BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	**Docket Nos. P-2009-2097639**
v.	:	**R-2009-2139884**
	:	
PHILADELPHIA GAS WORKS	:	

OFFICE OF SMALL BUSINESS ADVOCATE
STATEMENT IN SUPPORT OF THE
JOINT PETITION FOR SETTLEMENT

I. Introduction

The Office of Small Business Advocate ("OSBA") is an agency of the Commonwealth of Pennsylvania authorized by the Small Business Advocate Act (Act 181 of 1988, 73 P.S. §§ 399.41 – 399.50) to represent the interests of small business consumers as a party in proceedings before the Pennsylvania Public Utility Commission ("Commission").

II. Filing Background

On December 19, 2008, the Commission entered an Opinion and Order, which approved the request of Philadelphia Gas Works ("PGW or the Company") for $60 million in extraordinary rate relief. The Commission ordered, *inter alia*, that: a.) the $60 million increase be allocated among the rate classes on an across-the-board basis because the time schedule for the extraordinary rate relief precluded proper review of cost allocation, revenue allocation, and rate design issues; and b.) PGW file a base rate proceeding pursuant to Section 1308(d) of the Public Utility Code, 66 Pa. C.S. §1308(d), on or before December 31, 2009, to address whether PGW continues to need the $60 million in revenues and to address cost allocation, revenue allocation, and rate design issues.[1]

On March 26, 2009, PGW filed a Petition for Approval of Energy Conservation and Demand-Side Management Plan ("DSM Plan"). On April 3, 2009, PGW filed a Petition to Withdraw the DSM Plan. On April 20, 2009, PGW filed a Revised Petition for Approval of Energy Conservation and Demand-Side Management Plan ("Revised DSM Plan").

On December 18, 2009, PGW filed Supplement No. 36 to Philadelphia Gas Works' Gas Service Tariff–Pa. P.U.C. No. 2 ("Supplement No. 36"), to become effective February 16, 2010. The proposed Tariff, if approved by the Commission, would make permanent the $60 million increase granted in 2008 and further increase the retail distribution rates of PGW by $42.5 million per year. PGW also filed a Motion to Consolidate the Revised DSM Plan with its request to increase base rates.

On January 7, 2010, the OSBA filed a Complaint, alleging that the materials filed by PGW may be insufficient to justify the rate increase requested and that the Company's present and proposed rates, rules, and conditions of service may be unjust, unreasonable, unduly discriminatory, and otherwise contrary to law, particularly as they pertain to small business customers. Also on January 7, 2010, the OSBA filed an Answer to PGW's Motion to Consolidate. The OSBA opposed PGW's request to consolidate the Revised DSM Plan with its request to increase base rates.

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[1] *Pennsylvania Public Utility Commission v. Philadelphia Gas Works Pennsylvania Public Utility*, Docket No. R-2008-2073938 (Order entered December 19, 2008) at 16 and 32-33. *See also Pennsylvania Public Utility Commission v. Philadelphia Gas Works, Office of Small Business Advocate Petition for Reconsideration*, Docket No. R-2008-2073938 (Order entered March 26, 2009) at 7-9.

By Order entered February 11, 2010, the Commission granted PGW's Motion to Consolidate. In addition, the Commission also suspended Supplement No. 36 by operation of law until September 16, 2010. The Commission ordered an investigation into the lawfulness, justness, and reasonableness of the rates, rules, and regulations contained in the proposed Supplement No. 36.

Administrative Law Judge ("ALJ") Charles E. Rainey Jr. was assigned to this proceeding and issued a Prehearing Conference Order on February 12, 2010.

Public input hearings were held on April 6 and April 7, 2010.

The Office of Trial Staff ("OTS"), Office of Consumer Advocate ("OCA"), OSBA, Philadelphia Housing Authority ("PHA"), Citizens of Greater Philadelphia ("TURN"), Clean Air Council ("CAC" or "Council"), and Retail Energy Supply Association ("RESA") served direct testimony on March 26, 2010.

On April 23, 2009, rebuttal testimony and accompanying exhibits were submitted by PGW, OTS, OCA, OSBA, CAC, and Philadelphia Industrial and Commercial Users Group ("PICGUG"). Surrebuttal testimony and accompanying exhibits were submitted by PGW, OTS, OCA, OSBA, RESA, TURN, and PHA on May 4, 2010.

On May 11, 2010, PGW, OTS, OCA, OSBA, PHA, PICGUG, TURN, CAC, and RESA reached an agreement in principle to settle the consolidated case.

III. Summary of the OSBA's Principal Concerns

In its Complaint, Prehearing Memorandum, and testimony, the OSBA identified several issues of concern, including the following:

1. Whether PGW's proposed $42.5 million distribution rate increase is just and reasonable.

2. Whether PGW's proposed cost of service study ("COSS") is just and reasonable.

3. Whether PGW's proposed revenue allocation is consistent with the Commonwealth Court's holding in *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010 (Pa. Cmwlth 2006).

4. Whether PGW's non-residential customers should be required to contribute towards PGW's universal service costs.

5. Whether PGW's proposed rate design for the commercial class is just and reasonable.

6. Whether PGW's Revised DSM Plan is prudent and cost-effective.

7. Whether the costs for PGW's Revised DSM Plan are prudent and reasonable.

8. Whether PGW's non-residential customers should be required to bear any costs related to programs for residential customers in PGW's Revised DSM Plan.

9. Whether any waivers of the Public Utility Code that PGW may request during the course of the instant proceeding are lawful.

The OSBA has actively participated in the negotiations which led to the filing of the Joint Petition for Settlement ("Settlement"). The Settlement is a compromise that does not meet all of the OSBA's objectives in this case. However, the OSBA is satisfied that the Settlement is a reasonable resolution of the foregoing concerns and produces an overall outcome that is in the public interest. Therefore, the OSBA is a signatory to the Settlement and urges the Commission's approval of the Settlement without modification.

IV. Settlement

The Settlement sets forth a comprehensive list of issues which were resolved through the negotiation process. This statement outlines the OSBA's specific reasons for joining the Settlement. The following provisions were of particular significance to the OSBA in concluding that the Settlement is in the best interests of small business customers:

A. Revenue Requirement

In the Company's original filing, PGW proposed an increase in tariff rate revenue of \$102.5 million.[2] As OSBA witness Mr. Knecht explained, the \$102.5 million is comprised of PGW's proposed continuation of the \$60 million increase associated with its December 2008 extraordinary rate relief proceeding, plus an additional \$42.5 million requested by PGW in the instant proceeding.[3] In contrast, the Settlement provides PGW with an increase in tariff rate revenue of \$76 million. PGW continues to receive the \$60 million increase associated with its December 2008 extraordinary rate relief; however, instead of PGW's receiving an additional \$42.5 million, the Company will receive an additional \$16 million.[4]

In the instant proceeding, PGW witness Mr. Steven P. Hershey testified that the reason the Company filed for an additional \$42.5 million increase was to provide funding for its other-post-employment benefit ("OPEB") obligations.[5] OSBA witness Mr. Knecht summarized the matter as follows:

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[2] PGW Statement No. 1 at 2-4.

[3] OSBA Statement No. 1 at 6.

[4] Settlement at 4, para. 16.

[5] PGW Statement No.1 at 4.

> Like many state and local governments around the country, PGW has promised much more to its employees in the form of retirement benefits than it has funded. PGW faces an actuarial liability of $654 million related to its OPEB obligations, which is completely unfunded, and, for the most part, not recorded on its balance sheet as a liability. This amount is considerably more than double PGW's entire book equity. PGW proposes to begin funding this liability, starting at an annual level of $42.5 million, which is approximately equal to the incremental impact of the proposed rate increase in this proceeding. However, PGW then proposes to gradually reduce funding, declining to $7 million in 2015.
>
> In addition to reasons of financial prudence, PGW justifies this proposal on the grounds that funding the obligation will allow it to use more favorable actuarial assumptions for measuring the liability. PGW's witness Mr. Kikla summarizes this advantage, indicating, '*Financially, funding the OPEB obligations allows the plan to earn higher investment returns since the funds are not held internally in general PGW assets. This enables PGW to use a higher discount rate for determining plan liabilities, producing a significantly lower actuarial accrued liability ($198,262,000 decrease) and lower annual expense ($4,326,000 decrease).*' In particular, PGW concludes that it will be permitted to use a discount rate based on the earnings assumption for its pension plan, currently 8.25 percent. Mr. Kikla concludes that this will result in a present value reduction in payments by ratepayers of some $200 million.[6]

PGW witness Mr. Samuel Kikla testified that funding the OPEB will provide an enormous benefit to ratepayers.[7] While OSBA witness Mr. Knecht was skeptical that funding OPEB will provide an enormous benefit to ratepayers, Mr. Knecht did agree that there is an advantage to dedicating PGW's rate increase revenues to OPEB funding. Specifically, Mr. Knecht testified:

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[6] OSBA Statement No. 1 at 9.

[7] PGW Statement No. 4 at 6-9.

> Although I disagree with PGW that funding the OPEB will necessarily provide an enormous benefit to ratepayers, there is a potential advantage to dedicating rate increase revenues to such funding. If the Commission requires that rate increase revenues be invested in an OPEB fund, it puts those revenues off-limits to other PGW stakeholders, and continues the incentives faced by PGW to reduce costs. Therefore, to the extent that the Commission determines that PGW should be given a rate increase to improve its financial condition, I recommend that (to the extent the Commission can legally do so) PGW be required to contribute some fixed amount of the rate increase revenues in every year to the OPEB fund.[8]

The Settlement requires that the additional $16 million rate increase will be used only to fund PGW's OPEB obligations unless the Company files a Petition for Extraordinary/Emergency Rate Relief.[9] Therefore, the Settlement is consistent with the OSBA's proposal that PGW be required to contribute a fixed amount of the rate increase revenues to the OPEB fund.

The Settlement also precludes PGW from filing for a distribution rate increase for 24 months.[10] At a time when all types of utility service are becoming more expensive, the significant reduction in the overall revenue increase provided by the Settlement and the 24 month stay-out will benefit all of PGW's consumers, including the Company's small business customers.

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[8] OSBA Statement No. 1 at 10-11.

[9] Settlement at 6 and 7, paras. 19-20.

[10] Settlement at 5, para.18.

B. Revenue Allocation

1. Extraordinary Rate Relief Proceeding

As mentioned above, PGW filed an extraordinary rate relief petition in November of 2008, requesting a $60 million rate increase.[11] The Commission granted PGW's extraordinary rate relief request; however, the Commission also placed some conditions on PGW's rate relief.[12] One of the conditions required PGW to file a base rate proceeding pursuant to Section 1308(d) of the Public Utility Code, 66 Pa. C.S. §1308(d), on or before December 31, 2009, to address whether PGW continues to need the $60 million in increased revenues and to address cost allocation, revenue allocation, and rate design issues.[13] Because of the accelerated proceeding, the Commission imposed the $60 million revenue requirement as an across-the-board increase in the commodity portion of distribution rates and deferred the issues of cost allocation, revenue allocation, and rate design until the case to be filed by the end of 2009.[14] Therefore, one purpose of the instant proceeding is to evaluate revenue allocation from the perspective of the combination of both the increase of $60 million from the extraordinary rate relief case and the supplemental increase PGW proposed in the instant proceeding of $42.5 million.

OSBA witness Mr. Knecht explained the OSBA's approach to revenue allocation as follows:

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[11] *Pennsylvania Public Utility Commission v. Philadelphia Gas Works Pennsylvania Public Utility*, Docket No. R-2008-2073938 (Order entered December 19, 2008).

[12] *Id.*

[13] *Id.*

[14] *Pennsylvania Public Utility Commission v. Philadelphia Gas Works Pennsylvania Public Utility*, Docket No. R-2008-2073938 (Order entered December 19, 2008) at 16 and 32-33. *See also Pennsylvania Public Utility* Commission *v. Philadelphia Gas Works, Office of Small Business Advocate Petition for Reconsideration*, Docket No.R-2008-2073938 (Order entered March 26, 2009) at 7-9.

PGW's most recent distribution rate increase of approximately $60 million per year was implemented in an extraordinary rate relief ('ERR') proceeding. (citation omitted) The schedule for that proceeding did not permit a full review of PGW's revenue requirement. Moreover, the Commission approved that increase conditioned upon PGW filing a Section 1308(d) base rates proceeding on or before December 31, 2009. The current proceeding arises, at least in part, from that requirement. Therefore, the increase arising from the ERR proceeding has not been formally reviewed in a general rate proceeding. For that reason, I consider that this application is a proposal for a rate increase of approximately $102 million, consisting of the approximately $60 million awarded in the ERR proceeding, plus the supplemental increase PGW proposes in the current proceeding of $42 million.[15]

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. . . PGW's most recent distribution rate increase of approximately $60 million per year was implemented in an ERR proceeding. Because the schedule for that proceeding precluded proper review of cost allocation, revenue allocation and rate design issues, the increase was imposed on an across-the-board basis. Moreover, the Commission approved that increase conditioned upon PGW filing a Section 1308(d) base rates proceeding on or before December 31, 2009. The current proceeding arises, at least in part, from that requirement.

For those reasons, I evaluated the revenue allocation question from the perspective of the combination of both the preceding increase of approximately $60 million, and the supplemental increase PGW proposes in the current proceeding of $42 million.[16]

[15] OSBA Statement No. 1 at 6.

[16] OSBA Statement No. 1 at 17.

2. PGW's Filed Revenue Allocation Proposal

PGW witness Mr. Howard Gorman introduced a revenue allocation proposal in his direct testimony.[17] OSBA witness Mr. Knecht developed the following schedule which summarized PGW's revenue allocation as applied to the entire $102.5 million increase:

Table IEc-2[18]
Summary of PGW Proposed Revenue Allocation

	Pre-ERR Class RoR	PGW Prop. Increase $000	PGW Proposed Increase (%)	Proposed Rate Class RoR	Proposed Rate Cross-Subsidy ($000)
Residential	-1.0%	$91,965	32.6%	8.8%	($7,571)
Commercial	7.7%	$ 6,875	13.5%	11.9%	$3,897
Industrial	11.2%	$ 2,024	42.5%	25.9%	$2,250
Municipal	7.1%	$ 288	6.8%	8.7%	($ 165)
PHA	12.9%	$ 622	15.8%	18.0%	$1,035
Interr. Sales	34.2%	$0	0.0%	34.2%	$1,366
GTS/IT	7.7%	$0	0.0%	7.7%	($ 811)
Total	**1.1%**	**$101,774**	**27.9%**	**9.6%**	**$0**

Note: A negative number in the "Proposed Rate Cross-Subsidy" column means that the class is receiving a subsidy. In contrast, a positive number in that column means that the class is providing a subsidy.

Source: Exhibit IEc-4

[17] PGW Exhibit HSG-7A.

[18] OSBA Statement No. 1 at 19. Note that the class rates of return presented in this table are based on Mr. Gorman's cost of service study ("COSS") dated March 17, 2010, rather than the COSS submitted in PGW's original filing. Primarily as a result of OSBA discovery, Mr. Gorman acknowledged that the originally filed COSS contained significant errors and inconsistencies. Although Mr. Gorman filed the updated COSS, PGW did not submit a revised revenue allocation proposal at that time.

As the above table shows, PGW proposed to move most classes closer to the system-average rate of return. As Mr. Knecht testified:

> . . . the residential class exhibits a below-average rate of return at pre-ERR rates, and is assigned a modestly above-average rate increase. Similarly, the commercial, municipal, PHA, interruptible sales and GTS/IT classes exhibit above-average class rates of return at pre-ERR rates; PGW assigns below average rate increases to those classes. In addition, PGW does not propose to assign an increase to any rate class that is substantially above system average and which could be construed as rate shock. (The increase proposed for the industrial class comes closest to rate shock, as it is about 1.5 times the system average. Some regulators and analysts use a rule-of-thumb of 1.5 or 2.0 times the system average increase as an upper bound for class rate increases.) Moreover, PGW's proposal may reflect the potential competitive threats from alternative fuel use by larger customers, in that PGW proposes zero rate increases for those classes. PGW also recognizes value of service in the pricing of interruptible sales service, by setting rates consistent with the cost of competing fuels.[19]

However, there were some serious problems with PGW's proposed revenue allocation. As Mr. Knecht testified:

> First, PGW's proposal for firm service industrial customers is completely inconsistent with the results of its March 17 COSS. Although firm industrial customers exhibit a class rate of return far above system average at pre-ERR rates, PGW proposes to assign the largest percentage rate increase to that class. This result presumably obtains because, when PGW corrected the large errors in its filing with the March 17 COSS, costs allocated to the firm service industrial class declined considerably. Nevertheless, PGW explicitly declined to modify its revenue allocation proposal in response to its COSS change. Furthermore, PGW offered no defense of this proposal for firm service industrial customers based on non-cost criteria. As a result, PGW's revenue allocation

[19] OSBA Statement No. 1 at 19-20.

> proposal for firm industrial customers can and should be summarily rejected.
>
> Second, PGW's proposal results in rates for the GTS/IT class which are below allocated cost. This proposal is inconsistent with the Commission's decision in PGW's 2007 base rates case, in which it directed PGW to establish cost-based rates for these customers. (citation omitted) Revenues from GTS/IT should therefore be increased to match allocated costs. (citation omitted)
>
> Third, PGW's proposal will retain substantial cross-subsidies from most of the non-residential classes to the residential class. This is particularly inequitable in light of the Commission's adoption of a mains cost allocation methodology which is very favorable to residential customers compared to other commonly used approaches, and with the biases in PGW's COSS that I discussed in Section 3 of this testimony (which tend to understate costs for residential customers).[20] (citation omitted)

3. OSBA's Original Revenue Allocation Proposal

To move classes closer to cost of service than under PGW's filed revenue allocation, OSBA witness Mr. Knecht proposed his own full-requirement revenue allocation in his direct testimony.[21] Specifically, Mr. Knecht proposed the following changes to PGW's original full-requirement revenue allocation:

- Set the rate increase for the firm service industrial and PHA customer classes to zero (i.e., set the rates at those in effect prior to the ERR proceeding), to recognize the high class rates of return at pre-ERR rates;
- Increase rates for the GTS/IT class to be commensurate with costs;
- Eliminate the cross-subsidies *from* the commercial class; and,

[20] OSBA Statement No. 1 at 21.

[21] In addition to the full-requirement revenue allocation explained herein, Mr. Knecht also proposed an alternative, which would have produced essentially the same result if the Commission had awarded PGW less than the full requirement. OSBA Statement No. 1 at 23.

- Judgmentally reduce the cross-subsidies provided *to* the residential and municipal classes to balance the revenue requirement.[22]

The below schedule summarizes the revenue allocation proposed in Mr. Knecht's direct testimony:

Table IEc-3[23]

Summary of RDK Proposed Revenue Allocation

	RDK Proposed Increase ($000)	RDK Proposed Increase (%)	RDK Proposed Rate Class RoR	RDK Proposed Rate Cross-Subsidy ($000)
Residential	$ 97,529	34.6%	9.4%	($2,007)
Commercial	$ 2,977	5.8%	9.6%	$ 0
Industrial	$ 0	0.0%	11.2%	$ 226
Municipal	$ 453	10.6%	9.6%	$ 0
PHA	$ 0	0.0%	12.9%	$ 412
Interr. Sales	$ 0	0.0%	34.2%	$ 1,366
GTS/IT	$ 811	8.0%	9.6%	$ 0
Total	**$101,770**	**27.9%**	**9.6%**	**$ 0**

Note: A negative number in the "RDK Proposed Rate Cross-Subsidy" column means that the class is receiving a subsidy. In contrast, a positive number in that column means that the class is providing a subsidy.

Source: Exhibit IEc-4

Mr. Knecht also testified that if the Commission reduced PGW's proposed overall increase of $101.8 million, the Commission should use the traditional scaleback approach.[24] However, the scaleback would only apply to the classes receiving an

[22] OSBA Statement No. 1 at 21-22.

[23] OSBA Statement No. 1 at 22.

[24] OSBA Statement No. 1 at 23.

increase, *i.e.*, residential, commercial, municipal, and GTS/IT classes.[25] As Mr. Knecht testified:

> It is important to recognize, however, that I recommend applying a proportional scaleback based on the overall $101.8 million increase. The proportional scaleback cannot be applied only to the post-ERR rate changes proposed by PGW. Both PGW's proposal and my proposal involve rate reductions for some classes relative to post-ERR rates. Applying a proportional scaleback to a class with a proposed rate decrease would have the effect of actually increasing rates for those classes relative to the full requirements proposal. Such a result would be nonsensical.[26]

4. PGW's Rebuttal Revenue Allocation Proposal

PGW witness Mr. Gorman offered a new revenue allocation proposal in his rebuttal testimony.[27] Mr. Gorman's new revenue allocation addressed some of the concerns Mr. Knecht had identified in his direct testimony. Specifically, Mr. Gorman's new revenue allocation set GTS/IT rates at (or at least very near) cost, proposed a rollback from the ERR increases for the industrial and PHA rate classes, and adjusted the increase for the municipal class to be more in line with the Company's cost allocation study.[28] Below is Mr. Knecht's summary of PGW's rebuttal revenue allocation proposal:

[25] *Id.*

[26] *Id.*

[27] OSBA Statement No. 3 at 10.

[28] OSBA Statement No. 3 at 11.

Table IEc-SR1[29] Summary of PGW Proposed Revenue Allocation: Rebuttal Testimony Version					
	Pre-ERR Class RoR	PGW Prop. Increase $000	PGW Proposed Increase (%)	Proposed Rate Class RoR	Proposed Rate Cross-Subsidy ($000)
Residential	-1.0%	$92,759	34.9%	8.8%	($6,777)
Commercial	7.7%	6,765	13.2%	11.9%	3,787
Industrial	11.2%	521	10.9%	15.0%	747
Municipal	7.1%	538	12.3%	10.0%	84
PHA	12.9%	397	10.1%	16.2%	812
Interr. Sales	33.8%	22	0.3%	34.2%	1,366
GTS/IT	5.9%	1,597	1.7%	9.5%	(21)
Total	**1.1%**	**$102,598**	**29.6%**	**9.5%**	**$0**

Note: A negative number in the "Proposed Rate Cross-Subsidy" column indicates that the class is receiving a subsidy. A positive number in that column indicates that the class is providing a subsidy.

Source: Exhibit IEc-SR1

Mr. Gorman also offered a scaleback proposal in his rebuttal testimony, in the event that the Commission reduces PGW's overall proposed increase.[30] Unfortunately, Mr. Gorman's scaleback proposal was seriously flawed. Mr. Knecht explained that under Mr. Gorman's scaleback proposal, "most non-residential classes will pay *higher* rates if PGW is awarded an $85 million increase than if PGW is awarded a $103 million increase."[31] Mr. Knecht's Table IEc-SR2 (below) illustrates that under Mr. Gorman's scaleback proposal, reducing PGW's revenue requirement would result in a rate decrease

[29] OSBA Statement No. 3 at 10.

[30] OSBA Statement No. 3 at 10.

[31] OSBA Statement No. 3 at 11.

for the residential and GTS/IT classes and rate increases for the commercial, industrial, municipal, and PHA classes:

Table IEc-SR2[32]
PGW Revenue Allocation Proposals ($000)

	Full Increase Awarded	**$25 Million Net Supplemental Increase**	**Difference**
Residential	$92,759	$74,249	($18,510)
Commercial	6,765	7,965	1,200
Industrial	521	696	175
Municipal	538	663	125
PHA	397	517	120
Interr. Sales	22	22	0
GTS/IT	1,597	986	(610)
Total	**$102,598**	**$85,098**	**($17,500)**

Source: Exhibits HSG-11 (page 2) and HSG-12 (page 1). Note that I have added ERR increases to Interruptible Sales and GTS/IT classes per PGW's ERR compliance filing.

As Mr. Knecht testified, "While it is not necessary that every class participate in a rate scaleback, it is grossly inequitable to require rate classes who are already overpaying to pay even more if the utility's revenue requirement is reduced." [33]

5. OSBA's Surrebuttal Revenue Allocation Proposal

In OSBA's surrebuttal testimony, Mr. Knecht withdrew the revenue allocation proposals that he had made in his direct testimony and substituted a proposal for first

[32] OSBA Statement No. 3 at 12.

[33] OSBA Statement No. 3 at 12.

dollar relief ("FDR") relative to the Company's rebuttal full-requirement revenue allocation proposal.[34] Specifically, Mr. Knecht proposed the following FDR:

> - The Company's revised revenue allocation as detailed in Exhibit HSG-11 (labeled 'Rebuttal') serves as a starting point for revenue allocation. If PGW is awarded the full $103 million increase, the PGW rebuttal [full requirement] revenue allocation should be adopted;
>
> - The first $5.8 million in any reduction (i.e., the FDR) should be assigned to the commercial ($4.7 million), industrial ($0.5 million), municipal ($0.2 million) and PHA ($0.4 million) rate classes. This aspect of my proposal is simply a revised version of the FDR proposal presented in my direct testimony, updated only to reflect PGW's revised COSS and revised revenue allocation proposals set forth in the Company's rebuttal testimony. Consistent with the recommendations in my direct testimony, this FDR reduces the increases for the industrial and PHA classes relative to pre-ERR rates to zero. . . .
>
> - After FDR is applied, any further reduction in the revenue requirement should be allocated among the rate classes, in proportion to each class' remaining rate increase. For the reasons I explained in my direct testimony, this proportional scaleback should be based on the increases relative to *pre-ERR* rates.[35] . . .

6. Settlement Revenue Allocation

The revenue allocation in the Settlement continues to require significant subsidies from most of the non-residential classes to the residential class. However, it does address the concerns raised by OSBA witness Mr. Knecht during the proceeding and does a significantly better job of reducing cross-subsidies than any of the proposals made in this proceeding by PGW.

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[34] OSBA Statement No. 3 at 13.

[35] OSBA Statement No. 3 at 13-14.

First, the Settlement allocates the entire incremental increase ($16 million) to the residential class.[36] Therefore, the Settlement recognizes that the commercial and industrial classes are above cost and should not be required to contribute towards the additional increase in rates PGW is awarded.

Second, the Settlement actually reduces the annual commercial rates by $3.055 million and the industrial rates by $357,000 relative to the rates that resulted from the 2008 extraordinary rate relief proceeding.[37] Because the procedural schedule for PGW's extraordinary rate relief proceeding at Docket No. R-2008-2073938 precluded proper review of revenue allocation issues, those issues were deferred to the instant proceeding. The reduction in commercial and industrial rates reflect the revenue allocation issues which were deferred in PGW's extraordinary rate relief proceeding. In effect, the Settlement recognizes that commercial and industrial customers should have received smaller rate increases in 2008 if the issue of revenue allocation had been addressed at that time.

Third, as the table below shows, revenues from the commercial and industrial classes will move materially closer to cost of service than under present rates.

[36] Settlement at 8, para. 22.

[37] *Id.*

	ROR at Present Rates	Difference from System Average ROR at Present Rates	ROR at Settlement Rates	Difference from System Average ROR at Settlement Rates
Residential	-1.0%	-2.1%	8.3%	-1.0%
Commercial	7.7%	6.6%	13.3%	4.0%
Industrial	11.2%	10.1%	16.5%	7.2%
Municipal	7.1%	6.0%	11.8%	2.5%
PHA	12.9%	11.8%	16.5%	7.2%
Interruptible	34.2%	33.1%	35.5%	26.2%
GTS/IT	7.7%	6.6%	8.8%	-0.5%
System	1.1%	0.0%	9.3%	0.0%
* Source: Table IEc-2 **Source: Joint Settlement Petition- Exhibit 1, line 22				

C. Demand Side Management

PGW requested that the Commission approve the Philadelphia Gas Works Five-Year Gas Demand-Side Management Plan ("Revised DSM Plan").[38] The object of PGW's initial proposal, as analyzed by OSBA witness Mr. Knecht, was to facilitate cost-effective customer natural gas conservation efforts that its customers cannot or will not undertake on their own. The scope of the Revised DSM Plan is vast and includes seven separate programs that target different customers and different gas consumption practices. As Mr. Knecht testified, with the exception of the program targeted at Customer Responsibility Program ("CRP") customers, PGW proposed to recover both

[38] OSBA Statement No. 1 at 34, *citing*, Exhibit JJP-6, attached to PGW witness Mr. John J. Plunkett's testimony.

the direct costs and its own lost margins through a class-specific reconcilable Efficiency-Cost-Recovery Mechanism ("ECRM").[39] With regard to CRP-related DSM, PGW proposed that program costs (but not lost margin) for the Enhanced Low-Income Retrofit Program ("ELIRP") be recovered through the universal service charge ("USC"). However, the Company proposed to defer many specific issues related to DSM implementation and cost recovery to a subsequent stakeholder consultation proceeding.[40]

The OSBA has an economic interest in the ELIRP as proposed in the instant proceeding because small business customers (at this time) are required to pay the USC.[41] Because small business customers pay PGW's USC, the OSBA, through the testimony of Mr. Knecht, evaluated PGW's claims about the cost-effectiveness of ELIRP and CWP. Mr. Knecht agreed with PGW's rationale for ELIRP, *i.e.*, that cost-effective reductions in CRP load will reduce costs for all of the customers who are required to pay the USC. However, PGW's claim that the proposed ELIRP is cost-effective is based entirely on the assumption that the current CWP is cost-effective.[42] In support of its assertion, PGW relied heavily on the argument that ELIRP is simply an extension and expansion of its existing CWP.[43]

In response to PGW's claim, Mr. Knecht pointed out that the cost-effectiveness of the current CWP is tenuous at best, given that PGW's own evidence illustrates that the

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[39] PGW currently has three universal service programs including a customer assistance program for low-income customers (the CRP), a conservation program for low-income customers (the Conservation Works Program or "CWP"), and a senior citizen discount ("SCD") program. OSBA Statement No. 1 at 30.

[40] OSBA Statement No. 1 at 35, *citation omitted*.

[41] OSBA Statement No. 1 at 35.

[42] OSBA Statement No. 1 at 37.

[43] OSBA Statement No. 1 at 37, *citing* PGW Statement No. 7 at 9.

average gas consumption of CRP customers far exceeds the average gas consumption of non-CRP residential customers.[44] Additionally, the higher rate of gas consumption by CRP customers is increasing.[45] No witness contested these findings.[46] Based on the impact on universal service costs imposed on non-residential customers, the OSBA is very concerned about the overall costs of CWP and ELIRP, as well as the lack of any material progress in reducing gas consumption by low-income ratepayers despite years of cost and effort. The OSBA believes that these problems are, at least in part, related to the lack of economic incentives to encourage conservation within the design of the CRP.[47]

In addition to expressing concerns about the cost-effectiveness of CWP and ELIRP, Mr. Knecht analyzed the programs in the Revised DSM Plan that are aimed exclusively at non-residential customers or at both residential and non-residential customers. Of greatest significance, Mr. Knecht raised questions about the inequities for non-residential customers that are unable to participate in DSM programs but must provide large subsidies to other non-residential customers that are able to participate.[48]

The Settlement provides three important protections for PGW's small business customers. First, the Settlement outlines a procedure for parties to propose, and also get Commission rulings on, changes in the Revised DSM Plan. Specifically, the Settlement requires PGW to make a filing four months prior to the end of the implementation period

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[44] OSBA Statement No. 1 at 37.

[45] OSBA Statement No. 1 at 37.

[46] OSBA Statement No. 3 at 26.

[47] OSBA Statement No. 1 at 44.

[48] OSBA Statement No. 1 at 43.

and annually thereafter.[49] In response to the Company's filings, parties may submit comments and recommend changes or modifications to the plan.[50] In the event that the issues raised by various parties are not resolved through the comment process, parties may request the Commission to resolve those issues.[51]

Second, the Settlement imposes a cap on PGW's spending on the DSM programs. Specifically, the annual DSM budget for the first two plan years (FY 2011 and FY 2012) shall not exceed 1% of PGW's total projected gross intrastate operating revenues.[52] Through the Settlement, PGW has also agreed that for the first two years (FY 2011 and FY 2012), it will fully fund ELIRP at the budget levels originally proposed for this program by the Company.[53]

Third, PGW will be filing a proposal to implement further changes to its CRP pursuant to a separate settlement at Docket No. M-00072021 (Order entered October 23, 2009). Under the Settlement in the instant proceeding, PGW has agreed to include in that filing a proposal to create a positive incentive to encourage conservation by CRP participants. The OSBA is uncertain that the incentive proposed by PGW will be adequate. However, the Settlement permits parties to make their own proposals on the types of economic incentives that may truly encourage customers to conserve.[54]

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[49] Settlement at Paragraph 24(a).

[50] Settlement at Paragraph 24(a).

[51] Settlement at Paragraph 24(a).

[52] Settlement at Paragraph 24(b).

[53] Settlement at Paragraph 24(b). *See* Footnote 2 of the Settlement for specific dollar figures.

[54] Settlement at Paragraph 25.

D. Universal Service Costs

The OSBA has an economic interest in PGW's universal service programs because non-residential firm service customers are required (at this time) to pay the USC.[55] As explained in the preceding section, PGW currently has three universal service programs, the CRP, CWP, and SCD.[56] Mr. Knecht testified that it is not reasonable to recover the costs of these programs from non-residential customers because non-residential customers are ineligible to participate in the universal service programs.[57]

As set forth more fully in the testimony of Mr. Knecht, PGW is the only natural gas distribution company ("NGDC") for which non-residential customers are required to pay universal service costs.[58] Furthermore, the Commission has specifically declined to allocate universal service costs to non-residential customers in numerous gas proceedings and has adopted a policy that the cost of universal service programs should be borne entirely by the residential customers of NGDCs and of electric distribution companies ("EDCs").[59] Furthermore, the Commission's policy of not allocating universal service costs to non-residential customers was appealed to the Commonwealth Court and affirmed.[60] Finally, despite urging by other parties, the Commission has not ruled that PGW should be permanently exempt from this policy.[61]

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[55] OSBA Statement No. 1 at 35.

[56] OSBA Statement No. 1 at 35.

[57] OSBA Statement No. 1 at 30.

[58] OSBA Statement No. 1 at 31.

[59] *See* OSBA Statement No. 1, *footnote* 28 for a full list of recent case citations.

[60] OSBA Statement No. 1 at 31, *footnote* 28.

[61] OSBA Statement No. 1 at 31, and OSBA Statement No. 3 at 19.

In the evidentiary stage of the instant proceeding, the OSBA sought a phased transition for eliminating charges to non-residential customers for PGW's universal service programs.[62] As part of the Settlement, the OSBA has agreed not to pursue that argument any further in this proceeding. However, the Settlement provides that the withdrawal of any argument by a party to the Settlement, *e.g.*, the OSBA's argument against non-residential customers' paying for universal service, is without prejudice and allows the OSBA to raise its argument about the allocation of universal service costs in a future proceeding.[63]

Similarly, the Settlement preserves the OSBA's right to challenge in a future proceeding whether non-residential customers should be required to pay for CWP and ELIRP. Specifically, as part of his testimony on the Revised DSM Plan, Mr. Knecht gave notice of the OSBA's legal position that even if non-residential customers must continue to pay universal service costs, they should not be required to pay for the costs of CWP and ELIRP because those are conservation programs. PGW sought to portray its Revised DSM Plan as an NGDC equivalent of the EDC conservation plans required by Act 129. As Mr. Knecht pointed out, Act 129 provides that only residential customers are required to bear the costs of conservation programs in which only residential customers are eligible to participate.

Nevertheless, until the Commission rules that non-residential customers no longer have to pay the USC (or at least no longer have to pay for CWP and ELIRP), the OSBA's goal will be to reduce the amount which non-residential customers must contribute. To

[62] OSBA Statement No. 1 at 31.

[63] Settlement at Paragraph 38.

that end, PGW's agreement in this Settlement, and in a separate settlement at Docket No. M-00072021 (Order entered October 23, 2009), to propose a positive incentive to encourage conservation by CRP participants offers the potential to reduce costs for non-residential customers.[64]

[64] Settlement at Paragraph 25.

V. Conclusion

For the reasons set forth in the Settlement, as well as the additional factors enumerated in this statement, the OSBA supports the proposed Settlement and respectfully requests that the ALJ and the Commission approve the Settlement in its entirety.

Respectfully submitted,

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

Lauren M. Lepkoski
Assistant Small Business Advocate
Attorney I.D. No. 94800

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

Office of Small Business Advocate
Suite 1102
300 North Second Street
Harrisburg, PA 17101
(717) 783-2525
(717) 783-2831 (fax)

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