PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

Re: PA PUC v. Philadelphia Gas Works

Public Meeting: December 18, 2008
2073938-OSA-010
Docket R-2008-2073938

JOINT MOTION OF CHAIRMAN CAWLEY AND COMMISSIONER GARDNER

Before us is the November 14, 2008, Petition for Extraordinary or Emergency Rate Relief (Petition) filed by Philadelphia Gas Works (PGW). In this Petition, PGW requests a $60 million increase in distribution rates, effective January 1, 2009. PGW justified its request on the current financial crisis, specifically as it relates to access to credit, and a series of financial transactions which PGW intends to initiate over the course of the next 18 months. Those transactions include: a conversion of variable rate bonds issued in 2006 to fixed rate bonds; the termination of an interest rate swap agreement associated with the conversion of the 2006 bonds; the roll-over of PGW's commercial paper in the first quarter of 2009; required pay-off of the commercial paper for one day in May of 2009; and an additional issue of long term debt in 2010.

The recent turmoil in the financial markets, resultant complications in negotiations of financial instruments, and overall struggles in the local, regional, and national economy warrant decisive action by us to ensure that PGW's financial position remains strong through these difficult times. PGW should therefore be granted a $60 million rate increase, effective January 1, 2009, to cover the costs of conversion of the 2006 variable rate bonds to fixed bonds, termination of an interest swap agreement associated with these bonds, financial support for the continued roll-over of PGW's commercial paper, and improvement in PGW's financial ratios in order to support an upgrade of its debt rating. We must do more than simply hope that current economic conditions will not be reflected in future operating revenues. Rather, we must take affirmative and reasonable steps to ensure that adequate funds are available in case revenues fall as a result of declining economic conditions. PGW should also implement its quarterly Gas Commodity Rate (GCR)/Universal Service Charge (USC) filing coincidently with this rate increase, effective January 1, 2009, to effectuate its projected net bundled rate decrease of 4.2% ($47 million). GCR over-collections from the period December 1 to December 31, 2008 should be refunded to customers, with interest, consistent with normal GCR procedures.

PGW's interest rate swap with JPMorgan Chase Bank demonstrates the uncertainties of the present market and the magnitude of PGW's potential revenue needs. PGW originally projected its expenses related to terminating the swap transaction at between $15 million and $30 million as a one-time expense. Based upon that dollar range, PGW advanced $25 million in support of its requested rate relief. At the evidentiary hearing on December 4, 2008, however, PGW revised that figure upward to $54 million. The simple explanation is that the amount of money needed to operate the company in this economic environment is dynamic and based upon a formula that depends upon specific market data which fluctuates by the minute.

In addition, increased interest rate expense will result from the refinancing of previously issued bonds. The Office of Consumer Advocate (OCA) acknowledged this increase of $8.25 million based on a 6.76% interest rate, which was later increased to 7.36%, adding $2 million to this estimated cost. This once again confirms the inexactness and variability of the situation.

PGW must also rollover (reissue) commercial paper (CP) in several transactions. If the CP is not renewed and the letter of credit back-up is used, short term debt costs could increase from 0.9% to 4.0%.[1] PGW was successful in reissuing $73 million of CP at 0.9% to March 12, 2009. An additional $75 million of CP comes due on February 15, 2009. Should PGW be unsuccessful in reissuing the CP in February and March of 2009, short term borrowing costs would increase relative to current CP borrowing costs.

In testimony, PGW also expressed concerns regarding operating revenues in light of the deteriorating economic conditions. If, for example, collections dropped from 96% to 92%, operating revenues were estimated to decline $30-$35 million.[2] While we do not expect this to happen,[3] we cannot stand idly by and hope for the best. Hard economic times can also put downward pressure on overall natural gas demand, which has additional potential negative effects on operating revenues.

We must ensure that PGW continues to provide reliable service at reasonable rates. It is therefore critical that PGW have adequate funds to continue its approximately $70 million annual capital investment program to replace deteriorating gas mains and other projects. This will require additional funding that can only be acquired cost effectively if PGW has strong financial operating ratios to support lower cost debt. Therefore, as the Commission's Office of Trial Staff (OTS) advocated, PGW should retain $14 million in cash reserves.

Based on these challenges, PGW's near term cash flows could vary as follows:

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[1] If no buyers can be found for a CP tranche, then PGW must draw upon its letter of credit and "pay interest at the prime rate to the banks until the CP is remarketed."

[2] PGW's Petition for Extraordinary or Emergency Relief at 10.

[3] Collections only decreased to 95.10% for the 12 months ended November 21, 2008.

Change in Cash Flows, $millions

	Low Case	Expected Case	High Case
Swap termination	$15	$46	$54
Long term interest	$ 8	$10	$11
CP	$ 0	$ 1	$ 3
Bad debt Expense	$ 0	$ 8	$35
Cost containment	$ -5	$ -2	$ 0
Total	$18	$63	$103

1. Pursuant to the Office of Small Business Advocate's (OSBA) recommendation regarding any allowed rate increase, the $60 million should be allocated on an across-the-board base rates basis. Each class's base rates (including customer charges and delivery charges) should increase by the same percentage, consistent with the explanation set forth in OSBA's main brief.[4] Adoption of the OSBA revenue allocation proposal maintains the existing revenue allocations based on PGW's last base rate case and the cost of service studies introduced in that proceeding. For each customer class, the increased revenue requirement should be recovered in the delivery charges, maintaining existing levels of customer charges.[5]

2. This rate increase is not permanent, but rather should be reviewed in a Section 1308(d) base rate proceeding filed on or before December 31, 2009, in order to assess the effect of the relief ordered in this proceeding and the overall financial condition of the company. Adequate time should have passed for PGW's financial obligations and transactions to be addressed, and for PGW's credit rating to improve.[6]

3. OTS and OCA also appropriately point out that achievement of PGW's financial goals is dependent on all parties contributing to this objective. Specifically, customers, the City of Philadelphia, and PGW must all do their part. PGW should seek the repeal of the city ordinance mandating an annual $18 million payment by PGW to the City of Philadelphia. This would improve the fixed coverage charge, which could increase PGW's prospects of improving its bond rating to "A" or "AA".

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[4] OSBA MB at 40; OSBA Statement No. 1 at 18-19. The revenue increase should also be allocated to cost-based IT rate customers.

[5] There should be an exception to this rate design allocation methodology where delivery charges are zero, and only customer charges exist.

[6] To the extent that PGW's Supplement No. 28 to its Tariff No 2 constitutes a general rate request, or to the extent that any portion of Section 1308(d) or Section 1308(e) of the Public Utility Code requires PGW to file a general rate case pursuant to Section 1308(d) as a condition of receiving extraordinary rate relief, those provisions should be specifically waived, pursuant to 66 Pa.C.S. §2212(c) as required to establish just and reasonable rates in the public interest.

4. PGW must also contribute to these objectives in a clear and objective manner. As a condition of accepting the extraordinary rate increase proposed in this motion, within 60 days of the entry of an appropriate Order, PGW should file with the Secretary its plan to implement its Business Transformation Initiative-Full ("BTI-F") designed to realize the estimated benefits as discussed in the record of this proceeding. PGW should submit the plan and necessary schedules for approval and implementation which shall include a detailed description of the BTI-F, including yearly costs and benefits. PGW should thereafter submit yearly reports on its progress in implementing BTI-F which shall include: (a) identified costs and savings in the prior fiscal year; (b) projected costs and savings in the next fiscal year; (c) any revisions or modifications to the plan. PGW should also provide quarterly information on achievement of savings pursuant to paragraph 20(b) of its Petition.

5. It is also important for this Commission to ensure that this revenue increase is having a positive effect on PGW's cash position and investment in necessary infrastructure. Specifically, PGW should provide monthly updates and the last 12 months of data for the following items: capital expenditures; bad debt expense amounts and percentages; management and other labor expenses; non-labor operating and maintenance expenses (excluding gas cost items). End of month balances of commercial paper, other short term debt, cash and cash equivalent securities and long term debt should also be provided, together with the following monthly operational data: (1) end of month counts for number of employees by department, monthly employee-days of absenteeism by department, and number of gas theft cases identified each month, and resultant collections from these detections. PGW should provide immediate updates to any renewal of CP transactions and termination terms of interest rate swaps, or closing on any other new long term bond transactions. This information should also be provided to OCA, OSBA, and OTS. These responses should also provide information to the Commission on attainment of PGW's "cost containment" steps designed to reduce expenses and capital outlays.[7] PGW's cost containment plan is estimated to save $2.3 million in FYE 2009, and escalate to $5 million in FY 2010. Of course, PGW has an ongoing obligation under the Public Utility Code to furnish additional information if required by the Commission.

6. Management should be held accountable for achieving these objectives. As a condition of accepting the extraordinary rate increase authorized in Ordering paragraph 2, within 60 days of the entry of this Order, Philadelphia Gas Works should be required to file, for Commission review, a performance based incentive compensation plan ("ICP") for all management employees together with a narrative explanation which sets forth: the projected costs of such a program; and the anticipated benefits including projected efficiency or other benefits to PGW that will reduce expenses or increase revenues. Within 60 days of receiving the Commission's comments on the plan, PGW should be required to inform the Commission, in writing, of its plan for implementation of the ICP or provide an explanation and justification for declining to implement the Plan.

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[7] PGW MB at 31-32.

7. PGW should file, 90 days in advance of negotiating its next employee bargaining agreement, a plan for improving performance and implementing efficiencies for hourly employees. This plan should also include some degree of performance-based incentive compensation and set forth a thorough cost benefit analysis.

8. It is important that PGW explore any and all means of reducing the financial risks and costs of its utility business. PGW should therefore convene a collaborative process, no later than 60 days after entry of an appropriate Order, to explore options for transitioning some or all of its customers to an alternative default service supplier. For the first 60 days of the process, PGW and interested parties can work to develop a proposal. At the end of such period, PGW should then submit a report to the Commission and detail the progress made and identify any areas of agreement or disagreement among the stakeholders. Any participating stakeholder would be permitted to submit an alternative report to the Commission outlining its recommended course of action. The process should continue until the participants agree to submit a final action report, unless the Commission orders otherwise.

Finally, this Commission is cognizant of the impact this rate increase will have on customers. The timing of this increase, coincident with a purchase gas cost decrease, should provide a net decrease in rates. We shall ensure that the increase in non-gas cost revenues will be used to improve PGW's long-term cost structure, to provide lower financing costs in the future, and to provide more reliable service. Further, we shall closely monitor the effect of the rate increase by means of monthly updates. We intend to act in a proactive manner if additional relief is needed to maintain the financial health of the company.

THEREFORE, we move that the Office of Special Assistants draft an appropriate order consistent with this motion.

December 18, 2008
Date

James H. Cawley, Chairman

Wayne E. Gardner, Commissioner