

CAPTION SHEET

CASE MANAGEMENT SYSTEM

1. REPORT DATE: 00/00/00 :
2. BUREAU: FUS :
3. SECTION(S) : 4. PUBLIC MEETING DATE:
5. APPROVED BY: : 00/00/00
DIRECTOR: :
SUPERVISOR: :
6. PERSON IN CHARGE: : 7. DATE FILED: 02/25/02
8. DOCKET NO: R-00017034F0002 : 9. EFFECTIVE DATE: 00/00/00

PARTY/COMPLAINANT: PUC

RESPONDENT/APPLICANT: PHILADELPHIA GAS WORKS

COMP/APP COUNTY:

UTILITY CODE: 125042

ALLEGATION OR SUBJECT

PHILADELPHIA GAS WORKS PETITION FOR EXTRAORDINARY RATE RELIEF PURSUANT TO SECTIONS 1308(E) AND 2212(C) OF THE PUBLIC UTILITY CODE. THROUGH THIS PETITION PGW SEEKS \$44,000,000 IN EXTRAORDINARY RATE RELIEF IN ORDER TO AVOID AN IMMEDIATE DOWNGRADE OF ITS BOND RATING FROM INVESTMENT GRADE TO JUNK BOND STATUS.

DOCUMENT
FOLDER

DOCKETED

FEB 26 2002

- 1. REPORT DATE: 00/00/00 :
- 2. BUREAU: ALJ :
- 3. SECTION(S): *CORRECTED* :
- 4. PUBLIC MEETING DATE: 00/00/00 :
- 5. APPROVED BY: DIRECTOR: :
- 6. PERSON IN CHARGE: SUPERVISOR: :
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ORIGINAL
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February 25, 2002

VIA HAND DELIVERY

James McNulty, Secretary
PA Public Utility Commission
400 North Street
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Philadelphia Gas Works' Base Rate Filing
Docket No. R-00017034 *F0002*

SECRETARY'S BUREAU
02 FEB 25 PM 4:22

Dear Secretary McNulty:

On behalf of Philadelphia Gas Works, enclosed for filing is an original and eight copies of its Base Rate Filing, which, if implemented, would increase PGW's base rates by \$60 million annually. In addition, PGW has enclosed eight copies of its Petition for Extraordinary Rate Relief, pursuant to Section 1308(e) of the Public Utility Code, which seeks to have \$44 million of the overall proposed base rate increase approved as extraordinary rates, effective mid April 2002. In support of these filings, the following are enclosed:

- Petition for Extraordinary Rate Relief
 - Prepared Direct Testimony (attached to the Petition)
- Base Rate Proceeding Supporting Documentation:
 - Volume I - Prepared Direct Testimony;
 - Volume II – Supporting Financial Information;
 - Volume III – Fully Allocated Cost of Service Study (to be supplied on March 1, 2002); and
 - Volume IV – Responses to PUC Filing, Parts 1, 2 and 3;
- Proposed Supplement No. 17 to Tariff Gas – Pa. P.U.C. No. 1

DOCUMENT
FOLDER

DSH:31094.1/PHI211-156924

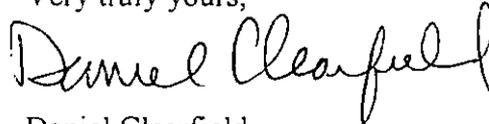
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James McNulty, Secretary
February 25, 2002
Page 2

Attached to this letter is Supplement 17 to PGW Tariff Gas No. 1 which sets forth PGW's proposed rates. The Supplement is proposed to become effective April 26, 2002.

All parties of record in the previous rate proceeding (Docket No. R-00006042) have been served according to the attached Certificate of Service.

Very truly yours,



Daniel Clearfield
For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

DC/lww
Enclosures

cc: Robert Rosenthal, Director FUS, w/enc.
Karen Moury, Esq., Law Bureau, w/enc.
Attached Certificate of Service w/enc.

SECRETARY'S BUREAU
02 FEB 25 PM 4:22

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document upon the participants listed below in accordance with the requirements of § 1.54 (relating to service by a participant).

VIA E-MAIL, FEDERAL EXPRESS AND/OR FIRST CLASS MAIL

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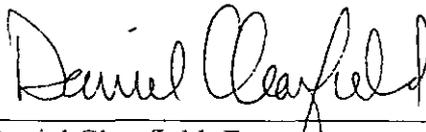
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Dated: February 25, 2002



Daniel Clearfield, Esq

02 FEB 25 PM 4:23
SECRETARY'S BUREAU

ORIGINAL

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

SECRETARY'S BUREAU

02 FEB 25 PM 4:23

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

Docket No. R-00017034
F0002

PHILADELPHIA GAS WORKS

**PHILADELPHIA GAS WORKS' PETITION FOR
EXTRAORDINARY RATE RELIEF**

Philadelphia Gas Works ("PGW") respectfully submits this Petition for Extraordinary Rate Relief pursuant to Sections 1308(e) and 2212(c) of the Public Utility Code.¹ Through this Petition, PGW seeks \$44 million in extraordinary rate relief in order to avoid an immediate downgrade of its bond rating from investment grade to junk bond status. Absent the relief requested in full, such a downgrade in PGW's bond rating is inevitable and will plunge the Company into a dangerous financial crisis. That financial instability will threaten PGW's ability to provide continuous and adequate service to its customers and seriously compromise the safety of PGW's gas distribution system by undermining the Company's maintenance and construction programs. Finally, absent extraordinary relief, PGW will certainly be required to make immediate and dramatic reductions in customer service and its current work force by whatever means are available.

In order to avoid this potentially disastrous situation, PGW requires extraordinary rate relief in the amount of \$44 million. Relief in full is required to meet S&P's immediate

¹ Concomitant with the Emergency Rate Relief Petition, PGW has submitted a base rate increase filing seeking rate relief in the amount of \$60 million.

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FEB 26 2002

**DOCUMENT
FOLDER**

requirements as reflected in the application of S&P's calculation of the level of fixed obligation coverage necessary to maintain an investment grade rating. The extraordinary increase will permit the Company to assure adequate liquidity to enable PGW to meet its minimum coverage obligations and continue to provide safe and adequate service to its customers.

PGW and its owner, the City of Philadelphia, are taking all steps possible to address the crisis. PGW has begun contingency planning, has put a hold on unnecessary spending and has instituted an aggressive collections effort to increase collected revenues. As explained in the attached testimony, the City will assist in the recovery effort by granting back, up to the full amount of, the statutorily protected \$18 million payment for this year, if necessary, which in combination with (and not as a replacement to) extraordinary rate relief, should enable PGW to meet its bond coverage requirements for 2002. Furthermore, the City will delay PGW's repayment obligations pertaining to the City's interest free \$45 million loan to PGW. However, neither of these critical steps will be enough to avoid a downgrade by S&P absent the requested extraordinary rate relief. S&P's requirements will be satisfied only by a demonstration that PGW satisfies the coverage formula with ongoing, permanent sources of revenue.

In order to meet its obligation to the rating agencies and permit the Commission to conduct an orderly proceeding, PGW proposes that the Commission address this Petition under a 45 day schedule (rather than the 30 days normally required), with a decision at the PUC's April 11, 2002 public meeting, and consider this Petition under a standard which comports with PGW's status as a municipally owned and operated utility.

I. BACKGROUND

1. The Petitioner is PGW, which has a principal place of business located at 800 W. Montgomery Avenue, Philadelphia, PA 19122.

2. PGW is a group of real and personal assets owned by the City of Philadelphia (“City”) and used for the acquisition, storage, processing and distribution of natural gas within the City. PGW is a “city natural gas distribution operation” as defined in Section 102 of the Public Utility Code.

3. On February 25, 2002, PGW filed a request for a general base rate increase pursuant to Section 1308(d) of the Code, seeking an additional \$60 million in permanent base rate revenues. This request follows the Commission’s Order of December 6, 2001, in which it denied PGW’s request for a \$65 million base rate increase and authorized PGW to increase its base rates by \$33.6 million.

4. The urgency of this emergency rate relief request was precipitated on February 12, 2002, when Standard and Poors (“S&P”), a key credit rating agency for PGW’s bonds and commercial paper, released a press notice (“Notice”) that updated its prior evaluation of PGW.² The February 12 Notice stated that “without immediate cash flow improvement [PGW’s] ratings will be lowered.” The factors listed in S&P’s Notice for the downgrade are PGW’s lack of liquidity and reliance on restricted funds, weak fixed charge coverage, potential inability to meet legal debt requirements, the limited ability of the City of Philadelphia to assist the Company, PGW’s continuing problems with reducing levels of account receivables and a warmer than normal winter which will strain any remaining mechanisms supporting fulfillment of bond coverage ratios in the next two years. Given PGW’s mandatory obligations over the next 18 months, S&P has determined that PGW will not be able to maintain the level of liquidity which is required for an investment grade bond rating.

² S&P’s prior evaluation of PGW, issued in July of 2000, warned of S&P’s concerns over PGW’s financial condition and placed the Company on a Credit Watch (With Negative Implication). *See* PGW E.R.P. St. 1 (Knudsen).

5. PGW has been informed that S&P will reevaluate PGW's position in the next six (6) weeks and that, absent an increase in the Company's permanent revenues sufficient to improve its coverages under S&P's formula, S&P will downgrade PGW's credit rating. Using the S&P fixed charge coverage formula, PGW presently is producing coverages of below one (non-investment grade). Coverage of between 1.2 – 1.3x is necessary to maintain an investment grade rating. As at least one of PGW's long term bonds and its commercial paper are already at the lowest "investment" grade of BBB minus, a downgrade of even one step will place the Company's bond rating below investment grade or at junk bond status causing far-reaching financial and operational repercussions for PGW which are potentially disastrous to PGW's ability to safely serve its customers. This consequence cannot be avoided without extraordinary rate relief.

II. LEGAL STANDARD

6. The legal standard for awarding extraordinary rates is set forth in Section 1308(e) of the Code, which reads in pertinent part:

(e) Extraordinary rate relief. —Upon petition to the commission at the time of filing of a rate request or at any time during the pendency of proceedings on such rate request, any public utility may seek extraordinary rate relief of such portion of the total rate relief requested as can be shown to be immediately necessary for the maintenance of financial stability in order to enable the utility to continue providing normal services to its customers, avoid reductions in its normal maintenance programs, avoid substantially reducing its employment and which will provide no more than the rate of return on the utility's common equity established by the commission in consideration of the utility's preceding rate filing.

66 Pa. C.S. § 1308(e).

7. In addition to this standard, the Commission is required to grant or deny the requested extraordinary rate relief within 30 days of the filing of the petition requesting the same.

III. PGW'S NEED FOR EXTRAORDINARY RATE RELIEF

8. PGW's need for extraordinary rates and its ability to satisfy the legal standard in Section 1308(e) are clear.

A. Financial Instability.

9. As detailed above, absent permanent rate relief, within the next six (6) weeks S&P will downgrade PGW's credit rating. PGW's calculations indicate that the downgrade would be to below investment grade. As detailed in the testimony attached hereto, the financial consequences of such a downgrade and the resulting dangerous financial crisis will be devastating to PGW and its customers.

10. First, financial consequences have already been felt by PGW as a result of the release of S&P's Notice. Due to a loss of revenue from the abnormally warm winter, PGW had been pursuing a one-time opportunity to access project revenues and working capital by completing a forward purchase agreement with an underwriting firm under which PGW could realize \$20 million in project revenues from the sale of seven years of future earnings, discounted to present value, on a portion of the sinking funds on the outstanding \$933 million of long term debt ("the Forward Purchase"). However, due to the S&P announcement, this Forward Purchase cannot proceed until the issue of PGW's credit rating is resolved. Any downgrade would eliminate the option completely. Absent the project revenues from the Forward Purchase, PGW's ability to make its debt service payments in July and August 2002 will be at risk and PGW's ability to satisfy its year-end obligations under its bond ordinance covenants will be seriously threatened.³

³ See PGW St. E.R.P. 1 (Knudsen).

11. Second, an S&P downgrade would result in further financial instability by virtually eliminating PGW's only source of short term debt – its commercial paper program. The downgrade would decimate the continued participation of the consortium of banks, led by J.P. Morgan, backing the Letter of Credit that supports the commercial paper program. As a result, PGW anticipates that most, if not all, of the banks behind the commercial paper program will refuse to renew the program in August 2002, potentially eliminating up to the entire \$100 million in short-term revolving credit which PGW has had at its disposal for more than a decade to enable its continuing financial viability.⁴ The cancellation of the commercial paper program would mean that PGW would be immediately faced with at least a \$70 million and up to a \$100 million repayment obligation in August 2002. In addition, PGW would lose its only source of intra-fiscal year liquidity

12. Third, and perhaps most damaging to PGW's financial stability is the fact that a downgrade would result in PGW completely losing access to the long term debt market. This means, among other consequences, that PGW will not be able to sell a bond in December 2002. The issuance of additional long term debt is essential to its continued ability to fund its construction program. Obviously, the ability to engage in construction is essential if PGW is to be able to keep its natural gas system safe and reliable. PGW's construction program is, and is projected to continue to be 100% externally financed and, thus, without access to external financing, continuation of the construction will no longer be possible. In addition, in recent years PGW has used the proceeds of each bond to supply much needed working capital during

⁴ See PGW Sts. E.R.P. 3 (Krellenstein) and 4 (Bisgaier). It is possible that one of the participating banks – Morgan – may agree to continue to participate in the program because of PGW's status as a longstanding customer. However, even under this scenario, PGW would face drastic reductions of at least \$70-\$75 million in the amount of available short-term, revolving credit.

the year by drawing from the bond proceeds in advance of actually expending the funds for construction.⁵ Without access to the long term bond market, this source of essential working capital will be lost and PGW's already dire liquidity situation will become even worse.

B. PGW's Need For Relief Is Immediate.

13. PGW needs extraordinary rate relief immediately if it is to avoid the financial instability described above and the associated reductions of service, maintenance programs and employment detailed below. While the Company would be able to continue to operate for several months using the meager resources it has available to it, PGW will run out of funds to operate the Company relatively quickly by the fall of this year.⁶ Moreover, once the downgrade occur, PGW would need to respond almost immediately by reducing normal construction maintenance and operations in order to conserve resources and perform its core function as long as possible.

C. Negative Impact On Service, Maintenance Programs, And Employment.

14. As detailed more fully in the attached testimony,⁷ the downgrade will have a host of negative operational consequences that include: 1) an immediate cessation of PGW's mains replacement program as well as all construction that is not already funded or directly related to an immediate safety concern; 2) the elimination of all services that are not directly related to gas delivery, billing and collection; 3) the termination of further improvements to call center performance through additional system modifications; 4) a reduction or elimination of all marginal services such as those supplied to customers by PGW's district offices; 5) a

⁵ Such provisioning is permitted provided that by the end of the fiscal period such advances have been used for construction or any unused money returned to the construction fund.

⁶ See PGW E.R.P. St. 2 (Bogdonavage)

⁷ See PGW E.R.P. St. 1 (Knudsen)

redeployment of field service personnel to essential maintenance services only and the elimination of PGW's appliance service program; 6) the reduction or elimination of all non-essential expenditures on personnel for both union and non-union employees resulting in the contraction of Call Center access and customer complaint handling; and 7) a request for Commission approval (as required under PGW's current collective bargaining agreement) of a downsizing plan that would implement substantial layoffs throughout the organization. Placed in proper context, the S&P downgrade is not only a direct and immediate threat to PGW, but an equally direct threat to PGW's customers and employees. Absent emergency relief, PGW will be unable to continue to assure safe, continuous and adequate service to its customers and many PGW employees will be left without jobs.

15. PGW and its owner, the City of Philadelphia, will also do its part to respond to the crisis. PGW has already put a hold on any unnecessary spending. The Company has also put in place an aggressive collection effort in attempt to effect short term increases in revenues. For its part, the City is in the process of extending for eight additional months the due date for the repayment of the \$45 million interest free loan it previously extended to PGW to assist the Company. Finally, recognizing that, even with extraordinary rate relief PGW will have a difficult time satisfying its bond covenants for this fiscal year, the City has indicated that, if necessary, it would grant back up to \$18 million on a one-time only basis.

16. As the testimony of City Finance Director Janice Davis makes clear,⁸ the City is unfortunately not in a position to do more. Even if it was, S&P's grading requirements cannot be satisfied by one-time temporary fixes. PGW must have 20-30% more earnings than all of its fixed obligations on a permanent basis if it is to avoid the disaster of a bond downgrade.

⁸ See PGW E.R.P. St. 5 (Davis)

17. If, and only if, the Commission grants the extraordinary rate relief requested in this Petition, will PGW be able to avoid a downgrade of its bond rating by S&P and the resulting financial instability and reductions in service, maintenance and employment detailed herein. As PGW has satisfied the standard in Section 1308(e), the Commission must grant the requested relief.

D. Required Rate Relief.

18. Through this Petition, PGW requests the Commission to authorize extraordinary rate relief in the amount of \$44 million. As explained above, the reason for the extraordinary nature of the relief requested is to avoid the bond rating downgrade by S&P.

19. The entire \$44 million is necessary to provide PGW with the necessary liquidity to avoid the S&P downgrade. While S&P has not publicly identified a specific level of required extraordinary rate relief, S&P has established a standard formula which will determine if a downgrade in PGW's bond rating is carried out.⁹

20. Under S&P's formula, PGW's available liquidity or cash to pay fixed costs (revenue minus operating expenses) must exceed its fixed costs (debt service on the 1975 and the 1998 ordinance bonds, capital lease payment, interest on the commercial payment and the statutorily protected \$18 million City payment) by a ratio of 1.2 to 1.3 in order to maintain an investment grade bond rating.¹⁰

⁹ See PGW E.R.P. St. 4 (Bisgaier).

¹⁰ *Id.*

21. By S&P's calculation, PGW's fixed cost coverage for the year ending August 1, 2002 will be .88.¹¹ It is this lack of coverage and absence of liquidity which caused the issuance of the downgrade notice.

22. PGW has calculated that, in order to achieve the required 1.2 - 1.3 coverage ratio and avoid a downgrade and associated repercussions, \$44 million in extraordinary rate relief is required.¹² As indicated above, this requested amount accounts for the City's grant back of this year's \$18 million payment in the calculation.

23. The \$44 million request does not represent an inflated figure. The entire amount is justified, and indeed required, to avoid a downgrade of PGW's bond rating and the severe repercussions to PGW and its customers which would follow.

IV. REQUEST FOR MODIFICATION TO SECTION 1308(e) STANDARD AND SCHEDULE OF PROCEEDINGS

24. Under Section 2212(e) of the Code, the Commission is empowered to suspend or waive the application to PGW of any provision of the Code, except those in Section 2212 itself. In consideration of this Petition, PGW respectfully requests that the Commission waive or modify Section 1308(e) in two respects.

25. First, Section 1308(e) states that the Commission shall grant or deny the extraordinary rate relief request within 30 days from the filing of this Petition. Based on the anticipated timeframe of S&P's action, PGW proposes that the Commission rule on the Petition by its April 11, 2002 Public Meeting. PGW's proposal provides the Commission with an extra

¹¹ S&P has also projected a fixed cost coverage ratio for PGW of .95 for the year ending August 1, 2003. *Id.*

¹² See PGW E.R.P. St. 2 (Bogdonavage). The calculation for 2003 utilizes PGW's fully forecasted FY 2002 test year which, because it has been adjusted to reflect representative, going forward conditions, represents the best basis on which to calculate the revenue requirement needed to produce the S&P required charges.

15 days to adjudicate this Petition and will enable the conduct of a more orderly proceeding, providing the parties a fair opportunity to review PGW's claims.

26. Second, the Commission should consider this Petition under an emergency standard which can be applied to a municipally owned and operated utility, like PGW. Section 1308(e) of the Code, which sets forth the criteria for emergency rate relief, provides that the relief not be "more than the rate of return on the utility's common equity established by the commission in consideration of the utility's preceding rate filing." This criterion essentially acts as a cap on the amount of emergency relief which can be ordered by the agency. As a municipally owned utility, PGW does not have private investors and does not have common equity or a return on that equity, like an investor owned utility. Accordingly, this criterion or cap is simply inapplicable to PGW. As a municipal utility, PGW is a cash flow company, and does not have its rates set utilizing the rate of return method as recognized by Section 2212(e) of the Code. Accordingly, the standard for review of this Petition requires adjustment to comport with PGW's status as a municipally owned and operated utility.

27. As the return on equity requirement is inapplicable, Section 1308(e) contains no constraint or cap on the amount of extraordinary rate relief that the Commission may authorize in this case. However, as an alternative to the return on equity standard, the Commission should focus on the amount of extraordinary rate relief required by S&P for PGW to maintain an investment grade rating for its bonds and commercial paper. The Commission's decision in PGW's 2001 base rate proceeding clearly envisioned, as a goal, that the Company would maintain its existing capital and ability to raise new capital in the short and long term debt markets. The only way for that goal to be achieved is for PGW to satisfy immediately the coverage requirements as determined by S&P's formulae which are described in the attached

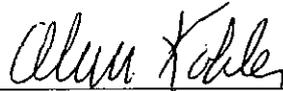
testimony.¹³ While the parties may differ on the considerations employed by S&P in its analysis of PGW, the undeniable conclusion is that the financial instability and reductions in service, maintenance programs and employment described in this Petition will be avoided only if S&P is satisfied with PGW's credit and liquidity status as viewed under its formulae. Therefore, to the extent that any constraint is placed on the level of extraordinary relief that the agency may grant, the Commission must utilize those formulae for determining the maximum allowable relief under Section 1308(e).

28. Attached hereto as Attachment "A" is a proposed schedule for the review of this Petition which PGW believes is appropriate under the exigent circumstances and fair to all parties. Regardless of the exact details of the procedural timeline, given S&P's deadline for action, the Commission must approve the requested extraordinary rate relief by its April 11, 2002 Public Meeting.

¹³ See PGW St. E.R.P. 4 (Bisgaier).

WHEREFORE, PGW respectfully requests that the Commission: (1) modify the requirements of Section 1308(e) of the Code to allow for extended consideration of this Petition and to declare that the rate of return requirement is inapplicable; (2) establish the proposed procedural schedule culminating in a Commission decision on PGW's Petition no later than its Public Meeting on April 11, 2002; and (3) grant PGW's request for \$44 million of extraordinary rate relief effective on one day's notice.

Respectfully submitted,



Daniel Clearfield, Esq.
Alan Kohler, Esq.
Mark S. Stewart, Esq.
Wolf, Block, Schorr and Solis-Cohen LLP
212 Locust Street, Suite 300
Harrisburg, PA 17101
(717) 237-7173

Date: February 25, 2002

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FEB 25 2002

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC
UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

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Docket No. R-000170340002

F-

TESTIMONY AND EXHIBITS

IN SUPPORT OF

PHILADELPHIA GAS WORKS'

EXTRAORDINARY RATE PETITION

DOCUMENT
FOLDER

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

TESTIMONY OF

THOMAS E. KNUDSEN

**ON BEHALF OF
PHILADELPHIA GAS WORKS**

**PHILADELPHIA GAS WORKS
EXTRAORDINARY RATE PETITION**

Docket No. R-000170340002

FEBRUARY 2002

1 Q. **MR. KNUDSEN, PLEASE STATE YOUR NAME, YOUR TITLE AND**
2 **YOUR BUSINESS ADDRESS.**

3
4 A. My name is Thomas E. Knudsen. I am Interim President and Chief Executive
5 Officer of the Philadelphia Gas Works, and my business address is 800 West
6 Montgomery Avenue, Philadelphia, PA 19122.

7 Q. **HAVE YOU TESTIFIED PREVIOUSLY IN PGW MATTERS OR**
8 **BEFORE THIS COMMISSION?**

9
10 A. Yes. I appeared before the Pennsylvania Public Utility Commission (PaPUC) as
11 Interim Chief Financial Officer of PGW in the recently completed base rate
12 proceeding. I have also appeared numerous times before the PaPUC in a variety
13 of matters brought before it by all of the major electric and gas utilities in the state
14 when I was a witness on behalf of the Office of Consumer Advocate.

15 Q. **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

16 A. The purpose of this testimony, along with additional PGW witnesses, Joseph
17 Bogdonavage (Senior Vice President, Finance, PGW), Gary Krellenstein (J.P.
18 Morgan), Barbara Bisgaier (Public Financial Management) and Janice Davis
19 (Finance Director, City of Philadelphia), is to present the evidentiary basis and
20 support for PGW's Petition for Extraordinary Rate Relief that accompanies our
21 filing for base rate relief and to emphasize, in the strongest terms possible, what
22 the consequences will be for PGW if the company is not able to secure the
23 necessary permanent rate relief on an emergency basis. In short, PGW needs the
24 PUC to implement an immediate base rate increase of sufficient size to avoid a
25 downgrading of the company's long term bonds by Standard and Poor's (S&P).
26 We calculate that an increase of \$ 44 million is necessary in order to do that. If

1 we are unsuccessful in securing the necessary emergency relief and the company's
2 bonds are downgraded, PGW would immediately find itself in a financial crisis
3 that would imperil the company as a going concern and impose enormous
4 additional costs on its customers if PGW survives such setbacks. I cannot
5 emphasize enough the seriousness of the situation in which the company finds
6 itself.

7 **Q. WHAT CIRCUMSTANCES GAVE RISE TO THIS REQUEST?**

8 The company gave notice to the PaPUC in December 2001 that it would file for
9 permanent base rate relief of approximately \$50 million in January 2002. (We
10 have since determined to request an increase of \$60 million.) The expectation
11 was that this case would follow the normal processes, culminating in rate relief in
12 November 2002. Circumstances at the company precluded our filing last month.
13 However, on February 12, 2001, S&P, one of three rating agencies that evaluates
14 our debt instruments, took a step which has materially changed the course of
15 future events for the company. Specifically, S&P released, in the form of a press
16 notice attached as (Exhibit BCB-1 to Ms. Bisgaier's testimony, that they refer to as
17 an update to their prior evaluation, a Credit Watch (With Negative Implications),
18 that had initially been issued in July 2000. It is my understanding that a Credit
19 Watch is normally issued for only a few months in anticipation of an enterprise
20 taking immediate corrective action, S&P has been willing to maintain our rating
21 status for more than a year and a half as we worked through the changes at PGW
22 to make it a functionally and financially stable enterprise -- and, for now,
23 continues to do so. The primary reason that S&P waited nineteen months to take

1 action is that it wanted to evaluate the Company after all permanent rate action
2 had been taken.

3 There is specific language in the press release/update that gives rise to the
4 need for this extraordinary rate action. That language is the following: "Without
5 immediate cash flow improvement, ratings will be lowered." In its press release,
6 S&P lists the factors that went into the determination that PGW's credit rating
7 should be challenged at this time. These factors include poor liquidity and
8 reliance on restricted funds, weak fixed charge coverage, potential inability to
9 meet legal debt requirements, limited ability of the City of Philadelphia to assist
10 the company, PGW's continuing problems with reducing levels of accounts
11 receivable and a warmer than normal winter which will strain whatever
12 mechanisms we have left to make coverage ratios this year and next. While the
13 \$33.6 million of rate relief proved salutary and addressed, in the main, PGW's
14 needs regarding ongoing operating requirements, S&P recognized that the level
15 was insufficient to address PGW's total lack of liquidity.

16 It is my understanding that S&P looked at the levels of funds and the fund
17 flows available to PGW over the next 18 months and determined that there is an
18 insufficient basis for assuming that the company can meet all of its operating and
19 financially/legally mandated obligations and maintain the level of liquidity (cash)
20 on hand, which is required for an investment grade company. S&P includes
21 within its evaluation both the regular debt service requirements associated with
22 over \$1 billion of debt, payments on its capital leases, and interest on commercial
23 paper, as well as PGW's legal obligations to the City, including repayment of the

1 \$45 million working capital loan. Ms. Bisgaier's testimony describes the
2 coverage formula and criteria that we understand S&P utilized to evaluate PGW.
3 Mr. Bogdonavage's testimony calculates where PGW stands using that formula
4 and what level of permanent rate relief is needed to satisfy S&P's investment
5 grade requirements. In short, having waited 19 months for the financial
6 fundamentals of the company to improve, S&P will not wait any longer. If it will
7 not wait, neither can we. It is my understanding that S&P will evaluate our
8 circumstances in the next 6 weeks and will determine whether the company has
9 received sufficient permanent revenues to improve its calculated coverages per
10 S&P's formula. If not, PGW bonds will be downgraded. Because at least one
11 series of PGW's long term bonds are already at the lowest "investment" grade, a
12 downgrade will necessarily put PGW below investment grade -- with disastrous
13 results. To avoid these results, we had no choice but to file this request for an
14 extraordinary rate increase.

15 One can argue that the evaluations, considerations, formulas and
16 judgments that go into S&P's determination should be more flexible or this fact or
17 that development should have been given more weight. I want to assure the
18 Commission and the parties that management has done everything it could over
19 the last 19 months to sustain the rating at the current level. The fact is that a
20 major review of our credit quality was undertaken, and PGW is found wanting.
21 Now it is time to take the corrective action necessary to avoid a disaster.

22 **Q. ARE THERE ANY IMMEDIATE CONSEQUENCES TO THE ACTION**
23 **THAT S&P TOOK THIS WEEK?**
24

1 A. Just the mere act of issuing the press release has jeopardized PGW in the short
2 term. Even before the S&P announcement, PGW had been planning to use a
3 certain financial instrument to secure a one-time source of cash. This winter will
4 likely be the warmest winter to date on record. Even if the remainder of the
5 winter is normal, PGW has lost upward of \$24 million of margin, (i.e., revenues
6 in excess of gas costs). PGW needed to find a way to replace that lost income in
7 order to satisfy its bond covenants and obtain sufficient cash working capital.

8 As a result of S&P's announcement, the one action that we could take
9 without complication to fill this gaping earnings hole will now have to be held in
10 abeyance until the extraordinary rate setting process is finished. Specifically,
11 management has been pursuing the opportunity to complete a forward purchase
12 agreement with an underwriting firm. It was anticipated that PGW could realize
13 \$20 million in project revenues from the sale of 7 years of future earnings,
14 discounted to present value, on a portion of the sinking funds on the outstanding
15 \$933 million of long term debt. However, due to the S&P announcement, and
16 because we cannot give assurance to the underwriter: that we (a) will not need
17 the funds for payment of debt service and (b) we will not be downgraded below
18 investment grade, we will not be able to act. Without action by the Commission
19 that would remove the impediments to this transaction, we cannot make our bond
20 debt service requirements for this fiscal period (FY 2002). Even assuming we
21 could have the full \$18 million of the City payment granted back to us, that
22 amount would still be inadequate, as Mr. Bogdonavage shows in his testimony
23 and schedules.

1 Q. **WHAT ARE THE FINANCIAL CONSEQUENCES TO THE COMPANY**
2 **IF S&P WERE TO ACTUALLY DOWNGRADE PGW'S LONG TERM**
3 **SECURITIES?**

4
5 A. There are three major financial consequences, and these are immediate and
6 severe. First, as I have explained above, the forward purchase agreement
7 transaction will not be able to go forward, which immediately puts our ability to
8 make debt service payments in July and August at risk. Such an outcome also
9 places at risk PGW's ability to satisfy the overall year-end debt service coverage
10 requirements imposed by our bond ordinance covenants.

11 Q. **WHAT IS THE SECOND FINANCIAL CONSEQUENCE?**

12 A. The second major consequence of a downgrade to non-investment grade is the
13 elimination of our commercial paper program. As Ms. Bisgaier and I have
14 testified previously, the commercial paper program is the only source of short
15 term debt available to the company, even if, in the last 2-3 years, it has been fully
16 extended by year end. The paper is backed by a Letter of Credit, which is
17 supplied by a consortium of banks, with Morgan being in the lead.

18 Ms. Bisgaier and Mr. Krellenstein testify that if PGW is downgraded, the
19 banking consortium will come undone and the whole effort since July 2000 to re-
20 build the financial stability of the company will have been for naught. We must
21 renew our Letter of Credit by August 29, 2002. For over 8 years, the company
22 has had \$100 million of short-term funds available to use as a revolving credit
23 instrument; that is, to finance seasonal needs for fuel purchases or to finance
24 seasonal increases in accounts receivable. Mr. Krellenstein, testifying from the
25 perspective of one of the major banks, as a representative of the financial

1 markets and security purchasers, and as one who is intimately familiar with
2 PGW's financial situation, has concluded that a downgrade would result in most if
3 not all of the existing banks declining to renew their portion of the letter of credit
4 (Morgan may stay with us because PGW is a longstanding customer). It must be
5 noted that last year it was extremely difficult to enlist the banks in support of a
6 Letter of Credit for \$100 million. The commitment contained an instruction to
7 pay the balance down to \$80 million by August 2002. The mere fact of the S&P
8 challenge will drive potential players away. It must also be noted that there are
9 fewer and fewer banks actively participating in these types of instruments.

10 A downgrade would allow the banks that provide the underlying Letter of
11 Credit to cancel the program in six month's time. However, since six months and
12 August 29 are essentially coterminus, all or virtually all of the supporting banks
13 would simply exercise their option not to renew the program in August 2001 for
14 any amount. I understand that amounts outstanding at that point would be
15 restructured with the advances being turned into taxable instruments when the
16 commercial paper matures. While it may be that one bank might stay with us to
17 some degree, it appears clear that the level of available credit would be drastically
18 reduced by \$70-75 million, at the very least. This means that PGW will be
19 robbed of the intra-year liquidity that the commercial paper program provides,
20 and at the same time would be responsible for paying back the outstanding
21 borrowings. This will create enormous additional annual payment requirements,
22 which alone would force PGW to spend the next few years doing nothing but
23 paying back the banks.

1 Q. **WHAT IS THE THIRD FINANCIAL CONSEQUENCE?**

2 A. Third, and perhaps most important, the downgrade would eliminate PGW's ability
3 to access the long term debt market. Most immediately, there could be no sale of
4 a long-term bond this December. A bond sale is essential in order to fund the
5 construction program and keep the system safe and reliable. As is shown on
6 Exhibit TEK-1, for the last several years, PGW's construction program is 100%
7 externally financed. Moreover, PGW has used the proceeds of each bond to
8 supply crucial working capital by drawing from the Construction Fund in advance
9 of actually expending the funds for construction (by fiscal year end, all capital
10 fund draws must either be expended on construction projects or returned to the
11 fund). Without a bond, this supportive source of intra-year cash working capital
12 will be eliminated.

13 Q. **WHY WILL A BOND SALE BE IMPOSSIBLE?**

14 A. Both Mr. Krellenstein and Ms. Bisgaier testify that, especially in the present
15 environment, the ability of a non-investment grade municipal utility to access the
16 capital markets to meet its construction needs would be simply nonexistent. In
17 addition, by the time we would move to sell the bond in the late fall, the lack of
18 confidence in the company, expressed first by the rating agencies and forward
19 purchase agreement underwriters and then by the banks, will have destroyed any
20 remaining interest by investors.

21 Q. **MR. KNUDSEN, ARE YOU AWARE OF THE STANDARD FOR
22 OBTAINING EXTRAORDINARY RATE RELIEF AS SET OUT IN THE
23 PUBLIC UTILITY CODE?**

24
25 A. Yes, I have reviewed it.

1
2 **Q. WILL A DOWNGRADE BY S&P CAUSE THE TYPES OF**
3 **OPERATIONAL EVENTS SET FORTH IN THE STATUTE TO OCCUR?**
4

5 A. It should be obvious that the answer is clearly yes. The cancellation of the
6 forward purchase and all or substantially all of the Letter of Credit and the
7 creation of payback requirements for the cancelled portion of the short-term debt
8 amounts that remain outstanding in August 2002, by themselves would put the
9 company in the position of not having the cash it needs to pay its debt service, gas
10 bills and other obligations when they come due. In addition, the lack of the
11 ability to issue a long-term bond at the end of 2002 means that, once the existing
12 construction funds are depleted, all construction would have to terminate. In
13 addressing the first criterion for extraordinary rate relief, a downgrading will
14 result in the financial stability of PGW being totally compromised.

15 Mr. Bogdonavage's testimony presents an analysis which shows PGW's
16 month-by-month cash flows assuming the loss of the forward purchase
17 agreement, the commercial paper line of credit and the inability to issue another
18 bond. Assuming that the company did not proactively respond to the crisis
19 (which it would) PGW would stop being able to pay its bills, fund payroll or do
20 any construction whatsoever by August of 2002.

21 **Q. DOES THAT ANALYSIS ACCURATELY DEPICT HOW PGW WOULD**
22 **RESPOND TO THE DOWNGRADE AND ITS ANTICIPATED**
23 **CONSEQUENCES?**
24

25 A. No. As CEO, it is my responsibility to prepare contingency plans for PGW.
26 Actions must start immediately and continue after a possible downgrading in
27 order to maintain the company's ability to operate at minimally acceptable levels

1 of safety and adequacy for as long as possible. Indeed, because the potential
2 downgrade would put PGW in such difficult financial circumstances, we have
3 already taken the following steps. First, under a plan that anticipated rate relief in
4 the fall, the company is planning to petition the City Council to defer payment of
5 the \$45 million short-term loan. The Administration has prepared the ordinance
6 change and will be submitting that request shortly (this is a step we had set in
7 motion even before the S&P notice). Second, we have been actively discussing
8 when and/or under what circumstances we might deplete gas inventories which
9 are presently unit priced above current market rates.

10 Third, I have instructed Mr. White, our Acting Chief Operating Officer,
11 and Ms. Walsh, our Acting Vice President for Operations, to undertake an
12 immediate review of our construction program in order to be in a position
13 immediately to conserve the remaining balances in the Construction Fund for only
14 the most essential needs going forward. To that end, we have contracted with
15 Navigant Consultants, the group who developed our main replacement models, to
16 study our options so that we can obtain the most safety improvements on the
17 system for the lowest expenditure of dollars. This also means that we must
18 coordinate with the Water and Highway Departments to minimize our enforced
19 replacement investment. If a downgrade were to occur, we would immediately
20 stop all construction that hasn't already been funded and which does not respond
21 to an immediate safety concern. This means that PGW's present efforts to
22 replace 18 miles of cast iron distribution mains each year -- which is part of its
23 normal maintenance program, would have to be suspended immediately. It is

1 very clear that the maintenance of PGW's distribution system will suffer
2 materially from a downgrade of its securities.

3 Fourth, I have instructed all of the Vice Presidents to immediately place a
4 hold on any unnecessary spending. I have also instructed all of the Vice
5 Presidents to determine how the operating budget can be reduced by shrinking the
6 operations of the utility. They are to determine what functions are not absolutely
7 essential and can be eliminated and what services can be reduced or done without.
8 If a downgrade occurs, we would move to minimize the impact on the levels and
9 types of services to which our customers have only recently grown accustomed.
10 Essentially we would have to cut back substantially or eliminate servicing
11 appliances and redeploying field service personnel to essential maintenance
12 services only. Our efforts to improve call center access and operations through
13 further system modifications would have to be terminated. Our ability to respond
14 to and address consumer complaints would be drastically reduced. Changes in
15 operations and procedures to implement the suggestions of the management audit
16 would be suspended. All work on the deregulation initiative and the July 1, 2002
17 filing would have to be stopped. Marginal services such as those supplied by the
18 district offices would also have to be suspended and so forth. In short, we would
19 focus only on assuring that gas flows through the mains and services and that we
20 bill and collect – that is all! Customer service that is not directly related to gas
21 delivery, billing and collection will suffer.

22 Fifth, in the context of the abrupt and profound downsizing that is implicit
23 in the actions above, we would be forced to cut staff and all non-essential

1 expenditures on personnel (overtime, temporary employees, etc.) – union and
2 non-union. Senior management will be asked to prioritize the positions that are
3 essential to a revised mission of survival and target all other people for separation.
4 Although the union contract contains a no-layoff clause, there is also a provision
5 in the Collective Bargaining Agreement that the PUC can modify any of the terms
6 of the Agreement as they determine appropriate. If the downgrade occurs, we
7 will present the PUC with a proposed downsizing plan and request that it take the
8 appropriate measures to effect the lay-offs, across the board, to meet the financial
9 requirements. Similarly, we will cut all nonpayroll discretionary spending, as
10 well. Obviously, the effect of these lay offs will be to further reduce the quality
11 of customer service. Tragically, the progress we have made on a variety of fronts,
12 including improving call center access, field service delivery, plant safety and
13 upgrades would be severely compromised.

14 Last, if a downgrade occurs, I will seek the advice of the PUC, the Bureau
15 of Consumer Services and the parties to suspend pertinent sections of Chapter 56,
16 which will allow us to approach our delinquent customers for payment more
17 aggressively. Management is very sensitive to the social contract which PGW has
18 as a provider of a municipal service. But in this financial emergency, PGW
19 would be required to preserve the assets to serve the greatest good. At a very
20 minimum, if we have reason to believe that a party has not paid for gas in the
21 past, we should not be required to reinstate that customer or someone in that
22 household going forward. PGW is providing tens of millions of dollars of gas to

1 people who will not or cannot pay for a host of reasons. For the system to survive,
2 even in skeletal form, customers must be required to pay for the gas they receive.

3 **Q. WHAT DO YOU SEE AS THE RESULT OF A DOWNGRADING AND**
4 **ALL OF THE ACTIONS THAT YOU DESCRIBE ABOVE?**

5
6 A. There will be immediate reduction in customer service, normal maintenance
7 levels and layoffs, resulting in irreparable harm to PGW, the City, investors,
8 employees and, most directly and importantly, PGW's customers.

9 **Q. ARE THERE OTHER COLLATERAL EFFECTS ON THE CITY IF PGW**
10 **LOSES ACCESS TO THE FINANCIAL MARKETS?**

11
12 A. Yes. There will be pressure on the City – Administration and City Council - to
13 support PGW operations following a downgrade. First, it is my understanding
14 that a one-time, or non-permanent cash allowance will not be sufficient to stop
15 S&P from downgrading. The rating agency is looking for evidence that, on an
16 ongoing basis, PGW has revenues and liquidity consistent with an investment
17 grade enterprise. Any one time assistance from the City to temporarily improve
18 PGW's S&P calculated coverages would not result in avoiding the downgrade.
19 Moreover, under the present fiscal circumstances, any redirection of funding to
20 PGW from the City will have an immediate adverse impact. We know from Ms.
21 Davis' testimony that the City is facing a substantial deficit over the next five
22 years. Were some portion of the General Fund to be needed for PGW, the City
23 department heads would have to make up an imposed level of austerity by cutting
24 services, cutting people, cutting discretionary spending or all of the above. The
25 citizens of Philadelphia will lose twice: first as customers of PGW and then as
26 taxpayers.

1 Q. MR. KNUDSEN, HOW DOES PGW PROPOSE THAT THE PUC
2 INTERPRET THE "RETURN ON EQUITY" STANDARD SET FORTH IN
3 SECTION 1308(E)?
4

5 A. It should be obvious that the financial standard that must be focused on here is the
6 maintenance of an investment grade rating for PGW's bonds and commercial
7 paper. The PUC's prior order clearly assumed that its decision would allow PGW
8 to maintain its existing external financing and continue to raise new capital. That
9 is only possible, for PGW, in today's environment, by the maintenance of an
10 investment grade rating. Now, on a going forward basis, and considering the
11 effect on the company of a much warmer than normal winter, and other factors, it
12 is necessary for the PUC to act by providing more rate relief if this goal is to be
13 achieved and disaster is to be avoided.

14 Q. WHY IS THERE AN IMMEDIATE NEED FOR THE PUC TO ACT?

15 A. Essentially, this is the deadline that S&P has imposed. It is looking to see
16 immediate, permanent improvement in PGW's liquidity or it will downgrade now.
17 Thus, the PUC must act now.

18 Q. IF S&P DOWNGRADED AND THEN THE PUC PROVIDED
19 SUFFICIENT ADDITIONAL REVENUES IN NOVEMBER, IN THE
20 CONTEXT OF PGW'S BASE RATE REQUEST, WOULDN'T THAT BE
21 SUFFICIENT.
22

23 A. Very definitely not. A downgrade now would cause irreversible harm to the
24 company and customers as detailed above. Moreover, as Mr. Krellenstein
25 testifies, even if the PUC were to act to increase PGW's rates sufficiently to put its
26 S&P calculated coverages at investment grade, there is no assurance that S&P
27 would act quickly to reverse its decision. It could take years. Moreover, in the
28 meantime, PGW would have lost all or most of its commercial paper program and

1 would be forced to pay premium for any long term debt it was able to issue after it
2 returned to investment grade. Waiting and hoping for the best is very definitely
3 not a viable option.

4

5 **Q. DOES THAT COMPLETE YOUR TESTIMONY?**

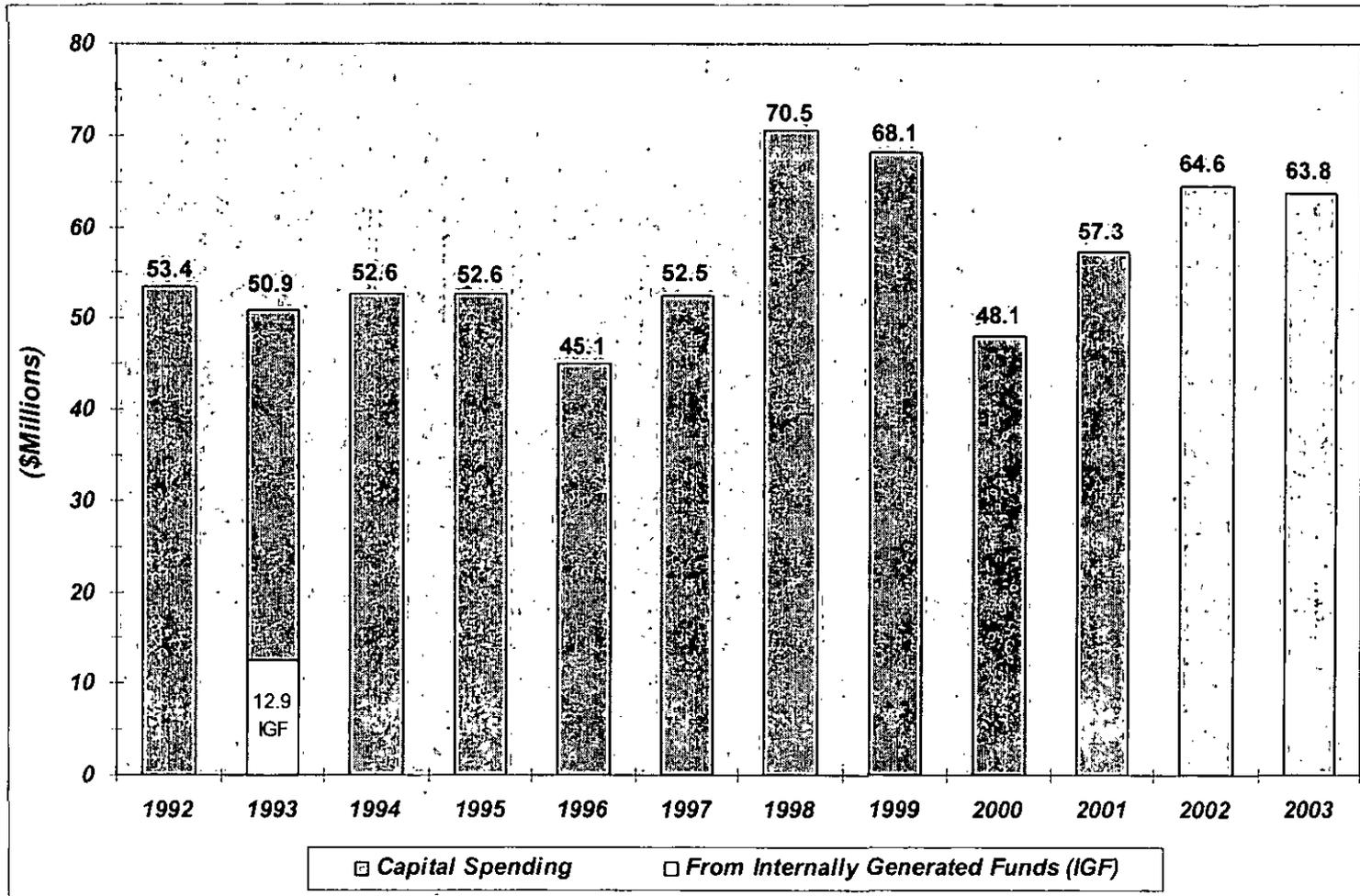
6 **A. Yes it does.**

Exhibit TEK-1

Docket No. R-000170340002

Philadelphia Gas Works

FY1992 - 2003 Capital Spending, & Internally Generated Funds



**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

TESTIMONY OF

JOSEPH R. BOGDONAVAGE

**ON BEHALF OF
PHILADELPHIA GAS WORKS**

**PHILADELPHIA GAS WORKS
EXTRAORDINARY RATE PETITION**

R-000170340002

FEBRUARY 2002

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Joseph R. Bogdonavage. My business address is 800 West Montgomery
3 Avenue, Philadelphia, PA 19122.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am employed by the Philadelphia Gas Works in the capacity of Senior Vice President
6 Finance.

7 **Q. WHAT ARE YOUR PRINCIPAL RESPONSIBILITIES AS SENIOR VICE
8 PRESIDENT?**

9 A. My principal responsibilities include the oversight of PGW's Accounting & Budget,
10 Treasury, Risk management and Procurement & Contract Services Departments. I am
11 currently responsible for the overall preparation of the financial areas of the operating and
12 capital budgets, review of operating budgets prepared by the individual departments, and
13 the coordination, analysis, issuance and overall control of the complete annual Operating
14 Budget filing. These activities include the preparation of varied analyses for the purpose
15 of generating alternative financial initiatives; i.e., proposed revenue bond and capital
16 lease offerings and base rate case presentations. Finally, in coordination with my staff,
17 the Budget area acts as a liaison between all department budget representatives regarding
18 budgeting and financial forecasting procedures and variance analysis reporting.

19 **Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE THE
20 PENNSYLVANIA PUBLIC UTILITY COMMISSION ("PUC")?**

21 A. Yes, I testified in PGW's last base rate proceeding (R-00006042).

22 **Q. PLEASE EXPLAIN THE REASON FOR YOUR TESTIMONY.**

23 A. The purpose of my testimony is twofold: (1) I will demonstrate the financial
24 consequences to PGW if it were in fact to be downgraded by S&P and it were to lose all
25 or most of its commercial paper program and be unable to sell long term debt to finance

1 its construction program. (2) I will show PGW's calculation of the level of rate relief
2 needed to produce the required fixed cost coverage ratios so that PGW will be able to
3 maintain an investment grade bond rating.

4 Q. **PLEASE EXPLAIN YOUR ANALYSES OF THE EFFECT ON THE COMPANY**
5 **IF IT WERE TO BE DOWNGRADED TO BELOW INVESTMENT GRADE.**

6
7 A. This analysis is shown on JRB-Exh. 1, page 1. It shows that if PGW took no proactive
8 steps the company would effectively stop functioning in August 2002 when it could not
9 make a debt service payment. Assuming the Company availed itself of the Debt Service
10 Reserve Fund to make that payment, it would still be \$7 million short of cash for other
11 operations. Being short of cash means that PGW doesn't have the funds to pay bills
12 when due. Looking at JRB-Exh. 1, page 2, the projections for FY 2003, PGW projects
13 negative cash positions from November to March. Even assuming the commercial paper
14 payment of \$77 million were pushed back to August of 2003, there is no way to repay the
15 commercial paper note or repay the \$45.0 million City loan.

16 Q. **PLEASE DESCRIBE YOUR ANALYSIS OF THE RATE INCREASE NEEDED**
17 **TO SATISFY STANDARD & POOR'S COVERAGE CRITERIA.**

18
19 A. I present the results of my analysis of the level of rate increase PGW needs on a
20 permanent and immediate basis if the Company is going to avoid a downgrade to "junk"
21 status by the rating agencies on JRB-Exh.2. This calculation utilizes the "coverage"
22 calculation and requirements that Ms. Bisgaier testifies S&P utilizes in evaluating the
23 financial position of a municipal utility. The analysis shows that a rate increase of \$44
24 million is needed if PGW's permanent revenues are to satisfy investment grade status,
25 thus maintaining our bond rating at its present levels.

26 Q. **WHAT PERIODS DID YOU ANALYZE TO CALCULATE THESE RESULTS?**

1 A. I applied the Standard & Poor's formula to actual projected 2002 and to our fully
2 forecasted, normalized FY 2002 Test Year because that is my best estimate of PGW's
3 earnings and cash flow on a normal, going forward basis; i.e. FY 2003. Utilizing this
4 data, I have calculated that a rate increase of \$44 million will be needed to produce the
5 necessary fixed charge coverage. It should be noted that the fully forecasted 2002 results
6 produce coverages of 1.27 times without considering the repayment of the \$45.0 million
7 City loan. Coverages drop to just under one when repayment of the \$45.0 million City
8 loan is factored in. This is consistent with our understanding of the S&P's criteria which
9 recognizes that the ratios may fall below the required levels when the repayment of a
10 large obligation comes due.

11 **Q. HOW DID YOU TREAT THE \$18.0 MILLION CITY PAYMENT FOR THE**
12 **PURPOSES OF THE STANDARD & POOR'S CALCULATION?**

13 A. As an annual obligation. As I understand S&P's approach, it must be shown that the
14 Company's financials satisfy an investment grade level on a permanent, ongoing basis.
15 S&P includes all ongoing legal obligations such as the City Payment in its "uses" of
16 funds whether the payment is granted back on a temporary or one time basis or not.
17 Accordingly, whether the City Payment is granted back from one year to the next to
18 respond to some special emergency in that year, PGW must have the capacity to make
19 this payment in its rates plus 30% liquidity over and above that amount if it is to maintain
20 its investment grade.

21 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

22 A. Yes.

Exhibit JRB-1

Docket No. R-000170340002

Estimated weather 3800 degree days
 City Loan \$45.0 MM Fully Outstanding @ 8/31/02
 \$33.8M Rate Increase - Current
 TXCP \$100.0 M with \$77.0 M Outstanding @ 8/31/02
 Reduced expenses per union contract settlement
 Pre-Draw Capital Funding during the Fiscal Period

ACTUAL WEATHER THRU 2/15/02 NO FINANCIAL TRANSACTIONS

ESTIMATE OF CASH RECEIPTS AND DISBURSEMENTS
 FISCAL YEAR ENDING AUGUST 31, 2002
 (Millions of Dollars)

	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	TOTAL
2/15/02	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	
OPENING BALANCE - CASH INCLUDES 97.0 TXCP RECEIPTS	\$1.7	\$0.7	\$3.7	\$4.2	\$3.8	\$1.0	\$35.2	\$46.4	\$58.8	\$65.7	\$44.1	(\$2.5)	\$1.7
Gas	32.2	40.9	42.9	41.5	63.1	65.0	63.0	63.0	59.0	45.8	39.0	37.0	592.4
Other	0.7	0.6	0.3	1.8	0.6	1.6	1.5	1.5	1.5	1.5	1.5	2.9	15.8
Drawn from Capital Funds - Principal (\$80.9MM)	12.9	20.0	0.0	20.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	52.9
Drawn from Capital Funds - Interest	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.7	1.9
Drawn from Lease Funds - Principal (\$3.8MM)	0.0	0.0	0.0	0.0	0.0	2.0	0.0	0.0	0.0	0.0	1.8	0.0	3.8
Drawn from Lease Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2
Advance (Repayment) of Capital Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pension Draw	0.0	0.0	0.0	9.2	6.5	0.0	0.0	2.3	2.3	2.3	2.4	2.4	27.4
City Loan	11.9	32.2	22.5	47.4	22.5	15.5	0.0	0.0	0.0	0.0	0.0	0.0	152.0
Rate Relief	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL RECEIPTS	57.7	93.7	65.9	119.7	92.7	84.1	64.5	66.8	62.8	49.6	44.7	44.2	846.4
TOTAL	59.4	94.4	69.6	123.9	96.5	85.2	99.7	113.3	121.6	115.3	88.8	41.7	848.1
DISBURSEMENTS													
Labor	10.3	11.1	11.9	10.9	10.6	10.5	11.1	11.3	11.5	10.4	11.4	10.9	131.9
Natural Gas	26.3	27.8	28.9	33.3	36.0	36.1	32.5	31.5	28.0	28.0	23.2	24.0	355.6
Debt Service	0.0	4.0	0.0	0.0	25.5	6.1	0.0	2.0	1.7	0.0	42.1	13.0	94.4
TXCP: Interest	3.5	0.1	0.2	0.1	0.0	0.2	0.3	0.3	0.3	0.3	0.3	0.2	2.5
Repayment of City Loan	14.5	36.7	17.2	68.1	15.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	152.0
Cost Savings/Reductions	0.0	0.0	0.0	0.0	0.0	(0.8)	(0.9)	(0.9)	(0.9)	(1.0)	(1.0)	(1.0)	(6.5)
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.2	0.0	0.0	18.2
Other Disbursements	7.5	7.9	10.6	10.2	10.9	10.8	10.3	10.3	10.3	10.3	10.3	10.3	119.7
TOTAL DISBURSEMENTS	58.7	87.7	68.8	122.6	98.5	63.0	53.3	54.5	50.9	66.2	66.2	57.5	867.8
MONTHLY CASH FLOW	(1.0)	6.0	(2.9)	(2.9)	(5.8)	21.1	11.2	12.4	11.9	(16.6)	(41.6)	(13.3)	(21.5)
CUMULATIVE CASH FLOW	(1.0)	5.0	2.0	(0.9)	(6.7)	14.5	25.7	38.1	50.0	33.4	(8.2)	(21.5)	
OPENING TXCP	78.0	78.0	75.0	78.5	81.0	84.0	97.0	97.0	97.0	92.0	87.0	82.0	78.0
TXCP ISSUED DURING MONTH	0.0	0.0	3.5	2.5	3.0	13.0	0.0	0.0	0.0	0.0	0.0	0.0	22.0
TXCP ISSUED PAID DOWN DURING MONTH	0.0	3.0	0.0	0.0	0.0	0.0	0.0	0.0	5.0	5.0	5.0	5.0	23.0
ENDING TXCP	78.0	75.0	78.5	81.0	84.0	97.0	97.0	97.0	92.0	87.0	82.0	77.0	77.0
OPENING BALANCE - CASH	1.7	0.7	3.7	4.2	3.8	1.0	35.2	46.4	58.8	65.7	44.1	(2.5)	1.7
MONTHLY CASH FLOW	(1.0)	6.0	(2.9)	(2.9)	(5.8)	21.1	11.2	12.4	11.9	(16.6)	(41.6)	(13.3)	(21.5)
NET TXCP ACTIVITY MONTHLY	0.0	(3.0)	3.5	2.5	3.0	13.0	0.0	0.0	(5.0)	(5.0)	(5.0)	(5.0)	(1.0)
ENDING BALANCE - CASH	0.7	3.7	4.2	3.8	1.0	35.2	46.4	58.8	65.7	44.1	(2.5)	(20.8)	(20.8)
CITY LOAN AVAILABLE - END OF MONTH	0.0	2.6	7.1	1.8	22.5	15.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
CITY LOAN UTILIZED - END OF MONTH	45.0	42.4	37.9	43.2	29.5	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0
CASH POSITION NET OF TXCP AND CITY LOAN	(119.7)	(109.2)	(117.5)	(99.7)	(112.5)	(106.8)	(95.6)	(83.2)	(71.3)	(87.9)	(129.5)	(142.8)	

DETAIL OF RECEIPTS
FISCAL YEAR ENDING AUGUST 31, 2002
(Millions of Dollars)

	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	TOTAL
OTHER RECEIPTS													
Interest:													
Sinking Fund	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$1.8	\$1.8
Capital Improvement Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Short Term Investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Natural Gas Refund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution & Scrap	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	1.1
Paid-for-Service	0.0	0.0	0.0	1.1	0.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	8.1
Other Accounts Receivable	0.6	0.7	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	6.0
TOTAL OTHER RECEIPTS	\$0.7	\$0.7	\$0.5	\$1.7	\$0.6	\$1.6	\$1.6	\$1.6	\$1.6	\$1.6	\$1.5	\$3.3	\$17.0
2/19/02													
INT INCOME	0.01	0.01	0.02	0.02	0.01	0.08	0.19	0.24	0.29	0.25	0.10	(0.05)	1.15
TXCP INT EXP	0.31	0.31	0.31	0.32	0.33	0.35	0.37	0.37	0.36	0.35	0.33	0.32	4.03

DETAIL OF OTHER DISBURSEMENTS
FISCAL YEAR ENDING AUGUST 31, 2002
(Millions of Dollars)

	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	TOTAL
OTHER DISBURSEMENTS													
State Sales Tax	\$0.3	\$0.4	\$0.5	\$0.7	\$0.9	\$1.5	\$1.4	\$1.2	\$0.8	\$0.5	\$0.4	\$0.3	\$8.9
Hospitalization & Insurance	1.4	2.2	3.0	3.0	1.4	3.0	3.1	3.1	3.1	3.1	3.1	3.1	32.6
General Matenal	0.7	0.8	0.7	0.4	0.7	0.4	0.3	0.3	0.3	0.3	0.3	0.3	5.5
Contracted Maintenance	0.1	0.0	0.4	0.5	0.2	0.5	0.4	0.3	0.3	0.3	0.3	0.3	3.6
Utilities	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	3.6
Rentals	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	1.3
Purchased Services	2.4	1.8	1.8	1.7	1.9	1.7	1.7	1.7	1.6	1.6	1.6	1.6	21.1
Postage	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.2	2.5
Capital	0.0	0.0	2.3	2.5	0.0	2.6	2.6	2.6	3.2	3.6	3.6	3.9	26.9
Adjust to actual	(2.6)		1.5		2.6	0.0	(0.3)		(0.2)	(0.2)	(0.2)	(0.3)	0.3
Other Miscellaneous	4.5	2.3	0.4	0.4	2.5	0.4	0.4	0.4	0.4	0.4	0.5	0.5	13.1
TOTAL OTHER DISBURSEMENTS	\$7.5	\$8.1	\$11.2	\$9.8	\$10.8	\$10.7	\$10.2	\$10.2	\$10.2	\$10.2	\$10.2	\$10.3	\$119.4

Exhibit JRB-2

Docket No. R-000170340002

PHILADELPHIA GAS WORKS
FISCAL YEAR 2001-02
PROJECTED INCOME STATEMENT

	<u>Current</u> <u>Estimate</u> <u>2001-02</u>	<u>Test Year</u> <u>Budget</u> <u>2001-02</u>
<u>Operating Revenues</u>		
Gas Revenues	\$672,188	\$638,733
Margin Loss Gas Sales	(25,000)	-
Proposed Base Rate Incr.	-	44,000
Other Revenues	27,450	28,117
Total Operating Revenues	<u>\$674,638</u>	<u>\$710,850</u>
<u>Operating Expenses</u>		
Natural Gas Costs	\$373,016	\$334,566
Raw Material Exp.	10	10
Total Nat. Gas & Raw Mat	<u>\$373,026</u>	<u>\$334,576</u>
Contribution Margins	\$301,612	\$376,274
Supply & Field Expenses	\$58,331	\$59,331
Customer Services	29,722	30,222
Bad Debt Expense	54,553	52,544
Marketing	4,000	5,596
Administrative & General	39,086	39,086
Health Insurance	31,490	30,490
Capitalized Benefits & A&G	(12,430)	(13,430)
Amortization	3,965	3,965
Pensions	3,091	3,091
Taxes	6,054	6,054
Added Costs PUC & Other	0	10,000
Labor/Cost Savings	(7,100)	(7,100)
Total Oper. & Maint.	<u>\$210,762</u>	<u>\$219,849</u>
Depreciation	\$31,585	\$31,587
Total Oper. & Maint. Exp.	<u>\$242,347</u>	<u>\$251,436</u>
Total Operating Expenses	<u>\$615,373</u>	<u>\$586,012</u>
Operating Income	\$59,265	\$124,838
Other Income	4,963	5,743
Income Before Interest	<u>\$64,228</u>	<u>\$130,581</u>
<u>Interest</u>		
Long-Term Debt	\$50,966	\$50,966
Other	6,148	6,498
AFUDC	(775)	(775)
Loss on Extinguished Debt	3,976	3,976
Total Interest	<u>\$60,315</u>	<u>\$60,665</u>
Net Income	<u>\$3,913</u>	<u>\$69,916</u>
City Payment	18,000	18,000
Net Loss From Operations	<u>(\$14,087)</u>	<u>\$51,916</u>

PHILADELPHIA GAS WORKS
FISCAL YEAR 2001-02
PROJECTED DEBT SERVICE COVERAGE

	<u>Current</u> <u>Estimate</u> <u>2001-02</u>	<u>Test Year</u> <u>Budget</u> <u>2001-02</u>
<u>Debt Service Calculation</u>		
<u>Funds Provided</u>		
Operating Revenues	\$674,638	\$710,850
Other Income +/-	-	-
Restricted Funds	4,963	5,743
AFUDC	775	775
Total Funds Provided	<u>\$680,376</u>	<u>\$717,368</u>
<u>Funds Applied</u>		
Fuel Costs	\$373,026	\$334,576
Other Operating Exp.	242,347	251,436
Less: Non-Cash Exp.	(36,165)	(36,165)
Total Funds Applied	<u>\$579,208</u>	<u>\$549,847</u>
<u>Funds Available To Cover Debt Service</u>		
	\$101,168	\$167,521
1975 Debt Service	<u>\$55,528</u>	<u>\$55,528</u>
Coverage Ratio	<u>1.82</u>	<u>3.02</u>
<u>Funds Available To Cover Capital Leases</u>		
	\$45,640	\$111,693
Capital Leases	<u>5,954</u>	<u>5,954</u>
Funds Available To Cover	<u>\$39,686</u>	<u>\$105,739</u>
<u>1998 Sr. Debt Service</u>		
	30,926	30,926
Coverage Ratio	<u>1.28</u>	<u>3.42</u>
<u>Funds Available To Cover 1998 Subordinate Debt Ser.</u>		
	\$8,760	\$74,813
1998 Subordinate Debt Ser.	<u>1,986</u>	<u>1,986</u>
Coverage Ratio	<u>4.41</u>	<u>37.87</u>
<u>Standard & Poor's Fixed Charge Coverage Ratio</u>		
<u>Net Available To Service</u>		
Aggregate Debt Service	\$101,168	\$167,521
Aggregate Debt Service	\$94,394	\$94,394
<u>Fixed Rate Coverage Ratio on</u>		
Aggregate Debt Service	1.07	1.77
<u>Fixed Rate Coverage Ratio</u>		
Including \$18.0 M City Fee	0.90	1.49
<u>Fixed Rate Coverage Ratio</u>		
Including \$18.0 M City Fee & \$20.0 M TXCP Payment	0.76	1.27

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

TESTIMONY OF

GARY KRELLENSTEIN

**ON BEHALF OF
PHILADELPHIA GAS WORKS**

**PHILADELPHIA GAS WORKS
EXTRAORDINARY RATE PETITION**

R- 000170340002

FEBRUARY 2002

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Gary Krellenstein. My business address is JP Morgan Guaranty, 60 Wall
3 Street, 33rd Floor, New York, NY 10260.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am a senior analyst and vice president in JPMorgan's Municipal Finance Department.
6 My areas of specialty are municipal utilities, cogeneration facilities, resource recovery
7 projects, and pollution control and industrial development bonds. I am the former
8 chairman of *The Bond Marketing Association's (TBMA) Credit Committee* and sat on the
9 Advisory Committee for *Public Utilities Fortnightly Magazine*. Since the early 1990s I
10 have been ranked as one of the top fixed-income (bond) analysts on Wall Street by
11 various financial publications such as *Institutional Investor Magazine* and the *Bond*
12 *Buyer*.

13 **Q. WHAT ARE YOUR PRINCIPAL RESPONSIBILITIES AS SENIOR ANALYST**
14 **AND VICE PRESIDENT?**

15
16 A. My responsibilities at JPMorgan include providing credit research and recommendations
17 to the firm's sales and trading desk, institutional investor clients and issuers. I also
18 advise JPMorgan Chase Bank regarding its municipal utility lending policies and
19 practices.

20 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

21 A. The purpose of this testimony is to advise the Commission about the risks that PGW
22 faces in renewing its commercial paper instrument and the consequences for both its
23 commercial paper program as well as its ability to issue long term debt should its bonds
24 be downgraded by Standard and Poors. It should also be noted that I am speaking as a

1 research analyst and not as a representative of JPMorgan Chase Bank. In that capacity, I
2 am very familiar with PGW's current financial and credit position.

3 **Q. PLEASE PROVIDE YOUR UNDERSTANDING OF S&P'S RECENT ACTION.**

4 A. On February 12, 2002, Standard & Poors issued a press release warning that "*without*
5 *immediate cash flow improvement, ratings [on PGW] will be lowered.*" The S&P release
6 also states that ratings will be affirmed only if the PUC grants emergency rate relief
7 sufficient to address concerns over the utility's weak liquidity position and overall
8 financial operations.

9 Morgan Bank has been the Agent Bank for the letter of credit (LOC) facility that
10 supports PGW's Tax Exempt Commercial Paper for several years. One of the key
11 criteria used by Morgan and other banks in determining PGW's credit quality are the
12 ratings assigned by independent credit agencies such as *Standard & Poors*, *Fitch's* and
13 *Moody's Investor's Services*. The Gas Works' bank facilities are on parity with its
14 subordinate debt and are currently rated BBB- by S&P. This is the lowest investment
15 grade rating assigned by S&P. If that rating were lowered further, they would be
16 characterized as sub-investment grade debt (i.e., "junk bonds").

17 It should be noted that it was difficult to receive internal approval to renew the
18 facility last year (June 2001) and that the other banks involved in this transaction were
19 reluctant to renew their respective portions. Consequently, the renewal came at a
20 substantial cost increase (double the cost of a similar transaction two years prior) and was
21 approved in anticipation of PGW receiving adequate rate relief sufficient to support these
22 instruments. Also, a condition for renewal of the letter of credit was a requirement for
23 PGW to reduce the outstanding balance from \$100 to \$80 million by August 2002.

1
2 **Q. WHAT WILL BE THE CONSEQUENCES OF A DOWNGRADE ON THE**
3 **ABILITY OF PGW TO SUSTAIN ITS COMMERCIAL PAPER PROGRAM?**
4

5 A. Since the renewal, there have been several developments (e.g., the economic downturn,
6 high level of losses incurred by banks on loans and credit facilities, Enron's bankruptcy,
7 etc.) that have adversely impacted the ability and willingness of banks and investors to
8 loan funds to entities such as PGW. Should the PUC fail to grant emergency rate relief
9 sufficient to prevent a downgrade by S&P, it is my professional opinion that one or more,
10 and possibly all, of the participating banks in the LOC facility will refuse to renew the
11 commitment when it comes due in August 2002. Furthermore, it will be difficult or
12 impossible to find other bank(s) to step forward as a substitute. Certainly, if PGW were
13 now, for the first time, seeking an LOC facility, I do not believe it would be available to
14 them.

15 The loss (or significant reduction in size) of the LOC facility and attendant
16 reduction in outstanding commercial paper will exacerbate the utility's cash flow and
17 credit problems and seriously impact its day-to-day operations and ability to purchase gas
18 for its customers by drawing funds from operations without maintaining the flexibility
19 provided by the commercial paper. It will also be viewed as a material adverse event by
20 investors and the rating agencies and would likely lead to additional downgrades by
21 Standard & Poors and/or the other credit agencies, effectively cutting off PGW's access
22 to the capital markets. Even if the utility were then granted an adequate rate increase, the
23 evidence shows that downgrades occur much more quickly than upgrades, and an
24 upgrade would not be guaranteed. Any upgrade, should one occur, could easily take as
25 long as 18 months to effect. During that time, PGW's access to capital markets would

1 continue to be severely constrained or non-existent. Furthermore, even after a return to
2 investment grade, the experience of other municipal utilities (MMWEC, WPPSS) is that
3 the damage done by the prior downgrades to sub-investment grade ratings would cause
4 PGW to incur dramatically higher financing costs for years to come, and those higher
5 costs would eventually have to be passed on to its customers (the utility has no equity
6 investors).

7 While no customer wants to see rates increase, it seems clear that an emergency
8 rate hike granted now would be the lowest cost option for maintaining a functional gas
9 utility that can adequately meet the needs of its customers. It is my view that without
10 further immediate attention to PGW's situation by the Commission, the utility's
11 customers will ultimately incur significantly higher costs as well as the potential for
12 inadequate gas service.

13 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

14 **A. Yes.**

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

TESTIMONY OF

BARBARA C. BISGAIER

**ON BEHALF OF
PHILADELPHIA GAS WORKS**

**PHILADELPHIA GAS WORKS
EXTRAORDINARY RATE PETITION**

R- 000170340002

FEBRUARY 2002

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. Barbara C. Bisgaier, Managing Director, Public Financial Management, Inc., 2 Logan
3 Square, Suite 1600, Philadelphia, Pennsylvania 19103-2770, (215) 567-6100. I am a
4 Financial Advisor to state and local governments and authorities.

5 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

6 A. I am employed by Public Financial Management, Inc. I am a shareholder in the firm.

7 Q. SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS.

8 I have been employed by PFM for more than 18 years. For approximately 16 of those
9 years, I have had the title of managing director and have managed the firm's municipal
10 utility practice. During my career at Public Financial Management, Inc., I have served as
11 a Financial Advisor to a broad range of state and local governments and authorities. In
12 particular, my experience has been concentrated in the area of publicly-owned utility
13 systems. In addition to the Philadelphia Gas Works, my utility clients have included the
14 Water Department of the City of Philadelphia, the Pittsburgh Water and Sewer Authority,
15 the Harrisburg Water and Sewer Authority, the New Jersey Water Supply Authority, the
16 North Jersey District Water Commissioners, the Passaic Valley Sewerage
17 Commissioners, the Middlesex County (NJ) Utilities Authority, the Ocean County (NJ)
18 Utilities Authority, the Atlantic County (NJ) Utilities Authority, the Southeast Morris
19 County Water Authority and the Atlantic City Sewerage Authority.

20 In addition, I have served, since 1992, as the Financial Advisor to the City of
21 Philadelphia. In that capacity, I have served as the City's advisor for all debt issued by
22 the City and by its authorities and enterprises (the Water Department, the Division of
23 Aviation, the Philadelphia Municipal Authority and PGW). This has included serving as
24 the advisor for two bond issues that were each in excess of one billion dollars. I served

1 as the Financial Advisor for the largest issue of municipal bonds to come to market in
2 2000: \$1.8 billion of Turnpike Revenue Bonds for the New Jersey Turnpike Authority.
3 Over the course of my career, I have served as the advisor for the issuance of long-term
4 debt having a par value in excess of \$25 billion.

5 In the course of these various engagements, my responsibilities include general financial
6 planning and the management of the debt issuance process. With regard to the financial
7 planning aspect of my work, I assist clients with their development of capital financing
8 strategies, debt policies, budgets and rate setting issues. With regard to the debt issuance
9 process, I frequently serve as the liaison between my clients and the bond rating agencies,
10 the municipal bond insurers and other credit-providing agencies. I also advise my clients
11 throughout the debt issuance process as to the costs and benefits of various alternative
12 approaches to business and financial issues under consideration. I am also frequently
13 responsible for working with my clients to prepare disclosure documents, offering
14 circulars and presentations to the bond rating agencies and credit enhancers.

15 **Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

16 A. I have an A.B. degree from Mount Holyoke College and a Masters of City and Regional
17 Planning degree from Rutgers University.

18 **Q. HAVE YOU EVER TESTIFIED BEFORE ANY REGULATORY AGENCIES?**

19 A. Yes, I have testified before the Philadelphia Gas Commission and I submitted testimony
20 to the Public Utility Commission in PGW's interim rate proceeding and the Company's
21 last general rate case.

22 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

23 A. The purpose of my testimony is to provide my expert opinion regarding the effect on the
24 Company of the downgrading to non-investment grade of PGW's bonds. I am also

1 incorporating into this submission my previous testimony in PGW's interim rate
2 proceeding and general rate case in which I explained the bond coverage requirements.

3 **Q. PLEASE EXPLAIN THE PRESENT STATUS OF PGW'S BOND RATINGS**
4 **PROVIDED BY THE RELEVANT BOND RATING AGENCIES?**

5
6 A. As may be recalled, in my previous testimony I discussed the implications to PGW of the
7 downgrade of its credit rating to below investment-grade status. In this previous
8 testimony, the concerns expressed were occasioned by the fact that two of the three credit
9 rating agencies, Moody's Investors Service and Standard & Poors Rating Services had
10 placed PGW on their respective watch lists with negative implications. Unfortunately,
11 the threat of a downgrade has now become imminent with the announcement by Standard
12 & Poors on February 12, 2002 that without immediate cash flow improvement, the
13 ratings of PGW's bonds¹ would be lowered. A copy of that report is attached hereto as
14 Exhibit BCB-1. Standard & Poors has not indicated the extent to which they will lower
15 the outstanding ratings; however, it is correct to say that, at a minimum, the subordinated
16 1998 Bonds (which are currently rated BBB-, the lowest investment-grade rating) would
17 be reduced to a below investment grade rating. There is also a significant likelihood that
18 the rating of the senior 1998 Bonds would also be lowered to below investment grade.

19 **Q. PROVIDE THE BACKGROUND OF S&P'S PRESENT ACTION.**

20 A. S&P originally placed PGW on credit watch with negative implications in July 2000. A
21 copy of that report (which was originally made part of my August 2000 testimony) is
22 attached hereto as Exhibit BCB-2. Normally, S&P uses its credit watch status to notify
23 the broader credit markets that they intend to take action on a particular credit rating

1 within, at most, two or three months once a particular milestone or action has or has not
2 occurred. The fact that PGW has remained on credit watch with negative implications
3 for almost 20 months is highly unusual and runs counter to normal practice at S&P. S&P
4 has sustained PGW's credit watch status because they have been willing to defer a final
5 determination while the various rate proceedings undertaken by PGW were in process.
6 The decision by the PUC in December to decline to revise upward PGW's authorized
7 rate increase from \$33.6 million, taken together with the increased pressure on PGW's
8 liquidity as a result of the historically warm winter of 2001-2002, has caused S&P to
9 notify the market that, absent sufficient emergency rate relief, it intends to lower PGW's
10 credit rating.

11 **Q. ARE YOU FAMILIAR WITH THE STANDARDS UTILIZED BY STANDARD**
12 **AND POORS TO EVALUATE THE FINANCIAL STATUS OF AN ENTITY FOR**
13 **RATING PURPOSES?**

14 A. Yes, in addition to scores of discussions which I have had with S&P analysts over a
15 number of years, Standard & Poors has provided to PGW the actual coverage formula,
16 standards and calculations that it is using to evaluate PGW.

17 **Q. CAN YOU EXPLAIN THE QUANTITATIVE STANDARDS THAT S&P IS**
18 **USING TO EVALUATE PGW AND THE RESULTS OF THAT ANALYSIS AS**
19 **YOU UNDERSTAND IT?**
20

21 A. Yes, S&P has been consistent in enunciating the standard by which it measures PGW.
22 While they have recognized that PGW's debt service coverage requirement of 1.5 times
23 annual debt service as a positive credit factor, they (along with Moody's) have expressed
24 concern that PGW's coverage, after the payment of operating expenses, of its fixed

¹ The bonds covered by the announcement include bonds issued pursuant to the 1975 Ordinance and both the senior and subordinated debt issued pursuant to the 1998 Ordinance.

1 obligations has been and will continue to be less than 1, absent reliance on non-recurring
2 revenues. They make a fairly simple calculation of this "fixed cost coverage ratio".
3 They subtract operating expenses and depreciation from revenues to obtain the amount
4 available to pay fixed costs. They define these fixed costs as debt service on the 1975
5 ordinance bonds and the 1998 ordinance bonds, the capital lease payments, interest on the
6 commercial paper and the \$18,000,000 payment to the City of Philadelphia. To this they
7 have added an additional \$20 million annual reduction in the commercial paper program.
8 Based upon this calculation, they project that PGW's fixed cost coverage ratio for the
9 year ended August 31, 2002 will be .88 and for the year ended August 31, 2003 will be
10 .95. The S&P worksheet is attached as Exhibit BCB-3. The S&P analyst responsible for
11 evaluating PGW was quoted on February 22 as stating that "given [PGW's] current
12 financial profile, they don't look investment grade."²

13 Obviously, anything below 1 times coverage gives extreme cause for concern.

14 **However, Standard & Poors has indicated that their standard for an investment**
15 **grade bond for a utility like PGW is not merely 1 times coverage, but rather fixed**
16 **cost coverage of at least 1.2 to 1.3 times.** This formula is specifically designed to insure
17 that the entity that they are rating has sufficient liquidity to withstand a variety of
18 exigencies. In fact, the loss of cash and margin that PGW has experienced during this
19 historically warm winter precisely illustrates why S&P is so insistent on this level of
20 fixed cost coverage. Absent the grant of emergency rate relief so that this fixed cost
21 coverage ratio can be achieved on a permanent ongoing basis, Standard & Poors will take
22 negative credit action within the next two months.

² *The Bond Buyer*, February 22, 2002.

1 Q. PLEASE DETAIL THE CONSEQUENCES TO PGW OF A DOWNGRADE BY
2 STANDARD AND POORS.
3

4 A. As I have previously testified, the impact of a downgrade of PGW's credit will be swift
5 and painful. The following is a discussion of what will occur.
6

7 Further Downgrades

8 Because the other two rating agencies, Moody's and Fitch, will quickly understand the
9 impacts of the S&P down-grade that are described below and the financial crisis that will
10 result, they too will reduce the rating of some or all of PGW's bonds to non-investment
11 grade status.
12

13 The Commercial Paper Program

14 In June 2001, PGW was able to renew the letter of credit that supports its \$100,000,000
15 commercial paper program. That letter of credit expires in August 2002. As a condition
16 of granting the 2001 extension of the letter of credit, the syndicate of banks that provide it
17 extracted two concessions from PGW. The annual fee more than doubled with an
18 increased cost to PGW of approximately \$800,000. More critically, the amount of the
19 letter of credit begins to decrease in April 2002 by \$5,000,000/month so that by the time
20 it expires in August, PGW must pay down the amount of commercial paper outstanding
21 to \$80,000,000. This \$20,000,000 pay down is mandatory.
22

23 PGW was barely able to renew the letter of credit in 2001. The decision by the syndicate
24 members to participate was not finalized until the week prior to the expiration of the
25 previous letter of credit and was obtained only after significant jaw boning by City

1 officials and with PGW's agreement to the concessions noted above. The renewal was
2 obtained while PGW's permanent rate case was being adjudicated so the syndicate
3 members were able to anticipate a favorable outcome to that case in making their lending
4 decision.

5
6 In my opinion, if any portion of PGW's bonds are downgraded to below investment
7 grade, the majority of the participants in the letter of credit will use this fact to justify
8 their withdrawal from the letter of credit syndicate., *At best*, only the syndicate leader,
9 Morgan Guaranty Trust will continue to participate in the letter of credit and the
10 commercial paper program (this is due to PGW's status as a "core" customer of
11 Morgan's). The result will be a reduction in the letter of credit from \$80,000,000 to
12 \$30,000,000, at the very least. I should note that even if PGW avoids a downgrade by
13 virtue of being awarded extraordinary rate relief, the Company may have some difficulty
14 getting the letter of credit renewal at the full \$80 million. This is due to such factors as
15 the California energy crisis, concerns created by the Enron bankruptcy and the general
16 business climate as well as specific concerns about PGW.

17
18 When the reduction of the letter of credit and the commercial paper program prompted by
19 the downgrade occurs in August 2002, PGW will be required to pay down at least
20 \$70,000,000 of commercial paper as it matures. When it is unable to do that, there will
21 be a \$70,000,000 (or whatever portion of the letter of credit is not renewed) draw on the
22 letter of credit and the banks will hold an immediately payable demand note. Because
23 PGW will be unable to make this demand payment, it will be necessary to try to enter

1 into some sort of loan workout agreement with the banks. While the loan is unpaid,
2 interest at a taxable rate will be due and owing the banks.

3
4 The impact of such an outcome on PGW will be devastating. The legitimate demands of
5 the bank creditors will pose a permanent barrier to PGW's ability to re-establish itself on
6 a firm financial basis. All remaining liquidity will be wrung out of the company.
7 Vendors, including gas providers, will be unwilling to advance credit to PGW. The
8 company will be in a financial meltdown.

9
10 Future Borrowings

11
12 It has been a number of years since PGW has been able to fund any portion of its capital
13 requirements on a pay-as-you-go basis from internally generated funds. Instead, it has
14 borrowed through the issuance of bonds to fund virtually 100% of its capital needs. In
15 order to continue to make improvements to its LNG plant and, more critically, to
16 continue to implement its main replacement safety program, it is imperative that PGW be
17 able to sell bonds. Prior to the current crisis, PGW had intended to sell its next series of
18 bonds in December 2002. Bond proceeds were to be used for capital purposes while also
19 providing a source of interim liquidity for the company.

20
21 **If PGW's rating is reduced to a below investment grade status, it will be unable to**
22 **sell its bonds.** Like the City of Philadelphia (which was unable to sell its general
23 obligation bonds from 1988-1993 while its credit rating was below investment grade),

1 PGW will be unable to sell bonds and will have no means of funding even the most
2 critical of its capital requirements. PGW would immediately need to suspend normal
3 operations in order to husband its resources so as to be able to respond to real
4 emergencies and to continue to provide gas service to customers as long as possible. Mr.
5 Knudsen describes some of those responses in detail.

6
7 The Forward Purchase Agreement
8

9 PGW's financial forecast for 2002 included the implementation of a new Forward
10 Purchase Agreement for its sinking fund reserve. This transaction, which was in progress
11 when the S&P credit statement was released, was anticipated to yield cash in the amount
12 of approximately \$20,000,000 during the spring of 2002. The transaction is now on hold.
13 If the investment grade rating is not sustained, PGW will be unable to complete this
14 transaction and will be short an additional \$20,000,000 in cash.

15 **Q. PLEASE SUMMARIZE YOUR ANALYSES OF THE EFFECT ON PGW AND**
16 **ITS CUSTOMERS IF THE COMPANY'S BONDS ARE DOWNGRADED.**

17
18 A. I cannot stress too strongly that the effect on PGW of a downgrade will be swift and
19 disastrous. It will almost immediately result in suspension of normal operations and
20 service will force the Company to lay off employees. As I indicated, it would begin a
21 complete financial meltdown which would impose enormous additional costs on
22 ratepayers from which PGW will not be able to extricate itself for years to come.

23 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

24 A. Yes.

Exhibit BCB-1

Docket No. R-000170340002

Philadelphia Gas Works' Ratings Remain on CreditWatch Due To Worsened Liquidity Position

*Aneesh Prabhu, New York (1) 212-438-1285;
Jodi E Hecht, New York (1) 212-438-2019*

NEW YORK (Standard & Poor's) Feb. 12, 2002--Standard & Poor's triple-'B' underlying rating (SPUR) and triple-'B' unsecured rating on Philadelphia Gas Works' (PGW) Ordinance 1975 and 1998 senior bonds, and its triple-'B'-minus SPUR on the 1998 Ordinance subordinated bonds remain on CreditWatch with negative implications where they were placed July 20, 2000.

PGW's poor liquidity position has worsened with December 2001 cash balances at \$3.8 million (2.5 days' cash) compared to ending cash of about \$8.4 million at fiscal year-end August 2000. PGW is filing an emergency rate relief in February 2002 with the Pennsylvania Public Utility Commission (PUC) to address liquidity issues. Without immediate cash flow improvement, ratings will be lowered. PGW's poor liquidity is due, in part, to the PUC final rate order of a \$33.6 million rate increase in December 2001, about \$31.0 million less than requested. This rate shortfall, combined with the warmer-than-budgeted weather this winter and higher receivables, contributes to poor liquidity, which is not appropriate for the current rating level. "If the PUC approves an emergency rate request, Standard & Poor's will review the adequacy of the increase and determine if ratings will be affirmed or lowered," said Standard & Poor's credit analyst Aneesh Prabhu.

PGW, the largest municipally owned gas utility in the U.S., purchases, sells, and distributes gas to more than a half-million customers within the city of Philadelphia. At fiscal year-end August 2001, PGW had about \$900 million of debt outstanding.

The ratings reflect the following risks:

-- The poor liquidity position required PGW to temporarily borrow from its capital fund account in January 2002 for servicing debt obligations, and requires PGW to rely on financial transactions that create nonrecurring revenues in this fiscal year. Without additional project revenues or rate relief, PGW may be unable to reimburse its capital fund. PGW will also seek a deferral on the \$45 million working capital city loan, due in January 2003.

-- Weak fixed-charge coverage that, including lease payments and the annual payment to the city of Philadelphia,

has ranged between 1.0 times (x)-1.1x during the past four years.

-- Limited ability of the city of Philadelphia to provide assistance due to the city's tight financial situation.

-- PGW's problems with high account receivables, which were exacerbated in 2001 due to escalating fuel prices recoverable through the gas cost recovery (GCR) mechanism. Receivables have been historically high due to a high proportion of low-income residents in the demographics of PGW's service territory.

-- A warm winter, which likely will cause PGW to miss budgeted forecasts in fiscal 2002.

-- Inability to convert from interim management to permanent management by December 2001, as directed by PUC's interim rate order in November 2000. The search for permanent management is at an advanced stage and is expected to conclude by April 2002.

Nonetheless, the following strengths offset the risks:

-- A favorable closing to the labor contract negotiations in June 2001; the contract freezes labor costs for the next two years, reduces benefits, and reasserts management prerogatives regarding work rules.

-- Operational improvements that included correcting the faulty billing system, improving call center performance, and auditing procedure improvements.

-- Sound legal provisions that require 1.5x coverage on an accrual basis on the senior bonds.

-- The PUC's timely approvals of required gas cost rate increases since regulatory oversight changed in July 2000.

-- PGW has successfully solicited federal and state funds in the form of LIHEAP and Crisis grants, which have aided the company's cash flow and earnings position.

Exhibit BCB-2

Docket No. R-000170340002

Ratings Services
55 Water Street, 38th Floor
New York, NY 10041-0003
Tel: 212 438-2064
Reference No.:

Curtis Moulton
Managing Director
Infrastructure Finance Ratings

Standard & Poor's 
A Division of The McGraw-Hill Companies

July 20, 2000

Mr. Kumar Kishinchand, P.E.
President & Chief Executive Officer
Philadelphia Gas Works
800 W. Montgomery Avenue
Philadelphia, PA 19122

Re: \$355,825,000 Philadelphia Gas Works, Revenue Bonds
\$103,550,000 Philadelphia Gas Works, Revenue Bonds, 1998 General Ordinance,
Series B (SPUR)
\$160,660,000 Philadelphia Gas Works, Revenue Bonds, 1998 General Ordinance,
Series A (SPUR)
\$112,245,000 Philadelphia Gas Works, Revenue Bonds, Second Series (SPUR)
\$61,960,000 Philadelphia Gas Works, Revenue Bonds, Sixteenth Series (SPUR)

Dear Mr. Kishinchand:

As part of Standard & Poor's ongoing secondary market surveillance, we have reviewed the latest financial report and other relevant data on the above debt. After such review, we have placed the rating of 'BBB' on CreditWatch with negative implications due to PGW's very weak cash flows arising from a convergence of budgeting that did not reflect the trend toward warmer winters; historic ongoing problems with high revenue receivables; and the faulty implementation of a new billing system.

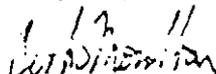
Please continue to send updated information including annual audit reports and budgets, and if applicable, updated operating and construction progress data, addressed to:

Standard & Poor's Ratings Services
Public Finance Secondary Market Surveillance
55 Water Street, Muni Drop Box No. 1, 38-2-2
New York, NY 10041-0003

If you have any questions please feel free to contact Jodi Hecht at (212) 438-2019.

Thank you for continuing your relationship with Standard & Poor's Ratings Services.

Very truly yours,



cc: Barbara C. Bisgaiet, Public Financial Management

STANDARD
& POOR'S



PHILADELPHIA GAS WORKS, PENNSYLVANIA

Credit Profile

Outstanding Ratings
\$794.2 mil rev bnds,
varies series BBB
\$20.0 mil rev bnds,
subordinate, 1998 gen ordinance, BBB-

Revised: CreditWatch
Neg-100

Analysts:
Iodi Hecht, New York
212) 438-2019
Elizabeth Fitzgerald Smith, Chicago
312) 669-2172

Rationale

The rating action reflects PGW's very weak cash flows arising from a convergence of budgeting that did not reflect the trend toward warmer winters; historic ongoing problems with high revenue receivables; and the faulty implementation of a new billing system. Rate relief is needed by this fall. The tariffs that PGW has filed before the state Public Utilities Commission are projected to generate an additional \$52 million and increase base rates and monthly charges by 10%. The proposed tariff will increase rates to above-average in a service area with below-average income levels.

Rate applications to the PUC are typically resolved over a nine-month period, but it is not clear that PGW's application, which was filed in July 2000, will be approved before the 2000 winter heating season that is a critical component of the utility's cash flow.

Other credit weaknesses include the following:

- Potentially above average gas rates if PGW's five year plan is not fully implemented, especially in a market that will be open to retail choice beginning in fiscal 2004;

- Aggressive future projections which assume normal weather conditions that have not been realized in recent years and productivity cost savings, ranging from 5% to 10% of expenditures;

- Deferred capital spending limited by declining excess cash flow; and

- Uncertainty regarding the long term management structure and operating strategy.

These are offset by sound legal provisions, which require, on an accrual basis, 1.50 times (x) coverage on the senior bonds, in spite of the lowered revenue requirement from the creation of a subordinate lien.

The bonds are secured by the net revenues of the gas system. Under provisions of the Natural Gas Choice and Competition Act, which was signed into law in June 1999 by Gov. Tom Ridge, after July 1, 2000 the rate relief and customer service functions for PGW were to be regulated by the PUC. Previously, these powers belonged to the Philadelphia Gas Commission (PGC). The PGC maintains the authority to approve operating and capital budgets, while the city of Philadelphia remains the owner of the system.

PGW filed a rate increase in July 2000, which they would like to take effect before the 2000 winter heating season. However, the PUC's approval process takes nine months to complete. PGW requested that the PUC allow this rate filing to be reviewed by PGW, which has a shorter process, and would enable the new rates to be effective by October 2000. Without the rate increase in place, the ending cash position for fiscal 2001 is projected to be negative \$16.9 million (approximately 4% of operating expenditures).

The 1998 indenture created senior and subordinate liens. The senior lien rate

PHILADELPHIA GAS WORKS, PENNSYLVANIA

covenant remains at 1.50 times (x) annual debt service, while the subordinate lien and refunded 1975 bond rate covenant require only 1x coverage of annual debt service. While 1.5x coverage is sound for a triple-B-rated gas system, debt service coverage of all obligations after the \$18 million annual transfer to the city was less than 1 times (x) in fiscals 1998 and 1999. The payment is made throughout the year. However, the city had been willing to defer the payment until year end, providing some latitude to address unanticipated year-end financial needs.

Minimal coverage has been a historic problem. PGW implemented non-recurring actions in fiscals 1995, 1998, and 1999 to meet its rate covenant. Steps were not needed in fiscal 2000, because the calculation of the rate covenant was liberalized under the provisions of the 1998 indenture. Another warmer-than-budgeted winter in 2000 led to reduced gas sales, and revenues were 15% lower than budget. Debt service coverage in fiscal 1999 of all revenue bonds was 1.11 times (x), with estimated fiscal 2000 results generating 1.31x DSC. However, when coverage of all fixed payments—including lease payments—is calculated, fiscal 1999 DSC was a minimal 1.01x, and fiscal 2000 DSC is 1.20x. Financial projections, while somewhat aggressive, assume a normal number of degree days, which has not occurred in the past three years; approval of the rate increase; discontinuation of the senior citizen discount program; and productivity and costs savings that are expected to be implemented under a new labor contract beginning in late fiscal 2001.

Over the past three years, including estimates for fiscal 2000, operating expenses have exceeded operating revenues, reducing reserves and cash balances. In fiscal 2000, no excess revenues were generated to contribute to ongoing and long-term capital needs. The revised five-year fiscal 2002-2006 capital program totals \$265.4 million—a \$91 million decline from the previous program. While current management believes this program is better targeted to address immediate needs, it is unclear that the ongoing investment has been adequately made in the system. Funding

for this program includes a \$75 million bond issue next fiscal year (23% of the program) with the balance (72%) funded from internally generated funds. Funding for the capital program is largely dependent on PGW's ability to implement the five-year operating plan, as projected.

Outlook

To preserve its ratings, PGW will need to obtain rate relief and implement the projected productivity savings ranging between 5% to 10% annually. Cost reductions are critical to PGW's ability to fund future capital needs and maintain competitive commodity charges to retain customers following the introduction of customer choice in fiscal 2004.

Exhibit BCB-3

Docket No. R-000170340002

PGWORKS

Fiscal Year Ending: 08/31

Operating Revenue ('000)

Base Rate Scenarios

	1998-99	1999-00	2000-01	2001-02	2001-02	2001-02	2002-03
Non-heating/Gas transportation/Unbilled gas adj.	\$72,751	\$91,143	\$107,035	\$103,103	\$103,103	\$103,103	\$100,966
Heating	\$390,242	\$434,544	\$620,867	\$536,079	\$536,079	\$536,079	\$525,008
Proposed Base Rate			\$0	\$32,224	\$34,724	\$62,224	\$62,417
Marginal Revenue Loss Customer Utilization			\$0				(\$2,000)
Unbilled Adjustment	(\$349)	\$7,299	(\$8,967)	(\$1,400)	(\$700)	(\$700)	\$950
Appliance and other revenues	\$13,683	\$11,978	\$12,075	\$12,260	\$12,260	\$12,260	\$20,571
Other operating revenues	\$10,558	\$10,911	\$19,048	\$16,785	\$17,540	\$17,540	\$17,210
Total Operating Revenues	\$486,885	\$555,875	\$750,058	\$699,051	\$703,006	\$730,506	\$725,122
Interest & other income	\$8,263	\$9,417	\$12,343	\$4,934	\$5,894	\$5,894	\$8,380
Swap and option agreement	\$0	\$8,645	\$0	\$0	\$0	\$0	\$0
AFUDC (Interest)	\$0	\$0	\$0	\$765	\$765	\$765	\$623
Total Non-Operating Revenues	\$8,263	\$18,062	\$12,343	\$5,699	\$6,659	\$6,659	\$9,003

Total Revenues

	\$495,148	\$573,937	\$762,401	\$704,750	\$709,665	\$737,165	\$734,125
--	------------------	------------------	------------------	------------------	------------------	------------------	------------------

Operating Expenses

Natural Gas	\$219,090	\$266,354	\$431,327	\$373,026	\$373,026	\$373,026	\$355,234
Gas Processing	\$13,881	\$14,033	\$13,400	\$13,161	\$13,161	\$13,161	\$13,643
Field Services	\$35,090	\$33,704	\$33,202	\$32,730	\$32,730	\$32,730	\$33,113
Distribution	\$15,527	\$14,246	\$14,837	\$14,440	\$14,440	\$14,440	\$14,434
Customer affairs	\$27,044	\$28,031	\$27,418	\$28,722	\$28,722	\$28,722	\$27,936
Bad Deb: expense	\$39,000	\$54,642	\$67,633	\$60,823	\$61,601	\$61,601	\$58,802
Marketing	\$5,253	\$3,041	\$3,486	\$6,596	\$6,596	\$6,596	\$5,616
Administrative & General	\$27,545	\$56,236	\$25,257	\$32,043	\$32,043	\$32,043	\$28,972
Health Insurance	\$23,432		\$27,404	\$30,490	\$29,190	\$29,190	\$33,559
Pensions	\$787	\$1,096	\$2,301	\$2,313	\$2,313	\$2,313	\$2,268
Taxes	\$6,091	\$6,512	\$6,299	\$6,430	\$6,430	\$6,430	\$6,374
Personal reductions/retirements				(\$7,100)	(\$10,500)	(\$10,500)	(\$10,000)
Total Operating Expenses	\$412,740	\$477,895	\$652,564	\$593,674	\$589,752	\$589,752	\$569,949

Net Depreciation

Net Depreciation	\$29,075	\$30,805	\$31,840	\$33,285	\$33,285	\$33,285	\$34,911
Payment in Lieu of Taxes	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Other - Amortization of Demand Side Management	\$0	\$0	\$0	\$0	\$0	\$0	\$0

Net Available To Service Debt (Exc. Depr.)

Net Available To Service Debt (Exc. Depr.)	\$82,408	\$96,042	\$109,837	\$111,076	\$119,913	\$147,413	\$164,176
Add Capital leases	\$7,882	\$7,988	\$7,977	\$5,954	\$5,954	\$5,954	\$3,997
Net Available To Service aggregate debt	\$90,290	\$104,030	\$117,814	\$117,030	\$125,867	\$153,367	\$168,173
PGW Provided Numbers	\$88,167	\$101,872		\$115,654	\$152,184	\$152,185	\$167,921

Debt Service Coverage Analysis

	1998-99	1999-00	2000-01	2001-02	2001-02	2001-02	2002-03
Net Available To Service 1975 Bonds	\$90,290	\$104,030	\$117,814	\$117,030	\$125,867	\$153,367	\$168,173
1975 Ordinance bonds debt service	\$57,741	\$59,345	\$51,611	\$55,528	\$55,528	\$55,528	\$47,292
Debt Service 1975 Bonds	1.56	1.75	2.28	2.11	2.27	2.76	3.56
1998 Ordinance bonds debt service	\$14,230	\$21,659	\$29,449	\$30,926	\$30,926	\$30,926	\$36,539
DS 1975 Senior Bonds/and 1998 Ordinance Senior Bonds	1.25	1.28	1.45	1.35	1.46	1.77	2.01
Capital Lease Costs	\$7,882	\$7,988	\$7,977	\$5,954	\$5,954	\$5,954	\$3,997
Debt Service 1975 bonds/Capital Leases/1998 senior	1.13	1.17	1.32	1.27	1.36	1.66	1.91
1998 Ordinance Subordinated Debt	\$1,988	\$1,987	\$1,990	\$1,986	\$1,986	\$1,986	\$1,988
Debt Service (revenue bonds plus capital leases)	1.10	1.14	1.29	1.24	1.33	1.62	1.87
Total Debt Service (Interest & Capital repayments)	\$81,841	\$90,979	\$91,027	\$94,394	\$94,394	\$94,394	\$89,816
Others-Commercial Paper Notes	\$2,822	\$3,927	\$4,537	\$20,000	\$20,000	\$20,000	\$20,000
Fixed Charge Cov. - Aggregate Debt Service	1.07	1.10	1.23	1.02	1.10	1.34	1.53
City Annual Payment			\$18,000	\$18,000	\$18,000	\$18,000	\$18,000
Fixed charge Cov., including city payment of \$18 million			1.04	0.88	0.95	1.16	1.32

Fixed Charge Cov. Weather adjusted in 2001-2002 (@ \$10 million impact)

0.81 0.88 1.08

Fixed Charge Coverage, including financial transaction @ \$20 million

0.96 1.03 1.23

Fixed charge coverage, including financial transaction and city annual payment grant back (all \$18 m)

1.11 1.19 1.43

Fixed Charge Coverage with City \$45 mill repayment (2002-2003)

0.97

Column F volumetric relief ; Column G compressed relief

Aggregate Fixed Charge Coverage for 2003 includes \$18 million city payment & the \$45 million loan repayment . However, \$20 million CP paydown, shown under debt service

**2001-2002 emergency rate increase assumes an additional \$30 million permanent rate over the amount already granted . However, the cash impact is only \$2.5 million in

If the additional \$30 million is available on a cash basis in 2002, fixed charge coverage assuming the financial transaction is 1.23 and with the city loan grantback is 1.43

The entire \$30 million emergency additional relief is available on a permanent basis in 2003 (first full year with \$65 million rate increase)

2002-2003 assumes normal degree days (4,555 degree-days). Past 3 winters have averaged lower

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

TESTIMONY OF

JANICE DAVIS

**ON BEHALF OF
PHILADELPHIA GAS WORKS.**

**PHILADELPHIA GAS WORKS
EXTRAORDINARY RATE PETITION**

R- 000170340002

FEBRUARY 2002

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.**

2 A. My name is Janice Davis. My business address is 1401 J.F. Kennedy Boulevard, Suite
3 1330, Philadelphia, PA 19102.

4 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

5 A. My testimony is presented on behalf of the City of Philadelphia as the owner of
6 Philadelphia Gas Works ("PGW").

7 **Q. PLEASE SUMMARIZE YOUR EDUCATION AND PROFESSIONAL**
8 **EXPERIENCE FOR THE RECORD.**

9 A. I was appointed as Director of Finance of the City of Philadelphia by Mayor John F.
10 Street. As a member of the Mayor's Cabinet and Chief Financial Officer of the City, I
11 am involved with financial and fiscal policy development and directly oversee all City
12 financial activities, including budget, accounting, revenue collection, treasury functions
13 and procurement, as well as activities related to risk management, the Minority Business
14 Enterprise Council and Bureau of Administrative Adjudication. I also serve as the
15 Chairman of the Philadelphia Board of Pensions and Retirement and as a member of
16 various boards and commissions, including City Planning Commission, Mayor's Office
17 of Community Services, Pennsylvania Intergovernmental Cooperation Authority,
18 Philadelphia Industrial Development Corporation, Philadelphia Housing Development
19 Corporation, and the Sinking Fund Commission. I also serve on the Board of Directors
20 of the Philadelphia Facilities Management Corporation. My curriculum vitae detailing
21 my professional experience is attached as Exhibit JD-1 to this testimony.

22 **Q. WHAT ARE YOUR RESPONSIBILITIES AS FINANCE DIRECTOR?**

23 A. As Director of Finance, I have responsibilities under the Management Agreement to
24 oversee the operations of PGW. Specifically, I assist in the preparation of the operating

1 budget and forecast and offer recommendations as to the form and extent of the capital
2 budget and forecast prior to its submission for City Council approval. My office further
3 receives plans for capital loans and participates in the approval process for short and
4 long-term borrowing, among other duties.

5 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE PUC ABOUT THE**
6 **LEVEL AND TYPES OF SUPPORT PROVIDED BY THE CITY OF**
7 **PHILADELPHIA TO PGW?**

8 A. Yes. I submitted testimony in PGW's previous base rate proceeding detailing the various
9 types of financial and other support that Philadelphia had provided to PGW at that time to
10 respond to PGW's existing and continuing financial crisis. I am attaching that testimony
11 as Exhibit JD-2.

12 **Q. CAN YOU UPDATE THAT SUMMARY?**

13 A. Yes. Most importantly, PGW continues to have use of a \$45 million interest free
14 revolving loan provided by the City to assist its cash working capital needs. As I
15 testified, the cost of such a loan would be \$2-3 million annually if it had been obtained
16 conventionally (which PGW would not have been able to do in any event). While, by its
17 terms, the loan is due to be paid back in January 2003, the administration shortly will
18 propose to permit PGW to delay repayment until August 2003. In addition, although the
19 earnings on PGW's bond sinking funds belong to the City, (since the bonds, technically
20 are City bonds), we have agreed to allow those earnings to be booked as Other Income.
21 Those earnings also form the basis of any forward purchase agreement when the
22 Company requires such a financing. (Mr. Knudsen explains the forward purchase
23 agreement in greater detail in his testimony.)

1 Q. **IN LIGHT OF STANDARD AND POORS THREATENED DOWNGRADE,**
2 **WHAT IS THE CITY'S PRESENT ABILITY TO PROVIDE ADDITIONAL**
3 **FINANCIAL SUPPORT TO PGW?**

4 A. Since the last time I testified, Philadelphia's financial circumstances, which mirror the
5 economy, have materially changed for the worse. In May 2001, (the date of my last PUC
6 submission) for a five year period I was projecting a surplus for the City in excess of \$
7 180 million. This year, in preparing our five year plan for fiscal years 2003 –2007, the
8 City was forced to take drastic steps to avoid a \$ 296 million deficit over the life of the
9 Plan. These steps included reducing our contribution to the pension fund and curtailing
10 planned tax reductions. Philadelphia's budget is subject to review and approval by the
11 Pennsylvania Intergovernmental Cooperation Authority ("PICA"). In its current five
12 year plan, (Fiscal years 2002 –2006) there is neither capacity nor provision for additional
13 subsidies to PGW. The City's five year plan is predicated on receiving \$135 million of
14 revenue from PGW, consisting of the \$18 million annual payment to the City for five
15 years, as well as a payback of the \$45 million emergency loan. Without these revenues
16 from PGW, there will be a hole in the City's plan that must be filled through other cuts.

17 Q. **IN LIGHT OF PGW'S PRESENT FINANCIAL EMERGENCY, WHAT**
18 **ADDITIONAL STEPS WILL THE CITY BE ABLE TO TAKE TO ASSIST THE**
19 **COMPANY?**

20 A. Under the circumstances, the City presently has very limited ability to provide even
21 temporary additional assistance to PGW. However, PGW has explained that, in light of
22 the effects of the extremely warm winter and the possibility of not being able to move
23 forward with a planned forward purchase financing, the Company is in danger of failing
24 to satisfy the debt service coverage requirements of its bond covenants for this fiscal
25 year. At present, the Company is projecting that even if the PUC awarded the Company
26 additional extraordinary rate relief this Spring, PGW will not be able to collect sufficient

1 additional revenue to offset the magnitude of losses it will experience by fiscal year end.

2 Missing the coverage requirement would be a disastrous consequence that must be
3 avoided at all costs.

4 To prevent this outcome the Administration may have no option but to grant back
5 to PGW all or the necessary portion of its \$18 million payment on a one time basis, to the
6 extent it is necessary, to assure that PGW will not fall below its covenant requirements
7 and be in technical default on its bonds. This cannot be done without having some
8 negative impact on the City's finances.

9 **Q. DO YOU EXPECT THAT THE CITY WILL BE ABLE TO PROVIDE ANY**
10 **FURTHER ASSISTANCE OF ANY SORT UNDER ANY CONDITION?**

11 A. No. To repeat, the City is facing a tight budget, principally due to the down turn in the
12 economy as well as additional funding requirements for the School District, another
13 financially troubled entity. PGW's City payment and payback of its loan are key
14 elements of our plan to balance our budget. We are truly in a situation where any
15 reduction in those sources of revenue for the City would result in a reduction in City
16 services, layoffs or a hiring freeze.

17 Additionally, it is my understanding that one-time stop gap measures will not
18 satisfy the liquidity deficiency that the rating agency has identified for PGW. The City is
19 in no position to provide ongoing support to the Company.

20 Any assistance will be for the current fiscal year only; to do more would be to
21 jeopardize the fiscal stability of the City.

1 Q. ASSUME, IF YOU WOULD, THAT PGW IS DOWNGRADED AND THAT THE
2 COURSE OF EVENTS AS OUTLINED BY MR. KNUDSEN OCCURS. WHAT
3 WOULD PGW'S CRISIS MEAN TO THE CITY?

4 A. Frankly, a scenario such as Mr. Knudsen describes would be a catastrophe. First, the
5 City would lose the string of \$18 million dollar payments and the \$45 million loan, as a
6 subordinate instrument to all other debt, would be placed in some indefinite position.
7 Given the nature of the work-out that would ensue -- bank loan restructuring, payment
8 deferrals, etc., I assume that the City could not count on repayment during the planning
9 period. I would then have a \$135 million larger gap in the budget. Some combination of
10 drastic reductions in programs and tax/fee changes would be needed. Without seeing the
11 specifics of a workout plan, I can't speculate further. Where the money would come from
12 other than customers at that point, I don't know.

13 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

14 A. Yes.

Exhibit JD-1

Docket No. R-000170340002

JANICE D. DAVIS

EXPERIENCE

May, 2000-
Present

City Of Philadelphia

Secretary of Financial
Oversight/Director of
Finance

Directs the financial operations of the City. Supervises the following departments: Purchasing, Accounting, Budget, Revenue, Minority Business Enterprise Commission, Treasury, Pension Trust, Risk Management, Board Of Administrative Review and the Sinking Fund Commission. Exercises financial oversight of related City entities such as the Philadelphia School District, Philadelphia Gas Works and the Philadelphia Parking Authority. Serves on the Board of Directors of several boards and commissions, including the Pennsylvania Convention Center, Penn's Landing, the Philadelphia Intergovernmental Cooperation Authority, the Philadelphia Facilities Management Corporation and the Philadelphia Industrial Development Authority. Participates in labor contract negotiations. Supervises the issuance of all debt of the City and its related entities. Serves on the City planning commission. Serves as a member of the Mayor's cabinet.

October 1998-
May, 2000

Dallas Independent School District

Chief Financial Officer

Directed the financial operations of the school district. Supervised the following departments: Purchasing, Finance and Accounting, Budget Development and Control, Risk Management, and Minority and Women Business Enterprise. Served as a member of the Superintendent's cabinet. Recommended policies and establishes procedures relating to the financial, cash management, risk management, debt management, procurement, minority business, budget and accounting operations of the District.

September 1995-
September 1998

Dallas/Fort Worth International Airport

Director of Finance
and Budget

Supervised Accounts Payable, Accounts Receivable, Payroll, Financial Planning, Grants Management, Cash Management, Cost Systems Budget and Risk Management. Established policies and procedures relating to the financial, cash management, risk management, debt management, budget and accounting operations of the Airport. Had responsibility for setting rates charged for use of Airport facilities. Evaluated borrowing alternatives and initiated all debt issuance. Served on the following committees: Investment, Capital, Information Technology Strategic Planning. Prepared monthly projections of revenues and expenses. Supervised the preparation of monthly report to the Board of Directors, quarterly report to the

airlines, the annual operating and capital budgets and the Comprehensive Annual Financial Report.

May 1993-
September 1995

**Finance and Administration
City of Houston, Texas**

**Deputy Director
Financial Services**

Supervised the Office of Budget and Management, Cash and Debt Management, Capital Improvement Management and Grants Management. Established policies and procedures relating to the financial, budget and debt operations of the City of Houston. Had responsibility for the development, preparation and management of all city budgets, which combined totaled in excess of one billion dollars. Supervised the preparation of the five year economic forecast and Capital Improvement Plan. Supervised capital spending to ensure compliance with IRS and other regulatory requirements. Evaluated borrowing alternatives and initiated all debt issuance. Appeared before rating agencies in conjunction with the issuance of debt. Supervised the preparation of monthly projections of revenues and expenditures for all City funds. Served as an advisor to the Mayor on matters relating to finance. Served on the following permanent committees: Investment, Arbitrage, Accounting Improvement. Appeared before the City Council and Council committees as needed. Served as City appointee and Treasurer on the Board of Directors of a tax increment/public improvement district.

August 1992-
May 1993

**City Controller's Office
City of Houston, Texas**

**Deputy Director/Director
General Accounting**

Directed, managed, planned and evaluated the accounting and financial reporting activities. Reviewed the analysis of revenue and expenditure projections for all fund types. Supervised the preparation of the Controller's Monthly Financial Report. Acted as the lead in the preparation, review and submission of the Comprehensive Annual Financial Report.

June 1989-
August 1992

**Sewerage and Water Board
New Orleans, Louisiana**

Utility Financial Administrator

Supervised the Finance, Payroll, Customer Accounting and General Accounting Departments. Established policies and procedures to provide for efficient operation of the financial and accounting functions. Served on various committees charged with designing and implementing new software systems. Served on the capital and operating budget committees. Supervised the preparation of the Comprehensive Annual Financial Report. Worked with the external auditors and the Computer Center to design an interface between the Customer Account Management

System and the general ledger. Appeared, as needed, before legislative, educational and community groups to address issues of fiscal importance to the Board. Participated in the Quality Management Project as a member of the implementation task force. Participated in the preparation of RFP's for a fixed asset inventory, computer management services and privatization of sewer treatment operations.

March 1979-
June 1989

New Orleans Public Schools

**Accounting Manager;
General Ledger Accountant;
Accountant II; Accountant I**

As Accounting Manager, directed the accounting functions of the Finance Department which included Accounts Payable, Payroll, Fixed Assets and General Ledger. Prepared cashflow/cash need projections. Served as the department's liaison to the various departments as it related to the MSA general Ledger and subsystems. Assisted in the preparation, review and submission of the Comprehensive Annual Financial Report. Assisted in bond sales.

As the General Ledger Accountant, developed the system for balancing the subsystem input into the general ledger posting. Supervised staff responsible for the data input and verification. Prepared departmental budget and monitored expenditures. Participated in the District's first audit.

As Accountant I and II, assisted in the installation and implementation of the computerized general ledger. Prepared and balanced all initializing input into the new general ledger. Supervised staff responsible for data input.

EDUCATION

University of New Orleans
Bachelor of Science in Accounting, 1978

PROFESSIONAL DESIGNATION

Licensed Certified Public Accountant, Louisiana, Texas; Certified Government Financial Manager

ORGANIZATIONS

American Institute of Certified Public Accountants; Texas Society of Certified Public Accountants; Government Finance Officers Association; Association of Government Accountants; 2001- 2003 Fellow, Urban Health Initiative

February 26, 2002

Subject: Philadelphia Gas Works
Rate Case Service List
R-00017034 – General Rate Increase
R-00017034F0002 – Extraordinary Rate Relief

To: James J. McNulty
Secretary

From: Robert A. Rosenthal, Director
Bureau of Fixed Utility Services



The Bureau of Fixed Utility Services would like to have Robert J. Bennett added to the service list for the above-cited cases. This will allow our bureau to receive copies of documents as soon as they are filed with the Commission.

Thanks for your cooperation.

Cc: R. Bennett, FUS
R. Wilson, FUS
D. Beebe, FUS
W. Zeiders, SEC ✓

DOCKETED

FEB 27 2002

DOCUMENT
FOLDER

Wolf, Block, Schorr and Solis-Cohen LLP

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ORIGINAL

Daniel Clearfield
Direct Dial: 717 237 7173
Direct Fax: 717 237 2753
E-mail: dclearfield@wolfblock.com

February 27, 2002

VIA HAND DELIVERY

James McNulty, Secretary
PA Public Utility Commission
400 North Street
P.O. Box 3265
Harrisburg, PA 17105-3265

DOCUMENT
FOLDER

RECEIVED
02 FEB 28 AM 9:21
PA.P.U.C.
SECRETARY'S BUREAU

Re: Philadelphia Gas Works' Revised Petition for Extraordinary
Rate Relief, Docket No. R-00017034-0002

Dear Secretary McNulty:

On February 25, 2002, Philadelphia Gas Works filed its Petition for Extraordinary Rate Relief along with supporting testimony and exhibits. We are filing today certain revised pages to correct typographical and production errors. Copies of the revised pages are attached. We are revising pages or exhibits in the following documents:

- Philadelphia Gas Works' Petition for Extraordinary Rate Relief (various typographical errors);
- Statement E.R.P. No. 1 (Thomas Knudsen), page 2;
- Statement E.R.P. No. 2 (Joseph Bogdonavage), JRB Exhibit 1, page two;
- Statement E.R.P. No. 4 (Barbara Bisgaier), pages 3, 4 and 5 and BCB Exh. 3; and
- Statement E.R.P. No. 5 (Janice Davis), page 2.

Please contact me if you have an questions.

Very truly yours,

Daniel Clearfield
Daniel Clearfield

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

DC/lww
Enclosure
cc: All Parties of Record w/enc.

DSH:31228.1/PHI211-156924

49

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document upon the participants listed below in accordance with the requirements of § 1.54 (relating to service by a participant).

VIA HAND DELIVERY, AND/OR FEDERAL EXPRESS

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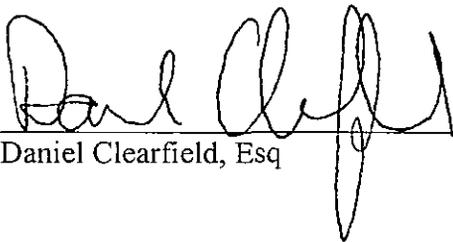
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Dated: February 28, 2002


Daniel Clearfield, Esq

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02 FEB 28 AM 9:21
MA.P.U.C.
SECRETARY'S BUREAU

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

Docket No. R-00017034,0002

PHILADELPHIA GAS WORKS

DOCUMENT
FOLDER

PHILADELPHIA GAS WORKS' PETITION FOR
EXTRAORDINARY RATE RELIEF

ORIGINAL FILED
SECRETARY'S BUREAU
APR 4 9:21 AM '02

DOCKETED
APR 4 2002

Philadelphia Gas Works ("PGW") respectfully submits this Petition for Extraordinary Rate Relief pursuant to Sections 1308(e) and 2212(c) of the Public Utility Code.¹ Through this Petition, PGW seeks \$44 million in extraordinary rate relief in order to avoid an immediate downgrade of its bond rating from investment grade to junk bond status. Absent the relief requested in full, such a downgrade in PGW's bond rating is inevitable and will plunge the Company into a dangerous financial crisis. That financial instability will threaten PGW's ability to provide continuous and adequate service to its customers and seriously compromise the safety of PGW's gas distribution system by undermining the Company's maintenance and construction programs. Finally, absent extraordinary relief, PGW will certainly be required to make immediate and dramatic reductions in customer service and its current work force by whatever means are available.

In order to avoid this potentially disastrous situation, PGW requires extraordinary rate relief in the amount of \$44 million. Relief in full is required to meet S&P's immediate

¹ Concomitant with the Emergency Rate Relief Petition, PGW has submitted a general base rate increase filing seeking rate relief in the amount of \$60 million.

requirements as reflected in the application of S&P's calculation of the level of fixed obligation coverage necessary to maintain an investment grade rating. The extraordinary increase will permit the Company to assure adequate liquidity to enable PGW to meet its minimum coverage obligations and continue to provide safe and adequate service to its customers.

PGW and its owner, the City of Philadelphia, are taking all steps possible to address the crisis. PGW has begun contingency planning, has put a hold on unnecessary spending and has instituted an aggressive collections effort to increase collected revenues. As explained in the attached testimony, the City will assist in the recovery effort by granting back up to the full amount of the statutorily protected \$18 million payment for this year, if necessary, which in combination with (and not as a replacement to) extraordinary rate relief, should enable PGW to meet its bond coverage requirements for 2002. Furthermore, the City will delay PGW's repayment obligations pertaining to the City's interest free \$45 million loan to PGW. However, neither of these critical steps will be enough to avoid a downgrade by S&P absent the requested extraordinary rate relief. S&P's requirements will be satisfied only by a demonstration that PGW satisfies the coverage formula with ongoing, permanent sources of revenue.

In order to meet its obligation to the rating agencies and permit the Commission to conduct an orderly proceeding, PGW proposes that the Commission address this Petition under a 45 day schedule (rather than the 30 days normally required), with a decision at the PUC's April 11, 2002 public meeting, and consider this Petition under a standard which comports with PGW's status as a municipally owned and operated utility.

I. BACKGROUND

1. The Petitioner is PGW, which has a principal place of business located at 800 W. Montgomery Avenue, Philadelphia, PA 19122.

2. PGW is a group of real and personal assets owned by the City of Philadelphia (“City”) and used for the acquisition, storage, processing and distribution of natural gas within the City. PGW is a “city natural gas distribution operation” as defined in Section 102 of the Public Utility Code.

3. On February 25, 2002, PGW filed a request for a general base rate increase pursuant to Section 1308(d) of the Code, seeking an additional \$60 million in permanent base rate revenues. This request follows the Commission’s Order of December 6, 2001, in which it denied PGW’s request for a \$65 million base rate increase and authorized PGW to increase its base rates by \$33.6 million.

4. The urgency of this emergency rate relief request was precipitated on February 12, 2002, when Standard and Poors (“S&P”), a key credit rating agency for PGW’s bonds and commercial paper, released a press notice (“Notice”) that updated its prior evaluation of PGW.² The February 12 Notice stated that “without immediate cash flow improvement [PGW’s] ratings will be lowered.” The factors listed in S&P’s Notice for the downgrade are PGW’s lack of liquidity and reliance on restricted funds, weak fixed charge coverage, potential inability to meet legal debt requirements, the limited ability of the City of Philadelphia to assist the Company, PGW’s continuing problems with reducing levels of account receivables and a warmer than normal winter which will strain any remaining mechanisms supporting fulfillment of bond coverage ratios in the next two years. Given PGW’s mandatory obligations over the next 18 months, S&P has determined that PGW will not be able to maintain the level of liquidity which is required for an investment grade bond rating.

² S&P’s prior evaluation of PGW, issued in July of 2000, warned of S&P’s concerns over PGW’s financial condition and placed the Company on a Credit Watch (With Negative Implication). See PGW E.R.P. St. 4 Exh. BCB-2 (Bisgaier).

the year by drawing from the bond proceeds in advance of actually expending the funds for construction.⁵ Without access to the long term bond market, this source of essential working capital will be lost and PGW's already dire liquidity situation will become even worse.

B. PGW's Need For Relief Is Immediate.

13. PGW needs extraordinary rate relief immediately if it is to avoid the financial instability described above and the associated reductions of service, maintenance programs and employment detailed below. While the Company would be able to continue to operate for several months using the meager resources it has available to it, PGW will run out of funds to operate the Company relatively quickly by the fall of this year.⁶ Moreover, once the downgrade occurs, PGW would need to respond almost immediately by reducing normal construction maintenance and operations in order to conserve resources and perform its core function as long as possible.

C. Negative Impact On Service, Maintenance Programs, And Employment.

14. As detailed more fully in the attached testimony,⁷ the downgrade will have a host of negative operational consequences that include: 1) an immediate cessation of PGW's mains replacement program as well as all construction that is not already funded or directly related to an immediate safety concern; 2) the elimination of all services that are not directly related to gas delivery, billing and collection; 3) the termination of further improvements to call center performance through additional system modifications; 4) a reduction or elimination of all marginal services such as those supplied to customers by PGW's district offices; 5) a

⁵ Such provisioning is permitted provided that by the end of the fiscal period such advances have been used for construction or any unused money returned to the construction fund.

⁶ See PGW E.R.P. St. 2 (Bogdonavage)

⁷ See PGW E.R.P. St. 1 (Knudsen)

21. By S&P's calculation, PGW's fixed cost coverage for the year ending August 1, 2002 will be .88.¹¹ It is this lack of coverage and absence of liquidity which caused the issuance of the downgrade notice.

22. PGW has calculated that, in order to achieve the required 1.2 - 1.3 coverage ratio and avoid a downgrade and associated repercussions, \$44 million in extraordinary rate relief is required.¹² As indicated above, this requested amount accounts for the City's grant back of this year's \$18 million payment in the calculation.

23. The \$44 million request does not represent an inflated figure. The entire amount is justified, and indeed required, to avoid a downgrade of PGW's bond rating and the severe repercussions to PGW and its customers which would follow.

IV. REQUEST FOR MODIFICATION TO SECTION 1308(e) STANDARD AND SCHEDULE OF PROCEEDINGS

24. Under Section 2212(c) of the Code, the Commission is empowered to suspend or waive the application to PGW of any provision of the Code, except those in Section 2212 itself. In consideration of this Petition, PGW respectfully requests that the Commission waive or modify Section 1308(e) in two respects.

25. First, Section 1308(e) states that the Commission shall grant or deny the extraordinary rate relief request within 30 days from the filing of this Petition. Based on the anticipated timeframe of S&P's action, PGW proposes that the Commission rule on the Petition by its April 11, 2002 Public Meeting. PGW's proposal provides the Commission with an extra

¹¹ S&P has also projected a fixed cost coverage ratio for PGW of .97 for the year ending August 31, 2003. *Id.*

¹² See PGW E.R.P. St. 2 (Bogdonavage). The calculation for 2003 utilizes PGW's fully forecasted FY 2002 test year which, because it has been adjusted to reflect representative, going forward conditions, represents the best basis on which to calculate the revenue requirement needed to produce the S&P required charges.

1 we are unsuccessful in securing the necessary emergency relief and the company's
2 bonds are downgraded, PGW would immediately find itself in a financial crisis
3 that would imperil the company as a going concern and impose enormous
4 additional costs on its customers if PGW survives such setbacks. I cannot
5 emphasize enough the seriousness of the situation in which the company finds
6 itself.

7 **Q. WHAT CIRCUMSTANCES GAVE RISE TO THIS REQUEST?**

8 The company gave notice to the PaPUC in December 2001 that it would file for
9 permanent base rate relief of approximately \$50 million in January 2002. (We
10 have since determined to request an increase of \$60 million.) The expectation
11 was that this case would follow the normal processes, culminating in rate relief in
12 November 2002. Circumstances at the company precluded our filing last month.
13 However, on February 12, 2001, S&P, one of three rating agencies that evaluates
14 our debt instruments, took a step which has materially changed the course of
15 future events for the company. Specifically, S&P released, in the form of a press
16 notice (attached as Exh. BCB-1 to Ms. Bisgaier's testimony), that they refer to as
17 an update to their prior evaluation, a Credit Watch (With Negative Implications),
18 that had initially been issued in July 2000. It is my understanding that a Credit
19 Watch is normally issued for only a few months in anticipation of an enterprise
20 taking immediate corrective action. S&P has been willing to maintain our rating
21 status for more than a year and a half as we worked through the changes at PGW
22 to make it a functionally and financially stable enterprise – and, for now,
23 continues to do so. The primary reason that S&P waited nineteen months to take

Normal weather 4555 degree days
 \$33.6M Rate Incr. - Current
 City Loan Repayment Due 8/31/03
 TXCP @ \$77.0 Million

BUDGET OF CASH RECEIPTS AND DISBURSEMENTS
 FISCAL YEAR ENDING AUGUST 31, 2003
 (Millions of Dollars)

PreDraw Capital Funding during Fiscal Period	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	TOTAL
2/19/2002	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	
OPENING BALANCE - CASH INCLUDES 77.0 TXCP	(\$20.8)	\$3.3	(\$0.3)	(\$12.1)	(\$9.0)	(\$32.1)	(\$23.8)	\$9.9	\$38.5	\$51.9	\$38.2	(\$4.3)	(\$20.8)
RECEIPTS													
Gas	33.7	36.0	37.4	48.9	60.2	71.0	79.7	73.4	60.2	44.4	35.4	35.3	615.6
Other	1.5	1.4	1.6	1.7	1.8	1.6	1.8	2.0	2.1	2.0	1.9	9.2	28.6
Drawn from Capital Funds - Principal (\$27.1MM)	27.1	6.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	33.3
Drawn from Capital Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.7	1.7
Drawn from Lease Funds - Principal (\$1.9MM)	0.0	0.0	0.0	0.0	0.0	1.9	0.0	0.0	0.0	0.0	0.0	0.0	1.9
Drawn from Lease Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2
Advance (Repayment) of Capital Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pension Draw	2.4	2.4	2.4	7.2	0.0	0.0	2.4	2.4	2.3	2.3	2.3	2.3	28.4
City Loan													0.0
Rate Relief	1.6	1.7	1.9	2.6	3.2	3.7	4.2	3.8	3.1	2.3	1.8	1.6	31.6
TOTAL RECEIPTS	66.4	47.7	43.4	60.4	65.2	78.2	88.1	81.6	67.7	51.0	41.4	50.4	741.2
TOTAL	45.6	51.0	43.1	48.3	56.2	46.1	64.2	91.5	106.2	102.9	79.6	46.0	720.4
DISBURSEMENTS													
Labor	10.7	12.3	12.1	11.9	12.6	11.0	11.1	11.3	11.5	10.4	11.4	10.9	137.2
Natural Gas	24.3	29.6	34.8	36.3	41.4	43.7	33.4	30.2	28.8	27.1	22.1	22.7	374.4
Debt Service	0.0	1.9	0.0	0.0	24.7	5.3	0.0	2.0	4.7	0.0	41.5	9.6	89.7
TXCP: Interest	3.5	0.2	0.2	0.3	0.3	0.2	0.3	0.3	0.3	0.3	0.2	0.2	3.3
Repayment of City Loan													45.0
Union/Management Reductions	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.1)	(1.1)	(1.1)	(1.1)	(12.4)
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.2	0.0	0.0	18.2
Other Disbursements	8.0	8.2	9.1	9.8	10.2	10.7	10.5	10.2	10.0	9.8	9.8	9.7	116.1
TOTAL DISBURSEMENTS	42.3	51.3	55.2	57.3	88.2	70.0	54.3	53.0	54.3	64.7	83.9	97.0	771.5
MONTHLY CASH FLOW	24.1	(3.6)	(11.9)	3.1	(23.0)	8.3	33.7	28.6	13.4	(13.7)	(42.5)	(46.7)	(30.2)
CUMULATIVE CASH FLOW	24.1	20.5	8.7	11.8	(11.3)	(3.0)	30.7	59.3	72.7	59.0	16.5	(30.2)	
OPENING TXCP	77	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0
TXCP ISSUED DURING MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TXCP ISSUED PAID DOWN DURING MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ENDING TXCP	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0	77.0
OPENING BALANCE - CASH	(20.8)	3.3	(0.3)	(12.1)	(9.0)	(32.1)	(23.8)	9.9	38.5	51.9	38.2	(4.3)	(20.8)
MONTHLY CASH FLOW	24.1	(3.6)	(11.9)	3.1	(23.0)	8.3	33.7	28.6	13.4	(13.7)	(42.5)	(46.7)	(30.2)
NET TXCP ACTIVITY MONTHLY	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ENDING BALANCE - CASH	3.3	(0.3)	(12.1)	(9.0)	(32.1)	(23.8)	9.9	38.5	51.9	38.2	(4.3)	(51.0)	(51.0)
CITY LOAN AVAILABLE - END OF MONTH	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	45.0	45.0
CITY LOAN UTILIZED - END OF MONTH	45	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	0.0
CASH POSITION NET OF TXCP AND CITY LOAN	(118.7)	(122.3)	(134.1)	(131.0)	(154.1)	(145.8)	(112.1)	(83.5)	(70.1)	(83.8)	(126.3)	(128.0)	

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1 incorporating into this submission my previous testimony in PGW's interim rate
2 proceeding and general rate case in which I explained the bond coverage requirements.

3 **Q. PLEASE EXPLAIN THE PRESENT STATUS OF PGW'S BOND RATINGS**
4 **PROVIDED BY THE RELEVANT BOND RATING AGENCIES?**

5
6 A. As may be recalled, in my previous testimony I discussed the implications to PGW of the
7 downgrade of its credit rating to below investment-grade status. In this previous
8 testimony, the concerns expressed were occasioned by the fact that two of the three credit
9 rating agencies, Moody's Investors Service and Standard & Poors Rating Services had
10 placed PGW on their respective watch lists with negative implications. Unfortunately,
11 the threat of a downgrade has now become imminent with the announcement by Standard
12 & Poors on February 12, 2002 that without immediate cash flow improvement, the
13 ratings of PGW's bonds¹ would be lowered. A copy of that report is attached hereto as
14 Exhibit BCB-1. Standard & Poors has not indicated the extent to which they will lower
15 the outstanding ratings; however, it is correct to say that, at a minimum, the subordinated
16 1998 Bonds (which are currently rated BBB-, the lowest investment-grade rating) would
17 be reduced to a below investment grade rating. There is also a significant likelihood that
18 the rating of the senior 1998 Bonds would also be lowered to below investment grade.

19 **Q. PROVIDE THE BACKGROUND OF S&P'S PRESENT ACTION.**

20 A. S&P originally placed PGW on credit watch with negative implications in July 2000. A
21 copy of that report (which was originally made part of my August 2000 testimony) is
22 attached hereto as Exhibit BCB-2. Normally, S&P uses its credit watch status to notify
23 the broader credit markets that they intend to take action on a particular credit rating

¹ The bonds covered by the announcement include bonds issued pursuant to the 1975 Ordinance and both the senior and subordinated debt issued pursuant to the 1998 Ordinance.

1 within, at most, two or three months once a particular milestone or action has or has not
2 occurred. The fact that PGW has remained on credit watch with negative implications
3 for almost 20 months is highly unusual and runs counter to normal practice at S&P. S&P
4 has sustained PGW's credit watch status because they have been willing to defer a final
5 determination while the various rate proceedings undertaken by PGW were in process.
6 The decision by the PUC in December to decline to revise upward PGW's authorized
7 rate increase from \$33.6 million, taken together with the increased pressure on PGW's
8 liquidity as a result of the historically warm winter of 2001-2002, has caused S&P to
9 notify the market that, absent sufficient emergency rate relief, it intends to lower PGW's
10 credit rating.

11 **Q. ARE YOU FAMILIAR WITH THE STANDARDS UTILIZED BY STANDARD**
12 **AND POORS TO EVALUATE THE FINANCIAL STATUS OF AN ENTITY FOR**
13 **RATING PURPOSES?**

14 A. Yes, in addition to scores of discussions which I have had with S&P analysts over a
15 number of years, Standard & Poors has provided to PGW the actual coverage formula,
16 standards and calculations that it is using to evaluate PGW.

17 **Q. CAN YOU EXPLAIN THE QUANTITATIVE STANDARDS THAT S&P IS**
18 **USING TO EVALUATE PGW AND THE RESULTS OF THAT ANALYSIS AS**
19 **YOU UNDERSTAND IT?**
20

21 A. Yes, S&P has been consistent in enunciating the standard by which it measures PGW.
22 While they have recognized that PGW's debt service coverage requirement of 1.5 times
23 annual debt service as a positive credit factor, they (along with Moody's) have expressed
24 concern that PGW's coverage, after the payment of operating expenses, of its fixed

1 obligations has been and will continue to be less than 1, absent reliance on non-recurring
2 revenues. They make a fairly simple calculation of this "fixed cost coverage ratio".
3 They subtract operating expenses and depreciation from revenues to obtain the amount
4 available to pay fixed costs. They define these fixed costs as debt service on the 1975
5 ordinance bonds and the 1998 ordinance bonds, the capital lease payments, interest on the
6 commercial paper and the \$18,000,000 payment to the City of Philadelphia. To this they
7 have added an additional \$20 million annual reduction in the commercial paper program.
8 Based upon this calculation, they project that PGW's fixed cost coverage ratio for the
9 year ended August 31, 2002 will be .88 and for the year ended August 31, 2003 will be
10 .97. The S&P worksheet is attached as Exhibit BCB-3. The S&P analyst responsible for
11 evaluating PGW was quoted on February 22 as stating that "given [PGW's] current
12 financial profile, they don't look investment grade."²

13 Obviously, anything below 1 times coverage gives extreme cause for concern.

14 **However, Standard & Poors has indicated that their standard for an investment**
15 **grade bond for a utility like PGW is not merely 1 times coverage, but rather fixed**
16 **cost coverage of at least 1.2 to 1.3 times.** This formula is specifically designed to insure
17 that the entity that they are rating has sufficient liquidity to withstand a variety of
18 exigencies. In fact, the loss of cash and margin that PGW has experienced during this
19 historically warm winter precisely illustrates why S&P is so insistent on this level of
20 fixed cost coverage. Absent the grant of emergency rate relief so that this fixed cost
21 coverage ratio can be achieved on a permanent ongoing basis, Standard & Poors will take
22 negative credit action within the next two months.

² *The Bond Buyer*, February 22, 2002.

PGWORKS

Fiscal Year Ending: 08/31

Revenue & Debt Service Analysis

	1998-99	1999-00	2000-01	2001-02	2001-02	2001-02	2002-03
Operating Revenue ('000)							
Base Rate Scenarios				\$ 33.6 Million	\$ 65 Million **	\$ 65 Million **	\$ 65 Million
Non-heating/Gas transportation/Unbilled gas adj.	\$72,751	\$91,143	\$107,035	\$103,103	\$103,103	\$103,103	\$100,966
Heating	\$390,242	\$434,544	\$620,867	\$536,079	\$536,079	\$536,079	\$525,008
Proposed Base Rate			\$0	\$32,224	\$34,724	\$62,224	\$62,417
Marginal Revenue Loss Customer Utilization			\$0				(\$2,000)
Unbilled Adjustment	(\$349)	\$7,299	(\$8,967)	(\$1,400)	(\$700)	(\$700)	\$950
Appliance and other revenues	\$13,683	\$11,978	\$12,075	\$12,260	\$12,260	\$12,260	\$20,571
Other operating revenues	\$10,558	\$10,911	\$19,048	\$16,785	\$17,540	\$17,540	\$17,210
Total Operating Revenues	\$486,885	\$555,875	\$750,058	\$699,051	\$703,006	\$730,506	\$725,122
Interest & other income	\$8,263	\$9,417	\$12,343	\$4,934	\$5,894	\$5,894	\$8,380
Swap and option agreement	\$0	\$8,645	\$0	\$0	\$0	\$0	\$0
AFUDC (Interest)	\$0	\$0	\$0	\$765	\$765	\$765	\$623
Total Non-Operating Revenues	\$8,263	\$18,062	\$12,343	\$5,699	\$6,659	\$6,659	\$9,003
Total Revenues	\$495,148	\$573,937	\$762,401	\$704,750	\$709,665	\$737,165	\$734,125

Operating Expenses

Natural Gas	\$219,090	\$266,354	\$431,327	\$373,026	\$373,026	\$373,026	\$355,234
Gas Processing	\$13,881	\$14,033	\$13,400	\$13,161	\$13,161	\$13,161	\$13,643
Field Services	\$35,090	\$33,704	\$33,202	\$32,730	\$32,730	\$32,730	\$33,113
Distribution	\$15,527	\$14,246	\$14,837	\$14,440	\$14,440	\$14,440	\$14,434
Customer affairs	\$27,044	\$28,031	\$27,418	\$28,722	\$28,722	\$28,722	\$27,936
Bad Debt expense	\$39,000	\$54,642	\$67,633	\$60,823	\$61,601	\$61,601	\$58,802
Marketing	\$5,253	\$3,041	\$3,486	\$6,596	\$6,596	\$6,596	\$5,616
Administrative & General	\$27,545	\$55,236	\$25,257	\$32,043	\$32,043	\$32,043	\$28,972
Health Insurance	\$23,432		\$27,404	\$30,490	\$29,190	\$29,190	\$33,559
Pensions	\$787	\$1,096	\$2,301	\$2,313	\$2,313	\$2,313	\$2,266
Taxes	\$6,091	\$6,512	\$6,299	\$6,430	\$6,430	\$6,430	\$6,374
Personal reductions/retirements				(\$7,100)	(\$10,500)	(\$10,500)	(\$10,000)
Total Operating Expenses	\$412,740	\$477,895	\$652,564	\$593,674	\$589,752	\$589,752	\$569,949

Net Depreciation

Net Depreciation	\$29,075	\$30,805	\$31,840	\$33,285	\$33,285	\$33,285	\$34,911
Payment in Lieu of Taxes	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Other - Amortization of Demand Side Management	\$0	\$0	\$0	\$0	\$0	\$0	\$0

Net Available To Service Debt (Exc. Depr.)

Net Available To Service Debt (Exc. Depr.)	\$82,408	\$96,042	\$109,837	\$111,076	\$119,913	\$147,413	\$164,176
Add Capital leases	\$7,882	\$7,988	\$7,977	\$5,954	\$5,954	\$5,954	\$3,997
Net Available To Service aggregate debt	\$90,290	\$104,030	\$117,814	\$117,030	\$125,867	\$153,367	\$168,173
PGW Provided Numbers	\$88,167	\$101,872		\$115,654	\$152,184	\$152,185	\$167,921

Debt Service Coverage Analysis

	1998-99	1999-00	2000-01	2001-02	2001-02	2001-02	2002-03
Net Available To Service 1975 Bonds	\$90,290	\$104,030	\$117,814	\$117,030	\$125,867	\$153,367	\$168,173
1975 Ordinance bonds debt service	\$57,741	\$59,345	\$51,611	\$55,528	\$55,528	\$55,528	\$47,292
Debt Service 1975 Bonds	1.56	1.75	2.28	2.11	2.27	2.76	3.56
1998 Ordinance bonds debt service	\$14,230	\$21,659	\$29,449	\$30,926	\$30,926	\$30,926	\$36,539
DS 1975 Senior Bonds/and 1998 Ordinance Senior Bonds	1.25	1.28	1.45	1.35	1.46	1.77	2.01
Capital Lease Costs	\$7,882	\$7,988	\$7,977	\$5,954	\$5,954	\$5,954	\$3,997
Debt Service 1975 bonds/Capital Leases/1998 senior	1.13	1.17	1.32	1.27	1.36	1.66	1.91
1998 Ordinance Subordinated Debt	\$1,988	\$1,987	\$1,990	\$1,986	\$1,986	\$1,986	\$1,988
Debt Service (revenue bonds plus capital leases)	1.10	1.14	1.29	1.24	1.33	1.62	1.87
Total Debt Service (Interest & Capital repayments)	\$81,841	\$90,979	\$91,027	\$94,394	\$94,394	\$94,394	\$89,816
Others-Commercial Paper Notes	\$2,822	\$3,927	\$4,537	\$20,000	\$20,000	\$20,000	\$20,000
Fixed Charge Cov. - Aggregate Debt Service	1.07	1.10	1.23	1.02	1.10	1.34	1.53
City Annual Payment			\$18,000	\$18,000	\$18,000	\$18,000	\$18,000
Fixed charge Cov., including city payment of \$18 million			1.04	0.88	0.95	1.16	1.32

Fixed Charge Cov. Weather adjusted in 2001-2002 (@ \$10 million impact)

0.81 0.88 1.08

Fixed Charge Coverage, including financial transaction @ \$20 million

0.96 1.03 1.23

Fixed charge coverage, including financial transaction and city annual payment grant back (all \$18 m)

1.11 1.19 1.43

Fixed Charge Coverage with City \$45 mill repayment (2002-2003)

0.97

Column F volumetric relief ; Column G compressed relief

Aggregate Fixed Charge Coverage for 2003 includes \$18 million city payment & the \$45 million loan repayment . However, \$20 million CP paydown, shown under debt service, is not mandatory
 **2001-2002 emergency rate increase assumes an additional \$30 million permanent rate over the amount already granted . However, the cash impact is only \$2.5 million in fiscal 2002 on a volumetric basis. If the additional \$30 million is available on a cash basis in 2002, fixed charge coverage assuming the financial transaction is 1.23 and with the city loan grantback is 1.43 The entire \$30 million emergency additional relief is available on a permanent basis in 2003 (first full year with \$65 million rate increase) 2002-2003 assumes normal degree days (4,555 degree-days). Past 3 winters have averaged lower.

1 budget and forecast and offer recommendations as to the form and extent of the capital
2 budget and forecast prior to its submission for City Council approval. My office further
3 receives plans for capital loans and participates in the approval process for short and
4 long-term borrowing, among other duties.

5 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE PUC ABOUT THE**
6 **LEVEL AND TYPES OF SUPPORT PROVIDED BY THE CITY OF**
7 **PHILADELPHIA TO PGW?**

8 A. Yes. I submitted testimony in PGW's previous base rate proceeding detailing the various
9 types of financial and other support that Philadelphia had provided to PGW at that time to
10 respond to PGW's existing and continuing financial crisis.

11 **Q. CAN YOU UPDATE THAT SUMMARY?**

12 A. Yes. Most importantly, PGW continues to have use of a \$45 million interest free
13 revolving loan provided by the City to assist its cash working capital needs. As I
14 testified, the cost of such a loan would be \$2–3 million annually if it had been obtained
15 conventionally (which PGW would not have been able to do in any event). While, by its
16 terms, the loan is due to be paid back in January 2003, the administration shortly will
17 propose to permit PGW to delay repayment until August 2003. In addition, although the
18 earnings on PGW's bond sinking funds belong to the City, (since the bonds, technically
19 are City bonds), we have agreed to allow those earnings to be booked as Other Income.
20 Those earnings also form the basis of any forward purchase agreement when the
21 Company requires such a financing. (Mr. Knudsen explains the forward purchase
22 agreement in greater detail in his testimony.)