

ORIGINAL

**TESTIMONY ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE
REGARDING
HOUSE RESOLUTION NO. 100**

**PRESENTED TO THE
JUDICIARY COMMITTEE
OF THE
HOUSE OF REPRESENTATIVES**

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Date: September 5, 2002

development of a competitive marketplace for retail gas supply that might allow smaller customers more flexibility for assuming gas price risk.

The Committee has also expressed an interest in the Pennsylvania Public Utility Commission's oversight of the Philadelphia Gas Works ("PGW"), the role of the Pennsylvania Public Utility Commission versus the Philadelphia Gas Commission ("PGC") and the Philadelphia Gas Work's compliance with the Public Utility Commission's directives.

As a general matter, PGW has, unfortunately, been in an almost constant state of litigation with the PUC since the summer of 2000. Since that time, PGW has filed for an interim rate increase, an interim purchased gas cost case, an initial base rate case, a petition for extraordinary rate increase, a second base rate case, two more purchased gas cost cases, and now a restructuring case. The sheer volume of PGW cases in just two years has resulted in a tremendous expenditure of resources by the PUC, the OSBA, the Office of Consumer Advocate ("OCA") and all the other parties in an effort to resolve the issues and difficulties of just one utility.

In addition, PGW has been the most arrogant and least responsive of the Pennsylvania natural gas distribution companies in the context of a regulatory proceeding. Consider Chairman Glen Thomas' reference to PGW's extraordinary rate filing as "shrill assertions" in his motion at the public meeting of April 11, 2002. However, the OSBA notes that PGW's new management team is slowly making progress in improving PGW's responsiveness to the questions and concerns of the stakeholders in the regulatory process.

The OSBA does not have any direct experience with the regulatory process of the Philadelphia Gas Commission and, therefore, cannot comment on its regulatory process. However, the OSBA believes that PUC oversight is beneficial to PGW's ratepayers and is vastly superior to the previous regulation by the Philadelphia Gas Commission, particularly for small business

customers. While the OSBA cannot offer any hard evidence on this issue, it appears that the PGC had less power to control PGW's rates than the PUC. PGW has certainly received rate increases in the last two years, but those increases were restrained by the PUC, and PGW has had to work hard to convince the PUC of the need for those increases.

Under the Philadelphia Gas Commission's regulation, PGW's rate structure was extraordinarily biased against small business customers. Changes for the better have occurred under PUC regulation but must continue. First and foremost, the rates for PGW's small business customers are set well in excess of costs. In addition, small business customers pay for PGW's low income and senior discount programs with each Mcf of gas they buy.¹ This is improper. For one thing, all non-gas expense claims, such as those related to the low income and senior discount programs, should be included in base rates. Those costs can then be allocated to the customer classes on whose behalf the costs were incurred. The OSBA will continue to advocate for changes in PGW's rate structure that will bring the rates for small business customers closer to cost.

The PUC's oversight would likely be more effective if PGW were privatized. PGW's responsiveness to both its customers and any regulatory body, whether it is the PGC or the PUC, is hampered by a bureaucratic and politicized decision-making process. To effect any significant change, the CEO of PGW must get approval from the political leadership of the City. PUC regulation is also less effective at controlling costs than it is for privately owned utilities. Because PGW is municipally owned, ratepayers are, for all intents and purposes, the providers of equity. There is no mechanism that encourages efficiency. If PGW spends, the ratepayers must pay. In

¹ The low income and senior discount surcharges do not apply to larger industrial customers because they are eligible for interruptible gas service that does not include this surcharge.

addition, the PUC has stated that it has no statutory authority to require the City of Philadelphia to provide equity. See Extraordinary Rate Case Opinion and Order, at 4, Docket R-00017034.

Overall, PGW's compliance with PUC Orders has been adequate, if begrudging, compared with other Pennsylvania NGDC's. Ultimately PGW will comply with any PUC Order, but, generally, not without a fight.

Finally, it appears that the key to limiting PGW's future need for more rate increases is the resolution of PGW's debt service problem. Until PGW can make progress buying down its debt, it will apparently always be held hostage to the debt rating agencies. The solution to this problem will require effective internal cost controls by PGW, keen oversight by the PUC to insure that debt reduction targets are met, and probably greater assistance from the City.

SUMMARY

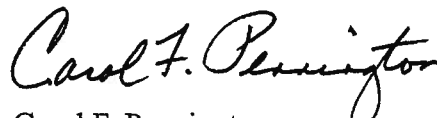
1. The price fluctuations facing Pennsylvania gas consumers reflect the wellhead price of natural gas which is set by continent-wide supply and demand which are beyond the control of the Pennsylvania Legislature.
2. Gas price fluctuations can be controlled to a significant degree through a variety of contractual and financial hedges, which are commonly used by Pennsylvania's natural gas distribution companies to achieve balanced gas portfolios with a manageable degree of risk.
3. The OSBA supports the development of a competitive marketplace for retail gas supply that would allow smaller customers more flexibility for assuming gas price risk.
4. PGW has participated in a significant number of contested rate proceedings before the PUC since the summer of 2000. This has resulted in a

tremendous expenditure of resources by the PUC, the OCA, the OSBA and other parties.

5. Nevertheless, the PUC's oversight of PGW is beneficial to PGW's customers and is superior to its past regulation by the Philadelphia Gas Commission.
6. The cost of PGW's residential low income and senior discount programs are improperly included in the cost of gas. The cost of these programs and all other non-gas expenses should be included in base rates. Costs can then be allocated to the rate classes on whose behalf the expenses were incurred. The OSBA will continue to advocate for rates for small business customers, which are closer to cost.
7. The PUC's oversight of PGW would improve if PGW were privatized.
8. PGW's need for rate increases is driven by its debt service problems. Resolution of this problem will require effective internal cost controls and continuing oversight by the PUC.

Thank you for giving the Office of Small Business Advocate the opportunity to present testimony.

Respectfully submitted,



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