

**PECO ENERGY COMPANY  
STATEMENT NO. 8**

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PECO ENERGY COMPANY – ELECTRIC DIVISION

DOCKET NO. R-2010-2161575

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DIRECT TESTIMONY

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WITNESS: HOWARD S. GORMAN

SUBJECT: CLASS COST-OF-SERVICE STUDY

DATED: MARCH 31, 2010

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1 4. Q. **Have you previously testified before this Commission?**

2 A. Yes, my prior testimony, including testimony before the Commission, is listed  
3 in Attachment B.

4 5. Q. **What was the source of the information that you used in performing this  
5 engagement?**

6 A. All of the information about PECO's operations was provided by PECO, and I  
7 relied on the genuineness and completeness of all information presented to me  
8 by PECO. Costs and other data were provided by PECO for the Future Test  
9 Year (the year ending December 31, 2010), as described in the testimony of  
10 Mr. O'Brien in PECO Statement No. 3. These data included forecasted costs  
11 of service, forecasted delivery volumes, forecasted customer information and  
12 forecasted revenues. Other operating and plant information was supplied by  
13 PECO for the purpose of cost classification and the development of direct-cost  
14 assignments and allocation factors that are required to perform the cost-  
15 allocation study. The budget was prepared by PECO.

16 6. Q. **How is your testimony organized?**

17 A. This Section I is the Introduction and sets forth the purpose of my testimony.  
18 In Section II, I provide background information and identify the exhibits that I  
19 am sponsoring. In Section III, I discuss the COS study methodology. In  
20 Section IV, I discuss the development of the revenue requirement for each rate  
21 class. In Section V, I present the results of the COS and discuss the contents

1 of the exhibits.

2 **II. BACKGROUND INFORMATION**

3 **7. Q. Please state PECO's distribution revenue requirement for the future test**  
4 **year.**

5 A. The Future Test Year distribution revenue requirement, which excludes  
6 commodity revenue, is \$1,425 million and \$4,872 million including  
7 commodity revenue.

8 **8. Q. What future test year revenues and costs are included in the PECO cost-**  
9 **of-service study?**

10 A. The PECO COS study reflects all revenues and costs included in the revenue  
11 requirement developed by Mr. O'Brien in PECO Statement No. 3 with those  
12 in the PECO COS study.

13 **9. Q. Please identify the exhibits that are included with your testimony.**

14 A. The following exhibits are included with my testimony. They are discussed in  
15 detail in Section 4 of my testimony.

Exhibit HSG-1	Summary of Results
Exhibit HSG-1A	Total Class Allocation - Revenue Requirement By Rate Class
Exhibit HSG-1B	Revenue Requirement By Functional Classification
Exhibit HSG-1C	Unitized functionally classified revenue requirement

Exhibit HSG-1D	Customer-related revenue requirement and customer charge
Exhibit HSG-1E	Meter-related revenue requirements
Exhibit HSG-2	Functionalization
Exhibit HSG-3	Classifications
Exhibit HSG-4A through Exhibit HSG-4G	Class Allocations
Exhibit HSG-5A	Allocator Values – Functionalization
Exhibit HSG-5B	Allocator Values – Classification
Exhibit HSG-5C	Allocator Values – Class Allocation
Exhibit HSG-5D	Assignment or Allocator Used for Each Account
Exhibit HSG-5E	Labor Report
Exhibit HSG-6	Development of External Allocator Values

1

2 **10. Q. Please summarize the results of your work as they apply to the changes to**  
3 **the tariff proposed by PECO in this filing.**

4 A. I have reached the following results and conclusions based on my work:

- 5 1. The current tariff rates result in the rate class net income as shown in  
6 Exhibit HSG-1, line 9, and the returns on rate base as shown on line 13.
- 7 2. PECO’s total distribution revenue requirement for the Future Test Year  
8 has been assigned among the rate classes on a cost-causation basis as  
9 shown on Exhibit HSG-1, line 22, with amounts shown separately for  
10 Distribution charges, Transmission charges, Purchased power, Forfeited  
11 discounts and Other revenue on lines 17-21.
- 12 3. The increases or (decreases) in rate class revenue needed to produce a  
13 return equal to the Company’s proposed overall return are shown in  
14 Exhibit HSG-1, line 32. The increases or (decreases) in Distribution

1 revenue are on line 33 and the increases or (decreases) in Transmission  
2 revenue are on line 35.

3 **III. PECO CLASS COST-OF-SERVICE STUDY**

4 **11. Q. Please briefly describe the purpose in performing a class COS study.**

5 A. The purpose of a fully allocated class cost-of-service study is to determine the  
6 revenue requirement for each rate class served by the utility. The revenue  
7 requirement for a rate class is that portion of the total cost-of-service incurred  
8 by the utility, in this case PECO, can be attributed to that rate class on a cost-  
9 causality basis. In a cost-of-service study, all of the utility's costs of providing  
10 service must be analyzed and assigned or allocated among the rate classes, so  
11 that the utility can establish rates that ensure, subject to assumptions such as  
12 delivery volumes and customer counts, that it recovers its costs in full.

13 **12. Q. What are the guiding principles in performing a class COS study?**

14 A. The essential element in performing a COS study is the selection of allocators  
15 based on causal relationships between customer demands, load profiles and  
16 usage characteristics on one hand and the costs incurred by the Company to  
17 meet those requirements on the other hand. The primary goals in selecting  
18 allocators are:

- 19 1. recognition of **cost causality** as opposed to **value of service**;
- 20 2. **stability** of results over time;
- 21 3. logical **consistency** and **completeness**; and

1 4. ease of implementation.

2 **13. Q. What rate classes are included in the PECO COS study?**

3 A. The rate classes included in the PECO COS study are Residential (rate R),  
4 Residential Heating (rate RH), Residential Off-Peak (rate OP), General  
5 Service (rate GS), Primary Distribution (rate PD), High Tension (rate HT),  
6 Electric Propulsion (rate EP) and Lighting (rates SLS, POL, SLE, AL, TL).

7 In the COS study, all of the lighting classes in PECO's current tariff are  
8 combined into Lighting, because their cost and usage characteristics are very  
9 similar to each other. These classes are Private Outdoor Lighting (POL),  
10 Street Lighting- Philadelphia (SL-P), Street Lighting- Suburban (SL-S), Street  
11 Lighting- Customer-owned (SL-E), Traffic Lighting (TL) and Alley Lighting  
12 (AL). In addition, the Company's new TL Constant Load Device subclass,  
13 which is discussed by Mr. Cohn in PECO Statement No. 9, is included in  
14 Lighting.

15 The current CAP Residential (CAP-R) rate class is included in Residential,  
16 because cost and usage characteristics are the same and CAP-R rates are  
17 designed with reference to Residential rates. Similarly, the current CAP  
18 Residential Heating (CAP-RH) rate class is included in Residential Heating.

19 The following tariff rates have been, or will be, discontinued and are not  
20 represented in the COS study - Residential Time-of-Use, Renewable Energy  
21 and Residential Real-Time Pricing. Net Metering customers are included in  
22 R, RH and GS, as applicable.

1 **14. Q. Please summarize the approach you followed in the PECO COS study.**

2 A. The most critical task in performing any COS study is establishing  
3 relationships between customer demands, load profiles and usage  
4 characteristics on one hand, and the costs incurred to meet those requirements  
5 on the other hand. This requires an understanding of the utility system design  
6 and its relationship to the characteristics of the customers it is designed to  
7 serve.

8 PECO, like most utilities, designs its electric distribution system to meet three  
9 primary objectives:

- 10 1. To extend distribution services to all customers;
- 11 2. To deliver the aggregate peak demand for electricity of all firm  
12 delivery customers, and
- 13 3. To deliver electricity to customers throughout the year.

14 It is important that the allocation methods used within a cost-of-service study  
15 recognize these *cost-causative* characteristics of the utility's plant investments  
16 and operating expenses. A cost-of-service study should objectively reflect  
17 cost-causation factors attributable to the utility's customers, their peak  
18 demands, and system operations, and, to the extent possible, should not be  
19 influenced by desired end-results, customer equity or other *rate design*  
20 considerations.

21 The PECO COS study I am presenting was performed using the Black & Veatch  
22 proprietary Electric Cost of Service Model ("Model"), a Microsoft Excel based

1 computer model. The Model is a tool that facilitates the preparation of the COS  
2 study, speeds up computations and helps create documentation. The Model uses a  
3 three-step process to allocate costs: 1) *functionalization* of rate base and costs  
4 among the following functions - Supply, Transmission, Primary Distribution High  
5 Tension (HT), Primary Distribution, Secondary Distribution and Billing  
6 (including metering and customer accounts); 2) *classification* of functionalized  
7 costs into demand-related, commodity-related and customer-related cost  
8 categories; and 3) *class allocation* of the functionalized, classified costs among  
9 the rate classes. The Model provides functionalized, classified cost information  
10 by rate class, develops unbundled revenue requirements by functional  
11 classification and in total for each rate class, and calculates unit costs.

12 **15. Q. Please describe the functions included in the COS study.**

13 A. The COS study includes the following functions:

14 Supply- Purchased Power and related costs incurred by the Company, which  
15 are recovered under its charges for Default Service.

16 Transmission- The Company's bulk transmission system, designed to move  
17 power from generation sources to the primary distribution system, operating at  
18 voltages of 69 kV and up.

19 Primary Distribution High Tension- Designed to move power from the  
20 transmission system to the Primary Distribution system, includes substations  
21 as well as conductors operating primarily at voltages of 13 kV up to and  
22 including 34 kV, and related assets.

1 Primary Distribution- Designed to move power from the Primary HT system  
2 to the Primary Distribution system, includes conductors operating at voltages  
3 of 2.4 kV up to and including 4 kV, and related assets.\_

4 Secondary Distribution- Designed to move power from the Primary  
5 Distribution system to customers' premises; includes services.\_

6 Billing- Includes meter as well as assets and activities related to enabling the  
7 distribution of electricity to customers, and billing and collecting revenue.\_

8 16. Q. **Please describe the classification step of a cost-of-service study.**

9 A. In the **classification** step, the previously functionalized assets and costs are  
10 separated according to the system design or operating characteristics that  
11 cause those costs to be incurred in the first instance. Each asset and cost is  
12 determined to be incurred to serve **customers**, to deliver the electricity or  
13 **commodity** year-round or to meet peak **demand** including coincident and  
14 non-coincident peaks.

15 **Customer** related costs are the costs incurred to attach a customer to the  
16 distribution system, to meter usage and to maintain the customer's account.

17 Customer costs are a function of the number of customers served and continue  
18 to be incurred whether or not the particular customer uses any electricity.

19 They include capital costs associated with services and meters, and operating  
20 costs such as customer service, field service, billing and accounting expenses.

21 **Commodity** related costs are those costs that vary with the quantity of  
22 electricity delivered throughput sold to, or transported for, customers. These

1 costs include commodity costs and related costs.

2 **Demand, or capacity,** related costs are associated with plant that is designed,  
3 installed and operated to meet peak usage. Transmission assets are designed  
4 to meet the *system peak* and are allocated among the rate classes based upon  
5 their contributions to the *system peak*. Distribution assets are designed to  
6 meet the peak loads of the customers they serve and are allocated among the  
7 rate classes based upon their respective *class non-coincident peaks* (“NCPs”).

8 17. **Q. Do all expenses fit neatly into one of these three classifications?**

9 A. Many costs do fit neatly into one of the three classifications, but some costs  
10 must be assigned between two classifications based upon special studies, or  
11 based upon how related costs have been classified.

12 18. **Q. Please describe the class allocation step of a cost-of-service study.**

13 A. In the **class allocation** step, the functionalized, classified costs are allocated  
14 among the rate classes, based on causal relationships with the utility’s system  
15 design and operations, its accounting records and its system and customer  
16 usage and load data. Based on those analyses of cost relationships, each plant  
17 and cost item in the rate base and revenue requirement is directly assigned to a  
18 rate class, or an allocator is selected to apportion the item.

19 19. **Q. Please explain the term “direct assignment.”**

20 A. The term “direct assignment” means identifying plant investments or costs

1 incurred exclusively to serve a specific customer or group of customers.

2 Direct assignments best reflect the cost-causation of serving individual  
3 customers or groups of customers, and should be used whenever the data are  
4 available.

5 **20. Q. Is a large portion of the assets and costs typically directly assigned in a**  
6 **cost-of-service study?**

7 A. No, most costs must be allocated. Utility operations are characterized by  
8 common facilities. In addition, direct assignments require detailed  
9 information which may be unavailable or may require a great deal of time to  
10 prepare. For those assets and costs that cannot be directly assigned, allocation  
11 factors are used to distribute them among the rate classes.

12 **21. Q. Please explain how allocators are derived.**

13 A. There are two types of allocators that are typically used in performing a cost-  
14 of-service study and employed in the Model: external allocators and internal  
15 allocators. *External allocators* are based on special studies derived from data  
16 in the utility's accounting and other records. Examples of external allocators  
17 are kWh deliveries, number of customers and class NCPs (*i.e.*, Non-  
18 Coincident Peaks, the peak electricity demand of each rate class, not  
19 necessarily coincident with the system peak or with each other). Exhibit  
20 HSG-6 shows the development of the main external allocators, based on data  
21 provided by PECO.

1           *Internal allocators* are based on some combination of external allocators,  
2           previously directly assigned costs and other internal allocators. For example,  
3           the allocator for property insurance costs is based on plant investment  
4           amounts assigned to components of the rate base; it is necessary to compute  
5           the rate base before property insurance costs can be allocated. Both external  
6           and internal allocators are used in functionalization, classification and class  
7           allocation.

8 22.   **Q.   What is the rate base and how does it affect the PECO cost-of-service**  
9           **study?**

10       A.   The rate base is the cost, net of accumulated depreciation, of PECO's  
11       investment in plant and other assets used to serve customers. The revenue  
12       requirement includes a return on the rate base at the rate proposed by Mr.  
13       Moul in PECO Statement No. 5.

14 23.   **Q.   What are the major components of PECO's rate base?**

15       A.   For purposes of discussing how I functionalized, classified and allocated the  
16       rate base in the PECO COS study, I will refer to the following groupings of  
17       rate base items. After presenting the list, I will describe how I treated each of  
18       these major rate base categories:

- 19       •   Intangible plant
- 20       •   Distribution plant
- 21       •   General plant

1           • Depreciation reserve

2           • Other rate base items

3 **24. Q. What is the total rate base?**

4           A. As reflected in Exhibit RLO-1, the total rate base is \$3.242 billion.

5 **25. Q. How did you functionalize, classify and allocate among the rate classes**  
6 **each component of the rate base?**

7           A. The principal allocators for each component of the rate base are:

8           *Intangible plant* represents the costs of Franchises and Consents and Other  
9           Intangible Assets. It was functionalized, classified and allocated in proportion  
10          to Distribution Rate base (*i.e.*, excluding Supply and Transmission functions).

11          *Distribution plant* comprises:

12           Land and Land Rights, Stations and Structures and Improvements were  
13           functionalized to Primary HT Distribution, classified as demand and  
14           allocated among the rate classes based on their respective class NCPs at  
15           the Primary HT level.

16           Poles, Towers and Fixtures; Overhead Conductors and Devices;  
17           Underground Conduit; Underground Conductors & Devices were  
18           functionalized between Primary HT Distribution / Primary Distribution on  
19           one hand, and Secondary Distribution on the other hand, based on a study  
20           provided by PECO of the respective costs (Exhibit HSG 6, p. 11) . The  
21           Primary HT / Primary portion was split between Primary HT and Primary

1 based on a study provided by PECO of the respective circuit miles  
2 (Exhibit HSG 6, p. 12). Costs identified to Primary HT and Primary were  
3 classified as demand-related and allocated among the rate classes based on  
4 their respective NCPs at the Primary HT and Primary voltage levels,  
5 respectively (Exhibit HSG 6, p. 21). Costs identified to Secondary  
6 Distribution were classified as customer-related and allocated based on the  
7 number of customer locations served.

8 Line Transformers were functionalized to Secondary Distribution and  
9 allocated among the rate classes based on NCPs at Secondary voltage  
10 (Exhibit HSG 6, p. 21).

11 Services connect individual customers to the system, and were  
12 functionalized to Secondary Distribution, classified as customer related  
13 and allocated based on the estimated total replacement cost for each rate  
14 class (Exhibit HSG 6, p. 13). Total replacement cost of Services for a rate  
15 class was estimated by multiplying: X) estimated replacement cost of a  
16 service for the class by Y) number of customer locations in the class.

17 Meters were functionalized to Billing, classified as customer related and  
18 allocated based on the estimated total replacement cost for each rate class.  
19 PECO uses meters provided by a third party for approximately 60% of  
20 Residential, Residential Heat, Off-Peak and General Service customers;  
21 for these rate classes the meter replacement cost used was the installed  
22 cost to PECO (Exhibit HSG 6, p. 14).

23 Street Lighting and Signal Systems were functionalized to Secondary

1 Distribution, classified as customer-related and directly assigned to  
2 Lighting.

3 **General plant** includes primarily Structures and improvements (relating to  
4 administrative activities), Tools, and Communications equipment, as well as other  
5 assets. These assets were functionalized, classified and allocated among rate  
6 classes based on direct labor content of operating expenses, reflecting the nature  
7 of the assets and common cost-of-service practice.

8 **Depreciation reserve** was provided by PECO detailed for each asset account; each  
9 component of the Depreciation reserve was functionalized, classified and  
10 allocated among rate classes in the same ratio as the related assets.

11 **Other Rate Base Items** includes primarily Materials and supplies, Accumulated  
12 deferred income taxes, Customer deposits, Common plant, Customer advances for  
13 construction, and Working capital, which are discussed below.

14 Materials and supplies was functionalized, classified and allocated among  
15 rate classes in proportion to plant in service.

16 Accumulated deferred income taxes was functionalized, classified and  
17 allocated among rate classes in proportion to plant in service.

18 Customer Deposits were directly assigned to rate classes based on  
19 information provided by PECO (Exhibit HSG 6, p. 15).

20 Common plant contains assets similar to those customarily found in  
21 General Plant, and was also functionalized, classified and allocated among  
22 rate classes based on direct labor content of operating expenses.

23 Customer Advances were functionalized to Secondary Distribution,

1 classified as customer-related and allocated among the rate classes based  
2 on Secondary Distribution assets.  
3 Working capital represents PECO's need for cash to keep the business  
4 running until revenues are collected to pay costs. Working capital was  
5 directly assigned to supply and transmission based on Mr. O'Brien's Lead  
6 Lag Study in PECO Statement No. 3.; these amounts were allocated based  
7 on Purchased power costs and contribution to system peak (1 CP)  
8 respectively The balance of Working capital was functionalized, classified  
9 and allocated among rate classes in proportion to operating expenses.

10 **26. Q. What are the major categories of PECO's costs?**

11 A. The major cost categories in PECO's cost-of-service are:

- 12 • Distribution operating and maintenance expenses
- 13 • Customer accounts and service expenses
- 14 • Administrative and general expenses
- 15 • Depreciation expense
- 16 • Tax expense, other than on income
- 17 • Income tax expense

18 **27. Q. In determining how to treat these expenses in the cost-of-service study,**  
19 **was there any other important category of costs that you considered?**

20 A. Yes, labor costs affect most of the cost categories because many costs are  
21 assigned based on the direct labor content of other costs. For example,

1 Administrative & General Salaries, Account 920, is allocated among rate  
2 classes based on the direct labor content of operating expense accounts. To  
3 enable these allocations to be performed, the direct labor content of each cost  
4 account was obtained from PECO, and appropriate allocators were developed.

5 **28. Q. What costs are included in PECO's Distribution operating and**  
6 **maintenance expenses and how were these costs, functionalized,**  
7 **classified and allocated among the rate classes?**

8 A. PECO's Distribution operating and maintenance costs includes operating and  
9 maintenance costs for its distribution system including stations; poles, towers  
10 and fixtures; overhead and underground conductors and related equipment;  
11 meters; line transformers; lighting; and other assets. The cost-of-service study  
12 also includes costs of Purchased power that are recovered through charges for  
13 Default Service. Each cost was analyzed to determine which assets it was  
14 incurred to operate or maintain, and the cost was functionalized, classified and  
15 allocated among rate classes in the same manner as those assets.

16 In addition to the costs of operating and maintaining PECO's distribution  
17 system, distribution costs includes:

18 Customer-installation expenses - Field investigations and high bill  
19 complaints and potential and actual energy theft; allocated based on  
20 number of customers.

21 Miscellaneous distribution expenses and Rents - Information technology

1 and other costs for all Distribution assets; functionalized, classified and  
2 allocated among rate classes in proportion to total distribution asset costs.

3 **29. Q. What costs were included in PECO's customer accounts and service**  
4 **expenses and how were these costs functionalized, classified and**  
5 **allocated among the rate classes?**

6 A. Customer-accounts costs includes primarily meter-reading expenses, customer  
7 records and collection expenses, uncollectible-accounts expense,  
8 miscellaneous customer accounts expense and customer-assistance expense.  
9 These costs were functionalized to Billing and classified as customer-related.

10 Meter reading expenses were allocated among rate classes based on the  
11 monthly costs of reading meters; for meters provided by the third party, this  
12 amount is the monthly meter read charge (Exhibit HSG 6, p. 14).

13 Customer records and collection expenses includes activities for billing, call  
14 center, payment processing, recoveries, support for CAP rates and  
15 terminations and restorations. The account was analyzed in detail to identify  
16 different activities and each activity was allocated among the rate classes  
17 using an appropriate allocation basis (Exhibit HSG 6, p. 16). For example, the  
18 cost of billing activities was allocated based on customer counts, and call  
19 center costs were allocated based on a study of the nature of calls.

20 Uncollectible accounts expense, or bad debts expense, was allocated among  
21 rate classes based on the Company's experience over the five-years 2005-2009  
22 (Exhibit HSG 6, p. 19).

1 Miscellaneous customer accounts expense includes the usage fee for third  
2 party meters, which was allocated based on actual costs; automated voice  
3 response system costs, which was allocated based on a study of the nature of  
4 calls; and other customer related costs, which were allocated based on number  
5 of customers (Exhibit HSG 6, p. 17).

6 Customer Assistance expense comprises costs for the LIURP program,  
7 marketing and conservation. The account was analyzed in detail to identify  
8 different activities and each activity was allocated among the rate classes  
9 using an appropriate allocation basis (Exhibit HSG 6, p. 18).

10 **30. Q. How were administrative and general expenses functionalized, classified**  
11 **and allocated among rate classes?**

12 A. Administrative and general (“A&G”) expenses include administrative and  
13 general salaries, office supplies and expenses, outside services, property  
14 insurance costs, injuries and damages, employee benefits, regulatory  
15 commission expenses, general advertising expenses, miscellaneous general  
16 expenses, maintenance of general plant and rents.

17 Except for items discussed immediately below, A&G costs are related to labor  
18 costs and therefore were functionalized, classified and allocated among rate  
19 classes in the same ratio as direct labor content.

20 Property insurance costs were functionalized, classified and allocated among  
21 rate classes in the same ratio as plant in service.

22 Regulatory commission expenses were functionalized to Billing, classified as

1 customer-related and allocated among rate classes in proportion to revenue.

2 General advertising expenses and Miscellaneous general expenses were  
3 functionalized, classified and allocated among rate classes in the same ratio as  
4 Distribution rate base.

5 **31. Q. How was depreciation expense functionalized, classified and allocated**  
6 **among the rate classes?**

7 A. Depreciation expense was provided by PECO detailed for each asset account;  
8 each component of the Depreciation reserve was functionalized, classified and  
9 allocated among rate classes in the same ratio as the related assets.

10 **32. Q. How were taxes other than gross receipts tax and income taxes**  
11 **functionalized, classified, and allocated among the rate classes?**

12 A. Taxes other than gross receipts tax and income taxes includes PURTA, capital  
13 stock tax, payroll-related taxes, local use taxes and real estate taxes. Payroll-  
14 related taxes were functionalized, classified and allocated among rate classes  
15 based on direct labor content; capital stock based on Distribution rate base;  
16 PURTA and real estate taxes based on Distribution plant; and local use taxes  
17 based on operating expenses.

18 **33. Q. How was gross receipts tax functionalized, classified, and allocated**  
19 **among the rate classes?**

20 A. Gross receipts tax is based on transmission and distribution revenue,  
21 purchased power revenue and forfeited discounts (i.e., late payment charges),

1 and was computed for each function, classification and rate class on that basis.

2 34. Q. **How was income tax expense functionalized, classified and allocated**  
3 **among rate classes?**

4 A. Income tax expense, which is computed based on revenue at present rates, was  
5 functionalized, classified and allocated among rate classes in proportion to the  
6 pre-tax income at present rates.

7 35. Q. **How was revenue at present rates computed for each rate class?**

8 A. Distribution revenue at present rates is shown on the proof of revenue at  
9 Exhibit HSG 6, pages 4-9 (distribution charges) and page 10 (transmission  
10 charges). The total was functionalized and classified based on pro forma  
11 revenue requirements, and was allocated among the rate classes based on the  
12 budgeted revenue as shown in the proof of revenue. Distribution revenue at  
13 present rates for each rate class is shown on Exhibit HSG-1, line 1.

14 Supply charge revenue was functionalized to Supply and allocated among the  
15 rate classes based on MWh of generation. For each rate class and in total,  
16 Supply charge revenue was equal to Supply cost-of-service except for very  
17 minor differences.

18 Transmission charge revenue was functionalized to Transmission and  
19 allocated among the rate classes based on budgeted transmission revenue as  
20 shown in the proof of revenue.

21 Finance charge revenue was functionalized to Billing and allocated based on

1 historical experience for write-offs.

2 Rent for Electric Property represents pole rental revenue and was  
3 functionalized, classified and allocated in the same ratio as Poles, Towers and  
4 Fixtures.

5 Decommissioning Payments, which is a negative revenue amount in the  
6 Future Test Year, represents PECO's transfer to Exelon Generation pursuant  
7 to a restructuring agreement and a Commission Secretarial Letter, amounts  
8 that it collects from customers for nuclear decommissioning expense. This  
9 amount was allocated among the rate classes in the same ratio as the revenue  
10 had been collected, that is, 1 CP- Transmission.

11 Other Electric Revenue was allocated among the rate classes based on MWh  
12 at the meter.

13 **IV. DEVELOPMENT OF RATE CLASS REVENUE REQUIREMENT**

14 **36. Q. How did you develop the revenue requirements for each class?**

15 A. The revenue requirements for each rate class are computed in the same  
16 manner as that used by Company witness Mr. O'Brien in PECO Statement  
17 No. 3 to compute the overall revenue requirement for 2010. The revenue  
18 requirements for each rate class are the sum of its allocated operating  
19 expenses, depreciation expense, general taxes, return on rate base and income  
20 tax expense. Return on rate base for each rate class was computed by  
21 multiplying the rate class' rate base by the proposed system average rate of  
22 return. Income taxes included in the revenue requirement for each rate class were

1            computed directly by grossing up the required return on rate base for the class at the  
2            income tax rate related to the overall revenue requirement. Exhibit HSG-1, line 22  
3            and Exhibit HSG-1A, line 209, both show the total rate class revenue  
4            requirements based on fully allocated distribution cost-of-service at the  
5            proposed system rate of return; Exhibit HSG-1, line 17 shows the portion of  
6            the total proposed by PECO to be collected in distribution rates.

7 **37. Q. How did you determine the increase or decrease in revenue needed for**  
8 **each class to produce the system average rate of return?**

9            A. The increase or decrease needed for each rate class is computed by comparing  
10           the revenue requirements for each rate class to the revenue that is forecast at  
11           present rates for that class. This is the same method used by Mr. O'Brien in  
12           PECO Statement No. 3 with respect to the overall revenue requirement and  
13           revenue deficiency. The increases or (decreases) in rate class revenue needed  
14           to produce a return equal to the Company's proposed overall return are shown  
15           in Exhibit HSG-1, line 32 (total increase is \$316,359,000). The increases or  
16           (decreases) in Distribution revenue are on line 33 (total increase is  
17           \$288,365,000) and the increases or (decreases) in Transmission revenue are on  
18           line 35 (total increase is \$26,681,000). In addition, Forfeited discounts are  
19           expected to increase by \$1,313,000 as a result of the increase in rates.

1           **V.       RESULTS OF THE PECO COST-OF-SERVICE STUDY**

2 **38.   Q.    Please describe the information on Exhibit HSG-1.**

3           A.   Exhibit HSG-1 compares the revenue at current rates provided by each rate  
4               class to the revenue requirement allocated on a cost-of-service basis.

5               Net income at present rates is shown on line 9. It is computed by subtracting  
6               operating expenses (line 6) and income tax expense (line 8) from revenue at  
7               present rates (line 5). The return on rate base at present rates for each rate  
8               class is shown on line 13, and the relative returns are shown on line 14.

9               Line 22 shows each rate class' revenue requirement (including revenue from  
10              Distribution charges, Transmission charges, Purchased power, Forfeited  
11              discounts and Other revenue) at the proposed rate of return. Line 24 shows  
12              the operating expenses, line 25 shows uncollectibles expense, line 26 is gross  
13              receipts tax and line 28 is income tax expense; lines 24-26 are based on the  
14              revenue requirement. Line 29 shows Net income at the revenue requirement  
15              assuming each rate class pays it full cost-of-service, and line 30 shows rate of  
16              return on rate base for each rate class.

17             Line 32 shows the increase (decrease) in revenue indicated for each rate class;  
18             it is the difference between the revenue requirement at full cost-of-service  
19             (line 22) and present revenue (line 5). Line 33 shows the increase (decrease)  
20             in distribution charges for each rate class; it is the difference between required  
21             revenue from distribution charges (line 17) and present revenue (line 1). Line

1 35 shows the increase (decrease) in transmission charges for each rate class; it  
2 is the difference between required revenue from transmission charges (line 18)  
3 and present revenue (line 2).

4 **39. Q. Please describe the information on Exhibits HSG-1A through 1F.**

5 A. Exhibit HSG-1A summarizes the allocation results on Exhibits HSG-4A  
6 through 4G. Exhibit HSG-1A shows the allocation of each element of rate  
7 base (lines 1-68, operating expenses (lines 69-120), depreciation expense  
8 (lines 121-137) and taxes (lines 138-157) among the rate classes. Total  
9 expenses are on line 158. The exhibit then shows revenues at present rates  
10 (lines 160-169) and Net income at present rates (line 172).

11 A summary of net income at present rates is on lines 174-168, the rate base is  
12 on line 190 and the return on rate base at present rates is on line 191.

13 Class revenue requirements are developed on lines 193-209, revenue at  
14 present rates is on line 211 and the excess or (deficiency) is on line 212.

15 Exhibit HSG-1B summarizes the results of the Class Allocations on Exhibits  
16 HSG-4A through 4G by functional classification. Exhibit HSG-1C presents  
17 the functionally classified revenue requirement on a unitized basis.

18 Exhibit HSG-1D presents unitized customer-related revenue requirement for  
19 each rate class (line 32), and those items typically included in the customer  
20 charge in Pennsylvania (shaded lines, summarized on line 32). Exhibit HSG-  
21 1E develops the unitized Meter-related revenue requirement for each rate

1 class.

2 **40. Q. Please describe the information on Exhibits HSG-2.**

3 A. Exhibit HSG-2 shows how each element of the revenue requirement has been  
4 allocated among the functions. The exhibit shows the allocator selected for  
5 each element, and the result of the allocation. The line captions are the same  
6 as in Exhibit HSG-1A.

7 **41. Q. Please describe the information on Exhibit HSG-3.**

8 A. Exhibit HSG-3 shows how each element of the Secondary Distribution  
9 functional revenue requirement was classified as demand-related or customer-  
10 related. The exhibit shows the allocator selected for each element, and the  
11 result of the allocation. The line captions are the same as in Exhibit HSG-1A.  
12 Items functionalized to Supply are classified 100% commodity, items  
13 functionalized to Transmission, Primary HT and Primary are classified 100%  
14 demand and items functionalized to Billing are classified 100% customer,  
15 therefore there is no need to show the classification of these functions.

16 **42. Q. Please describe the information on Exhibits HSG-4A through HSG-4G.**

17 A. Exhibits HSG-4A through HSG-4G shows how each element of each  
18 functionally classified revenue requirement is allocated among the rate classes.  
19 Each shows the allocator selected for each element, and the result of the  
20 allocation. The line captions are the same as in Exhibit HSG-1A.

1 43. Q. Please describe the information on Exhibits HSG-5A through HSG-5E.

2 A. Exhibit HSG-5A shows the values for functional assignment and allocation of  
3 each element of the revenue requirement. Exhibit HSG-5B shows the values  
4 for classification of the Secondary Distribution components. Exhibit HSG-5C  
5 shows the values for assignment and allocation of functionally classified  
6 components of the revenue requirement among the rate classes.

7 Exhibit HSG-5D shows the allocator used for each account, at each step:  
8 functionalization; classification; and allocation among rate classes.

9 Classification is shown only for Secondary Distribution, as all other functions  
10 are 100% classified to commodity, demand or customer.

11 Exhibit HSG-5E presents the Labor cost report. The Labor percentages shown  
12 on the exhibit are applied to the functionally classified account balances on  
13 Exhibits HSG-4A through HSG-4G and the resulting Labor allocators are  
14 shown on Exhibits HSG-5A, HSG-5B and HSG-5C.

15 44. Q. Please explain how the unit-cost results presented in Exhibit HSG-1C  
16 were prepared.

17 A. The Electric COS Model calculates the revenue requirement for each  
18 functional classification, as shown on line 209 of Exhibits HSG 4A-4G  
19 (Supply Commodity, Transmission Demand, Primary HT Distribution  
20 Demand, Primary Distribution Demand, Secondary Distribution Demand,  
21 Secondary Distribution Customer and Billing Customer). The functionally

1 classified revenue requirements are unitized by dividing the totals by the  
2 appropriate billing units, as shown on the exhibit.

3 **45. Q. Which costs were considered in developing the proposed customer**  
4 **charges?**

5 A. The proposed customer charges are based on the specific customer-classified  
6 costs in the PECO COS study which are typically considered in Pennsylvania.  
7 Customer related costs include all costs incurred to attach a customer to the  
8 distribution system, to meter usage and to maintain the customer's account.  
9 They include capital costs associated with services and meters, and operating  
10 costs such as operation and maintenance of these assets, metering and billing  
11 and customer service and account expenses. Total customer costs by rate class  
12 for the Future Test Year are shown on Exhibit HSG-1D, line 32.

13 The costs typically considered in Pennsylvania in developing customer  
14 charges are presented on a customer-month basis on line 33, and include the  
15 costs on line 10 and lines 13-18.

16 **46. Q. Please describe the information on Exhibit HSG-6.**

17 A. Exhibit HSG-6 presents the development of the external allocator values.  
18 These are described in the table below. Except where noted, all data are for  
19 the Future Test Year.

20

1        Index (page 1)

2        Summary of External Allocator Values- Class Allocation (page 2)

3        Summary of External Allocator Values- Functionalization (page 3)

4        Distribution Revenue at Current Rates (pages 4-9)- Distribution revenue at current  
5        rates for 2010, using forecast customer counts, kWh and kW, and current rates

6        Transmission Revenue at Current Rates (page 10)- Transmission revenue at  
7        current rates for 2010

8        Conductors- Functional Splits (page 11)- Splits Overhead Conductors and  
9        Underground Conductors between Primary HT / Primary on one hand, and  
10       Secondary on the other hand, based on cost splits. Same for Underground  
11       Conductors.

12       Conductors- Primary Splits (page 12)- Splits Overhead Conductors Primary HT  
13       and Primary, based on conductor mileage splits. Same for Underground  
14       Conductors.

15       Service Costs (page 13)- Computes investment in services for each rate class at  
16       average replacement cost for the period 2004-2009.

17       Meter Costs (page 14)- Computes investment in meters for each rate class using  
18       total installed costs for meters provided by third party. Computes monthly meter  
19       reading fees for each rate class using costs for meters provided by third party.

1 Computes meter asset use fee for each rate class using total costs for meters  
2 provided by third party; this information is used in Account 905 allocator.

3 Customer Deposits (page 15)- Average customer deposit balances for the period  
4 December 2006-May 2009.

5 Acct903 Allocator (page 16)- Allocates each activity in Customer Records and  
6 Collection, Account 903, using an appropriate external allocator. Rows 1-9 list  
7 each activity, the cost of the activity and the allocator assigned to it. Row 10  
8 summarizes the costs by rate class, and the allocator values are on row 11.

9 Acct905 Allocator (page 17)- Allocates each activity in Miscellaneous Customer  
10 Accounts, Account 905, using an appropriate external allocator. Rows 1-3 list  
11 each activity, the cost of the activity and the allocator assigned to it. Row 4  
12 summarizes the costs by rate class, and the allocator values are on row 5.

13 Acct908 Allocator (page 18)- Allocates each activity in Customer Assistance,  
14 Account 908, using an appropriate external allocator. Rows 1-5 list each activity,  
15 the cost of the activity and the allocator assigned to it. Row 6 summarizes the  
16 costs by rate class, and the allocator values are on row 7.

17 Write-Offs (page 19)- Computes the allocator values for the Write-Off allocator  
18 using Net write-offs for 2005-2009.

19 Over60 (page 20)- Computes the allocator values for the Over60 allocator. The  
20 column OVER60-Dol Allocator shows the percentage of the PECO Electric total

1 accounts receivable over 2 months outstanding for each rate class, at each month-  
2 end from November 2008-October 2009.

3 Demand Allocators (page 21)- Computes the demand allocators used in the COS  
4 study.

5 MWh Sales at Voltage Levels (page 22)- Computes MWh at the generator based  
6 on 2010 sales at the meter and loss factors, for each rate class.

7 **VI. CONCLUSION**

8 **47. Q. Does this conclude your direct testimony?**

9 A. Yes.

**HOWARD S. GORMAN**  
**Principal Consultant**  
**Black & Veatch Corporation**

Mr. Gorman has more than 20 years of diversified experience in the energy industry, and over 25 years of experience covering all areas of finance. He specializes in rate and regulatory matters including electric and gas revenue of requirements, cost of service and rate design; energy industry accounting and costing; energy project financing and analysis; energy asset valuations, acquisitions and divestitures; mergers and related management and organizational matters; economic and financial planning; and computer modeling and information systems. He also has extensive experience in budgeting and reporting; procurement and contract negotiation; interest and currency derivatives; and all areas of financial management including treasury and insurance. He has worked with regulated and unregulated utilities; independent power plants, combined heat and power facilities, other cogeneration facilities and district heating and cooling systems; and other industries including leisure goods and software.

**Professional Employment**

1997 - Present	Black & Veatch Corporation (originally joined R.J. Rudden Associates) Principal Consultant
1995 - 1997	Independent Consultant
1987 - 1995	Trigen Energy Corporation 1987-1993 Corporate Controller; Trigen was formed in 1987 1993-1995 Treasurer; Trigen had IPO with NYSE listing in 1994
1982 - 1987	Coleco Industries, Inc. Director, Treasury
1976 - 1979	Touche Ross & Co. Staff Accountant

**Representative Project Experience**

*Rate and Regulatory Matters*

Mr. Gorman has extensive experience in rate and regulatory matters for electric and gas utilities. He has performed revenue requirements, cost of service and rate design assignments for numerous electric and gas clients. These assignments have included developing the unbundled, fully allocated cost of service for an electric company undergoing deregulation pursuant to FERC Order 888; developing revenue requirements and identifying customer class cross-subsidizations for electric and gas LDCs; revenue allocation and rate design for electric and gas LDCs; cost allocation and assisting with FERC rate filings for electric regional transmission organizations; budgeting and costing for an electric regional transmission organization.

These assignments included development of test year data under the regulatory basis, review and documentation of operations, establishment of cost causality, selection of allocation bases, development of allocators and developing revenue allocation and rate design proposals. Mr. Gorman is one of the chief developers of Black & Veatch's proprietary Electric and Gas Cost of

Service Models.

Mr. Gorman has testified on matters pertaining to revenue requirements, cost of service, cost allocations and related matters. He has testified before the Massachusetts Department of Public Utilities, New Jersey Board of Public Utilities, New York State Public Service Commission, Ontario Energy Board, Pennsylvania Public Utility Commission, Philadelphia Gas Commission and Rhode Island Public Utilities Commission.

Mr. Gorman's rate and regulatory clients have included Baltimore Gas & Electric, CT Enterprises, Duquesne Light Company, Freeport Electric, Hydro One Networks, KeySpan Energy, Massachusetts Electric Company, Midwest Energy, Narragansett Electric Company, Niagara Mohawk Power Corporation, PECO Energy, Philadelphia Gas Works and Village of Rockville Centre, as well as American Transmission Company, Hydro One, Inc., Midwest Independent System Operator, New York Independent System Operator, Ontario Power Generation, PJM Interconnection, LLC and Toronto Hydro Corporation.

Mr. Gorman has extensive experience in financial accounting as well as cost accounting. As Controller of Trigen Energy Corporation, he founded and built the finance and accounting function; developed reports, procedures and management tools; and managed subsidiary controllers across North America.

*Energy Project Financing and Analysis*

Mr. Gorman has successfully completed numerous energy asset financing transactions as a principal and has also supported the financing of many other energy assets.

He has negotiated and completed transactions including construction and term loans, tax-exempt bonds, taxable bonds, subordinated debt, asset-backed (receivables and inventory) revolving credit facilities and other instruments. The borrowers have included corporations, joint ventures, special purpose entities and partnerships. He has worked successfully with lenders and borrowers to source and structure transactions, and has been instrumental in the negotiation of the loan documents and in the design of power sale contracts and supply procurement contracts to be financable. Among these financings are a \$28 million construction and term loan for the joint venture which constructed the district heating and cooling system for McCormick Place Exposition Center, Chicago; a \$62.5 million corporate acquisition and expansion facility secured by a portfolio of energy assets; a \$40 million tax-exempt financing for the Trenton cogeneration and district energy system; a \$39 million IPO for Trigen Energy Corporation (NYSE- TGN); and over \$150 million in connection with acquisitions.

These projects have included independent power plants, combined heat and power facilities, other cogeneration facilities including plants which were Qualifying Facilities under PURPA, district heating and cooling systems, and regulated and unregulated entities.

Mr. Gorman has performed analysis of several energy projects in connection with due diligence for financing, including contract review, financial modeling, supply analysis, forward price projections, and economic valuation with cash flow forecasting, and the identification, assessment and mitigation of financial and operating risks for the project and its investors.

The clients and entities with which he has worked include Trigen Energy Corporation; The Toronto-Dominion Bank; Societe Generale; Peoples Gas Corporation; Calpine; Bank of

Montreal; and Donaldson, Lufkin and Jenrette.

#### *Energy Asset Valuations, Acquisitions and Divestitures*

Mr. Gorman has participated both as principal and consultant in the valuation of energy assets, and also in the subsequent acquisition or divestiture. He has performed financial and strategic valuations of power plants, business units, public corporations, private corporations, partnerships and other entities.

These valuations included development and review of assumptions, analysis of data, modeling and forecasting, sensitivity testing under various constraints, and forming and supporting an opinion as to valuation.

These valuations were used to support strategic decisions as to which assets to acquire or divest, and what price to pay or accept, as well as the development of post-acquisition strategic alternatives for the acquiror. In the case of acquisitions, the valuations were often used to support the financing for the assets. Among these activities are valuations of power plants, combined heat and power plants, and energy companies for the purpose of acquisition; valuation and assessment of alternatives for the waste-to-energy assets and other energy assets of a diversified company on behalf of an interested acquiror; valuation of the common stock of a publicly traded multi-jurisdiction utility for the purpose of investment; assessment of strategic fit and valuation for a utility seeking to diversify into energy-related services; and assistance with valuation and preparation for negotiation for a private entity seeking a buyer for energy assets.

The clients and entities with which he has worked include Trigen Energy Corporation; Ameren Corporation; Blavin and Co.; and several confidential assignments.

#### *Mergers and Related Management and Organizational Matters*

In connection with his work in asset valuations and acquisitions, Mr. Gorman has extensive experience integrating newly acquired assets into a company. He was successfully completed the financial integration of several acquisitions, including development of accounting, reporting and control systems, consolidation of functions and procurement. In addition, he has advised clients on the operating implications of transactions under consideration, as well as the financial, regulatory and strategic implications. Mr. Gorman has performed these services on behalf of the Midwest ISO, Mappcor, Star Gas MLP, Trigen Energy Corporation, Calpine and several confidential assignments.

#### *Computer Modeling and Decision Support*

Mr. Gorman has extensive expertise in spreadsheet and database applications, as well as the use of programming tools. He has developed analytical tools to perform valuations, projections and simulations. These models have been applied to financial analysis, cost allocations, rate design and pricing, forecasting revenue requirements, numerous tax and accounting matters, supply modeling and optimizations. Several of these models have contained interactive modules for automated scenario testing and sensitivity analysis.

Mr. Gorman has performed analyses and created applications in Excel, Lotus, Access and VB/VBA. Among these assignments, he specified, designed and programmed the Black & Veatch's proprietary Electric and Gas Cost of Service Models.

*Financial Management and Related Areas*

Mr. Gorman has developed, sourced and procured competitive contracts for loans as well as for energy, both as principal and on behalf of clients. This included an RFP for competitive supply of electricity for the State of New Jersey and its agencies.

He has bought and sold derivatives in the course of business transactions for the purposes of managing interest rate risk and currency risk. This included interest rate forwards and options in connection with financings; and currency swaps and forwards in connection with intercompany transfers and international procurement.

He managed the corporate insurance portfolios and the benefit plans for Trigen Energy Corporation and for Coleco Industries.

**Publications and Presentations**

“Difficulties Surround Transmission System Financing,” published in *Electric Power & Light*, November 2002, co-authored.

“A Balanced Look at Balance Sheets,” published in R.J. Rudden Financial, LLC’s *Energy Capital Markets Report*, June 2002.

“From Wires To Riches: Shareholder Value Creation In The T&D Business,” April 2002 (co-authored).

“Assessment of Retail Choice Programs,” presented at the American Gas Association Rate and Strategic Issues Committee Conference, March 2002.

“Value Creation With Transmission Assets,” quoted in *Electrical World’s Special Edition Quarter 1, 2002*, March 2002.

“The Remarkable Story of Enron,” published in Scudder’s *Annual End of Year Issue*, December 2001.

**Education**

New York University, BS Accounting, 1976

Harvard Business School, MBA, 1981

Certified Public Account, New York State

SUMMARY OF TESTIMONY HOWARD S. GORMAN				
JURISDICTION	DOCKET	CLIENT	APPROX -IMATE DATE	SUBJECT MATTER
New York	10-E-0050	Niagara Mohawk Power Corporation	Jan. 2010	Electric class cost of service
Pennsylvania	R-2009 2139884	Philadelphia Gas Works	Dec. 2009	Gas class cost of service
Rhode Island	RIPUC 4065	Narragansett Electric Company dba National Grid	June 2009	Electric class cost of service; revenue allocation; rate design
Massachusetts	DPU 09-39	Massachusetts Electric Company and Nantucket Electric Company dba National Grid	May 2009	Electric revenue requirements; adjustment mechanisms; class cost of service; revenue allocation; rate design
Pennsylvania	R-2008-2028394	PECO Energy Company (Gas)	March 2008	Gas class cost of service
Pennsylvania	R-00072350	Wellsboro Electric Company	April 2007	Electric class cost of service; rate design
Pennsylvania	R-00072348	Citizens' Electric Company of Lewisburg, PA	April 2007	Electric class cost of service; rate design
Pennsylvania	R-00072349	Valley Energy, Inc.	April 2007	Gas class cost of service; rate design
Pennsylvania	R-00061931	Philadelphia Gas Works	Dec. 2006	Gas class cost of service
New York	06-E-0911	Village of Freeport	July 2006	Electric cost of service; rate design

<b>SUMMARY OF TESTIMONY HOWARD S. GORMAN</b>				
<b>JURISDICTION</b>	<b>DOCKET</b>	<b>CLIENT</b>	<b>APPROX -IMATE DATE</b>	<b>SUBJECT MATTER</b>
Pennsylvania	R-00061346	Duquesne Light Company	March 2006	Electric class cost of service
Ontario	EB-2005-0378	Hydro One Networks Inc.	Jan. 2006	Electric Transmission and Distribution Cost allocation
New York	03-E-1568	Village of Rockville Centre	Oct. 2003	Electric class cost of service; rate design; sales forecast
New Jersey	ER02080506 et al	Gerdau AmeriSteel aka Co-Steel	Dec. 2002	Electric cost allocation and rate design; industrial rates
New Jersey	ER02050303 et al	Gerdau AmeriSteel aka Co-Steel	Oct. 2002	Electric cost allocation and rate design; industrial rates
Pennsylvania	M-00021612	Philadelphia Gas Works	July 2002	Gas rate unbundling
Pennsylvania	R-00017034	Philadelphia Gas Works	Feb. 2002	Gas class cost of service
Pennsylvania	R-00006042	Philadelphia Gas Works	Jan. 2001	Gas class cost of service; recovery of fixed costs