0%	14.8%
Municipal	13.0%	26.4%	7.0%	12.4%
Housing Auth.	15.9%	28.9%	9.8%	14.8%
Total	6.0%	14.1%	0.0%	0.0%
Source: Exhibit IEC-4, Table 4-A				

PGW's proposed revenue allocation makes no progress, gradual or otherwise, toward aligning rates with allocated costs. The proposal is inconsistent with common sense and with the results of the revenue-cost ratio, dollar cross-subsidy, and differential rate of return metrics. Therefore, PGW's proposed revenue allocation must be rejected.⁸³ Furthermore, if the Commission awards PGW less than the full revenue requirement, a straight scaleback from PGW's proposed revenue allocation will produce rates which are unjust, unreasonable, and discriminatory.

3. First Dollar Relief

Despite the OSBA's objections to using the indexed rate of return to measure progress, the indexed rate of return metric does demonstrate the inequity in PGW's

⁸² Knecht, OSBA Statement No. 3 at 3-4

⁸³ Knecht, OSBA Statement No. 1 at 18

proposal and the virtue in FDR as recommended by the ALJs. Specifically, at both present and proposed rates, the residential class is the only major class with an indexed rate of return below 100%. Each of the non-residential classes has an indexed rate of return of greater than 100%.⁸⁴ Therefore, if the Commission awards an overall revenue increase which is smaller than PGW has requested, first dollar relief should go to the non-residential classes with indexed rates of return which are higher than the residential class' indexed rate of return.

The principle behind first dollar relief for the non-residential classes is simple. If the Commission awards PGW less than the requested \$100 million, the overpaying non-residential classes are entitled to relief before any is provided to the underpaying residential classes. Furthermore, first dollar relief would not conflict with the principle of gradualism because the underpaying residential class would never receive an increase larger than the one originally proposed by PGW, regardless of the size of the total revenue increase ultimately awarded by the Commission.⁸⁵

Both OSBA's witness Knecht and OTS' witness Kubas offered FDR proposals. Mr. Knecht's proposal specified \$27 million in FDR for the non-residential classes. Therefore, if the Commission awards PGW a revenue increase of less than \$73 million, the residential class will actually receive a smaller rate increase than the Company originally proposed. Similarly, Mr. Kubas proposed that the first \$28.345 million be applied as FDR to the non-residential and non-municipal rate classes, with the next

⁸⁴ Knecht, OSBA Statement No. 1 at Exhibit IEC-4: Table 4D

⁸⁵ Knecht, OSBA Statement No. 1 at 24-25_

\$1.317 million applied to the municipal class.⁸⁶ Therefore, under Mr. Kubas' proposal, the residential class will be assigned a lower rate increase than originally proposed by PGW, if the overall award to PGW is no more than \$70.338 million.

Therefore, either the OSBA or OTS FDR proposal will provide for relief to those rate classes that are over-paying their allocated cost of service at PGW's originally proposed rates, while not requiring the residential rate class to pay any more than originally proposed by PGW.

E. REPLY TO OCA EXCEPTION NO. 2: The revenue allocation recommended by the ALJs does not assign a disproportionate share of the rate increase to the residential class. (R.D. at 56-63; OCA Exception No. 2)

1. Background

There are only three revenue allocation proposals in the evidentiary record of this proceeding: 1) PGW's proposal, which would assign a smaller than system average rate increase to the underpaying residential class and a larger than system average increase to the overpaying non-residential classes; 2) the OSBA's proposal, which would assign the underpaying residential class a percentage rate increase which is 1.2 times the system average and proportionately scale back the rate increases proposed by PGW for the overpaying non-residential classes; and 3) the OTS proposal, which would provide first dollar relief to the overpaying non-residential classes.

The OCA supported the Company's revenue allocation. Specifically, OCA witness Galligan recommended that the Company's proposed spread of any rate increase

⁸⁶ Kubas, OTS Statement No. 3, at 21 to 24.

to the classes be adopted, and that such increases be proportionally scaled back if the Commission awards PGW less than the full revenue increase requested.⁸⁷

The ALJs rejected the use of a proportional scale-back method to allocate their recommended rate increase of \$25 million. Instead, the ALJs agreed with the OSBA and the OTS that relief should be afforded the non-residential firm sales customers. To provide that relief, the ALJs recommended the use of the OTS' proposal for first dollar relief.⁸⁸

2. OCA's Argument

The OCA has filed an Exception to the ALJs' recommendation of FDR. The OCA argues that the ALJs made at least three errors. First, the ALJs analyzed the proposed revenue allocation by using PGW's flawed COSS instead of using OCA's COSS. Second, the ALJs' reliance on OSBA's Table IEC-2 is misplaced. 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."⁸⁹

OCA witness Galligan did not offer a revenue allocation proposal of his own. Instead, he supported PGW's proposal as reasonable for residential customers based on the results of his COSS. However, as OSBA witness Knecht testified, Mr. Galligan's

⁸⁷ OCA Exceptions at 9-10

⁸⁸ R.D. at 72-73

⁸⁹ OCA Exceptions 10-11, 15-18, and 18-20

conclusion is not reasonable.⁹⁰ First, for the reasons detailed above, Mr. Galligan's COSS methodology does not represent a reasonable basis for allocating costs. Second, PGW's revenue allocation proposal is not consistent with the results of Mr. Galligan's COSS. Even Mr. Galligan's COSS indicates that the residential class is receiving cross-subsidies from the other rate classes at proposed rates. However, despite already being the recipient of cross-subsidies the proposed base rate tariff increase for the residential class would be only 30.0%, compared to a system average of 33.9% if PGW were awarded its full revenue increase request of \$100 million.⁹¹ At the same time, the overpaying classes would be assigned rate increases in excess of system average. As Mr. Knecht testified, and as common sense would dictate, that means that rates would be moving farther away from—rather than closer to—costs.⁹²

The implications of the OCA's COSS methodology, in conjunction with PGW's revenue allocation, are set forth in Table IEC-R3.⁹³ For ease of reference, the table is reprinted below.

⁹⁰ Knecht, OSBA Statement No. 2 at 6

⁹¹ Knecht, OSBA Statement No. 2 at 7

⁹² Knecht, OSBA Statement No. 2 at 6-9

⁹³ Reproduced from Knecht, OSBA Statement No. 2 at 8

Table IEc-R3 Implications of OCA COSS Methodology and PGW Revenue Allocation On Rate Class Dollar-Value Cross-Subsidies			
	Tariff Rate Increase %	Subsidy at Present Rates \$000	Subsidy at Proposed Rates \$000
Residential	30.0%	(9,693)	(14,267)
Commercial	49.5%	12,325	22,541
Industrial	35.3%	1,348	1,876
Municipal	51.5%	753	1,437
Housing Authority	42.4%	1,264	1,913
Firm Sales	33.9%	5,997	13,500
Interruptible Sales	NM	(1,483)	(4,114)
GTS/IT	0.0%	(4,512)	(9,384)
Total	NM	0	0

Source: OCA Statement No. 3, Exhibit RAG-1; IEc calculations.
Note: In preparing a cost allocation study for OCA, PGW inexplicably modified its revenue allocation proposal to reduce the rate increase for residential customers and to increase it for other customer classes. As that did not appear to be Mr. Galligan's intent, I re-estimated the subsidies at proposed rates based on PGW's original deficiency allocation. Therefore, both the tariff rate increases and subsidy at proposed rates are based on PGW's original revenue allocation proposal, and they are therefore different from those reported in the PGW IR response. If PGW's revised proposal were adopted along with the cost allocation change, the cross-subsidies from the non-residential firm sales customers would all be worse.

According to the OCA, the ALJs' recommended revenue allocation is inequitable because the residential class would bear almost the entire revenue increase.⁹⁴ The OCA's argument ignores the results of its own COSS. As shown in Table IEc-R3, the residential class receives a subsidy from non-residential classes at present rates. That subsidy would grow at proposed rates.⁹⁵ Therefore, it is reasonable for the residential class to absorb the lion's share of the rate increase, because it is the rate class that is receiving the massive subsidies under every COSS filed in this proceeding.

⁹⁴ OCA Exceptions at 9-19

⁹⁵ See OSBA Statement No. 1 at 23. Under the OCA's COSS methodology, the only other rate classes that are receiving cross-subsidies are the Interruptible Sales and GTS/IT rate classes. However, no party to this proceeding has proposed a larger increase for those rate classes, because those rates are market-based.

3. OSBA's First Dollar Relief Alternative

Although the underlying principles are the same, there are substantive differences in the first dollar relief proposal advocated by the OSBA and the first dollar relief proposal advocated by the OTS. The most significant difference is that if PGW is awarded a revenue increase of less than \$71.6 million, the OTS' FDR proposal would result in no increase at all for the non-residential classes. In contrast, the OSBA's proposal would assign modest increases to the non-residential classes.⁹⁶ In effect, the OSBA's FDR proposal would assign the residential class a rate increase equal to 1.2 times the system average.⁹⁷

Relying on Appendix A to PGW's Exceptions (to which the OSBA objects), the OCA claims that the R.D. would assign residential heating customers an increase which would be 1.39 times the system average.⁹⁸ Even if that calculation is correct (and the OSBA has been unable to verify that), it is critical to recognize that the residential class would still get a rate increase of only \$24,359,000 at the \$25 million revenue increase recommended by the ALJs. That would be \$48,249,000 if Appendix A is correct. That would be \$45,038,000 less than originally proposed by PGW, if PGW Exhibit HSG-7C, page 1, row 11 is correct.⁹⁹

⁹⁶ Knecht, OSBA Statement No. 2 at 5

⁹⁷ OSBA Main Brief at 47. The ALJs found the mechanics of OSBA's first dollar relief proposal moot because they understood OSBA's proposal to apply only if the rate increase were in excess of \$60 million. RD at 70. However, the ALJs' conclusion was not correct. The mechanics of OSBA's first dollar relief approach apply whether PGW's rate increase is in excess of \$60 million or less than \$60 million. Knecht, OSBA Statement No. 1 at 27-28

⁹⁸ OCA Exceptions at 11

⁹⁹ PGW Exceptions, Appendix A; PGW Exhibit HSG-7C

Nevertheless, if the Commission determines that all classes should bear at least part of whatever systemwide revenue increase is ultimately awarded, the OSBA recommends the adoption of the OSBA's FDR proposal. Under that proposal, the residential class would receive an increase which is 1.2 times the system average and the increase for the overpaying classes would be scaled back proportionally.

4. Precedent

The Commonwealth Court held in *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006), *appeals denied*, 916 A.2d 1104 (Pa. 2007), that cost of service is the "polestar" of ratemaking concerns. As OSBA witness Knecht testified, the process for determining class revenue requirements generally begins with a review of the revenues produced under existing rates from each class.¹⁰⁰ Consistent with *Lloyd*, most utilities and regulators adopt a policy in a base rates proceeding of attempting to move revenues more into line with allocated costs (the "cost of service" criterion).¹⁰¹ Utilities generally address this criterion by assigning above-system average rate increases to those classes that under-recover, *i.e.*, underpay, allocated costs, and by assigning below-system average rate increases to those classes that over-recover, *i.e.*, overpay, allocated costs.¹⁰²

PGW's unbundled corrected cost of service study ("CCOSS") reflects that every major class of customers is overpaying at present rates except for the residential class.¹⁰³ Furthermore, as shown above in Table IEc-R1, every other COSS submitted in this

¹⁰⁰ Knecht, OSBA Statement No. 1 at 14

¹⁰¹ Knecht, OSBA Statement No. 1 at 14

¹⁰² Knecht, OSBA Statement No. 1 at 15

¹⁰³ OSBA Main Brief at 38

proceeding also shows that the residential class is underpaying and that the non-residential classes are overpaying at present rates. Nevertheless, PGW argues that its proposed revenue allocation (at the full requested revenue requirement) is fair, and somehow appropriately balances the interests of its various rate classes, even though every overpaying rate class would receive an above-system average rate increase and the only underpaying class (*i.e.*, residential) would receive a below-system average rate increase.¹⁰⁴

The Commission recently applied *Lloyd* to the issue of revenue allocation in PPL Gas' base rates case.¹⁰⁵ In *PPL Gas*, the utility ignored its own cost of service study in proposing a revenue allocation. Specifically, PPL proposed a higher than system average increase for the small commercial and industrial ("Small C&I") customers who already provided an above system average rate of return at present rates. Additionally, rather than basing the revenue allocation on distribution only, PPL proposed to allocate the distribution rate increase by including commodity or purchased gas costs ("PGC"). To remedy the revenue allocation inequity in *PPL Gas*, the OSBA proposed, and the ALJ and the Commission supported, an alternative revenue allocation involving first dollar relief for the Small C&I class.¹⁰⁶

The similarity of the fact patterns in both *Lloyd* and *PPL Gas* to this case are striking. Every COSS submitted in this proceeding shows that the residential class is underpaying and that the commercial class is overpaying its cost of service at present

¹⁰⁴ PGW Main Brief at 79

¹⁰⁵ *Pennsylvania Public Utility Commission v. PPL Gas Utilities ("PPL Gas")*, Docket No. R-00061398 (Order entered February 8, 2007)

¹⁰⁶ *PPL Gas* at 131

rates. Notwithstanding that, and in spite of the aforementioned precedents, PGW has proposed (and OCA supports) a revenue allocation that would result in the imposition of a higher than system average increase on commercial customers while the residential customer class—the only major class that is underpaying at present rates—would receive a smaller than system average increase.

In *Lloyd*, 904 A.2d at 1020-1021, the Commonwealth Court held that the Commission may consider the effects of gradualism, but that the utility must have a *plan* for eliminating interclass subsidies over time. Approval of PGW's proposed revenue allocation (as supported by the OCA) would not be an endorsement of a plan to phase out the subsidies provided to PGW's underpaying residential class by the overpaying non-residential classes. Rather, approval of PGW's proposal would constitute a Commission endorsement of a plan to make those interclass subsidies worse. Consequently, Commission approval of PGW's revenue allocation proposal would violate *Lloyd*.

III. CONCLUSION

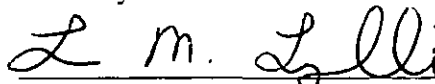
For the reasons stated herein, the OSBA respectfully requests that the Commission deny PGW Exception Nos. 6, 11, and 16; grant PGW Exception 15; and reject OCA Exception Nos. 1 and 2.

Furthermore, 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 proceeding under Section 1307(f).

Respectfully submitted,



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2007 APR 30 PM 3:15

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Dated: August 30, 2007

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

DOCKET NO. R-00061931

2007-03-14
3:14
3:14

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Dear Secretary McNulty:

Enclosed are the original and nine copies of Philadelphia Gas Works' Reply 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

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :

v. :

Philadelphia Gas Works :

Docket No. R-00061931

ORIGINAL

REPLY EXCEPTIONS OF PHILADELPHIA GAS WORKS

DOCUMENT
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INTRODUCTION

Philadelphia Gas Works ("PGW" or "the Company") hereby submits these Replies to the Exceptions to the Recommended Decision ("RD") filed by the Office of Trial Staff ("OTS"), the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), Hess Corporation ("Hess"), Interstate Gas Supply, Inc. ("IGS"), Philadelphia Industrial and Commercial Gas Users Group ("PICGUG"), Action Alliance For Senior Citizens ("Action Alliance) and the Philadelphia Housing Authority ("PHA").

REPLIES TO EXCEPTIONS

- 1. The OTS's Claim That PGW Should Be Required To Use Excess Revenues That It Would Allegedly Collect If It Received A \$25 Million Rate Increase Should Be Rejected Because It Is Wrong Factually And Disregards Evidence That Shows That A \$25 Million Increase Will Have No Material Effect On PGW's Level Of Debt.**

The OTS continues its misguided assertions that PGW should be ordered to use so-called "operating efficiencies"¹ that OTS allegedly has identified to reduce PGW's debt-to-equity ratio. OTS paints a picture of millions of dollars of revenues that it is "permitting" PGW to continue to collect by acquiescing to a \$25 million rate increase even though, it alleges, if the Commission were to make each and every adjustment to PGW's *pro forma* income statement recommended by OTS, PGW's rate increase could justifiably be less. OTS claims that PGW should be ordered to use these funds to finance its construction program or otherwise reduce the level of debt in its capital structure.²

¹ The term "operating efficiencies" is the term the OTS has used throughout the proceeding to designate *pro forma* adjustments that OTS claims could have been made to PGW's test year income and which would have reduced PGW's allowed rate increase, but which OTS chose not to recommend be used in that manner. At one point, OTS asserted that the "operating efficiencies totaled over \$11 million." See, OTS MB at 38. However, there was agreement between OTS and PGW on most of these adjustments such that, by the close of the record, PGW's claimed *pro forma* net income differed from the OTS's by just \$2.5 million. See, PGW Exceptions at 31, n. 116.

² OTS Exceptions at 6-7. There are only two ways that the level of debt in PGW's capital structure can be reduced: (1) finance construction from internally generated funds; or (2) retire existing debt. In either

First, it is gratifying that, for the first time in this proceeding, OTS has acknowledged the enormous problem caused by PGW's excessively high debt-to-equity ratio.³ But the notion that if PGW receives a \$25 million rate increase it will have funds to reduce its debt-to-equity ratio is completely misplaced. What OTS failed to understand is that, with or without consideration of the remaining contested adjustments, PGW's debt-to-equity ratio will not improve materially if it only receives a \$25 million rate increase. In its Exceptions, PGW presented its projection of its test year debt-to-equity ratio as well as its projection of its debt-to-equity ratio over the five-year planning period. For ease of reference here is that portion of that schedule:

**PGW Debt-to-Equity Ratio
\$25M rate increase⁴**

	<i>Pro Forma</i>	Realistic
FY 07	82%	83%
FY 08	80%	81%
FY 09	80%	82%
FY10	79%	81%
FY11	81%	83%
FY12	81%	83%

The reason that PGW's debt-to-equity ratio does not improve materially in the test year or beyond is that, at \$25 million, PGW will not produce sufficient internally generated funds to

instance the percentage of debt in the capital structure will go down only if, on net, PGW is not simultaneously adding more debt.

³ OTS Exceptions at 6: "The Company's continued claim of inordinately high debt levels and its impact on operations must be addressed in this proceeding."

⁴ PGW Exceptions, p. 4, Table 2. The *pro forma* calculation assumes that PGW receives a \$25 million rate increase in the test year (which, of course, is not impossible), while the "realistic" calculation assumes that it is received starting September 1, 2007, the beginning of FY 2008. *Id.*

avoid or significantly reduce future bond issuances, and certainly will not be able to retire existing debt (other than that which it is contractually obligated to retire).

However, OTS apparently is under the misimpression that PGW's analysis understates its available sources of cash because it understates income by including expense items that OTS believes should not be considered.⁵ OTS further appears to believe that, if these items were removed from *pro forma* expenses, PGW would have sufficient funds to make a material impact on its debt-to-equity ratio.⁶ Unfortunately, OTS apparently did not look at any of PGW's analysis (and presented none of its own on this issue). As noted, by the end of the proceeding, the total of the contested adjustments remaining between the parties was just \$2.5 million.⁷ Thus, PGW's calculation of income, cash flow and debt-to-equity ratio in the test year assuming a \$25 million rate increase is not materially different than that which was calculated by the RD.

Accordingly, whether or not the remaining accounting adjustments are included, a \$25 million increase is not going to have any impact on PGW's debt-to-equity ratio – in the test year or beyond. This is because, absent continued external financing, a \$25 million rate increase is far short of the level PGW needs to fund all of its obligations. The cash flow statements presented in the record show that, even after considering all sources of funds, including net income and depreciation (and adjusting PGW's "sources" to remove the effect of the \$2.5 million

⁵ OTS Exceptions at 6. OTS actually appears to characterize these expense items as "imprudent." Characterizing these disputed expense adjustments as "imprudent" expenditures is extremely inappropriate. All of the expense items at issue involve disputes about how to calculate a *pro forma* allowance for a particular item (e.g., bad debt expense) or whether an item is properly included in *pro forma* expenses (e.g., lobbying/government relations expense). In no case has any party suggested that PGW acted imprudently in incurring these expenses.

⁶ OTS Exceptions at 6.

⁷ This can be seen by comparing PGW's calculated net income with a \$25 million rate increase (\$37,780 million – PGW MB, App. C, p. 1) with the RD's calculation of test year income after including a \$25 million rate increase (\$40,335 million – RD, App. A, Statement of Income). The OTS did not except to the one adjustment that it had proposed that was not accepted by the RD.

remaining contested expense items), PGW is millions of dollars short of the level of cash it needs to fund all its cash needs without external borrowing:

**PGW Comparison of Sources & Uses of Funds
Compared to Long Term Debt**

\$25 million rate increase

	07	08	09	10	11	12
Total Sources ⁸	\$197.3M ⁹	\$185.1M ¹⁰	\$150.5M ¹⁰	\$145.6M ¹⁰	\$125M ¹⁰	\$131.7M ¹⁰
Long Term Debt	\$72.0M	\$60M	\$63M	\$61M	\$60M	\$58M
Sources w/o Ext. Financing	\$125.3M	\$125.1M	\$87.5M	\$84.6M	\$65M	\$73.7M
Total Cash Needs	\$150.7M	\$182.8M	\$148M	\$142.8M	\$122.2M	\$130M
Shortfall	(\$25.4M)	(\$57.7M)	(\$60.5M)	(\$58.2M)	(\$57.2M)	(\$56.3M)

This table shows that, when all of PGW's cash needs are considered, including its need to pay for construction, the Company would be between \$25 - \$60 million short of the funds it needs to continue to operate if it did not have the proceeds of a long-term bond available. Notably, in order to meet these needs, PGW will have to issue additional long-term debt in 2009 and 2011.¹¹ Thus, PGW would need between \$50 - \$60 million a year more in "sources" before it would be able to forego one or both of its projected bond issuances in 2009 or 2011 – or even materially reduce the amount it needs to borrow.¹² Thus, as PGW indicated in its Exceptions, PGW needs an increase of at least \$50-\$60 million to be able to avoid or reduce even one future

⁸ Total Sources include income and depreciation. This shows that OCA's argument claiming that PGW really has internally generated funds (OCA St. 1 at 15-16) is grossly misleading. As this table shows, when all sources and uses are considered, PGW has no net internally generated funds from which it can fund its construction program – without continuing to incur long term debt. No OCA witness has ever disputed this statement.

⁹ RD, App. A "Cash Flow Statement."

¹⁰ PGW projected net income (PGW MB, App. C, p. 2, plus \$2.5 million).

¹¹ See, PGW Exh. JRB-10.

¹² PGW Exceptions at 4-5.

bond issuance.¹³ It is only by generating sufficient cash – starting now – that PGW is going to be able to change its existing debt-to-equity ratio in any material way. Certainly, the evidence shows that the OTS claim about using "operating efficiencies" to reduce PGW's level of debt is way off base and should be rejected.

2. The Exceptions of Hess Energy Should Be Denied.

(a) Introduction

Hess makes a variety of arguments in an attempt to convince the Commission to reverse the RD and to adopt a whole series of changes to PGW's existing Supplier Tariff rules that would make it easier for Hess to do business as a natural gas supplier ("NGS") on PGW's system. PGW would like nothing more than for Hess and other NGSs to be able to operate successfully on its system. PGW even stipulated that natural gas competition can provide benefits to the Company and its ratepayers.¹⁴ But, PGW's primary obligation is to assure the reliability and operational flexibility of its system. For this reason, while PGW itself endeavored to propose modifications to assist suppliers in doing business on its system,¹⁵ and elected not to except to the RD's recommendation that it "update and clarify costs and responsibilities of suppliers" with respect to firm transportation annual over- and under-deliveries,¹⁶ PGW urges that the Commission accept the RD's recommendations to reject the rest of Hess's proposals.¹⁷ The evidence shows that they pose an unacceptable threat of creating risks to PGW's operational flexibility and reliability as

¹³ *Id* at 22.

¹⁴ PGW Hearing Exh. 2.

¹⁵ Those proposals are: (1) extend day-ahead nominations for gas deliveries deadlines from noon to 12:30 p.m. for upstream interstate pipeline contracts; (2) insert tariff language that PGW's use of FERC interest rate to calculate carrying charge on gas loaned to supplier of firm customers; (3) update and provide the marketing files for commercial and industrial customers monthly instead of quarterly; and (4) run customer enrollment processing jobs at 10 a.m. and noon for additional opportunities to correct enrollment mistakes. RD at 95 (PGW MB at 101-02)

¹⁶ RD at 95, 102.

¹⁷ All of Hess's proposals were joined in by IGS.

well as imposing significant added costs and Hess did not provide any probative evidence to counter or assuage these concerns. The RD's recommendation that the Commission consider Hess's proposals in the context of its ongoing natural gas competition investigation would appear to be the most reasonable and logical approach to dealing with Hess's various demands.

(b) Hess's Claim That Its Issues Should Not Be Referred To The PUC's Gas Competition Investigation Should Be Rejected.

Hess complains that the RD failed to accept its demands for relaxed supplier rules, instead recommending that the Commission consider these issues in the context of the Commission's pending *Gas Supply Competition Investigation*.¹⁸ The RD observed that it would be "more appropriate and administratively efficient to consider these issues in [that proceeding] to be consistent in treating NGDCs and NGSs and to achieve the goal of uniformity within the gas industry."¹⁹ The RD was clearly correct in this regard.

However, Hess claims that it was legally entitled to a decision, not a referral to the Commission's *Gas Supply Competition Investigation*.²⁰ Yet, at the same time, it quotes extensively from the PUC's *Competition Report Order*²¹ strongly suggesting that, in that docket, the Commission has already endorsed the menu of supplier rule changes Hess is arguing for here. Hess cannot have it both ways. By quoting from the PUC's generic *Competition Report Order*, Hess clearly endorsed the PUC's generic approach to determining appropriate and fair revisions to the rules for gas supply competition throughout Pennsylvania. Considering Hess's positions in the context of that generic proceeding, as the RD recommends, thus, makes sense because the Commission can consider data from all service territories – including those in which a greater

¹⁸ Hess Exception at 1.

¹⁹ RD at 101-102.

²⁰ Hess Exceptions at 6, 8.

²¹ *Id.* at 2, 3.

number of customers are utilizing competitive alternatives.²² In this way, the PUC will be able to identify practices that have proven to minimize costs and to enable competition while not threatening the reliability of the NGDCs' systems.²³ Indeed, it is significant that, in most instances, Hess failed to present any evidence that PGW's present rules were inconsistent with the rules followed by other Pennsylvania NGDCs. Since such evidence would be useful in evaluating Hess's proposals, it was quite reasonable for the ALJs to suggest that the Hess issues would best be considered in a generic proceeding.

But, Hess contends that it was unreasonable – and even a violation of its due process rights – to refer implementation of these decisions to the generic proceeding.²⁴ Of course, the logical hole in Hess's argument is the assumption that the ALJs had found that Hess's proposed rules changes were otherwise supported by the evidence and reasonable. In fact, the RD either explicitly or implicitly found that Hess's demands were not supported by the record.²⁵ Thus, the referral to the PUC's *Gas Competition Investigation* was actually a resurrection of issues that, by rights, could have been rejected outright, and with prejudice, by the ALJs. However, PGW has not excepted to the RD's recommendation that these issues be initially addressed generically in the Commission's Gas Competition Investigation.

(c) The RD Properly Ruled That Hess Had Not Met Its Burden of Persuasion That Its Proposed Supplier Tariff Modifications Were Just Reasonable And In The Public Interest.

²² Hess quoted with favor the level of competition being experienced in other service territories, such as The Peoples Natural Gas Company. Hess Exceptions at 4, n. 10.

²³ Presumably such generically endorsed practices will still need to be reflected in the supplier tariff of individual NGDCs and PGW reserves the right to review whether PGW's special circumstances make them right for PGW, but, with the Commission's guidance, the issues will be far more focused and easier to resolve.

²⁴ Hess Exceptions at 6, 8.

²⁵ RD at 98, 101: "We conclude that Hess did not satisfy its burden of persuasion to demonstrate that the current tariff and operational rules go against the public interest."

Hess complains that, in rejecting most of its requests for modifications to PGW's existing Supplier Tariff rules, the RD improperly shifted the burden of proof to Hess. It claims further that if PGW had properly been assigned the burden, Hess's positions should have been accepted because PGW did not specifically refute Hess's evidence that several of PGW's existing supplier rules were difficult for Hess to comply with.²⁶

Hess has improperly construed the legal rules with respect to burden of proof, and has also misconstrued the evidentiary record. There appears to be agreement that PGW has the ultimate "burden of proof."²⁷ But that burden is to show that both its proposed and existing tariff provisions are just, reasonable and in the public interest,²⁸ not that the tariff rules do not inconvenience a particular party. Moreover, what Hess refuses to acknowledge is that, with respect to existing tariff provisions, a utility meets its initial burden of going forward – or makes out a *prima facie* case of reasonableness – by virtue of the fact that the tariff provisions have already been reviewed and approved as just and reasonable by the PUC.²⁹ If this were not true, a utility could not meet its "burden of proof" with respect to the hundreds of rules and rates set forth in its existing tariff without presenting evidence of reasonableness for each and every one of them in each rate case. Thus, the RD was correct that, when an existing tariff provision is challenged, the challenging party has the burden of going forward with evidence (or the burden

²⁶ Hess Exceptions at 10-12.

²⁷ RD at 92-93. PGW accepts this responsibility – as it must.

²⁸ RD at 93.

²⁹ RD at 93; *Brockway Glass v. PaPUC*, 437 A.2d 1067, 1071 (Pa.Cmwth. 1981); see, *PaPUC v. Columbia Gas of Pennsylvania, Inc.*, R-00072175, Order entered May 31, 2007, at 17 (even in Section 1307(f) proceeding, *Columbia* may rely upon reasoning and conclusions in prior order approving *Columbia's* local gas purchasing practices as evidentiary support that its practices remain just, reasonable and in the public interest).

of persuasion)³⁰ to show that the existing tariff provision is unjust, unreasonable and not in the public interest, even if the ultimate burden of showing the reasonableness of the provision rests with the utility.

Hess did present evidence in an attempt to meet its burden of going forward. But PGW responded to that evidence and, indeed, showed why the changes were not reasonable when their potential effect on PGW's overall system was considered. Thus, PGW met its burden of going forward with evidence to refute Hess and met its ultimate burden to show the reasonableness of its tariff provisions.

Hess's claim that PGW did not adequately respond to its "evidence" is simply not correct. In virtually every case, Hess's "evidence" amounted to complaints that it was difficult for Hess (and allegedly, other unidentified NGSSs) to comply with PGW's existing, PUC-approved rules. PGW's response showed that the rules were needed to maintain operational flexibility, assure reliability and minimize costs. Hess's claim that this detailed response was "vague, unsubstantiated and unspecified"³¹ grossly mischaracterizes PGW's evidence, but also improperly assumes that the ultimate issue is whether PGW's rules are good for Hess (or for competition) – not whether the rules, overall, are just and reasonable and in the public interest. So, for example, when Hess proclaims that it has "proven" that PGW's daily and monthly balancing tolerances and penalties are unreasonable because Hess presented evidence that the

³⁰ Hess claims that the term "burden of persuasion" is synonymous with "burden of proof" (Hess Exceptions p. 10, n. 23), but Hess is incorrect. "Burden of persuasion" is synonymous with the term "burden of going forward with evidence." (See, *Mary Daniels v. Duquesne Light Co.*, 2006 PaPUC LEXIS 102, 12-13 (PaPUC 2006)), and that is how the ALJs understood and applied the concepts: see, RD at 93: "The issue the parties dispute is whether the burden of persuasion or going forward . . ."; "Consequently, the burden of persuasion or the burden of going forward shifts to Hess." However, to the extent "burden of persuasion" has been equated with the "burden of proof" (see, e.g., *PaPUC v. Bell Atlantic Inc.*, 1996 Pa. PUC LEXIS 209), the ALJs' assignment of the burden of persuasion to Hess is harmless error because the ALJs actually based their conclusions and recommendations on all the record evidence on these issues.

³¹ Hess Exceptions at 10.

tolerances were "often" missed by Hess,³² that fact alone does not make the existing rules unjust and unreasonable. PGW responded with evidence of why the present tolerances were needed to assure that suppliers did everything possible to deliver the quantities of natural gas needed to serve their customers on a daily basis because PGW's limited operational flexibility and costly LNG and storage assets made it imperative to avoid last minute changes in supply requirements.³³ Accordingly, the RD quite properly found that Hess's evidence, and the goal of facilitating competition on PGW's system was not sufficient to justify any changes in PGW's present rules and, that, therefore, Hess had not met its burden of going forward, or burden of persuasion.

(d) The RD Properly Found That Hess Had Not Satisfied Its Burden Of Persuasion That The Proposed Changes It Was Advocating Were In The Public Interest.

(i) Introduction

Contrary to Hess's claims, the RD correctly concluded that Hess had failed to provide any evidence tending to show that the benefits to Hess or to customers of its proposed Supplier Tariff modifications outweighed the risks and costs that would be imposed upon PGW and its customers if Hess's changes were ordered. The RD succinctly pointed out this failure:

Again, Hess has the burden of persuasion. We agree with PGW that there is no record evidence that the Company's existing tariff impedes competition on its distribution system. Rather, the record evidence provides reasons why Hess is dissatisfied with PGW's existing tariff and operating policies. We conclude that Hess did not satisfy its burden of persuasion to demonstrate that the current tariff and operational rules go against the public interest.³⁴

³² See, Hess Hearing Exh. 4.

³³ See, PGW Reply Exceptions, Section (d)(ii), *infra*. If Hess "often" misses the tolerances, it may need to invest in additional personnel to communicate better with its customers and suppliers to avoid these errors.

³⁴ RD at 101.

PGW has already addressed Hess's arguments with respect to burden of persuasion. The correctness of the RD's conclusion is easily seen when one examines the evidence presented by PGW. In each case, PGW showed that the modifications proposed by Hess would create unacceptable threats of additional costs and potential risks.

When evaluating Hess's supplier rules changes, it is important to keep in mind that PGW's natural gas supply structure has unique characteristics which limit PGW's operational flexibility. PGW witness Muntzer explained that, unlike most other Pennsylvania NGDCs, PGW is served by only two pipelines: Texas Eastern Transmission Corp. and Transcontinental. In addition, PGW's gate stations are located on pipeline laterals rather than mainlines, which further constrains deliverability.³⁵ This means that PGW's options and ability to deliver supply to its gate stations are far more limited than for other companies.

Adding to PGW's limited supply options, PGW does not own any underground storage and instead must contract for storage with interstate pipelines.³⁶ Thus, its storage capacity is limited and subject to injection requirements.³⁷ For this reason, its contracted storage capacity represents just one-half the daily delivery quantity of its firm transportation capacity on its two pipelines.³⁸ Mr. Muntzer explained that, in a normal winter, PGW fully utilizes its available pipeline capacity and its storage assets in order to deliver required supplies to its city gates.³⁹ Moreover, during the winter season, PGW relies on its LNG facilities to meet day-to-day swings

³⁵ PGW St. 11 at 5.

³⁶ *Id.* at 6

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.* at 6-7.

in demand or to replace pipeline capacity that becomes unavailable or restricted due to operational flow orders.⁴⁰

The result is a system that, for generations, has reliably met PGW's customer demands, but which requires careful planning and coordination to assure that daily and seasonal requirements are met. To add to the problem, as PGW's Exceptions made clear, PGW is financially strapped and has very limited resources to devote to coordinating and revising its supply plans to accommodate the convenience of suppliers. Accordingly, PGW opposed several of Hess's proposed operational rules because its evaluation indicated they posed a real risk of forcing PGW to utilize costly pipeline and LNG assets or imposing additional unreasonable administration costs on the Company. More troubling, the demanded changes could threaten the Company's ability to deliver necessary supplies to its customers on a daily basis in times of peak demand.

(ii) Changes in Daily/Monthly Balance Requirements/Cash Out.

PGW's interruptible transportation rules require suppliers to nominate daily supply deliveries on a day ahead basis. PGW supply rules impose a 5% +/- tolerance for daily deliveries (with a daily imbalance penalty of \$0.50/Dth) and a 2.5% +/- tolerance for total, monthly imbalances.⁴¹ PGW imposes monthly "cash-out" rules which compensate an NGS for over-deliveries (or require payment for undelivered gas ultimately supplied by PGW) at increments below (or above) the market price.⁴² The interruptible balancing/monthly cash out rules are intentionally designed to make it unattractive for suppliers to "game" PGW's system by failing to

⁴⁰ *Id.* at 5-6.

⁴¹ PGW St. 11 at 4-5.

⁴² Hess Hearing Exh. 3 (Customer Tariff, Rate Schedule DB, Section 6(f)).

deliver nominated gas in order to sell the gas or available capacity in a more lucrative market, and to ensure system reliability by encouraging accurate deliveries.⁴³

Contrary to Hess's insistence that PGW's interruptible balancing/cash-out rules are difficult to meet and "punitive," PGW presented testimony that the rules "are necessary for PGW to maintain control and reliability of its system, and to avoid unnecessary LNG withdraws and excessive storage injections and withdraws."⁴⁴

Because of PGW's limited delivery options and operational flexibility, PGW designed its balancing rules to create "strong incentives" to NGSs to accurately nominate and deliver nominated supply.⁴⁵ Daily (rather than just monthly) balancing requirements are needed to prevent wide swings in deliveries which would cause PGW to have to utilize its limited assets to accommodate the discrepancies.⁴⁶ A monthly only balancing rule would permit a supplier to incur wide daily swings so long as its account at the end of the month was in balance. For example, without daily balancing requirements, a supplier could elect to deliver a fraction of its daily delivery requirement on one day and then deliver twice the amount the next – and suffer no penalty or charge. Of course, PGW – and its GCR customers – would incur additional costs, or potentially supply shortages, as PGW was forced to scramble at the last minute to find a way to replace supply it thought was going to be delivered.

While far less drastic, the effect of liberalizing PGW's daily balancing requirements poses the same risks that suppliers will consistently fail to satisfy their daily delivery obligations, again sending PGW scrambling to find backup supply or coordinate its LNG facility supply.

⁴³ *Id.* at 5-8.

⁴⁴ *Id.* at 5.

⁴⁵ *Id.* at 5, 7.

⁴⁶ *Id.* at 7.

Hess's main argument against PGW's existing balancing tolerances was that they were so tight they were "often" missed.⁴⁷ But PGW presented detailed testimony showing that operational characteristics of its system made daily swings in load and last minute supply alternations problematic to respond to and potentially costly to GCR customers. Further, PGW's testimony showed that, to avoid transferring these risks and costs to firm ratepayers, PGW intentionally designed its balancing rules to assure the likelihood of maximum compliance.⁴⁸ Thus, the fact that Hess has difficulty meeting PGW's existing balancing tolerances is not a basis for eliminating or modifying them.

Hess also contended that because Hess's daily deliveries are so small, the effect on PGW's system similarly will be small.⁴⁹ Mr. Muntzer pointed out, however, that while the effect on PGW's system of a single supplier currently is small, PGW's rules obviously must be designed to accommodate potential growth in IT throughput.⁵⁰

Hess also claimed that PGW's concerns amount to a concern about "potential gaming" on the peak day and that the more appropriate means of dissuading such conduct is by "gaming penalties."⁵¹ First, PGW does not have a "gaming penalty." Second, Hess has misstated the goal of the balancing rules – which is to assure accurate deliveries on all days, not just the peak day.

Hess's ultimate answer to PGW's extensive evidence concerning the potential risks and costs that could be imposed on PGW's firm customers if balancing requirements are eliminated or made less stringent does not refute PGW's evidence. Instead, Hess claims that the rules as

⁴⁷ Hess's exceptions imply that Hess's evidence was that Hess often missed the tolerances, but Hess's statement, in fact, was that "NGSs are often unable to avoid both daily penalties and monthly cash-outs due to tight tolerance bands at both levels." Hess Hearing Exh. 4 (emphasis added).

⁴⁸ PGW St. 11 at 6-8.

⁴⁹ Hess Exceptions at 22.

⁵⁰ PGW St. 11-RJ at 3.

⁵¹ Hess Exceptions at 23.

structured do not serve as incentives to NGSs to accurately forecast and deliver because the tolerances are difficult to meet and "constitute punishment rather than a deterrent."⁵² But, Hess certainly made no effort to demonstrate that, with the application of additional resources and expertise, Hess could not do a better job in nominating and delivering. Hess's customers are large enough and sophisticated enough to take advantage of interruptible transportation service. They all have daily feed meters⁵³ and load within their pool, which assists the supplier to meet balancing obligations.⁵⁴ Thus, Hess is not being asked to get its customer's usage exactly right but, instead, based on actual day previous usage data, to project the total usage of all of its customers within 5% (as also explained below concerning pool netting and trading) and the total monthly pool use within 2.5%. While PGW suspects that any inability on Hess's part to consistently avoid penalties under this system is due to Hess's own decision not to spend the time or to commit the resources necessary to do so,⁵⁵ all that is required here is the recognition that Hess, having the burden of going forward with evidence to show that PGW's operational flexibility and supply obligations would not be harmed if Hess's proposals were adopted, has not satisfied its evidentiary obligations.

(iii) Modification of Nomination Deadline and Retroactive Nomination Rules.

PGW currently requires suppliers to nominate quantities of natural gas for next day delivery by 12:00 p.m. and permits nomination adjustments and correction of nomination errors when doing so will not adversely affect operations.⁵⁶ To provide some additional time for NGSs

⁵² *Id.*

⁵³ PGW St. 11-RJ at 4.

⁵⁴ *Id.*

⁵⁵ PGW St. 11 at 3, 8; Hess agreed with OCA's witness that NGSs' "successful operation should be predicated on their operating efficiency and skill." Hess St. No. SR-1 at 11:13-15, 25-26.

⁵⁶ PGW St. 11 at 3-4.

to submit their nominations, PGW voluntarily agreed to move the deadline from 12:00 p.m. to 12:30 p.m. which is the deadline that PGW's interstate gas pipeline suppliers impose on its customers.⁵⁷ Hess insisted that a later deadline – it suggested 2:00 p.m. – was necessary to give NGSs time 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 claimed that an NGS's should have a right to make retroactive nominations unless it is shown that it is "abusing" its right.⁵⁸ But, PGW's Mr. Muntzer testified that a later deadline, as well as an obligation to accept retroactive nominations, would "jeopardize the safety and reliability of our system,"⁵⁹ because it would require PGW to revise its supply plan after the 12:30 p.m. pipeline deadline, and, thus, after PGW itself had prepared its supply plan (or, alternatively, to wait until the 2:00 p.m. deadline expired). Such a revision obligation could threaten PGW's ability to meet its supply obligations. At the very least, it will impose additional administrative burdens on a company that can ill afford such new obligations. In the face of these concerns, Mr. Muntzer explained that Hess's insistence on a 2:00 p.m. nomination deadline simply was an attempt to "maximize profitability by seeking out the best possible deals in the market."⁶⁰ Hess again failed to satisfy its burden of going forward with evidence because it did not successfully rebut PGW's testimony that extending the deadline beyond 12:30 p.m. would threaten reliability and reduce operational flexibility.⁶¹

(iv) Intra-Pool Netting and Inter-Pool Trading

⁵⁷ *Id.* at 3.

⁵⁸ Hess Exceptions at 14. To support its red herring argument concerning the burden of persuasion, Hess's exceptions imply that these points were offered only in surrebuttal testimony. However, these points were also offered in Hess's direct testimony. Hess St. No. 1 at 3:20-22; 4:3-6.

⁵⁹ PGW St. 11 at 3.

⁶⁰ PGW St. 11-RJ at 2.

⁶¹ PGW would also point out that Hess's assertion that a later nomination deadline and automatic retroactive revisions "will benefit PGW and its customers" (Hess Exceptions at 16) would not appear to be accurate. In point of fact, any savings that Hess might garner by revising a nomination will flow to Hess, as its end user contracts are usually at fixed prices.

PGW permits NGSs to serve their firm and interruptible customers from separate pools, which makes it easier for NGSs to balance their total customer supply needs (because NGSs can balance deliveries for individual customers against one another).⁶² Because "one tool that NGSs have on many LDC systems,"⁶³ is the right "trade" imbalances between an NGS's pools (interruptible to firm and vice versa) as well as to trade with other NGS pools,⁶⁴ Hess demanded the right to do so on PGW's system. Hess claims that the RD improperly rejected this proposal because PGW's objection was grounded on a claim that it would be costly to implement a system to permit intra- and inter-pool trading. Since Hess responded that, in its opinion, it would not be costly to set up such a system, it claimed the ALJs were required to accept its position in this regard. But the record simply does not correspond to Hess's claims. While Hess claimed that all that would be needed would be a spreadsheet to handle the complicated transactions,⁶⁵ PGW explained that the process would be far more extensive and difficult, involving the rewriting of supplier billing procedures and reprogramming to incorporate the functionality into PGW's BCCS and Oracle financial systems.⁶⁶ Mr. Muntzer testified that implementing the revised system would cost several hundred thousand dollars.⁶⁷

Hess never refuted any of these detailed claims, instead choosing simply to refuse to acknowledge the complicated systems changes necessary for a major utility to effectuate a major policy change such as pool netting or trading. Moreover, Hess completely ignored PGW's additional testimony that permitting an NGS to net imbalances between its firm and interruptible

⁶² PGW St. 11-RJ at 4.

⁶³ Hess Exceptions at 25.

⁶⁴ *Id.*

⁶⁵ Hess Exceptions at 26.

⁶⁶ PGW St. 11-RJ at 4.

⁶⁷ PGW St. 11 at 10.

pools would permit the NGS to avoid imbalance penalties for under-deliveries -- and thus shift the costs of the under-deliveries to firm customers.⁶⁸ Hess submitted absolutely no evidence showing that its imbalance trading and netting proposal would not impose such costs on firm ratepayers. Therefore, the RD was entirely correct in rejecting this proposal.

3. IGS's Ill-defined And Unsupported Proposal For A MST-Type Proposal Was Correctly Rejected By The RD.

Interstate Gas Supply, Inc. ("IGS") presented a proposal to "jump start" residential competition by creating a Market Share Threshold ("MST") type of program wherein a winning bidder would become the natural gas supply service provider for 30% (approximately (150,000) of PGW's residential customers.⁶⁹ IGS claimed that the program would provide lower rates to customers and finance any billing and infrastructure improvements necessary to effectuate such a program via a "shared discount."⁷⁰ The RD rejected IGS's proposed pilot on the ground that IGS had not quantified the cost of implementing such a first-of-its-kind program for NGDCs in Pennsylvania and had not shown that any benefits outweighed the cost.⁷¹ IGS now excepts, claiming that the RD incorrectly concluded that IGS had not quantified the costs and benefits because IGS had claimed that "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" and that "the record is clear that the savings provided to customers would be guaranteed."⁷²

⁶⁸ PGW St. 11 RJ at 5.

⁶⁹ IGS St. at 1 at 7-8.

⁷⁰ IGS Exceptions at 2,3.

⁷¹ RD at 102-103.

⁷² IGS Exceptions at 3.

IGS's arguments are illogical and simply do not match the record evidence. PGW presented evidence that its present billing system simply cannot handle the consolidated billing duties for 150,000 customers at the present time.⁷³ PGW is in the process of evaluating the upgrade or replacement of its entire billing system, which would necessarily include the kind of billing capability that would be needed to carry out IGS's proposal. But, PGW currently estimates the cost of replacing its billing system at approximately several million dollars.⁷⁴ No quantification of the costs of revising PGW's current billing system to handle such an enormous number of customers was made. How can IGS claim that implementation of its proposal will not cause customers to incur any costs when no quantification of the costs of revising or replacing PGW's present billing system – or any of the other costs that would inevitably be associated with such a proposal – was ever made? IGS is asserting that it could begin to serve 30% of PGW's residential customers, provide service to them at rates lower than PGW's existing charges, and pay for PGW's new billing system and all other associated costs. How can IGS claim that this can be covered by "discounts" from PGW's gas charges when IGS did not suggest how big these "discounts" might be? PGW respectfully submits that such an MST or SOLR alternative plan is not realistic.⁷⁵

PGW continues to support competition on its system and is open to any proposals that improve its financial status. But, in light of the likely enormous costs that would be associated

⁷³ PGW currently is capable of providing billing service to the level of choice customers it now has or anticipates in the next few years. Hence, IGS's contention that PGW's billing system does not comply with the requirements of the Natural Gas Choice & Competition Act (IGS Exceptions at 2, n. 1) is not correct. But to do such work for 150,000 customers is well past the current system's capacity or capability.

⁷⁴ See, PGW St. 2 at 13. Phase II of PGW's LNG liquefaction project and the upgrade of its existing billing system together are estimated to cost \$50 million.)

⁷⁵ In addition, to the extent that the IGS proposal contemplates that it or another NGS would act as an alternative SOLR – or if the proposal amounts to such a replacement – the concept is barred by statute, without PGW's approval. 66 Pa. C.S. § 2207(e).

with an MST or alternative SOLR type proposal, PGW submits that further study or exploration by the Commission or the parties in this case would not be an efficient use of their time or resources. Such a proposal can be revisited once PGW's new billing system is successfully installed.

4. The Exceptions Of OSBA And PICGUG Must Be Rejected Because They Needlessly Propose To Shift An Even Greater Financial Burden To Residential Customers Solely To Alleviate The Burden On Business Customers

OSBA and PICGUG except to the ALJs' decision to reject OSBA's proposal to eliminate firm business customers' obligation to pay a share of the cost of PGW's universal service programs.⁷⁶ The RD opined that the proposal "would be overwhelming to the residential customers."⁷⁷ This was clearly the correct decision. Currently, all firm customers, which include residential and business customers, contribute to the costs of universal service programs through PGW's Universal Service and Energy Conservation Surcharge ("USEC"). PGW's position, as accepted by the RD, is that the current USEC cost recovery mechanism should be maintained as it has successfully provided a worthwhile benefit that the Commission has long recognized as important.⁷⁸ Further, the current structure of PGW's USEC appropriately balances the burden of universal service programs on all firm customers. To tinker with this mechanism now just to provide some financial benefit to business customers is unnecessary and will result in needless significant financial consequences for residential customers – consequences which can be completely avoided by adopting the RD on this point.

Moreover, OSBA and PICGUG ask the Commission to put on blinders and ignore the very real ramifications that OSBA's cost shifting proposal will have on PGW's non-CRP

⁷⁶ OSBA Exceptions at 16-17; PICGUG Exceptions at 5.

⁷⁷ RD at 80-81.

⁷⁸ PGW RB at 80.

residential customers, many of whom are just above 150% of the poverty level.⁷⁹ Despite their advocacy to the contrary, the Commission cannot analyze OSBA's proposal in a vacuum.

As the RD found, PGW's rates for residential service do not cover their cost, and the rates for commercial and industrial customers exceed their cost to serve.⁸⁰ In order to remedy this circumstance, the RD recommended that residential customers shoulder a substantial portion of the burden of any rate increase granted.⁸¹ If the Commission accepts OSBA's additional proposal on USEC, it will be adding a total 3.9% increase to residential customers on top of a rate increase of up to 12% that could occur as a result of this rate case.⁸² In contrast, commercial and industrial customers may see very little of any authorized rate increase and further applying OSBA's proposal to them will result in rate reductions.⁸³ The potential impact of these numbers makes obvious that this is not the case to affect a policy change regarding the status quo of PGW's USEC, if the Commission has any inclination to change PGW's long-standing policy.

Moreover, the record reveals a host of policy reasons to affirm PGW's present practice of assigning universal service costs to all firm customers.⁸⁴ The Commission's duty under the Gas

⁷⁹ For a family of four, this translates to a total annual income, before taxes, of \$30,975. See 2007 Poverty Guidelines, 72 Fed. Reg. 3147 (Jan. 24, 2007).

⁸⁰ RD at 4.

⁸¹ RD at 72. See also, PGW Exceptions, App. A. The first column on this chart under the heading "RecDec Allocation" shows the impact on each customer class of the RD's proposed allocation for rate increases of \$25 million through \$100 million.

⁸² PGW Exceptions, App. A. The last full column on this chart under the heading "RecDec Allocation" shows the percentage impact on each customer class of the RD's proposed allocation for rate increases of \$25 million through \$100 million. OSBA proposal would add a total of 3.9% onto those figures for residential customers.

⁸³ *Id.* For commercial customers, OSBA's proposal would subtract a total of 11.7% from the figures presented in the last full column on this chart.

⁸⁴ The Commission's previous pronouncements on the issue of cost recovery for universal service programs as well as PGW's specific USEC have already been detailed by all the parties and the RD. See, e.g., PGW RB at 84. Further, PGW has specifically responded to each argument of OSBA and PICGUG making clear that (1) PGW is different from traditional regulated utilities based on its ratemaking methodology, customer demographics, and municipal status; (2) PGW's universal service programs are successful programs that the Commission should continue to encourage and support; (3) when faced with the issue of PGW's USEC

Choice Act is to "ensure that 'universal service and energy conservation policies are appropriately funded and available' in each nature gas distribution service territory."⁸⁵ In fulfilling this goal, the Commission must decide which ratepayers should be required to shoulder the burden of universal service funding in light of the fact that assigning the costs of the programs to the direct beneficiaries (i.e. program participants) is not feasible because they participate in the program to receive needed financial assistance. Removing the universal service participants from the pool of available funding sources, the Commission is left with assigning costs to business customers and/or residential customers. Neither of these customers participate in universal service programs and, therefore, neither of these classes are direct beneficiaries of universal service programs.⁸⁶ However, both classes do receive indirect benefits from PGW's customer assistance programs, therefore, equally imposing upon them the costs of these programs is reasonable.⁸⁷

PGW does not dispute that in cases for other NGDCs, the Commission has established a policy of collecting universal service costs only from residential customers based on the NGDC's

mechanism in prior proceedings, the Commission has adopted the status quo for PGW and identified PGW as an exception to the Commission's general policy regarding universal service funding; (4) the Commission's general policy regarding universal service funding is based on other NGDCs which do not have customer demographics similar to PGW; (5) the Commission has expressed a desire to refrain from implementing universal service funding policy changes that could have a detrimental impact; and (6) under pure cost causation principles none of the customer classes that are asked to fund universal service programs receive direct benefits from the programs. PGW RB at 79-85.

⁸⁵ PGW RB at 79.

⁸⁶ *Id.* at 84-85.

⁸⁷ *Id.* at 84.

company specific circumstances.⁸⁸ Nor can OSBA or PICGUG dispute that PGW has the largest number of customers participating in its CAP program of any NGDC, and, therefore, the burden on remaining residential customers would be far greater than for other utilities if this change were made. It is not surprising, therefore, that the Commission has maintained the *status quo* regarding USEC for PGW and, in its most recent pronouncement on this issue, noted that there are exceptions to the Commission's standard policy of allocating universal service costs to residential customers.⁸⁹ Everyone agrees that PGW is such an exception. The difference is that OSBA and PICGUG nonetheless advocate that the Commission dramatically change course now with respect to PGW. They take this position even though to do so would be initiating a policy change for PGW that could have a detrimental impact on the businesses and jobs in Philadelphia which is the very result the Commission has clearly expressed a desire to avoid.⁹⁰

Taking into consideration all of this background, neither party presented compelling evidence to justify adoption of OSBA's proposal. In contrast, there is substantial evidence in the record to support the ALJs' conclusion that, particularly in this case, OSBA's proposal would be "overwhelming to the residential customers" and they should not be burdened with both the rate increase and an increase in the universal service cost, particularly at the same time that the historic below-cost relationship of the residential rates is being reduced or eliminated.⁹¹ Because the RD appropriately assessed the entire picture regarding OSBA's proposal and reached the only fair conclusion for PGW's entire rate base, the Commission must reject the exceptions of OSBA and PICGUG.

⁸⁸ *Id.* at 82-83.

⁸⁹ *Id.* at 83 quoting *Customer Assistance Programs: Funding Levels and Cost Recovery Mechanisms Final Investigatory Order*, Docket No. M-00051923 (Order entered December 18, 2006) at 31.

⁹⁰ *Id.*

⁹¹ RD at 81.

5. The Exceptions of Action Alliance Must Be Rejected.

(a) The RD Properly Rejected AA's Reliance on the Cold Weather Survey Results.

Action Alliance excepts to the RD's conclusion that the results of the Commission's Cold Weather Survey ("CWS") merely provide statistics "alone without supporting data about the participants" and this leads to "presumptions" which do not support Action Alliance's ultimate position that PGW provides inadequate service.⁹² Action Alliance responds that the CWS data, along with the opinions of Action Alliance's Witness Harry S. Geller, is sufficient to support its position that PGW is providing inadequate service to its low-income customers.⁹³ This claim, however, cannot be substantiated and the Commission should affirm the ALJs' decision. First, the purpose of the CWS is not to assess a utility's service and, therefore, drawing conclusions from it regarding service is inappropriate. Second, Action Alliance did not present the evidence necessary to increase the probative value of the CWS. Finally, the substantial evidence in the record proves that PGW provides adequate assistance to low-income customers.

The CWS is required pursuant to 52 Pa. Code § 56.101(5), and it obligates companies to file with the Commission's Bureau of Consumer Services ("BCS") "a brief report outlining their pre-December 1 survey and personal contact results."⁹⁴ As PGW explained in the testimony of PGW Witness Randall Gyory, PGW's provisioning of utility service covers a whole range of issues that are not captured within the limited confines of the CWS.⁹⁵ Rather, the CWS serves one specific purpose – to inform BCS of the results of PGW's survey of those premises where heat-related service has been terminated during the year and PGW's attempts to make post-

⁹² Exceptions of Action Alliance at 2-6; RD at 108.

⁹³ *Id.* at 3-4.

⁹⁴ 52 Pa. Code § 56.101(5).

⁹⁵ PGW St. 6R at 4.

termination personal contact in an effort to address possible restoration of service.⁹⁶ As the RD properly notes, the CWS does not provide any type of case-by-case analysis of each of the households without service.⁹⁷ It does not provide any details about why service to the household was terminated nor the specific reasons why reconnection was not possible. It does not reveal whether those persons surveyed stayed in PGW's service territory throughout the winter season or whether those persons remained eligible, and decided to enroll, in CRP⁹⁸ throughout the winter season. Because the CWS provides no real useful information about the service provided by PGW, the RD properly concluded that Action Alliance could not support its claim that PGW provides unreasonable service to low-income customers on the basis of the CWS alone.

While Action Alliance tries to prop up its reliance on the CWS by offering the opinion of its witness Harry S. Geller and comparing PGW's CWS results with that of other utilities,⁹⁹ neither of these provides any meaningful explanation of the CWS results on a case-by-case basis. Since Action Alliance could not provide this type of information, in combination with a complete picture of PGW's provisioning of service to its entire customer base, Action Alliance's enormous leap to conclude that the CWS results mean that PGW has either improperly terminated or inappropriately failed to reconnect these customers was properly rejected by the

⁹⁶ *Id.* Contrary to Action Alliance's assertions, PGW has consistently taken the position throughout this proceedings that the CWS results alone are not a proper basis upon which to conclude that PGW is providing inadequate service to its low-income customers.

⁹⁷ RD at 108.

⁹⁸ As explained by PGW Witness Cristina Coltro, there are other programs in which low-income customers may enroll which may be more appropriate for their specific circumstances. These include the senior citizen discount program, the Philadelphia Housing Authority gas allowance, and payment arrangements. PGW St. 7R at 5.

⁹⁹ Action Alliance Exceptions at 2, 5.

RD as "presumptive evidence" which cannot "substantiate or support a conclusion of inadequate service."¹⁰⁰

Also within the context of Exception No. 1, Action Alliance finds fault with the RD's reliance on PGW's testimony setting forth all the various measures PGW has taken to assist low-income customers.¹⁰¹ As detailed in the record, PGW has worked to assist low-income customers with paying their bills in numerous ways ranging from maintaining one of the most successful Customer Assistance Programs in the Commonwealth to aggressively working with the City and the Commonwealth to establish additional grants for low-income customers.¹⁰² While Action Alliance tries to minimize these substantial efforts by asserting that "whatever PGW has provided has not been enough,"¹⁰³ the RD correctly assessed all of PGW's efforts in this area and found that "PGW's service is adequate to the low-income segment of its customer base."¹⁰⁴ Therefore, Action Alliance's Exception No. 1 must be rejected.

(b) The RD Properly Relied On The Fact That PGW Has Not Violated The Law Or Commission Orders Regarding Its Service To Low-Income Customers.

Action Alliance excepts to the RD's focus on whether PGW has violated the law, regulations or Commission guidelines as a basis for determining if PGW has provided adequate service.¹⁰⁵ In sum, Action Alliance argues that violations are irrelevant when looking at the results of the CWS because the results of the CWS show that there must be some violation somewhere or something unreasonable in PGW's termination and reconnection policies or else

¹⁰⁰ RD at 108.

¹⁰¹ Action Alliance Exceptions at 5.

¹⁰² PGW RB at 53-56.

¹⁰³ Action Alliance Exceptions at 6.

¹⁰⁴ RD at 108.

¹⁰⁵ Action Alliance Exceptions at 6-8; RD at 110-116.

the results of the CWS would be different.¹⁰⁶ As explained in response to Exception No. 1, the RD properly concluded that reliance on the results of the CWS survey is not enough to substantiate Action Alliance's claims of inadequate service.

While Action Alliance disagrees with the RD regarding the value of the CWS, it does nothing more than generally restate its position on PGW's various termination and reconnection policies. According to Action Alliance, these various policies are a "misuse of discretion provided by Chapter 14," or they are "not reasonable under PGW's demographic circumstances" even if permissible under Chapter 14, or they "violate specific Commission standards of reasonableness."¹⁰⁷ Each and every one of these claims were specifically addressed in the record of this proceeding¹⁰⁸ and the ALJs properly concluded that none of Action Alliance's allegations were legally or factually sustainable.¹⁰⁹ More specifically, the ALJs stated that "Chapter 14 provides discretion to the utilities,"¹¹⁰ and they will not "find that the utility violates a regulation where that regulation does not hold the utility responsible."¹¹¹ Finally, the ALJs concluded that they were "reluctant to find that the utility's conduct is prohibited based on subjective reasoning,"¹¹² These recommendations were clearly reasonable and logical. Therefore, to the extent Exception No. 2 is intended to challenge the RD's determinations on each of the specific termination and reconnection policies identified by Action Alliance, it should be rejected.

¹⁰⁶ *Id.* at 6.

¹⁰⁷ Action Alliance Exception at 7-8.

¹⁰⁸ PGW RB at 57-67.

¹⁰⁹ RD at 113, 116, 118-120.

¹¹⁰ *Id.* at 112 (regarding upfront payments from customers seeking payment arrangements); 110 (regarding budget billing).

¹¹¹ *Id.* at 114 (regarding PGW's medical certification policy).

¹¹² *Id.* at 116.

(c) The RD Properly Found That PGW's CARES Program Is Not In Violation Of The Law.

Action Alliance excepts to the RD's conclusion that PGW is in compliance with its obligation to provide a Customer Assistance and Referral Evaluations Services ("CARES") program.¹¹³ Action Alliance criticizes PGW's CARES program as not constituting a "casework approach" in violation of the law.¹¹⁴ While Action Alliance believes that PGW's CARES program should be structured differently, it did admit on the record that "[t]he standard for judging the adequacy of PGW's CARES program are [sic] not contained in Chapter 14 or Chapter 56 or other PUC Order imposing a specific duty or obligation on PGW."¹¹⁵ Without any legal standard upon which to base its subjective opinion of PGW's CARES program, Action Alliance's position that PGW's CARES program somehow violates the law lacks any support.

Moreover, the record in this case provides details regarding PGW's CARES program, the Commission's own evolving position about CARES programs in general, and the fact that the financial consequences of implementing Action Alliance's proposed have not been assessed.¹¹⁶ Based on all of this substantial evidence, the ALJs properly found that Action Alliance "fail[ed] to show that CARES is ineffective, inefficient, mismanaged or inadequately financed."¹¹⁷ Consequently, the Commission must reject Action Alliance's Exception No. 3.

(d) The RD Properly Found That PGW Is In Compliance With The Requirements Of 52 Pa. Code § 56.97(b) When Establishing Payment Arrangements.

¹¹³ Action Alliance Exceptions at 8; RD at 111.

¹¹⁴ Action Alliance Exceptions at 9.

¹¹⁵ PGW RB at 59 quoting PGW Exh. No. CC-4.

¹¹⁶ PGW St. 7R at 13-14.

¹¹⁷ RD at 111.

Action Alliance excepts to the RD's conclusion that Action Alliance failed to present evidence demonstrating violation of Chapter 14 or 52 Pa. Code § 56.97(b) when PGW establishes payment arrangements for customer.¹¹⁸ Action Alliance claims its reference to and reliance upon PGW's Payment Arrangement Guidelines was sufficient to satisfy its burden of proof that PGW was providing inadequate service.¹¹⁹ Because the substantial evidence in this proceeding showed that PGW's Payment Arrangement Guidelines are not "utilized on a daily basis" to "dictate" to all PGW's customer service representatives ("CSRs") how they must act in establishing payment arrangements,¹²⁰ the ALJs properly rejected Action Alliance's proffered evidentiary support. PGW has been very clear in this proceeding about the use of its Payment Arrangement Guidelines. In fact, PGW presented undisputed testimony that "[t]he Payment Arrangement Guidelines are only part of a bigger collection of the training materials provided to CSRs" and "are not scripted rules that [CSRs] must follow," but rather they are "a reference to basically bridge the gap on what [the CSRs have] been trained and maybe what they remember so they can complete the call as necessary."¹²¹ As such, the ALJs were correct to conclude that Action Alliance's sole reliance on this document failed to support its position that PGW violated either Chapter 14 or 52 Pa. Code § 56.97(b) requirements.¹²²

- (e) The RD Properly Found That PGW Is In Compliance With The Requirements Of 52 Pa. Code § 56.97(b) When Seeking Upfront Payment Of Arrearages And Establishing Minimum Monthly Payments For Payment Arrangements.

¹¹⁸ Action Alliance Exceptions at 9-10; RD at 113.

¹¹⁹ Action Alliance Exceptions at 11.

¹²⁰ PGW RB at 60.

¹²¹ *Id.* at 60 citing to Tr. at 940-41; 959-961; PGW St. 7R at 11-12.

¹²² RD at 112.

Action Alliance argues that the ALJs should have concluded that PGW improperly seeks upfront payment of arrearages and requires "inflexible" minimum monthly payments when working with customers seeking to establish payment arrangements.¹²³ To support its position, Action Alliance - as in Exception No. 4 - claims that PGW's Payment Arrangement Guidelines are a "rigid system" that lacks the flexibility required by 52 Pa. Code Section 56.97(b), the Commission's Second Implementation Order, and the Commission's pronouncements regarding Section 1405(b) of Chapter 14.¹²⁴

As explained in the previous section, PGW's Payment Arrangement Guidelines are not the "inflexible" and "rigid" tool described by Action Alliance and, therefore, Action Alliance's claim lacks any foundational support. Beyond this, however, PGW's Payment Arrangement Guidelines do show that PGW's CSRs obtain income and occupancy information and during telephone calls, CSRs "look at the account to establish if [the customer] had been previously on CRP and what type of agreements they had."¹²⁵ Further, PGW's CSRs "are trained extensively regarding what to do with these particular customers."¹²⁶ 52 Pa. Code § 56.97(b) requires that the utility "exercise good faith and fair judgment in attempting to enter a reasonable. . . payment agreement," and the record in this proceeding clearly demonstrates that PGW is in compliance with these requirements.¹²⁷ Further, as the ALJs stated, the Commission's Second Implementation Order allows utilities to require up-front payments after considering the

¹²³ Action Alliance Exceptions at 11-13; RD at 113.

¹²⁴ Action Alliance Exceptions 11-13.

¹²⁵ PGW RB at 62 quoting Tr. at 961.

¹²⁶ *Id.* at 62 quoting Tr. at 965.

¹²⁷ 52 Pa. Code § 56.96(b).

appropriate factors.¹²⁸ The RD properly concluded that PGW has not violated either of these requirements in establishing payment arrangements and Action Alliance's Exception to the contrary must be rejected.

Action Alliance's attempt to use 66 Pa. C.S. § 1405(b) of Chapter 14 to support its conclusions must also be rejected because this section applies to the Commission and not to utilities.¹²⁹ Therefore, reliance on the Commission's pronouncement regarding 1405(b) cannot be used to assess PGW's policies under 66 Pa. C.S. § 1405(d). The ALJs have properly concluded that Chapter 14 provides discretion to the utilities, nothing prohibits PGW from requesting upfront payments, and nothing in this record shows that PGW has acted inappropriately in this regard.¹³⁰ Therefore, the Commission must reject Action Alliance's Exception No. 5.

(f) The RD Properly Found That PGW Is In Compliance With The Commission's Requirements Regarding Payment Of Budget Billing True-up Amounts.

Action Alliance excepts to the RD's finding that PGW has not violated the Public Utility Code through its policies for budget billing.¹³¹ Action Alliance believes that PGW should be required to provide a system-wide accommodation establishing a payment schedule for customers who must pay a "true-up" amount.¹³² However, as the ALJs properly concluded, such

¹²⁸ RD at 113 citing *Re: Chapter 14 Implementation*, Docket No. M-00041802F0002, Second Implementation Order entered September 12, 2005 at 35-36.

¹²⁹ PGW RB at 61.

¹³⁰ RD at 114.

¹³¹ Action Alliance Exceptions at 13; RD at 110.

¹³² Action Alliance Exceptions at 15.

a requirement is not required and is not necessary based on the substantial evidence in the record.¹³³

The only legal support Action Alliance offers for its position is a stretched and incomplete reading of the Commission's budget billing reconsideration order¹³⁴ that Action Alliance failed to acknowledge even existed until this phase of the proceeding. Initially, Action Alliance took the position that the Commission's first budget billing order entered June 2, 2006 required PGW to allow customers to pay true-up amounts over a period of installments.¹³⁵ In making these arguments, Action Alliance never addressed the Commission's subsequent reconsideration order which reversed its earlier determination.¹³⁶ Now, after the RD has made clear that the reconsideration order controls, Action Alliance actually attempts to claim that the Commission's reconsideration order entered November 14, 2006 still supports Action Alliance's claims. Incredibly, Action Alliance makes this argument even while acknowledging that the exact provisions in the first order previously (and mistakenly) relied upon by Action Alliance were unquestionably "deleted" by the Commission on reconsideration.¹³⁷ In trying to explain away this fact, Action Alliance specifically quotes a section of the reconsideration order which refers to the Commission's use of the word "should" and, based on this, Action Alliance leaps to the overbroad conclusion that "[p]lainly, the Commission does not consider 'good judgment' to be PGW's current practice."¹³⁸ In making this argument, Action Alliance ignores the next

¹³³ RD at 110.

¹³⁴ *In re: Insuring Consistent Application of 52 Pa. Code § 56.12(7) Equal Monthly Billing*, Docket No. M-0005925 (Order entered November 14, 2006).

¹³⁵ AA MB at 28. *In re: Insuring Consistent Application of 52 Pa. Code § 56.12(7) Equal Monthly Billing*, Docket No. M-0005925 (Final Interpretative Order entered June 2, 2006).

¹³⁶ *In re: Insuring Consistent Application of 52 Pa. Code § 56.12(7) Equal Monthly Billing*, Docket No. M-0005925 (Order entered November 14, 2006).

¹³⁷ Action Alliance Exceptions at 14.

¹³⁸ *Id.* at 15.

sentence in the reconsideration order which states "the elements listed as acceptable budget billing components are guidelines, not a mandate."¹³⁹ Further, nothing in the Commission's budget billing orders reviewed PGW specifically or made any determinations about PGW's budget billing policies. Despite its efforts to the contrary, Action Alliance simply has no basis in the Commission's orders to claim that PGW's budget billing practices are in violation of the law or PUC orders.

Even setting this aside, the record in this proceeding clearly demonstrates that PGW does make an effort to help customers avoid large true-ups at the end of the year by quarterly reviewing and adjusting a customer's budget bill as necessary.¹⁴⁰ Since there is no legal or factual basis upon which Action Alliance can support its Exception No. 6, the Commission must reject it.

(g) The RD Properly Found That Removal Of PGW's Current Tariff Section 2.4.E Is Consistent With PGW's Proposal To Streamline Its Tariff And The Removal Does Not Abrogate PGW's Legal Responsibilities.

Action Alliance excepts to the RD's conclusion that PGW should be permitted to remove Tariff Section 2.4.E from its current tariff and replace it with Section 2.4.C.¹⁴¹ Section 2.4.E provides an itemized statement of conditions of service to an applicant when PGW rejects an application for service.¹⁴² Action Alliance believes that the ALJs' recommendation should be rejected by arguing that Section 2.4.E is necessary "as a matter of federal constitutional due process law" and retention of Tariff Section 2.4.E is required by 66 Pa. C.S. §§ 1501, 1501 and

¹³⁹ *In re: Insuring Consistent Application of 52 Pa. Code § 56.12(7) Equal Monthly Billing*, Docket No. M-0005925 (Order entered November 14, 2006) at 10.

¹⁴⁰ RD at 110; PGW RB at 58.

¹⁴¹ Action Alliance Exceptions at 15-20; RD at 87-89.

¹⁴² PGW St. 6, Ex. RG-2.

2203(7).¹⁴³ Upon reviewing these arguments, the ALJs properly concluded that PGW should be permitted to remove current Tariff Section 2.4.E.¹⁴⁴

While PGW seeks to remove current Tariff Section 2.4.E, it proposes to replace it with new Section 2.4.C which states that "Where PGW rejects an application for Gas Service, PGW shall inform the Applicant as required by applicable law."¹⁴⁵ To the extent the specific requirements set forth in current Tariff Section 2.4.E are determined to be established as required "as a matter of federal constitutional due process law," then PGW would be obligated to comply with those requirements based on the language in the proposed Section 2.4.C regardless of whether or not PGW specifically detailed the requirement in its tariff. Moreover, PGW has been clear throughout this proceeding that it does not intend to change its existing practice but proposes to remove the language to be consistent with other utilities throughout the Commonwealth that do not specifically include this policy in their tariffs and, thus, retain the flexibility needed to revise policies or procedures to accommodate regulatory changes – ultimately benefiting customers.¹⁴⁶ Finally, Action Alliance's legal arguments that retention of Section 2.4.E is required by state law was properly rejected by the ALJs.¹⁴⁷ For all of these reasons, Action Alliance's Exception No. 7 must be rejected.

- (h) The RD Properly Found That Tariff Provisions "Unauthorized Use" Is Appropriate As A Person Who Lacks Permission To Use Gas Service Is An Unauthorized User.

Action Alliance excepts to the RD's conclusion that its proposed additional tariff language to clarify the meaning of "unauthorized use" to exclude "user without contract" should

¹⁴³ Action Alliance Exceptions at 16, 19.

¹⁴⁴ RD at 89.

¹⁴⁵ *Id.* at 87.

¹⁴⁶ PGW RB at 93-94.

¹⁴⁷ RD at 89.

be rejected because it is not necessary and is more confusing.¹⁴⁸ According to Action Alliance, PGW's use of the term "unauthorized use" could mislead "users without a contract" into believing that they could be terminated without prior notice and have no basis for claiming other consumer protections available to customers and occupants. Action Alliance bases its position on narrowing the definition of "unauthorized use" to mean receiving gas service through physical tampering with the company's facilities, and claiming that such a narrow definition does not include "users without contract" defined as those acquiring company service through other means without the company's knowledge.¹⁴⁹

However, as the ALJs properly concluded "[a] user without contract is a party that has taken utility service without agreement and necessary approval of the utility" and there is no basis upon which to require PGW to create a separate definition for "user without a contract."¹⁵⁰ Moreover, the clear language of 66 Pa. C.S. § 1405(c), uses the term "unauthorized use of service" and gives PGW permission to immediately terminate service.¹⁵¹ Therefore, the ALJs properly concluded that the term "unauthorized use" in PGW's tariff is appropriate without the need for any further clarification, and Action Alliance's Exception No. 8 must be rejected.

6. The ALJs Properly Concluded There Was No Evidence To Support Its Proposed Mandatory Budget Billing Program And PGW Should Not Be Required To Undertake A Costly Review Of OCA's Proposal.

OCA's Exception No. 3 asks the Commission to reverse the ALJs' conclusion that OCA did not provide substantial evidence to support implementation of its proposed mandatory budget

¹⁴⁸ Action Alliance at 20-22; RD at 87.

¹⁴⁹ Action Alliance at 20.

¹⁵⁰ RD at 87.

¹⁵¹ 66 Pa. C.S. § 1406(c)(1)(i) ("A public utility may immediately terminate service for any of the following actions by the customer: (1) Unauthorized use of the service delivered on or about the affected dwelling."). PGW currently does not subject alleged "users without a contract" to termination without notice and does not reject an applicant solely on the grounds that such applicant was a "user without a contract." PGW St. 6R at 17.

billing program.¹⁵² If the Commission rejects OCA's exception to direct implementation of this program, then OCA argues that the Commission should adopt the alternate proposal offered by PGW – a proposal OCA was not willing to accept before the RD was issued.¹⁵³ OCA's exception, including its primary and alternate positions, must be rejected because the ALJs properly found no foundational support for OCA's mandatory proposal and, therefore, found no reason to direct PGW to undertake a costly study of the issue.

As detailed in this proceeding and properly accepted by the ALJs, OCA's mandatory budget billing proposal is fraught with concerns which justify not directing PGW to implement it. First, it does not guarantee that payment troubled customers will pay more consistently. Second, automatically enrolling someone in a mandatory system for missing one payment may be an overly draconian response (and potentially illegal). Third, OCA's timeframe for implementing the program in November of each year will have a negative impact on PGW's cash flow. Finally, implementing OCA's program would require a costly modification of PGW's billing systems.¹⁵⁴ Based on all of these reasons and the fact that OCA failed to present any cost versus benefits analysis of its proposal, the RD properly rejected OCA's proposal.

PGW's alternative to being directed to implement OCA's mandatory proposal was to study the implications of OCA's proposal as part of PGW's customer segmentation study so that PGW could better assess the potential costs and benefits of the program.¹⁵⁵ OCA was unwilling to accept this offer, instead insisting that its mandatory program be implemented.¹⁵⁶ Now that the ALJs have declined to order PGW to implement OCA's proposal, OCA suggests that the

¹⁵² OCA Exceptions at 21-23; RD at 124.

¹⁵³ OCA MB at 101.

¹⁵⁴ PGW RB at 68.

¹⁵⁵ PGW MB at 94.

¹⁵⁶ OCA RB at 55.

Commission at least adopt the alternative offered by PGW.¹⁵⁷ PGW respectfully suggests that this suggestion should also be rejected. PGW made the offer to further study OCA's proposal as an alternative to being directed to implement the program. Because the ALJs have properly concluded that implementing the program is not supported by the record, there is no need to direct PGW to undertake further study of the proposal. Further, the record does not provide any evidence of the costs PGW would incur to study this issue. Unless PGW is awarded substantial rate relief here imposing even more cost obligations on this financially strapped company simply does not make sense.

7. The Philadelphia Housing Authority's Exceptions Should Be Denied.

The Philadelphia Housing Authority ("PHA") takes exception to the ALJs' recommended denial of PHA's request for the reclassification of its rates. Specifically, before the ALJs, PHA requested that Conventional Site properties (currently billed at the PHA Rate) and Scattered Site properties (currently billed at the GS Residential Rate) be billed at the lowest rate after allocation of PGW's rate increase. PHA bases its request upon its claim that the Conventional Site and Scattered Site properties have always been eligible for three rates – MS, PHA and GS – therefore, applying a rate to PHA other than the lowest rate is violative of Section 1303 of the Public Utility Code.¹⁵⁸ Additionally, PHA requested a refund for alleged over-billings based

¹⁵⁷ OCA Exceptions at 22-23.

¹⁵⁸ Section 1303 of the Public Utility Code states:

No public utility shall, directly or indirectly, by any device whatsoever, or in anywise, demand or receive from any person, corporation, or municipal corporation a greater or less rate for any service rendered or to be rendered by such public utility than that specified in the tariffs of such public utility applicable thereto. The rates specified in such tariffs shall be the lawful rates of such public utility until changed, as provided in this part. 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.A 1303.

upon its claim that it should have historically been billed at the MS Rate which is currently the lowest rate among the MS, PHA and GS Rates.

The ALJs considered PHA's arguments but clearly found that PGW did not violate the Public Utility Code by charging PHA and its tenants at their current rates.¹⁵⁹ After rejecting PHA's claim that it has always qualified for the MS, PHA and GS Rates, the ALJs denied both PHA's request for a refund and its request for a prospective rate reclassification.

PHA filed exceptions to the RD but it is quite difficult to determine exactly what PHA is trying to communicate in these exceptions. What adds to this difficulty is that PHA does not state what relief it is seeking.

As best as can be deciphered, it seems that PHA is criticizing the ALJs for not clearly stating if both Scattered Sites and Housing Choice properties qualify for PHA or MS Rates and for leaving PHA in a position of not knowing which of three rates (i.e. MS, PHA and GS) will apply to PHA in the future. Neither position has merit. First, PHA's Reply Brief clearly sets forth that when it refers to Scattered Site properties, it is inclusive of Housing Choice properties.¹⁶⁰ As a result, when the RD denied rate reclassification for Scattered Site properties, it also denied the same for Housing Choice properties. As for PHA not knowing which rate applies to PHA in the future, the RD was very clear – rate reclassification is denied – therefore, the PHA Rate still applies to Conventional Sites in the future and the GS Rate still applies to Scattered Sites in the future. As a result of the foregoing, Section 1303 of the Code is not violated and the RD must be affirmed.


¹⁵⁹ RD at 83.

¹⁶⁰ PHA's Reply Brief states:
PHA requested in its Main Brief that both the Conventional Sites currently invoiced at the PHA Rate and its Scattered Sites and Housing Choice properties (collectively "Scattered Sites"), be reclassified to the Municipal Rate class or to the lowest class ultimately determined by the Commission.
PHA Reply Brief at 3 (emphasis added).

CONCLUSION

WHEREFORE, Philadelphia Gas Works respectfully requests that the exceptions of be dismissed in accordance with this document.

Respectfully submitted,



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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 participants listed below in accordance with the requirements of § 1.54 (relating to service by a participant).

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TO: Cheryl W. Davis, Director
Office of Special Assistants

FROM: James McNulty
Secretary
nvl

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FOLDER**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION ET AL
V.
PHILADELPHIA GAS WORKS**

Copies of the Recommended Decision have been served upon all parties of interest.

Exceptions have been filed by:

**OFFICE OF CONSUMER ADVOCATE
OFFICE OF TRIAL STAFF
INTERSTATE GAS SUPPLY INC
OFFICE OF SMALL BUSINESS ADVOCATE
PICGUG**

Reply Exceptions have been received from:

**OFFICE OF TRIAL STAFF
OFFICE OF CONSUMER ADVOCATE
OFFICE OF SMALL BUSINESS ADVOCATE
PHILADELPHIA HOUSING AUTHORITY
ACTION ALLIANCE ET AL
PHILADELPHIA GAS WORKS
PICGUG**

KJR

cc: Susan Hoffner