**BEFORE THE**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission : R-2009-2139884

:

v. :

:

Philadelphia Gas Works :

Philadelphia Gas Works’ Revised Petition :

For Approval of Energy Conservation and : P-2009-2097639

Demand Side Management Plan :

**RECOMMENDED DECISION**

Before

Charles E. Rainey, Jr.

Administrative Law Judge

HISTORY OF THE PROCEEDING

On December 18, 2009, PGW filed Supplement No. 36 to Tariff Gas – Pa. P.U.C. No. 2 to become effective February 16, 2010, containing proposed changes in rates, rules, and regulations calculated to produce $42.5 million (4.8%) in additional annual revenues. Also on December 18, 2009, PGW filed a motion to consolidate its petition for approval of its Demand Side Management (DSM) Plan with its request to increase base rates.

By order entered February 11, 2010, the Commission granted the motion and consolidated PGW’s petition for approval of its DSM Plan with its request to increase base rates.

The Commission also instituted an investigation into the lawfulness, justness, and reasonableness of PGW’s proposed changes in rates, rules, and regulations. The Commission stated that pursuant to 66 Pa.C.S. § 1308(d), the rate filing will be suspended by operation of law on February 16, 2010, until September 16, 2010, unless permitted by Commission order to become effective at an earlier date. The Commission also stated that during the course of the investigation, consideration should be given to the reasonableness of PGW’s existing rates, rules and regulations.

The Commission assigned PGW’ s petition for approval of its DSM Plan and request to increase base rates to the Office of Administrative Law Judge for the prompt scheduling of such hearings as may be necessary culminating in the issuance of a Recommended Decision.

Formal complaints were filed by Office of Consumer Advocate (OCA), Office of Small Business Advocate (OSBA), Tenant Union Representative Network and Action Alliance of Senior Citizens of Greater Philadelphia (TURN *et al.*), Philadelphia Industrial and Commercial Gas Users Group (PICGUG) and Philadelphia Housing Authority (PHA). Formal complaints were also filed by the following residential consumers: Stanton Bubis, George W. Craigie, Denise Devlin, Kathleen Golden, Sydella Hodge, Floyd M. Jones, Linda J. Montgomery and Dominic A. Stango. Office of Trial Staff (OTS) filed a Notice of Appearance. Petitions to intervene were filed by Retail Energy Supply Association (RESA) and Clean Air Council (CAC). The petitions to intervene were granted.[[1]](#footnote-1)

A prehearing conference was held on March 2, 2010, at which time a schedule for discovery, written testimony, hearings and briefs was established. Present at the prehearing conference were PGW, OTS, OCA, OSBA, PICGUG, TURN *et al*., CAC, RESA and PHA. The matters addressed during the prehearing conference were memorialized in my prehearing order dated March 11, 2010.

On April 1, 2010, PGW filed a motion for a protective order. By order dated April 8, 2010, I granted PGW’s motion.

Five public input hearings were held in Philadelphia on April 6-8, 2010. On April 6, 2010, public input hearings were held at 1:00 p.m. and 7:00 p.m. at the Community College of Philadelphia. On April 7, 2010, public input hearings were held at 1:00 p.m. at Community Academy of Philadelphia and at 7:00 p.m. at George Washington High School. On April 8, 2010, a public input hearing was held at 6:00 p.m. at the Dorothy Emanuel Recreation Center. A total of fifteen people gave sworn testimony at the five public input hearings.

On March 9, 2010, PGW and CAC filed a Joint Motion for Partial Summary Judgment (Motion) to Approve Settlement for Expedited Implementation of Residential DSM Programs. That same day, they also filed a Joint Petition for Interlocutory Review of a Material Question (Joint Petition). By Order entered April 15, 2010, the Commission ruled that the Joint Petition was improper, and it returned the matter to the Office of Administrative Law Judge for further proceedings. On April 19, 2010, PGW filed a Petition for Leave to Withdraw its Motion for Partial Summary Judgment (Petition). By order dated May 5, 2010, I granted PGW’s Petition.

Hearings were held on May 10 and 12, 2010. At the hearing on May 10, 2010, testimony was given by Linda Montgomery, a residential consumer complainant. Ms. Montgomery also introduced an exhibit, which was admitted into evidence.

Also at the hearing on May 10, 2010, the parties announced that a settlement in principle had been reached between PGW, OTS, OCA and OSBA. The parties requested that the hearing scheduled for the next day, May 11, 2010, be cancelled in order for PGW to share the most recent version of the settlement with the parties who had not yet entered into the settlement. The parties’ request was granted and the hearing scheduled for May 11, 2010, was cancelled. At midday on May 11, 2010, I was informed by email that PGW, OTS, OCA, OSBA, PICGUG, TURN et al., CAC, RESA and PHA had entered into a settlement in principle.

At the hearing held on May 12, 2010, the aforementioned parties confirmed that they entered into a settlement. The parties were directed to file their Statements in Support of the Settlement with the Settlement. The parties stated that a Joint Petition for Settlement with proposed tariff modifications, proof of revenues and appended Statements in Support of the Settlement, would be filed by May 19, 2010. The parties indicated that a stipulation for the admission of statements and exhibits into the record would be filed by May 13, 2010.

On May 13, 2010, a Stipulation for Admission of Evidence (Stipulation) was filed by PGW, OTS, OCA, OSBA, PICGUG, TURN et al., CAC, RESA and PHA. The parties requested that the statements and exhibits which they sent to the court reporter and are listed in the Stipulation, be admitted into evidence. I am admitting into evidence the statements and exhibits listed in the Stipulation.

On May 19, 2010, a Joint Petition for Settlement (Joint Petition or Settlement) was filed. The Settlement was signed by PGW, OTS, OCA, OSBA, PICGUG, TURN et al., CAC, RESA and PHA (collectively “Joint Petitioners”). Each of the Joint Petitioners provided a Statement in Support of the Settlement. The Statements in Support of the Settlement are appended to the Settlement as Statements A through I.

On May 19, 2010, OCA sent a letter to each of the eight residential consumer complainants. Prior to the letter being sent, I gave OCA direction in regard to the content of the letter. The letter advised the residential consumer complainant that PGW, OTS, OCA, OSBA, PICGUG, TURN et al., CAC, RESA and PHA had entered into a Settlement. The letter included the key terms of the Settlement, and compared it to PGW’s original proposals. The letter informed the residential consumer complainant that he or she could either: (1) join in the Settlement by signing an enclosed signature page and sending it to both me and the Commission Secretary; (2) neither join nor oppose the Settlement, and so inform both me and the Commission Secretary in writing; or (3) oppose the Settlement, and so inform both me and the Commission Secretary in writing. The letter further encouraged any residential consumer complainant opposed to the Settlement to set forth “facts, affidavits, argument and relevant legal analysis, and if desired, a specific request to continue to litigate.”[[2]](#footnote-2) The letter stated that the consumer complainant had until May 29, 2010 (ten days from the date of the letter) to inform me and the Commission’s Secretary in writing of his or her position on the Settlement.[[3]](#footnote-3)

On May 27, 2010, I received the signature page signed by Stanton Bubis and dated May 22, 2010. His signed signature page indicates that he is joining in the Settlement.

On May 27, 2010, I received the signature page signed by Dominic Stango and dated May 23, 2010. His signed signature page indicates that he is joining in the Settlement.

On May 27, 2010, I received the signature page signed by Denise Devlin and dated May 26, 2010. Her signed signature page indicates that she neither supports nor opposes the Settlement and that she may file written Exceptions to this Recommended Decision if she disagrees with it.

On May 28, 2010, I received the signature page signed by Sydella Hodge and dated May 26, 2010. Her signature page does not indicate what position if any she takes in regard to the Settlement.

On June 2, 2010, I received the signature page signed by Linda Montgomery and dated May 30, 2010.[[4]](#footnote-4) Her signature page indicates that she neither supports nor opposes the Settlement, but when approved the Settlement will resolve her complaint.

The other three residential consumer complainants did not provide timely written notice of their positions regarding the Settlement. All of the signature pages which were timely submitted were made a part of the record in this case.

For the reasons set forth below, I find that the Joint Petition for Settlement is just and reasonable and in the public interest. I therefore recommend approval of the Joint Petition for Settlement in its entirety and without modification.

DISCUSSION

Description of the Company

PGW is a municipal gas utility owned by the City of Philadelphia and operated and managed by the Philadelphia Facilities Management Corporation, a non-profit Pennsylvania corporation. PGW came under Commission regulation on July 1, 2000, pursuant to the Natural Gas Choice and Competition Act, 66 Pa. C.S. Section 2212. PGW furnishes natural gas service to approximately 494,500 residential, commercial and industrial customers in Philadelphia, Pennsylvania.

Commission Policy Regarding Settlements

It is the policy of the Commission to encourage settlements. 52 Pa. Code § 5.231.

In its policy statement regarding settlements in major rate cases the Commission provides in pertinent part:

In the Commission’s judgment, the results achieved from a negotiated settlement or stipulation, or both, in which the interested parties have had an opportunity to participate are often preferable to those achieved at the conclusion of a fully litigated proceeding.

52 Pa. Code § 69.401.

The Joint Petitioners have agreed to a Settlement that resolves all of the issues in this proceeding. The Joint Petitioners agree that the Settlement is in the public interest. Each signatory to the Settlement provided a Statement in Support of the Settlement. Residential consumer complainants Stanton Bubis and Dominic Stango have joined in the Settlement. While residential consumer complainant Linda Montgomery neither supports nor opposes the Settlement, she indicated that with the approval of the Settlement, her complaint will be resolved. The only other residential consumer complainant who provided timely written expression of her opinion on the Settlement, Denise Devlin, indicated that she neither supports nor opposes the Settlement and that she may file Exceptions to the Recommended Decision if she disagrees with it. No party has requested the continued litigation of this case. For the reasons set forth below, I find that the Settlement is in the public interest and I recommend its approval without modification.

Below are the key terms and conditions of the Settlement followed by analysis.

1. **REVENUE REQUIREMENT**

**Settlement Terms**

PGW will be permitted to maintain the $60 million revenue increase authorized in the extraordinary rate relief proceeding.[[5]](#footnote-5) In addition, PGW will be permitted to increase annual distribution revenues by $16 million. The amounts necessary to fund PGW’s other than pension employee benefit (OPEB) obligations are reflected in this increase. PGW shall not file a distribution rate case earlier than twenty-four months after Commission approval of the Settlement (Stay Out). The Stay Out however does not preclude PGW from seeking extraordinary or emergency rate relief from the Commission. Settlement at ¶s 16, 18.

**Analysis**

The Settlement allows PGW to retain the $60 million in emergency rate relief that the Commission granted the Company in December 2008. PGW’s retention of the $60 million will: (1) allow it to maintain its key financial indices at appropriate levels; (2) assure that its bond rating at least does not drop below investment grade; (3) assure that it successfully renews its short term borrowing facility; and (4) enable it to sell bonds to finance its capital program. PGW St. 1 at 2-3; OTS Statement in Support at 5.

In the present proceeding, PGW initially requested an additional $42.5 million in annual revenues to fund the Company’s OPEB. Due to changes in accounting standards it is necessary to fund PGW’s obligations with regard to post-employment health care and life insurance. Government Accounting Standards Board (GASB) 45 requires government entities to use an accrual method versus the cash (pay-as-you-go) method for recording post-employment benefits expense for financial accounting purposes. PGW implemented this change in accounting starting in fiscal year 2007. This change is identical to the accounting changes mandated in the early 90’s by the Financial Accounting Standards Board in FASB 106 for nongovernment entities. PGW St. 1 at 4; PGW St. 2 at 10.

PGW has a substantial balance of post employment benefits liability associated with current employees. The accrued liability is projected at $653 million for the test year (September 1, 2009 – August 31, 2010). Absent funding the expense will increase substantially each year. PGW St. 2 at 10.

The Settlement permits PGW to increase annual revenues by $16 million or 1.81% overall, in lieu of the $42.5 million, or 4.8% increase requested by the Company in its initial filing. For residential customers, rates will increase by 2.91% instead of 6.5%, as initially proposed by PGW. Under PGW’s initial filing, a typical residential heating customer with an annual usage of 92 Mcfs would have seen an increase of $8.54 per month. However, under the Settlement, that customer will see a bill increase of approximately $3.58 per month. OCA Statement in Support at 4-5.

The Settlement provides that PGW will not file for another general base rate increase for at least 24 months from the date the Commission approves the Settlement. The Stay Out provision however does not preclude PGW from filing a petition for extraordinary or emergency rate relief. PGW’s agreement to refrain from filing for a base rate increase for at least 24 months will give its customers a level of rate stability over that period.

In support of the revenues that the Settlement allows PGW to collect, OTS asserts as follows:

The rate increase achieved in the Settlement provides PGW with solid financial footing. As stated by the Company in PGW Statement No. 1, it was important for PGW to retain the $60 million because that would allow PGW to maintain investment grade bond rating, renew its short term borrowing facility and sell its bonds to finance capital programs. The $16 million increase is also in the public interest as it helps to ensure PGW’s $18.5 million OPEB obligation is funded. The combination of the $16 million, along with retaining the $60 million will give PGW the tools to significantly improve their debt structure and credit rating.

OTS Statement in Support at 5 (footnote omitted).

OCA opines as follows in support of the Settlement rates:

Based on OCA’s analysis of the Company’s filing and discovery responses received, the rate increase under the proposed Settlement represents a result that would be within the range of likely outcomes in the event of full litigation of the case. The increase is appropriate and, when accompanied by other important provisions contained in the Settlement, yields a result that is just and reasonable.

OCA Statement in Support at 5.

For all of the foregoing reasons, I find that the revenues allowed under the Settlement are just, reasonable and in the public interest. I recommend that the Commission authorize PGW to collect those revenues.

B. **OPEB FUNDING**

**Settlement Terms**

## 1. On a monthly basis, PGW shall deposit into an irrevocable trust fund the amounts necessary to fund its OPEB obligation as follows: $15 million annually for an initial five year period to fund the Unfunded Actuarial Accrued Liability (“UAAL”) and $3.503 million annually, which represents a 30-year amortization period for the Net OPEB Obligation of $105.1 million as of FYE 2010. In addition, PGW agrees to:

#### Provide to the Commission and the active parties to this proceeding, a complete copy of the Irrevocable Trust Agreement in a subsequent submission filed with the Commission to inform them that the Trust Agreement has been finalized. The Irrevocable Trust shall be established prior to any effective date for the rate increase to fund OPEBs;

#### Begin monthly OPEB deposits into the Irrevocable Trust in the first full month following Commission approval of this Settlement and the filing of the Trust Agreement, whichever is later; and

#### Maintain an accurate account of all monthly OPEB deposits and, during the initial five year period, provide a quarterly report and a yearly summary to the Commission and the active parties to this case.

#### PGW may suspend the monthly OPEB funding obligation on the date the Company files a Petition for Extraordinary/Emergency Rate Relief. The suspension of the monthly OPEB funding obligation will continue until the Commission, by Order, sets forth the date that monthly funding must resume.

## PGW shall recover the amount of its OPEB funding through a Rider from all customer classes. The funding amount contained in the Rider shall be $16 million annually and (except for over/undercollection true-ups) this amount shall not change until reviewed and updated in PGW’s next distribution base rate proceeding or after the initial 5-year period. If it is not filed as part of a distribution rate case, PGW shall file the proposed revision at least 6 months prior to the time when the change is scheduled to go into effect. At those times, PGW shall provide a current actuarial study to determine the level needed to fund any remaining Unfunded Actuarial Accrued Liability and OPEB obligation funding, and shall change the Rider accordingly. The Rider shall be collected on a volumetric basis from each class and will be adjusted to account for over or under collections of the $16 million on an annual basis. The clause will be offset by other rate changes such that the net impact of the rate change will be to effectuate the rate allocations agreed to in paragraph 22 of this Settlement.

## Settlement at ¶s 16, 19, 20.

**Analysis**

In support of the Settlement provisions regarding OPEB funding, OCA states as follows:

The OCA had two significant concerns with regard to PGW’s request for the recovery of OPEB costs. OCA witness Catlin first recommended that a 20-year amortization period be utilized for the net OPEB obligation to mitigate the effect of the adoption of GASB 45 on ratepayers and stabilize revenue requirements over the next several years. OCA St. 3 at 8. Mr. Catlin noted that this recommendation was consistent with the 20-year time period established in the Commission’s policy statement regarding recovery of the OPEB costs that investor owned utilities deferred after the adoption of Statement of Financial Account Standards (SFAS) No. 106.  Id.; 52 Pa. Code § 69.351.

The second concern identified by the OCA was the lack of an established irrevocable trust in which the amounts collected from ratepayers to fund accrual basis OPEB costs would be deposited. OCA St. 3 at 9-11. Mr. Catlin testified that such a trust fund is necessary to ensure the availability of the funds to pay future OPEB costs and to minimize the amounts that must be collected as a result of the return earned on the invested trust funds. Id. The Settlement reached in this docket addresses both of the OCA’s concerns.

First, the Settlement calls for an increase in rates of $16 million to assist in funding the incremental OPEB costs. Settlement, ¶ 19. The Settlement provides that PGW will amortize the Net OPEB Obligation over 30 years instead of the five years originally requested by the Company. Id. Additionally, in order to mitigate the impact of changing from recovery of OPEB costs on a pay-as-you-go basis to recovery on an accrual basis under GASB 45, the Settlement provides for $15 million annually for an initial five year period for funding of the Unfunded Actuarial Accrued Liability (UAAL). Settlement, ¶ 19. This funding mechanism will continue until PGW’s next distribution rate case or until the end of a 5-year period, whichever comes first. Settlement, ¶ 20.

Second, the Settlement requires that PGW establish an irrevocable trust fund for OPEB collections prior to any effective date for the rate increase. Settlement, ¶ 19. PGW has agreed to establish this trust and to make monthly deposits to this trust so that $18.503 million annually is deposited in trust to fund the UAAL and the net OPEB obligation. PGW has agreed to use existing revenues to fund the difference between the $16 million collected through the Rider and the $18.503 million necessary to fund its OPEB obligations. Settlement, ¶¶ 19, 20.

The OCA would also note that $16 million of the $18.503 million to be deposited in the trust will be collected through a Rider that reconciles for over- and under-collections. The Rider will be collected on a volumetric basis for all customer classes. The Rider will assist PGW in the collection of this OPEB amount.

Based on the OCA’s analysis of the Company’s filing and discovery responses received, the treatment of OPEBs under the proposed Settlement is appropriate and, when accompanied by other important provisions contained in the Settlement, yields a result that is just and reasonable.

OCA Statement in Support at 6-7.

OTS had this to say regarding how the public will benefit from the Settlement’s provisions regarding OPEB funding:

The Settlement provides that PGW will establish an Irrevocable Trust prior to any effective date for the rate increase to fund OPEBs. This was a critical factor in the OTS evaluation of the Settlement as we provided testimony rejecting OPEB funding because the Company had not yet established an irrevocable trust. Consistent with the recommendation found in OTS Statement No. 1, the Settlement prohibits PGW from collecting any funding for OPEBs until the trust is put in place and approved by the Commission. This is in the public interest because it ensures that this Trust will be set up and that the funds will be used for their intended purpose. Setting up the Trust also provides PGW with a benefit because it ensures funding for the OPEB obligation will be provided. This is important because as stated in PGW Statement No. 2, this will improve PGW’s debt to capitalization ratio; this is something credit rating agencies will look favorably upon. PGW will make monthly deposits into the Trust amounts necessary to fund the OPEB obligation. Further the Company will be required to provide a copy of the Irrevocable Trust Agreement to the parties and the Commission to inform them that the Trust has been established.

OTS Statement in Support at 5-6 (footnotes omitted).

PGW’s filing for a base rate increase in this proceeding was driven by the legal requirement that it fund its OPEB obligations (post employment health care and life insurance). The Settlement requires PGW to enter into an irrevocable trust agreement and to make monthly deposits of specific amounts into the trust to fund its OPEB obligations. PGW is to report to the Commission on its establishment of an irrevocable trust and its deposits into the trust. The Settlement thus provides assurances that the rate increase granted in this proceeding will be used for its intended purpose. For all of the foregoing reasons I find that the Settlement provisions regarding OPEB funding are in the public interest, and I recommend that the Commission approve those provisions.

### C. **DEBT REPAYMENT**

**Settlement Terms**

Under the terms of the Settlement PGW agrees to make principal debt repayments on a monthly basis in the amount of $276.6 million; and agrees that it will not sell new money bonds for at least three years. During the Stay Out period PGW agrees to provide quarterly reports to the Commission and the active parties to this proceeding listing its monthly debt repayments with the amounts of principal and interest for each clearly set out. PGW may suspend its discretionary debt repayment obligation on the date it files a Petition for Extraordinary/Emergency Rate Relief. The suspension of the debt repayment obligation will continue until the Commission, by order, sets forth the date that the payment may resume. Settlement at ¶ 17.

**Analysis**

As of the end of the test year, the 12-month period ending August 31, 2010, PGW projects to have over $1.2 billion of outstanding long-term debt, including a new issue of approximately $150 million presently scheduled to be issued in July. Ex. JRB – 2A, p. 4; OCA Statement in Support at 7. A significant issue in this case concerned PGW’s payment of its existing debt, and limits on its incurrence of future debt, in order to improve its financial standing. In support of the terms of the Settlement, OCA asserts, “The OCA submits that these provisions assure that PGW will continue to pay down the portions of long-term debt that become due over the period ending with FY 2015 and that no incremental long-term debt is to be issued over the next three years.” OCA Statement in Support at 8.

The Settlement requires PGW to reduce its debt by making monthly repayments of a specific amount. The Settlement also requires PGW to refrain from selling new money bonds for at least three years. The Settlement is therefore in the public interest because it is designed to improve PGW’s financial condition through measures to lower its level of indebtedness.

D. **SWAP ARRANGEMENT**

**Settlement Terms**

## The Settlement provides that to the extent that PGW decides to maintain currently-in-force interest rate swap agreements (“Swap Arrangement”), and later decides to terminate the Swap Arrangement, PGW agrees that:

#### (a) No one-time termination/cancellation/unwinding or exit fee(s) will be included in any request for future rate relief. The prior sentence shall not apply to the costs (including debt service, debt service coverage and issuance costs) of the financing of any associated swap termination fee;

#### (b) Consistent with its ongoing commitment to provide utility service at the lowest reasonable cost, PGW shall continue to monitor its options with regard to the Swap Arrangement, and shall, in conjunction with the City of Philadelphia, consider terminating the Swap Arrangement when doing so would prudently reduce the total cost of the financing to ratepayers;

#### (c) During the Stay Out, PGW shall provide to the OTS and the OCA monthly reports of the status of the Swap Arrangement which shall include: 1) the latest available cost of terminating the swap made available from the City’s independent swap advisor; 2) the interest cost differential that PGW would have had to incur if it had terminated the swap during the reporting month and replaced variable rate with fixed rate securities; and 3) an update of PGW’s current view of its plans relative to terminating the Swap Arrangement. PGW shall make knowledgeable experts and consultants available to provide additional explanations or data as reasonably requested; and

#### (d) For three years after the approval of this Settlement, PGW agrees not to enter into a new swap agreement (i.e., an interest rate hedge) without providing at least sixty (60) days notice to the Commission and to the active parties to this proceeding.

Settlement at ¶ 21.

**Analysis**

OCA provides the following explanation of the SWAP Arrangement, its concerns, and how the Settlement resolves those concerns:

In PGW’s recent emergency rate proceeding, the details and possible termination fees for an interest rate swap agreement (Swap Arrangement) were a key issue. PGW had originally entered into the Swap Agreement as a means to smooth out the projected interest payments on its variable rate bonds. PGW had provided testimony during the emergency rate proceeding as to its intentions to terminate the Swap Arrangement, which as of 12/31/2008 would have required a one-time termination payment of approximately $64 million. OCA St. 1 at 14. Subsequent to the emergency rate proceeding, PGW continued to investigate its options as to the Swap Arrangement.

Prior to filing the instant rate case, PGW did terminate a small portion of the Swap Arrangement, at a cost of approximately $3.7 million. The bulk of the Swap Arrangement remains in place. As outlined in the direct testimony of OCA witness Richard LeLash, the OCA had serious reservations about any future payments that might be required in order to terminate this last vestige of the original Swap Arrangement. OCA St. 1 at 14. As Mr. LeLash explained:

To put the swap agreement into perspective, it is useful to understand the magnitude of its potential cost to PGW. According to Mr. Bogdonavage’s response to discovery request OCA Set I-34, toward the end of 2008 its associated mark to market value was a loss of between $54 and $64 million. Even as recently as November 2009, it still had a mark to market loss of $35 million. Indeed, in the last extraordinary rate proceeding, it appears that the inherent cost risk of the swap agreement was a critical factor in the level of rates that were ultimately authorized for the Company.

OCA St. 1 at 14. The Settlement provisions herein address and adequately resolve the OCA’s concerns on this issue.

First, PGW has agreed that it will not seek rate recovery for any future, one-time termination payments associated with the Swap Arrangement. Settlement ¶ 21(a). Second, PGW has agreed that if the need to terminate the Swap Arrangement arises in the future, it will engage in a cost/benefit analysis to determine the most prudent time to do so in order to provide the best outcome for ratepayers. Settlement ¶ 21(b), (c). Finally, PGW has agreed to not enter into any new interest rate swaps for a period of three years without first giving the Commission and the parties 60 days notice. Settlement ¶ 21(d). This notice would enable the parties to analyze any possible course of action on this issue before a new interest rate swap was consummated.

Based on the OCA’s analysis of the Company’s filing and discovery responses received, the resolution of the Swap Arrangement is appropriate and in the public interest.

OCA Statement in Support at 8-9.

OTS also expressed concern about PGW’s Swap Arrangement. However, it also indicates that the Settlement helps allay those concerns. OTS states as follows:

In testimony, OTS argued that PGW’s currently in-force interest rate swap agreements carry many risks. However, OTS believes that the Settlement provides appropriate ratepayer safeguards from the risk of interest rate swaps by requiring PGW to give 60 days notice before entering into any new swaps, implementing reporting requirements and encouraging PGW to terminate the swap agreement when favorable economic conditions emerge. Further, PGW has agreed that no one-time termination/cancellation/unwinding or exit fee(s) will be included in any request for future rate relief. These terms of the Settlement insulate ratepayers from future risk related to interest rate swaps.

OTS Statement in Support at 7-8, ¶ 18 (footnotes omitted).

I find that the Settlement is in the public interest because it insulates ratepayers from bearing the costs associated with any termination of highly risky interest rate hedge agreements that PGW has entered into.

E. **REVENUE ALLOCATION AND RATE DESIGN**

**Settlement Terms**

## Under the terms of the Settlement the increase in revenues, including the collection of the OPEB funding, shall be allocated to the classes such that the Residential rates will be increased by $20 million. The Commercial, Municipal, Industrial, Public Housing Authority, Interruptible and GTS/IT classes will receive rate decreases as follows:

|  |  |
| --- | --- |
| Commercial | ($3,055,000) |
| Industrial | ($357,000) |
| Municipal | ($148,000) |
| PHA | ($440,000) |
| Interruptible | $0 |
| GTS/IT | $0 |

Settlement at ¶ 22, Settlement Ex. 1.

**Analysis**

As OCA indicates, the allocation of any proposed rate increase among the customer classes was a major issue in this proceeding. OCA Statement in Support at 9. In litigation, PGW proposed to increase residential rates by $45 million annually in order to collect an overall annual increase of $42.5 million. PGW St. 8R, Ex. HSG-11, p. 1. OCA presents the following explanation regarding why it opposed PGW’s litigation position and why the Settlement is acceptable:

OCA witness Watkins disagreed with the Company’s cost of service study and resulting allocation of the requested increase. OCA St. 4 at 24. Given the size of the Residential class (relative to the total system), the Residential class’ lower rate of return, and all other firm classes higher rates of return, Mr. Watkins recommended that the Residential class absorb 100% of the authorized increase in revenues in this case. Id. He based his recommendation on making progress towards the system average return as well as on the principles of gradualism and the avoidance of rate shock. As Mr. Watkins explained:

I view this case as one in which rate stability and gradualism are especially important. In terms of rate stability, I do not believe it is in the public interest for base rates to bounce up and down. In terms of gradualism, my proposal for the Residential class to absorb the entire rate increase makes significant strides in moving to cost of service, yet tempers an abrupt move toward cost of service.

OCA St. 4 at 23-24. Mr. Watkins also recommended that if PGW was allowed to maintain the $60 million revenue increase from the emergency proceeding, but was awarded no additional increase, and if the Commission wanted to take this opportunity to move all rate classes closer to cost of service unity, then rate reductions could be made to the Commercial, Municipal, Industrial and Public Housing Authority classes. OCA St. 4 at 26. Mr. Watkins based his recommendation on his cost of service study that utilized the Peak and Average methodology and found that the revenue reductions should total no more than four percent of base rate (non gas, non USEC, and no REC) revenues. Id. In addition to the Company and the OCA, OSBA witness Knecht, OTS witness Kubas and PHA witness Pender made revenue allocation proposals. All of these witnesses proposed assigning a higher revenue increase to the Residential class than the Company or the OCA. OSBA St. 1 at 14-24; OTS St. 4 at 7-12; PHA St. 2 at 3-9.

Under the Settlement, PGW’s total distribution rate increase will be $16 million. The rate increase will be allocated such that residential customers will see a distribution rate increase of $20 million while most other rate classes will see a reduction in their rates. Settlement, ¶ 22. Under the lower revenue requirement ($16 million versus $42.5 million) agreed to in the Settlement, this allocation allows for all customer classes to make significant progress toward the system average return without undue rate shock being experienced by any one class. As was mentioned above, for residential customers, rates will increase by 2.91%, as compared to the 6.5% increase that PGW originally requested. Under the Company’s initial filing, a typical residential heating customer with an annual usage of 92 Mcfs, would have seen an increase of $8.54 per month, but under the Settlement, the total bill increase will be approximately $3.58 per month.

Indeed, in this proceeding, the Company submitted a cost of service study that showed wide ranging disparities in the returns being provided by the various customer classes. The Company’s study showed several of the classes with indexed rates of return above the system average and other classes providing revenues below the system average. The Company’s cost of service at current rates for the Residential Class showed anindexed Rate of Return of 0.77. Settlement Exh.1. Under the Settlement, the Residential Class’ indexed Rate of Return moves to 0.89, which represents a significant step towards the system average return. Settlement Exh. 1.

The OCA would also note that in the 2008 Emergency Rate Proceeding filed by PGW, the $60 million revenue increase approved by the Commission was applied using the Company’s then current Cost of Service allocations. *P.U.C. v. PGW*, Docket No. R-2008-2073938 at 32 (Order Entered December 19, 2008). In other words, the $60 million revenue increase was allocated in such a way as to preserve the different rate classes’ existing rate of returns, and the issue of allocation of those funds was specifically reserved for resolution in this proceeding. Id. at 47. Accordingly, the allocation agreed to by the parties in this Settlement effectuates not only a reallocation of the $60 million of emergency rate relief but also a collection of the $16 million increase agreed to in this Settlement.

Based on the OCA’s review of the cost of service studies presented in this proceeding and the varying revenue allocation proposals presented by the other parties and the OCA, the OCA views the Settlement to be within the range of reasonable outcomes from full litigation of this case. The revenue allocation under the Settlement represents a compromise and falls within the litigation positions of the Joint Petitioners. The OCA would note that the Settlement does not resolve the differences of the parties as to methodology or specific cost allocation issues on a going forward basis, but the allocation agreed to here is intended to move all rate classes toward the system average Rate of Return while at the same time respecting the principles of gradualism and avoidance of rate shock. The OCA submits that the revenue allocation agreed to in the Settlement is appropriate at this time, and, when accompanied by other important provisions contained in the Settlement, yields a result that is just and reasonable.

OCA Statement in Support at 9-12.

OSBA provides the following reasons why it believes the Settlement’s revenue allocation is in the public interest:

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.

First, the Settlement allocates the entire incremental increase ($16 million) to the residential class. 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. 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.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | 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 | | | | |

OSBA Statement in Support at 17-19.

PHA notes that PGW in its original filing allocated rates to PHA resulting in a 21.1% rate of return. However, under the Settlement, PHA’s rate of return is 16.5%, the same as the industrial customers. PHA opines that although it believes its rate of return should be even lower, especially given its public mission, it finds the Settlement acceptable, given that the overall rate for PHA Rate 8 is reduced by $440,000, and all customer classes are moved closer to unity in rates of return. PHA Statement in Support at 2-3.

The Settlement’s revenue allocation and rate design are in the public interest because rates are allocated so as to move all customer classes closer to the system average return, without causing rate shock in the residential customer class. For all of the foregoing reasons, I find that the provisions of the Settlement regarding revenue allocation and rate design are just, reasonable and in the public interest. I recommend that the Commission approve those provisions.

F. **DEMAND SIDE MANAGEMENT PROGRAMS**

**Settlement Terms**

## 1. PGW shall be permitted to implement its Proposed Demand Side Management (“DSM”) Program (“Program”) with the following modifications:

#### PGW shall be permitted to implement a five year DSM program in accordance with the process set forth herein. After PUC approval of the Program and approval of the initial implementation plans through the end of PGW fiscal year (FY) 2011, PGW shall make a filing with the parties and the Commission four months prior to the end of the initial implementation period, and four months prior to the end of each subsequent year. Such filing shall report on the progress of its plan to date and describe its operational plans and budget for the next year. Parties shall have the right to submit comments to PGW’s future plans and proposed budget for the upcoming year to which PGW shall respond, indicating whether it agrees with the comments or, if it disagrees setting forth its reasons for disagreement. In their comments to the annual filing, all parties shall have the right to propose modifications to, or to propose the termination -- in whole or in part -- of any part of, the implementation plan or any specific program, including proposed modifications to the filed budgets. Any party may request the Commission to resolve any issue raised by the annual filing that was not resolved through the comment process.

#### The yearly DSM spending budget for the plan for the first two years (FY 2011 and FY 2012) shall not exceed 1% of PGW’s total projected gross intrastate operating revenues. PGW agrees that for the first two years (FY 2011 and FY 2012), it will fully fund the Enhanced Low Income Retrofit Program at the budget levels originally proposed for this Program by the Company in this proceeding. The annual budgets for the remaining years (FY 2013, FY 2014 and FY 2015) shall be determined in the annual reporting process described in paragraph 24(a) above, but in no event shall exceed the original level for that year proposed by the Company in this proceeding.

#### The Premium Appliances and Heating Equipment rebate program and the Commercial and Industrial Retrofit program shall be rolled out earlier (at least 3 months earlier) than in the Company’s filed Plan, and the Comprehensive Residential Heating Retrofit Program (CRHRP) shall be rolled out later (at least 6 months later) than PGW’s proposed roll-out.

#### The Plan shall include the delivery of CFLs only in instances in which PECO agrees to provide the devices or pay for them.

#### PGW shall seek to coordinate its DSM programs with those of other programs being deployed in its service territory. PGW shall provide a report of its efforts and a matrix of all linkages to other programs with its compliance filing and each annual program filing.

#### For the CRHRP, PGW will impose a modest fee for the initial energy audit. PGW will propose the specific fee as part of the initial, CRHRP Implementation Plan, after attempting to reach a consensus on the proposed level with the active parties. In formulating the level of the charge, PGW shall consider making the modest fee affordable for lower income customers, in balance with any operational and implementation requirements.

#### PGW shall be permitted to establish a section 1307-type automatic adjustment clause for the recovery of DSM costs. PGW agrees not to make a claim for lost revenues during the Stay Out.

Settlement at ¶s 24, 25.

**Analysis**

OCA presented the following description of the DSM Plan under the Settlement and why it should be approved:

A. Introduction

PGW proposed to implement seven individual Demand Side Management (DSM) programs including: (1) Enhanced Low-Income Retrofit, a program designed to improve the efficiency of existing houses’ building shells, space and water heating equipment, and lighting, and an expansion of the Company’s existing Low Income Usage Reduction Program (LIURP), the Conservation Works Program (CWP); (2) Comprehensive Residential Heating Retrofit, similar to the Enhanced Low-Income Retrofit program, except for non-low-income residential customers; (3) Premium Appliances and Heating Equipment, which will promote high efficiency appliances and systems to residential and non-residential customers; (4) Commercial and Industrial Equipment Efficiency Upgrades, which will promote additional high-energy equipment and systems to non-residential customers; (5) Commercial and Industrial Retrofit, which will offer supplemental measures to the Commercial and Industrial Equipment Efficiency Upgrades program; (6) Municipal Facilities Comprehensive Efficiency Retrofit, a program which will offer technical advice on improvement of City of Philadelphia buildings and facilities; and (7) High-Efficiency Construction, promoting efficient buildings and systems in residential and non-residential new construction. PGW St. 10 at Exh. JJP-6, 31-46; OCA St. 6 at 5. The Company proposed a total five year budget of approximately $54 million. PGW St. 10 at Exh. JJP-6, 2-3; OCA St. 6 at 6.

As discussed in the Direct Testimony of OCA witness David Nichols, the OCA had several concerns regarding specific program design and implementation elements and the proposed costs and cost recovery mechanism, including PGW’s proposal for recovery of net lost revenues. OCA St. 6 at 3-4. Specifically, the OCA recommended that the Commission review the Company’s DSM Plan on a year-by-year basis, including proposed spending levels; that the total spending budget be set at no more than 1% of PGW’s projected gross intrastate operating revenues; that the cost recovery mechanism not include net lost revenues; that various program design changes be implemented specifically as to the Premium Appliances Heating Equipment program, the Commercial and Industrial Retrofit Program, and the Comprehensive Residential Heating Retrofit Program (CRHRP); and that the Company take explicit steps to coordinate the delivery of the DSM programs with those of PECO Energy Company, including the CFL replacement program. OCA St. 6 at 3-4. The Settlement addresses each of these issues.

B. Overall Program

The Settlement provides that PGW shall be permitted to file a proposed five year DSM program with the Commission in accordance with the provisions of the Settlement that will allow all customers the opportunity to participate in measures specifically designed to lower natural gas usage and thereby reduce total gas costs for all ratepayers. Settlement, ¶ 24(a). The Settlement provides support for Commission approval of the DSM Programs for an initial two year period (FY 2011 and FY 2012). Thereafter, PGW will make annual filings with the Commission and the parties four months prior to the end of the initial implementation period and four months prior to the end of each subsequent program year. Settlement, ¶ 24(a). The annual filing will include information on the program activities to date; future operational plans for the next program year; and the budget for the next year. Prior to the end of Fiscal Year 2012, the annual filing will also contain a budget proposal for the following program year. All parties have specifically reserved the right to comment on these future plans and the proposed budget in the annual review proceedings. Settlement, ¶ 24(a). All parties also have the right in their comments to the annual filing to propose modifications to the program, or to propose the termination, in whole or in part, of any part of the implementation plan, or a specific program within the DSM program. Further, any party may also request that the Commission resolve any issue raised by the annual filing that is not resolved through the comment process. Settlement, ¶ 24(a).

PGW’s Plan for a comprehensive suite of DSM programs for all customer classes should provide benefits to all PGW customers. OCA St. 6 at 5-6, 13-14. The DSM Plan, serving all customer classes, will maximize the efficiencies available in PGW’s service territory and will have the maximum impact on the reduction of total gas costs for all ratepayers. The Settlement allows for a comprehensive program so that all customer classes can participate.

The annual review of these programs also provides an important protection for customers. PGW has proposed a significant expansion to the scope and scale of its DSM programs, well beyond the current PGW Low Income Usage Reduction Program (LIURP). Such an annual review process is necessary in order to allow the Company to make “mid-course” corrections and to evaluate whether its measures are effectively accomplishing the goals set forth in the Plan. Importantly, the Settlement provides all parties the opportunity to comment on each of the Company’s annual filings and to attempt to resolve any issues with the Company or other parties. However, if these issues cannot be resolved, the parties still retain the right to bring the matter to the Commission for resolution.

C. Cost and Cost Recovery

Costs for PGW’s DSM program will be recovered through a 1307-type automatic adjustment clause, the Efficiency Cost Recovery Mechanism (ECRM). The Settlement establishes specific limits as to the spending levels that may be recovered through the ECRM. For the first two years of the program (FY 2011 and FY 2012), the annual spending budget will not exceed 1% of PGW’s total projected gross intrastate operating revenues. Settlement, ¶ 24(b). During this two year period, PGW will fully fund the Enhanced Low Income Retrofit Program at the budget levels included in the Company’s filing: $6,783,440 for FY 2011 and $6,708,440 for FY 2012. Thereafter, the annual budgets for FY 2013 through FY 2015 will be determined in the annual reporting process, but the annual spending budgets will not exceed the levels set forth in the Company’s original filing. Settlement, ¶ 24(b). PGW also had requested the recovery of net lost revenues in the ECRM. In this Settlement, PGW agrees to not make a claim for lost revenues during the Stay Out period. Settlement, ¶ 24(g).

The OCA submits that the proposed annual spending budgets for FY 2011 and 2012 are reasonable. OCA witness Nichols recommended that PGW’s annual budget not exceed 1% of corresponding annual revenues until the Company’s programs show demonstrated results. OCA St. 6 at 19-21. Re-evaluating the budget level after FY 2012 will allow for the Company to gain experience with a comprehensive DSM program and to adjust the program budgets on a going forward basis in a reasonable manner. The Settlement allows the Company and the parties to re-evaluate the budget as the program develops and progresses and ensures annual reviews of the level and types of expenditures. The Settlement also provides that “in no event shall [the annual budget for FY 2013-2015] exceed the original level for that year proposed by the Company in this proceeding.” Settlement, ¶ 24(b). This provides an important cap on the maximum level of expenditures permitted in the Company’s subsequent year budgets over the course of the five year plan.

Finally, the Settlement calls for the elimination of the lost revenues from the calculation of the ECRM for the duration of the Stay Out period. The OCA had opposed this claim on both legal and policy grounds. Removal of this claim eliminates a contentious issue that could have impeded the development of a robust DSM program.

D. Program Roll-out and Design Changes

The Settlement provides for several timing changes to the proposed program roll-out and a change to the coordination initiatives included in the program design. The Premium Appliances and Heating Equipment rebate program and the Commercial Retrofit Program will be rolled out at least three months earlier than the dates proposed in the Company’s filing. Settlement, ¶ 24(c). OCA witness Nichols recommended that these programs be rolled out earlier because the Premium Appliances and Heating Equipment rebate program is the single most cost-effective program in PGW’s Plan and would allow both residential *and* non-residential customers the early opportunity to participate in the DSM programs. OCA St. 6 at 22. The Commercial Retrofit Program would provide additional efficiency services to non-residential customers. Id. at 23.

The Comprehensive Residential Heating Retrofit Program (CRHRP) -- a program for non-low-income residential customers -- will roll-out at least six months later than the Company’s original proposed roll-out. Settlement, ¶ 24 (c). OCA witness Nichols recommended delay on this program because these programs are more difficult to market and deliver than are the other programs within this Plan. This program will require an adequate infrastructure of delivery vendors in an environment where new electric utility energy efficiency programs, expanded federal weatherization dollars and the Company’s proposed low-income house retrofit program will all be competing for delivery vendors. Additionally, the OCA submits that it will be important to first see how the Conservation Works Program (CWP) for low-income customers is expanded into the Enhanced Low-Income Retrofit before launching the CRHRP. OCA St. 6 at 21-22.

When PGW does roll-out the CRHRP, PGW has agreed to the use of a modest fee for the initial energy audit. Settlement, ¶ 24(f). The OCA submits that this proposal is reasonable. PECO, who will be providing a similar program in the same general area, has also proposed that a fee be charged for its energy audit in its Act 129 Energy Efficiency and Conservation Plan (EE&C Plan).

In accord with the recommendations of OCA witness Nichols, the Company will coordinate its DSM programs with other programs in its service territory, including the Act 129 programs deployed by PECO. OCA St. 6 at 23-24. PGW will report on these efforts and provide a matrix of linkages to other programs with its compliance filing and in each annual program filing. Settlement, ¶ 24(e). To the extent possible, the OCA submits that it would be most cost-effective to attempt to leverage other available resources and to coordinate resources and visits with other existing programs, such as PECO’s Act 129 EE&C program.

In the Settlement, PGW has also agreed that it will only include the delivery of Compact Fluorescent Lamps (CFLs) in its program in instances in which PECO will agree to provide the devices or pay for them. Settlement, ¶ 24(d). CFLs are electricity saving devices. While the house retrofit programs may provide a useful delivery vehicle for CFL installation, the cost of the CFLs should not be recovered from PGW ratepayers. In addition, a CFL replacement program is a part of PECO’s Act 129 EE&C program and costs for this program are being recovered through PECO’s program. OCA St. 6 at 24. PGW’s DSM Plan should work cooperatively, rather than competitively, with PECO’s CFL replacement program.

E. Conclusion

Based on the OCA’s analysis, PGW’s DSM Plan as modified by the Settlement is reasonable and in the public interest, and therefore, should be approved.

OCA Statement in Support at 12-18.

The Clean Air Council provides the following support for the DSM Plan as proposed in the Settlement:

# The Settlement allows PGW to move forward with the implementation of a robust DSM Plan for multiple customer classes that will lead to increased energy efficiency, reduce consumption of natural gas, reduce the creation of greenhouse gases that contribute to global warming, reduce air pollutants in the Philadelphia region and thus improve the region’s overall health, and create hundreds of new jobs in the Philadelphia region (including green collar jobs) and thus improve the region’s economy. Further, the Settlement’s provisions regarding the DSM Plan are protective of lower income residential customers. Accordingly, the Council believes that the Settlement adequately addresses the issues that the Council has identified and pursued in this proceeding, and is in the public interest.

CAC Statement in Support at 7.

The DSM programs under the terms of the Settlement are designed to promote conservation, reduce customer bills, create green collar jobs and foster a cleaner and healthier environment. For all of the foregoing reasons, I find that the provisions of the Settlement regarding PGW’s DSM Plan are just, reasonable and in the public interest. I recommend that the Commission approve those provisions.

G. **CUSTOMER RESPONSIBILITY PROGRAM**

**Settlement Terms**

## Pursuant to a separate settlement at Docket No. M-00072021 (Order entered October 23, 2009), PGW will be filing a proposal to implement further changes to PGW’s CRP. Under this Settlement, PGW agrees to include in that filing a proposal to create a positive incentive to encourage conservation by CRP participants. Settlement at ¶ 25.

**Analysis**

On October 9, 2009, PGW, OTS and TURN, *et al.* filed at Docket No. M-00072021 a Joint Petition for Interlocutory Review, Answer to a Material Question and Approval of a Settlement Agreement (Petition). The Petition was in response to a directive from the Pennsylvania Department of Public Welfare (DPW) that PGW cease using LIHEAP cash grants to offset the subsidy paid by non-CRP customers so that CRP customers can receive a discount on their bills. DPW directed PGW to instead apply the LIHEAP cash grants directly to the CRP customer’s bills or any CRP arrears. *Re: Philadelphia Gas Works Universal Service and Energy* *Conservation Plan; Joint Petition for Interlocutory Review, Answer to a Material Question and* *Approval of a Settlement*, M-00072021 (Order entered October 23, 2009) at 2. The Commission granted the Petition for Interlocutory Review, answered the Material Question in the affirmative, and approved the Settlement Agreement. *Id*. at 10-11. The Settlement Agreement in that case included the following provision:

Not later than January 31, 2010, PGW will file a separate proceeding to modify its CRP. The filing will be separate from PGW’s next base rate case. PGW agrees to meet with the Joint Petitioners, the OCA and other interested stakeholders to seek input on appropriate modifications to the CRP. The Joint Petitioners and the OCA agree that they will seek a schedule for that proceeding designed to provide for a Commission decision by the last Public Meeting scheduled for August 2010. Subject to any confidentiality agreements or provisions regarding customer specific information, PGW agrees to provide to stakeholders and their consultants customer data concerning CRP participants in PGW’s existing program.

*Id*. at 6.

In the present Settlement, PGW agrees to include in the modifications it will propose to its CRP, provisions that will incentivize CRP participants to reduce their gas usage. This Settlement provision is in the public interest as it is intended to help payment troubled low income customers reduce their gas bills, while also lowering PGW’s costs and fostering energy conservation for a cleaner and healthier environment.

H. **BAD DEBT OFFSET**

**Settlement Terms**

## PGW shall implement a Bad Debt Expense Offset (“Offset”) which will offset CRP credit amounts and pre-program arrearages by 7.1% on a monthly basis. The Offset shall be applied to the CRP credit associated with incremental CRP participants over 84,000 participants, with the level reset in each distribution base rate case. Settlement at ¶ 26.

**Analysis**

OCA gives the followingexplanation of the bad debt expense offset and why the Settlement provisions are in the public interest:

A. Overview

PGW collects its universal service costs, or Customer Responsibility Program (CRP) costs, through a reconcilable Universal Service and Energy Conservation (USEC) Rider. PGW projects these universal service costs based on historic participation in the various programs. On a monthly basis, PGW determines its actual universal service costs. OCA St. 5 at 4. For the CRP, those actual universal service costs include the CRP credits and the arrearage forgiveness credits granted. The actual CRP costs incurred are reconciled to past collections, and the surcharge is adjusted up or down for under- and over-collections at the time of PGW’s Section 1307(f) proceedings.

The natural gas bill for a CRP participant is comprised of two parts: (1) the portion of the bill that is at or below an affordable percentage of income and (2) the portion of the bill that is above an affordable percentage of income. *Id*. at 6. The amount above the affordable percentage is referred to as the CRP credit (or CRP shortfall) and is recovered from all other customers. Before a low-income customer becomes a CRP participant, the portion of the bill the customer cannot afford to pay, becomes uncollectible and is recovered in the uncollectible expense in base rates. A problem arises between base rate cases when a reconcilable rider is used such as PGW’s USEC. When a low-income customer enrolls in CRP between base rate cases, the portion of the bill that the customer could not pay and that was included as an uncollectible expense in base rates now becomes the CRP credit and is recovered again on a dollar-for-dollar basis through the USEC. OCA St. 5 at 7. A Bad Debt Expense Offset (Offset) is necessary to address this double recovery. A similar adjustment is needed for arrearage forgiveness as the same form of double recovery results between base rates and the USEC Rider.

B. Settlement

The Settlement provides that PGW will implement an Offset to its CRP credit amounts and pre-program arrearages of 7.1% on a monthly basis in the calculation of its USEC Rider for incremental participants in the CRP. Settlement, ¶ 26. The Offset will be applied to the CRP credit that is associated with incremental CRP participants over 84,000 participants. This level will be re-set in each distribution base rate proceeding. *Id*. As OCA witness Roger Colton discussed in his Direct Testimony and calculated in his Appendix A, Step-by-Step Determination of Bad Debt Double Recovery, the Offset is necessary in order to prevent the double recovery of bad debt expense through the USEC.

As explained in Appendix A of his Direct Testimony, OCA witness Colton found that there is a double recovery of bad debt expense when more customers move into the CRP program than projected during the base rate case. OCA St. 5 at Appendix A. As Mr. Colton explained, the USEC should only recover the incremental costs of CRP participation that are not reflected in base rates. OCA St. 5 at 12-13. Mr. Colton found that to the extent that CRP participation exceeds the base number of customers included in the Company’s filing, the costs used to establish the USEC rates will result in an overstatement of the USEC and a double recovery of costs. *Id.*

The Settlement resolves this Offset issue identified by OCA witness Colton. The OCA submits that the Settlement represents a reasonable resolution of this issue. The Settlement provides a 7.1% adjustment to CRP credits and arrearage forgiveness amounts included in the USEC for incremental CRP participants over 84,000 participants. This will provide the necessary off-set to avoid double recovery of bad debt and pre-program arrearages through the USEC.

OCAStatement in Support at 18-20 (footnotes omitted).

The Settlement imposes a bad debt expense offset in order to prevent double recovery by PGW of CRP amounts. The Settlement ensures that non-CRP customers are not double billed for amounts associated with the CPR credit and arrearage forgiveness. For all of the foregoing reasons, I find that the provisions of the Settlement regarding bad debt offset are just, reasonable and in the public interest. I recommend that the Commission approve those provisions.

I. **EMPLOYEE BENEFIT EXPENSES**

**Settlement Terms**

## At the time of filing its next distribution base rate case, the Company will report on its efforts to control the claimed employee benefit expenses so as to continue providing employee benefits that do not unduly burden the Company and its ratepayers. Such report must include documentary evidence of the Company’s efforts including the measures investigated.

Settlement at ¶ 27.

**Analysis**

PGW claims that it has “worked extremely hard to reduce the overall compensation and benefit costs that it incurs, which accrues, 100% to the benefit of ratepayers.” PGW Statement in Support at 16. The Settlement provision indicates that PGW will take further steps to control its costs for the benefit of ratepayers and report on those efforts in its next base rate case filing. This Settlement provision is in the public interest, and I recommend its approval.

J. **TARIFF ISSUES**

**Meter Relocation Proposal**

**Settlement Terms**

PGW will amend its tariff language so that if PGW discovers that the meter has been tampered with, interfered with or bypassed two times within a twelve month period, PGW may, in its sole judgment and where physically feasible, elect to move the meter from inside the building to an outside, above ground meter location and may charge the customer being supplied through such equipment the labor costs of moving the meter. Nothing herein waives the right of the customer to file a complaint with the Commission disputing the PGW determination. Settlement at ¶ 28.

**Analysis**

TURN *et al.* provides the background information and why the Settlement terms are in the public interest:

Paragraph 28 addresses PGW’s Meter Relocation Proposal. PGW agrees to substantially narrow the very broadly written proposal for amendment of Tariff § 9.5 that was contained in its initial filing. That filing proposed that PGW be allowed to relocate a residential meter “in its sole judgment and where physically feasible” to an outside, above ground meter location whenever the meter has been “tampered or interfered with.” PGW would also be authorized to charge the “Customer being supplied through such equipment the costs and expenses of moving the meter.”

TURN et al. opposed this amendment, because the Meter Relocation Charge, likely to be over $2000, would represent an impossible barrier to service reconnection in many cases. Moreover, the proposed Meter Relocation Charge further threatened residential access to service because there was a substantial risk that Customers who may not in fact have tampered or interfered with the meter might become subject to the charge. Indeed, due to the fact that the burden of showing that the Customer was not responsible for the unauthorized use was upon the Customer, a Customer might have to endure many months and perhaps even a heating season without service before he/she would be able to establish non-responsibility for unauthorized use through the Commission’s complaint processes.

In the Settlement, PGW agrees to language which virtually eliminates these risks. PGW agrees that it would be permitted to relocate a meter from inside a building to an outside, above ground location only when it has discovered unauthorized use two times within a twelve month period at the same premises. When PGW discovers unauthorized use, its policy is to promptly terminate service. Only after service has been illegally restored after this initial termination for unauthorized use would PGW, upon discovery of this second, subsequent occurrence, be authorized to consider relocating the meter. Moreover, the second instance of unauthorized use would have to be discovered within twelve months of the discovery of the initial unauthorized use. TURN et al. believe that the requirement that PGW detect unauthorized use twice at the same premises within a twelve month period adequately ensures against the possibility that a Customer would become initially subject to a Meter Relocation Charge on the basis of a mistaken allegation of unauthorized use.

TURN *et al.* Statement in Support at 5-6.

The Settlement makes service restoration more affordable following termination due to meter tampering, because the customer will not have to pay the costs of relocating the meter from the inside of the property to the outside unless tampering is found twice within a twelve month period. For all of the foregoing reasons I find that the Settlement provisions regarding meter relocation are in the public interest, and I recommend approval.

**Establishing Prior Occupancy**

**Settlement Terms**

When the Applicant is a person who resided at the same premises for which application for service is requested, the Company may require payment of the portion of the outstanding balances which accrued during the time that the Applicant resided at those premises.

The Company may establish that an Applicant previously resided at those premises through the use of any of the following:

Mortgage, Deed or Lease Information

Commercially Available Consumer Credit Reporting Service

Driver’s License or PennDOT Identification Card

Nothing in the Settlement waives the right of the Customer or Applicant to file a complaint with the Commission disputing the PGW determination. Settlement at ¶ 29.

**Analysis**

TURN *et al.* presents the following explanation and reasons why the Settlement provisions are in the public interest:

Paragraph 29 addresses PGW’s proposal to allow the Company greater latitude regarding the documents upon which it may rely in making the initial determination that an Applicant for service previously lived at the address for which service is being requested during the time that an unpaid balance accrued. When such a determination is made, the utility is authorized under Chapter 14 §1407(d) to condition granting the service application upon payment or arrangement to pay for service provided in the name of another person at the service address. In Chapter 14 §1407(e), the Legislature limited those documents to a mortgage, deed, lease, or commercially available consumer credit reporting service information. In that Section, the Legislature also specified that a utility might utilize “other methods approved as valid by the commission.”

PGW initially proposed to amend §2.1.A of its Tariff to include many types of documents: (1) government issued licenses, permits, vehicle registrations; (2) available tax records and bankruptcy petitions; (3) documents electronically archived at PGW which had previously been obtained from customers, applicants and occupants concerning medical certifications, LIHEAP documents; (4) and personal checks. TURN et al. opposed this extensive expansion of permissible documents, because of substantial doubts concerning whether they provided an adequate basis for initially establishing that a particular person actually resided at a particular address at a particular time. All these documents generally were created for other purposes and taken individually, even when an accurate reflection of occupancy at the time of issuance, do not provide information concerning the date when the occupancy may have ended.

Regarding this issue, TURN et al. was concerned that increasing the list of permissible documents substantially increased the risk that Applicants would be wrongly required to assume liability for service provided in the name of another person, not because they really had occupied the account premises during the time that an arrearage accrued, but because they could not afford to go without utility service during the period of time when they were contesting PGW’s requirements through the Commission’s complaint processes.

In the Settlement, PGW agreed that only a Driver’s License or PennDOT Identification Card could be used as the basis for an initial determination of an Applicant’s prior occupancy at the address for which service was being requested. Although TURN et al. does not consider these documents as reliable for the proposed purposes as the ones identified by the Legislature, they appear to be more suitable than any of the other documents proposed by PGW.

TURN *et al.* Statement in Support at 7-8.

The Public Utility Code provides that “a public utility may establish that an applicant previously resided at a property for which residential service is requested through the use of mortgage, deed or lease information, a commercially available consumer credit reporting service or other methods approved as valid by the commission.” 66 Pa.C.S. § 1407(e). To the list of documents specified by statute, the Settlement adds driver’s license or PennDOT Identification Card. The additional documents represent reasonable means of determining whether an applicant for service previously resided at the property. For all of the foregoing reasons I find that the Settlement provisions regarding establishing prior occupancy to be in the public interest and I recommend approval.

**(3) Collection Issues**

**Settlement Terms**

## PGW agrees to waive the collection of a security deposit from a Level 1 income non-CRP Applicant. PGW agrees that an applicant or customer who is no longer eligible for CRP will be offered one additional Payment Arrangement by PGW, regardless of the customer’s or applicant’s prior payment agreement history. Settlement at ¶s 30, 31.

**Analysis**

TURN *et al.* provides the following description and support for the Settlement:

In Paragraphs 30 and 31, PGW agrees to take two steps which further universal service goals for low and lower income customers.

In Paragraph 30, PGW agrees to give up its asserted right to collect security deposits for low income (Level 1) Applicants for service who do not enroll in the PGW’s Customer Responsibility Program (CRP). Because CRP is a Percentage of Income Program (PIP), some low income Applicants with relatively high numbers of household members or relatively low gas usage will not benefit from CAP, and therefore opt to pay the standard rate for residential service, rather than a fixed percentage of income on a monthly basis. These Applicants are nonetheless low income, with little disposable income for payment of a deposit, even when the deposit may be paid in installments. Under Chapter 14 §1404(f), PGW is not allowed to charge a deposit to low income customers who enroll directly into CRP. This agreement extends that deposit exclusion to all Level 1 Applicants, and accordingly works in favor of allowing prompt access to natural gas service to the poorest of Philadelphia’s poor.

In Paragraph 31, PGW agrees to provide one additional Payment Agreement to a former CRP customer who due to an increase in income, or a decrease in household members, has become no longer income eligible for CRP. The problem for such customers has been that when they become ineligible and go off CRP, they may have unforgiven pre-CAP arrearages which come back on their bills. At the same time, because of their pre-CRP payment history, they may have defaulted on more than one Payment Agreement. Under such circumstances, PGW has been authorized under Chapter 14 §§1405(d) and 1407(c)(2)(i) to refuse a payment agreement, and to require payment of the total outstanding balance to continue or restore service. This provision of the Settlement furthers universal service, recognizing that many Level 2 and Level 3 customers are not financially capable promptly of paying off previously frozen pre-CAP arrears.

TURN *et al.* Statement in Support at 8-9.

The Settlement waives collection of a security deposit from Level 1 low income ratepayers who are not enrolled in CRP. The Settlement also requires PGW to enter into one additional payment arrangement with a customer no longer eligible for CRP. These Settlement provisions help make gas service more affordable for low income customers not enrolled in CRP and those customers no longer eligible for CRP. For all of the foregoing reasons, I find that the Settlement provisions regarding collection issues are in the public interest and I recommend approval.

**(4) Competitive Issues**

**Settlement Terms**

## 

## PGW shall convene a collaborative with the purpose of identifying the systems (e.g., EDI) and billing improvements (e.g., utility consolidated billing) it needs to make in order to implement a Purchase of Receivables Program, as well as a time line for implementing the necessary systems and billing changes. The collaborative shall be initiated within 60 days after a Final Commission Order in this proceeding. If a consensus cannot be reached on these matters within 180 days after initiation of the collaborative, or if a consensus cannot be reached on the timing by which PGW will move forward to implement the necessary systems and billing changes, PGW agrees to put the matter(s) to the PUC for resolution, absent an agreement by all collaborative parties to continue with the collaborative process.

## PGW shall make the changes in the imbalance management rules as per the tariff page attached to the Settlement (Exhibit 2).

## Settlement at ¶s 32, 33.

**Analysis**

RESA provides the following support for approval of the Settlement provisions regarding the competitive issues:

## From RESA's perspective, the Settlement is a lawful resolution of competitive issues that is in the public interest because it requires numerous tariff modifications that will serve to facilitate retail gas supply competition in the PGW service territory. These modifications will result in the following improvements to PGW's operational rules:

## A 10% tolerance for daily imbalances, which will not increase costs to PGW or to customers, but will enhance competitiveness by creating a reasonable and attainable performance metric. RESA Statement No. 1, pp. 5-9, 13-14.

* The elimination of the carryover for monthly balances to the next month, which ensures a fair price for cashouts and eases the administrative burden of managing imbalances. RESA Statement No. 1, pp. 13-14.
* A modification to the penalty calculation for monthly imbalances so that suppliers are not penalized for erroneous or modified data resulting in an imbalance that cannot be resolved by the end of the month, which promotes fairness and equity. RESA Statement No. 1-S, pp. 5-9.
* An increase in the number of data points used in the calculation of the monthly cashout for imbalances from two to five, which provides a more equitable price that is more representative of the average market price for the month. RESA Statement No. 1, pp. 9-10, 12, 13-14.

## The Settlement is also in the public interest because it will facilitate the implementation of a Purchase of Receivables (“POR”) program and the necessary infrastructure improvements (e.g., utility consolidated billing and EDI) in the PGW service territory. The Commission has recognized the importance of POR programs to competition with its finding that POR programs are critical to immediately increasing supplier participation, and in turn, effective competition in Pennsylvania’s retail natural gas market. RESA Statement No. 2, p. 4. This point was supported by uncontroverted record evidence that the existence, or non-existence, of a POR program is an extremely important factor that a supplier will consider in deciding whether to offer service in distribution company service territory, especially with respect to

the residential/small commercial customer market. In fact, for some NGSs seeking to serve this market, the availability of a POR program is the single most important factor in determining whether to offer service. RESA Statement No. 2, p. 4. The POR collaborative agreed to as part of the Settlement represents an important step towards implementation of a POR in the PGW service territory.

## RESA Statement in Support at 2-3.

## The Settlement benefits natural gas suppliers by: (1) increasing the tolerance level for imbalances, and (2) imposing reasonable penalties for imbalances that exceed the tolerance level. The Settlement also provides for the convening of a collaborative by PGW for the purpose of identifying the systems (e.g., Electronic Data Interface or EDI) and billing improvements it needs to make in order to implement a Purchase of Receivables program.[[6]](#footnote-6)

For all of the foregoing reasons I find that the Settlement provisions regarding competitive issues are in the public interest and I recommend approval.

ORDER

THEREFORE,

IT IS RECOMMENDED:

1. That the Joint Petition for Settlement filed at Docket Nos. R-2009-2139884 and P-2009-2097639 is approved without modification.

2. That Philadelphia Gas Works shall be permitted to increase annual operating revenues in the total amount of $16 million consistent with the rates, rules and regulations set forth in Exhibit 3 (proposed tariff modifications) and Exhibit 4 (proof of revenues) to the Joint Petition for Settlement.

3. That upon entry of a Commission order approving the Joint Petition for Settlement, Philadelphia Gas Works shall be permitted to file tariff supplements in the form set forth in Exhibit 3 to the Joint Petition for Settlement, to become effective upon one day’s notice.

4. That the statements and exhibits listed in the Stipulation for Admission of Evidence filed on May 13, 2010, are admitted into evidence.

5. That the complaint of the Office of Consumer Advocate at Docket No. C‑2010-2153064 is deemed satisfied.

6. That the complaint of the Office of Small Business Advocate at Docket No. C-2010-2151419 is deemed satisfied.

7. That the complaint of Philadelphia Industrial and Commercial Users Group at Docket No. C-2010-2160512 is deemed satisfied.

8. That the complaint of Tenant Union Representative Network and Action Alliance of Senior Citizens of Greater Philadelphia at Docket No. C-2010-2155856 is deemed satisfied.

9. That the complaint of Philadelphia Housing Authority at Docket No. C‑2010-2160858 is deemed satisfied.

10. That the complaint of Stanton Bubis at Docket No. C-2010-2160918 is deemed satisfied.

11. That the complaint of George W. Craigie at Docket No. C-2010-2160860 is dismissed.

12. That the complaint of Denise Devlin at Docket No. C-2010-2160919 is dismissed.

13. That the complaint of Kathleen Golden at Docket No. C-2010-2169748 is dismissed.

14. That the complaint of Sydella Hodge at Docket No. C-2010-2160924 is dismissed.

15. That the complaint of Floyd M. Jones at Docket No. C-2010-2160929 is dismissed.

16. That the complaint of Linda J. Montgomery at Docket No. C-2010-2160887 is dismissed.

17. That the complaint of Dominic A. Stango at Docket No. C-2010-2167827 is deemed satisfied.

18. That upon acceptance and approval by the Commission of the tariff supplements and proof of revenues filed by Philadelphia Gas Works consistent with this Order, this proceeding shall be marked closed.

Date: June 18, 2010 \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Charles E. Rainey, Jr.

Administrative Law Judge

1. RESA was permitted to participate in this proceeding on the issues it raised in its petition to intervene with the exception of those issues that are the subject of a Commission ordered collaborative process. See my prehearing order dated March 11, 2010. CAC’s Petition to Intervene was granted at the hearing held on May 10, 2010. [↑](#footnote-ref-1)
2. *See*, 52 Pa. Code § 69.406(a) (“Review of full and partial settlements”). [↑](#footnote-ref-2)
3. Because May 29, 2010, was a Saturday, the following day, May 30, a Sunday, and the day after that, Monday, May 31, Memorial Day, a Federal and State holiday, any response filed and submitted by Tuesday, June 1, would have been considered timely. *See*, 52 Pa. Code § 1.12 (“Computation of Time”). [↑](#footnote-ref-3)
4. One might assume that Ms. Montgomery’s mailings to me and the Commission’s Secretary was not picked up by the United States Postal Service until June 1, 2010, since the date on the signature page, May 30, was a Sunday, and the following day, May 31 was Memorial Day, days on which there was no postal service. Commission rules provide in pertinent part that a document will be deemed filed “on the date deposited in the United States Mail as shown by the United States Postal Service stamp on the envelope or noted on a United States Postal Service Form 3817 certificate of mailing.” 52 Pa. Code § 1.11(a)(3). Although I neither have the envelope in which the signature page was mailed nor a Form 3817 certificate of mailing, it will be assumed in this instance that Ms. Montgomery’s signature page was timely filed and submitted. [↑](#footnote-ref-4)
5. *PUC v. PGW*, R-2008-2073938 (Order entered December 19, 2008). [↑](#footnote-ref-5)
6. RESA’s witness provided the following description of a Purchase of Receivables (POR) program and its importance in a competitive environment:

   **Q. Describe what a POR is.**

   A. Under a POR, the Natural Gas Distribution Company (“NGDC”) purchases a Natural Gas Supplier’s (“NGS”) accounts receivable, typically at a discount. The discount may be attributable to uncollectible expense, i.e., bad debt of the NGS’s customers, and the NGDC’s administrative costs for billing and collection.

   **Q. How does a POR program relate [to] the competitive environment?**

   A. The existence, or non-existence of a POR, is critical factor in an NGS decision of whether or not to commit to offering service in an NGDC’s service territory, especially with respect to the residential/small commercial customer market. In fact, for some NGSs seeking to serve a new market, the availability of a POR program is the single most important factor in determining whether to offer service in a particular NGDC service territory.

   RESA St. 2 at 4. [↑](#footnote-ref-6)