

ORIGINAL

COMMONWEALTH OF PENNSYLVANIA

PUBLIC UTILITY COMMISSION

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 :  
 Pennsylvania Public Utility Commission :  
 v. Philadelphia Gas Works :  
 : Docket No.  
 Petition for extraordinary rate relief :  
 pursuant to Sections 1308(e) and 2212(c) : R-00017034F0002  
 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. :

DOCKETED

Initial Hearing.

APR 16 2002

Pages 24 through 244

Hearing Room No. 1  
 State Office Building  
 Broad and Spring Garden Streets  
 Philadelphia, Pennsylvania

DOCUMENT FOLDER

Tuesday, March 26, 2002

Met, pursuant to notice, at 10:00 a.m.

BEFORE:

CYNTHIA W. FORDHAM, Administrative Law Judge

APPEARANCES:

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 (For Office of Trial Staff)

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WITNESS INDEX

<u>WITNESS</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
Barbara C. Bisgaier				
By Mr. Clearfield	44	--	70	--
By Mr. Simms		49	--	--
By Ms. McCloskey		56	--	--
By Mr. Gray		68	--	73
By Mr. Bertocci		70	--	--
Joseph R. Bogdonavage				
By Mr. Clearfield	75	--	106	--
			108	
By Mr. Simms		94	---	--
By Ms. McCloskey		99	---	108
By Mr. Gray		101	---	---
By Mr. Bertocci		103	---	---
Gary Krellenstein				
By Mr. Clearfield	111	---	---	---
By Mr. Gray		116	---	---
By Ms. McCloskey		122	---	---
Thomas E. Knudsen				
By Mr. Clearfield	127	---	---	---
By Mr. Simms		143	---	---
Janice D. Davis				
By Mr. Clearfield	152	---	161	---
By Mr. Simms		153	---	---
By Mr. Gray		156	---	---
By Ms. McCloskey		158	---	---
Thomas E. Knudsen (Recalled)				
By Mr. Simms		162	---	---
By Ms. McCloskey		168	---	---
By Mr. Gray		174	---	---
By Mr. Bertocci		183	---	---
By Mr. Clearfield			187	---

WITNESS INDEX

<u>WITNESS</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
Charles T. Weakley, III				
By Mr. Simms	192	---	----	---
By Mr. Clearfield		192	---	---
		195		
By Mr. Gray		194	---	---
Kevan Deardorff				
By Mr. Simms	197	---	---	---
By Mr. Clearfield		200	---	---
Richard W. Lelash				
By Ms. McCloskey	211	---	---	---
By Mr. Clearfield		211	---	---
		235		
By Mr. Gray		228	---	---
By Ms. Burak		231	---	---
By Mr. Bertocci		233	---	---

-- 0 --

EXHIBIT INDEX /

<u>NUMBER</u>	<u>FOR IDENTIFICATION</u>	<u>IN EVIDENCE</u>
<u>PGW</u>		
✓ ERP Statement No. 4 (Bisgaier)	74	74
✓ Exhibits Nos. / BCB-1, BCB-2 & BCB-3	74	74
✓ ERP Statement No. 2 (Bogdonavage)	109	109
Exhibits Nos. ✓ JRB-1 & ✓ JRB-2	109	109
✓ Bogdonavage Rebuttal Exhibit No. 1	78	109
✓ Bogdonavage Rebuttal Exhibit No. 2	89	109
BRP Statements Nos. ✓ 1 & ✓ 3 with Volume II (Supporting Testimony & Documentation)	110	110
✓ ERP Statement No. 3 (Krellenstein)	126	126
✓ Knudsen Rebuttal Exhibit No. 1	128	191
ERP Statements Nos. ✓ 5 & ✓ 5.1 (Davis)	162	162
✓ ERP Statement No. 1 (Knudsen)	191	191
✓ Exhibit No. TEK-1	191	191
✓ Cross-Examination Exhibit No. 1 (Bond Buyer Article)	226	242

EXHIBIT INDEX

<u>NUMBER</u>	<u>FOR IDENTIFICATION</u>	<u>IN EVIDENCE</u>
<u>OCA</u>		
✓ Cross-Examination Exhibit No. 1 (IR-OSBA-II-5, 6 & 7)	62	68
/ Cross-Examination Exhibit No. 2 (IR-OCA-I-2, 4 & 6)	65	68
✓ Statement No. 1-ERP (Lelash)	210	242
<u>OTS</u>		
✓ Cross-Examination Exhibit No. 1 (IR-OTS-III-RE-20)	146	190
✓ Statement No. 1 w/Exhibit No. 1 and errata sheets (Weakley)	196	196
✓ Statement No. 2 w/Exhibit No. 2 (Deardorff)	210	210

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## P R O C E E D I N G S

1  
2 ADMINISTRATIVE LAW JUDGE CYNTHIA W. FORDHAM: Good  
3 morning.

4 I am Administrative Law Judge Cynthia Williams  
5 Fordham and this is the time and place for a hearing on  
6 the petition for extraordinary rate relief in the matter  
7 of Pennsylvania Public Utility Commission versus  
8 Philadelphia Gas Works at Docket Number R-00017034F0002.

9 At this time I would ask Counsel to enter their  
10 appearances, beginning with Mr. Clearfield.

11 MR. CLEARFIELD: Thank you, Your Honor. Good  
12 morning.

13 I am Dan Clearfield, along with my colleague, Mark  
14 Stewart, who is out of the room at the moment. And we  
15 are representing PGW in the proceeding.

16 JUDGE FORDHAM: Thank you.

17 Mr. Simms.

18 MR. SIMMS: Good morning, Your Honor.

19 My name is Johnnie Simms. I am representing the  
20 Office of Trial Staff.

21 JUDGE FORDHAM: Ms. Burak.

22 MS. BURAK: Good morning, Your Honor.

23 I am Charis Burak. I am here on behalf of the  
24 Philadelphia Industrial and Commercial Gas Users Group.

25 JUDGE FORDHAM: Mr. Gray.

1 MR. GRAY: Good morning, Your Honor.

2 I am Steven Gray. I'm representing the Office of  
3 Small Business Advocate.

4 JUDGE FORDHAM: Ms. McCloskey.

5 MS. McCLOSKEY: Good morning, Your Honor.

6 Tanya McCloskey and with me is Stephen Keene, on  
7 behalf of the Office of Consumer Advocate.

8 JUDGE FORDHAM: Thank you.

9 MR. BERTOCCI: Good morning, Your Honor.

10 I am Philip Bertocci. I represent the Consumers  
11 Education and Protective Association, the Association of  
12 Community Organizations for Reform Now, Tenants Action  
13 Group and the Action Alliance of Senior Citizens of  
14 Greater Philadelphia.

15 JUDGE FORDHAM: Thank you.

16 Any other Counsel?

17 MR. SATINSKY: Good morning, Your Honor.

18 I am Barnett Satinsky representing Trigen  
19 Philadelphia Energy Corporation and Grays Ferry  
20 Cogeneration Partnership.

21 JUDGE FORDHAM: Thank you.

22 Did I miss anyone?

23 (No audible response.)

24 JUDGE FORDHAM: Let me give you a brief history of  
25 the proceedings before we begin.

1           On February 25 of 2002 the Philadelphia Gas Works  
2       filed Supplement No. 17 to Tariff Gas Pa. PUC No. 1 to  
3       become effective April 26 of 2002. Concurrently PGW  
4       filed a petition for extraordinary rate relief pursuant  
5       to sections 1308(e) and 2212 of the Public Utility Code,  
6       66 Pa. C.S., sections 1308(e) and 2212. In the petition  
7       PGW requested that \$44 million of its \$60 million base  
8       rate request be approved as extraordinary rate relief.  
9       PGW asked the Commission to address the petition pursuant  
10      to a 45 day schedule instead of the usual 30 day schedule  
11      set forth in the statute and rule on the petition at the  
12      April 11, 2002, Commission meeting. The rate increase  
13      would be effective on April 12, 2002.

14           Furthermore, PGW requested that the petition be  
15      considered under a standard which comports with PGW's  
16      status as a municipally owned and operated utility.

17           PGW averred that Standard & Poor's, otherwise S&P,  
18      an important credit rating agency, will downgrade its  
19      bond rating if PGW does not receive the \$44 million rate  
20      increase. S&P issued a notice on February 12, 2002,  
21      warning that PGW's ratings would be lowered without  
22      immediate cashflow improvement. PGW believes that S&P  
23      will reevaluate PGW's position in the next six weeks and  
24      downgrade PGW's credit rating from investment grade to  
25      junk bond status without the extraordinary rate relief.

1           In addition, PGW contends that without the relief  
2 will following will occur: the main replacement program  
3 will end, the safety of its gas distribution system will  
4 be compromised and there will be immediate and dramatic  
5 reductions in customer service and its current workforce.

6           The matter was assigned to the Office of  
7 Administrative Law Judge for resolution by hearings. The  
8 record will be certified to the Commission for  
9 resolution. The matter was assigned to me.

10           Johnnie E. Simms, Esquire and Charles F. Hoffman,  
11 Esquire entered a notice of apperance on behalf of the  
12 Commission's Office of Trial Staff.

13           The Consumers Education and Protective Association,  
14 the Association of Community Organizations for Reform  
15 Now, Action Alliance of Senior Citizens of Greater  
16 philadelphia and Tenants Action Group, collective CEPA,  
17 et al., through its attorney filed a complaint against  
18 the base rate case. In paragraph 13 and 14 of the  
19 complaint CEPA, et al. objected to PGW's request for  
20 extraordinary rate relief.

21           On March 6, 2002, OSBA through its Counsel filed an  
22 answer to the petition. OSBA requested that the petition  
23 be denied.

24           On March 6, 2002, the Philadelphia Industrial and  
25 Commercial Gas Users Group through its Counsel filed a

1 petition to intervene in the proceeding docketed at F0002  
2 and a petition to intervene in the base rate proceeding.

3 Prehearing memoranda was submitted by OCA and OSBA.

4 A prehearing conference in this matter was held on  
5 Thursday, March 7 at 10:00 a.m. The Presiding Officer  
6 and Mr. Bertocci and Mr. Stunder, representing PGW, were  
7 in the Philadelphia State Office Building. The other  
8 parties were in Harrisburg. Mr. Clearfield and Mr.  
9 Stewart represented PGW. Ms. McCloskey and Mr. Keene  
10 represented the OCA. Mr. Simms represented the Office of  
11 Trial Staff. Mr. Gray represented the Office of Small  
12 Business Advocate. And Ms. Burak represented the  
13 commercial group.

14 During the prehearing conference the commercial  
15 group's petition to intervene in the proceeding docketed  
16 at R-00017034F0002 was granted. In addition, the  
17 petition to intervene in the base rate proceeding was  
18 also granted.

19 On March 5 of 2002 PECO Energy Company through its  
20 Counsel filed a petition to intervene in both  
21 proceedings.

22 I issued a prehearing order dated March 8, 2002.  
23 The order included among other things the schedule that  
24 was established in this matter.

25 By correspondence dated March 12, 2002, PGW stated

1 that it did not object to PECO's intervention in the  
2 extraordinary rate relief proceeding or the base rate  
3 proceeding. There were no other objections so the  
4 petition to intervene of PECO was granted. And that was  
5 by order dated March 12, 2002.

6 The schedule that was established during the  
7 prehearing conference had discovery for March 13 and 14,  
8 informal discovery conferences, responsive testimony due  
9 March 21, hearings for today and tomorrow, memos to be  
10 submitted to the Commission by noon on April 3rd and the  
11 Commission ruling at the public meeting on April 11.

12 On March 13, OCA filed an answer to PGW's petition.  
13 In accordance with Prehearing Order No. 2 PECO filed a  
14 prehearing memorandum on March 14. And on March 19 OTS  
15 and CEPA, et al. filed an answer to the petition.

16 We have the following testimony: PGW filed the  
17 testimony of five of its witnesses when it filed the  
18 petition. That was PGW Statement ERP No. 1 of  
19 Mr. Thomas E. Knudsen. With that there was Exhibit  
20 TEK-1, which is a chart of PGW's capital spending and  
21 internally generated funds for fiscal years '92 through  
22 2003.

23 Next we have PGW ERP Statement 2, which is the  
24 testimony of Joseph R. Bogdonavage. With that we have  
25 two exhibits, JRB Exhibit 1 and JRB Exhibit 2.

1           Then we have the third testimony, which is PGW ERP  
2 Statement No. 3 of Gary Krellenstein. There are no  
3 exhibits with that statement.

4           The next statement is that of  
5 Ms. Barbara C. Bisgaier, which is PGW ERP Statement No.  
6 4. There are three exhibits, Exhibits BCB-1, 2 and 3.

7           We also have the statement of Janice Davis, which  
8 is PGW ERP Statement No. 5. There is one exhibit  
9 attached to that statement.

10           The testimony of Craig White was filed on March 12,  
11 2002. That is PGW ERP Statement No. 6 which attachments  
12 one and two.

13           With respect to the other parties, OTS filed the  
14 statement of two witnesses, OTS Statement No. 1 of  
15 Charles Weakley, with OTS Exhibit No. 1, and OTS  
16 Statement No. 2 of Kevan Deardorff with OTS Exhibit  
17 Number 2.

18           OCA filed the testimony of Richard W. Lelash with  
19 supporting schedules.

20           On March 22 of 2002, Trigen Philadelphia Energy  
21 Corporation and Grays Ferry Cogeneration Partnership  
22 through its Counsel filed a petition to intervene.

23           With respect to the hearing prehearing order  
24 indicated that each party should make sure that the  
25 requisite number of copies for the statements and

1 exhibits were available to the parties and for the court  
2 reporter. After the statements and exhibits have been  
3 entered into evidence the sponsoring party will submit a  
4 copy of the admitted statements and exhibits to each  
5 Commissioner's office, the Office of Special Assistants  
6 and the Law Bureau electronically and in paper format.  
7 The documents for OSA are to be sent to Kirk House,  
8 Esquire and the documents for the Law Bureau are to be  
9 sent to Karen Moury, Esquire.

10 There are two preliminary matters that I know of.  
11 First, is the petition of Trigen. And then with respect  
12 to Ms. Davis, I note that she is not available in the  
13 courtroom. She will be available by telephone, so we  
14 need to address that issue.

15 Mr. Satinsky.

16 MR. SATINSKY: Your Honor, we have filed on behalf  
17 of Trigen Philadelphia Energy Corporation and Grays Ferry  
18 Cogeneration Partnership a petition to intervene in this  
19 proceeding. However, based on our understanding that the  
20 contracts between PGW and Trigen Philadelphia and Grays  
21 Ferry Cogeneration Partnership regarding the  
22 transportation of gas will not be affected by this  
23 proceeding we would seek inactive party status and simply  
24 remain a party of record for receipt of any documents  
25 filed in the matter and Commission orders.

1 MR. CLEARFIELD: We have no objection, Your Honor.

2 JUDGE FORDHAM: Are there any other objections?

3 (No audible response.)

4 JUDGE FORDHAM: Hearing none, your petition is  
5 granted.

6 MR. SATINSKY: Thank you.

7 May I be excused, Your Honor?

8 JUDGE FORDHAM: Yes, you may.

9 MR. SATINSKY: Thank you.

10 JUDGE FORDHAM: Mr. Clearfield.

11 MR. CLEARFIELD: Yes, Your Honor. One of our  
12 witnesses, Ms. Davis, is unfortunately not able to attend  
13 the hearing in person. We have made arrangements for her  
14 to be available by telephone to be cross-examined. She  
15 is available at 1:30. We have taken the liberty of  
16 setting a specific time so that we will be sure to get  
17 her.

18 JUDGE FORDHAM: Okay.

19 MR. CLEARFIELD: I am not sure to what extent the  
20 other parties have cross-examination. That is obviously  
21 up to them. We did, because of the fact that she was  
22 going to be unavailable in the hearing room, take the  
23 liberty of preparing a short piece of rebuttal and  
24 submitted it to all the parties beforehand, I believe on  
25 Monday, so that we didn't have to go through the process

1 on the phone of having her try to provide rebuttal  
2 testimony over the phone. That has been distributed. We  
3 have marked that as PGW ERP Statement 5.1, just to follow  
4 along with her designations. We can deal with that when  
5 we deal with the rest of the testimony.

6 JUDGE FORDHAM: Okay.

7 MR. CLEARFIELD: So with Your Honor's permission,  
8 at 1:30 whatever we are doing, assuming it is convenient,  
9 we can break and get her on the phone if there are in  
10 fact questions for her.

11 JUDGE FORDHAM: Okay. So far Mr. Simms, Mr. Gray  
12 and Mr. Bertocci have indicated that they wanted to  
13 cross-examine Ms. Davis.

14 Do you have any other preliminary matters?

15 MR. CLEARFIELD: Yes, Your Honor, a few.

16 To start off with one where we are all in  
17 agreement, the parties have been able to come to a  
18 stipulation and settlement with respect to the allocation  
19 of any proposed or any granted extraordinary rate relief  
20 that the Commission would see fit to award. This morning  
21 we have prepared this stipulation and settlement which  
22 all of the parties have agreed to and this morning we  
23 have had all the parties sign that agreement. Here is a  
24 copy for Your Honor. And we have made copies that we are  
25 distributing now of the executed document.

1           Essentially, just as a summary, it sets forth a  
2 proposed allocation between residential, commercial and  
3 industrial firm customers of any proposed increase. So  
4 if it is 44, a certain percentage of that would go to the  
5 residential classes as they are designated. If it is  
6 less than 44, a percentage that has been determined in  
7 the settlement would then be used to allocate that rate  
8 increase for the extraordinary rate relief.

9           So with the stipulation, assuming it is accepted by  
10 the Commission -- and I don't see why it wouldn't -- it  
11 removes the issue of the allocation of the rate increase  
12 from the proceeding. And as part of the stipulation we  
13 will not be offering Mr. White's testimony into the  
14 record.

15           JUDGE FORDHAM: Okay.

16           MR. CLEARFIELD: If any parties have anything to  
17 add to that.

18           JUDGE FORDHAM: And Mr. White's testimony is PGW  
19 ERP Statement 6?

20           MR. CLEARFIELD: That's correct, Your Honor.

21           JUDGE FORDHAM: Do any other parties have anything  
22 to say about the stipulation?

23           (No audible response.)

24           JUDGE FORDHAM: Thank you.

25           MR. CLEARFIELD: Next, Your Honor, we wish to enter

1 into the record certain of the testimony from the base  
2 rate proceeding that forms the underlying base, if you  
3 will, for some of the testimony that has been presented  
4 by Mr. Bogdonavage in particular. We have arrived at a  
5 stipulation with the parties as to what parts of that  
6 testimony would be admitted into the record and its use.  
7 Another agreement, Your Honor.

8 JUDGE FORDHAM: Thank you.

9 MR. CLEARFIELD: And we have copies for the other  
10 parties.

11 This stipulation indicates that for the purposes  
12 set forth in the stipulation we will admit into the  
13 extraordinary rate relief record, the Folder record, the  
14 testimony of Mr. Bogdonavage in the base rate proceeding,  
15 which is BRP Statement 1, and the documents or the  
16 supporting data that he is sponsoring, which is Volume II  
17 of the base rate proceeding supporting financial  
18 information.

19 We have also agreed that we will enter into the  
20 record BRP Statement 3, which is another piece of  
21 testimony that forms -- provides support for  
22 Mr. Bogdonavage's financial calculations in the  
23 extraordinary rate relief proceeding. And the  
24 stipulation indicates that this testimony, unless it is  
25 referenced specifically in someone's testimony here, is

1 only for the purposes of supporting those schedules and  
2 that testimony and won't be independently a basis for our  
3 extraordinary rate relief request or cited separately in  
4 any way.

5 JUDGE FORDHAM: Thank you.

6 Do you have anything further?

7 MR. CLEARFIELD: One more thing, Your Honor. Prior  
8 to beginning this morning I discussed with the parties  
9 the potential of a stipulation initially to the  
10 authenticity of the testimony that is going to be  
11 admitted into the record so that it would save time as we  
12 go forward, and I believe the parties are amenable to  
13 that. What we would propose is that we stipulate that  
14 the testimony that we have outlined -- and I would just  
15 add Davis Statement 5.1 to that list, and the base rate  
16 testimony that I have just indicated -- was prepared by  
17 the witnesses as indicated under their direction or  
18 supervision and it is true and correct to the best of  
19 their knowledge, information and belief subject to any  
20 connections or additions they would make once they are  
21 put on the stand for cross-examination. And of course it  
22 would still be subject to any timely filed motions to  
23 strike portions of the testimony that would be made at  
24 the time that they are presented.

25 JUDGE FORDHAM: And that stipulation also would

1 apply to OTS's and OCA's witnesses?

2 MR. CLEARFIELD: Yes. To all the testimony that  
3 has been presented for the presentation this morning.

4 JUDGE FORDHAM: Okay.

5 MR. CLEARFIELD: And that way each party doesn't  
6 have to go through the process of authenticating their  
7 testimony from the witnesses.

8 JUDGE FORDHAM: That's fine.

9 Anything else?

10 MR. CLEARFIELD: I just want to check my notes,  
11 Your Honor. I believe that's it.

12 JUDGE FORDHAM: Okay. You can call your first  
13 witness.

14 MR. CLEARFIELD: Just for your sake, Your Honor,  
15 the order that we have arrived at that we are going to  
16 put the witnesses on for various reasons, scheduling, et  
17 cetera, is Ms. Bisgaier first, Mr. Bogdonavage, Mr.  
18 Krellenstein, Mr. Knudsen and then assuming we have not  
19 reached the 1:30 hour we will put Ms. Davis on at 1:30.  
20 If we do run past that, I would propose we break and have  
21 Ms. Davis brought in at that point by phone and then go  
22 back to whatever we were doing.

23 JUDGE FORDHAM: Okay.

24 MR. CLEARFIELD: If that is acceptable. If not, we  
25 can just wait.

1 JUDGE FORDHAM: Is that acceptable to everyone?  
2 Fine. With that, we would call Ms. Bisgaier.  
3 Whereupon,

4 BARBARA C. BISGAIER  
5 having been duly sworn, testified as follows:

6 JUDGE FORDHAM: Would you state your name and  
7 business address for the record and spell your last name?

8 THE WITNESS: It's Barbara Bisgaier,  
9 B-I-S-G-A-I-E-R, 1600 Two Logan Square, Philadelphia,  
10 19103.

11 JUDGE FORDHAM: Thank you.  
12 You may proceed, Mr. Clearfield.

13 MR. CLEARFIELD: Thank you, Your Honor.

14 DIRECT EXAMINATION

15 BY MR. CLEARFIELD:

16 Q. Ms. Bisgaier, you are sponsoring PGW ERP  
17 Statement 4 and the associated exhibits, is that correct?

18 A. Is it four or three?

19 Q. It is four on my copy.

20 A. Okay.

21 Q. Ms. Bisgaier, do you have any additions or  
22 corrections you would like to make?

23 A. An addition. BCB-1, the first exhibit to my  
24 testimony, was a copy of the press release issued by  
25 Standard & Poors. I would like to add to it the actual

1 report issued by Standard & Poors on February 12, 2002.  
2 It is identical to the press release but it is their  
3 formal document.

4 MR. CLEARFIELD: Your Honor, the copies that we  
5 have provided to the reporter have that addition to her  
6 testimony and to your copy, I believe.

7 JUDGE FORDHAM: Okay.

8 MR. CLEARFIELD: But we can give you a copy.

9 JUDGE FORDHAM: Yes, please.

10 MR. CLEARFIELD: Your Honor, we have some short  
11 rebuttal testimony to Mr. Lelash that we would like to  
12 present.

13 JUDGE FORDHAM: Okay.

14 BY MR. CLEARFIELD:

15 Q. Ms. Bisgaier, on page eight of Mr. Lelash's  
16 testimony he suggests that the formula that Standard &  
17 Poors is using to evaluate PGW's bond rating and the  
18 relative weighting it is giving to the various factors it  
19 uses in making its evaluation is unknown. And he also  
20 characterizes this process as a black box, quote unquote.  
21 Do you agree with his characterization?

22 A. No, I don't. As I have testified and I think  
23 Mr. Krellenstein has testified, S&P has made it  
24 absolutely clear that they will downgrade PGW absent  
25 permanent rate relief. While I agree with the statement

1 that there are many factors that go into the rating, they  
2 have taken those factors into account and their  
3 conclusion is that rate relief to remedy the liquidity  
4 and cashflow situation of PGW is required, otherwise they  
5 will downgrade PGW's long-term bond rating.

6 Q. How did you come to that opinion?

7 A. Basically I have followed this credit for a  
8 long time. I am familiar with the people at S&P. I am  
9 familiar with the writings that they have done about PGW  
10 and specifically this writing, which is very explicit.

11 I have also had, along with Mr. Knudsen and  
12 Mr. Bogdonavage and Joseph Golden, the treasurer of PGW,  
13 a number of conversations with S&P and they have been  
14 very clear about where they are on the credit and what  
15 their intentions are.

16 Q. Ms. Bisgaier, in the course of your  
17 professional activities do you have occasion to regularly  
18 analyze and understand credit agency actions or potential  
19 actions for your clients?

20 A. Yes. This is what I do for a living. I have  
21 been doing it for 20 years. When any of my clients is  
22 getting ready to issue bonds one of the critical steps in  
23 that process is to present themselves to the rating  
24 agencies for a rating. Many credits -- or many issuers  
25 also have between bond issues occasion to visit the

1 rating agencies and it is my responsibility including for  
2 the City of Philadelphia to prepare or assist them in  
3 preparing for those meetings and to represent them in  
4 discussions with the analysts at the rating agencies to  
5 the extent issues arise or questions arise.

6 Q. Now, have you used those same techniques and  
7 steps that you normally use to evaluate the credit agency  
8 actions, have you used those here to evaluate S&P's  
9 likely steps?

10 A. I have. It is a cumulative of ten years of  
11 working with PGW and the rating agencies.

12 Q. Mr. Lelash at pages 16 and 17 of his statement  
13 says that rating agencies look at a variety of factors,  
14 not just a formula of fixed coverage ratios. How do you  
15 respond to that?

16 A. That is absolutely true. They look at many  
17 factors and they have considered all of those factors.  
18 In their credit report, for example, they list a number  
19 of positive developments at PGW. What they are basically  
20 saying in their report is we have looked at everything,  
21 we note that there have been positive developments,  
22 however we still find that the liquidity issues as  
23 represented by the fixed charge coverage calculation that  
24 they do and the cashflow situation are such that the  
25 credit doesn't meet their standards for an investment

1 grade rating.

2 Q. Mr. Lelash's overall recommendation that is an  
3 extraordinary rate increase, or a rate increase, of \$18  
4 million in the form of a capital infusion surcharge along  
5 with the City of Philadelphia's promise to grant back its  
6 \$18 million city payment for three consecutive years  
7 should be sufficient to keep Standard & Poors from  
8 downgrading PGW to junk bond status. In your opinion is  
9 he correct?

10 A. No. S&P has made it very clear that after  
11 years of doing one-time fixes to sustain its bond  
12 covenant ratios they are looking for a permanent  
13 solution, not just interim fixes. They rate the bonds  
14 for the long-term. PGW has bonds outstanding that are  
15 going to remain outstanding for 29 more years. They want  
16 to make sure that a proper rate structure is in place to  
17 sustain those bonds over the 29 year period. So an  
18 interim fix is not acceptable to them as a means of  
19 solving this problem.

20 Q. Did you arrive at your opinion as to how S&P  
21 would respond to that, if that is what the Commission  
22 did, in the same way that you have testified you have  
23 come to your opinions about S&P actions in the normal  
24 course?

25 A. Yes. It is based on reading the S&P documents,

1 numerous conversations with them. I think it is very  
2 clear what their intention is.

3 MR. CLEARFIELD: Your Honor, that concludes our  
4 rebuttal and Ms. Bisgaier is available for  
5 cross-examination.

6 JUDGE FORDHAM: Mr. Simms.

7 MR. SIMMS: Thank you, Your Honor.

8 CROSS-EXAMINATION

9 BY MR. SIMMS:

10 Q. Good morning.

11 A. Good morning.

12 Q. I believe in your rejoinder testimony you  
13 indicated that you have been an advisor to PGW for about  
14 ten years. Before July, 2000, did any of the three  
15 credit rating agencies for PGW place PGW on credit watch?

16 A. Moody's Investors Service, which is one of the  
17 big three, also has them on -- they have a different  
18 nomenclature. They call it negative outlook. So PGW is  
19 on negative outlook. I can't tell you for certain what  
20 date that occurred, but they are on negative outlook  
21 right now at Moody's.

22 MR. CLEARFIELD: Excuse me just a second. To make  
23 sure the reporter hears you if you can sort of talk to  
24 make sure your voice goes both ways.

25 THE WITNESS: Okay.

1 BY MR. SIMMS:

2 Q. Do you know whether or not it occurred before  
3 July, 2000?

4 A. I don't know for certain.

5 Q. Now, for clarification, when you make a  
6 reference to the 1.2 through 1.3 times on page five of  
7 your testimony you would agree, would you not, that that  
8 is not a published statistic?

9 A. I would agree.

10 Q. Now, in your response to an OTS interrogatory  
11 in which we asked PGW to provide the criteria S&P uses to  
12 evaluate municipal bonds, you provided a section of the  
13 S&P municipal rating handbook, did you not?

14 A. I did.

15 Q. Again, in that section of the S&P municipal  
16 rating handbook, the 1.2 through 1.3 times does not  
17 appear as a criteria?

18 A. That's right.

19 MR. CLEARFIELD: Your Honor, may I approach the  
20 witness and provide her with a copy of that?

21 JUDGE FORDHAM: Yes, you may.

22 (Document handed to witness.)

23 BY MR. SIMMS:

24 Q. Did you need to review that?

25 A. No. I am familiar with it.

1 Q. You are familiar with it?

2 A. Yes.

3 Q. Is it your understanding that based upon those  
4 pages from the S&P municipal rating handbook that the  
5 criteria that S&P issues for rating definitions are  
6 expressed in terms of default risk?

7 A. Yes.

8 Q. Now, in your direct testimony you attached, did  
9 you not, Exhibit BCB-3?

10 A. Yes.

11 Q. It is my understanding that this exhibit is a  
12 copy of a schedule done by S&P, is it not?

13 A. It is.

14 Q. You would agree, would you not, that Exhibit  
15 BCB-3 does not represent any conclusions by S&P?

16 A. Well, it doesn't present a conclusion. It just  
17 shows their method of calculating the fixed charge  
18 coverage ratio.

19 Q. Just for clarification, on page four of your  
20 direct testimony -- I am looking at lines six through  
21 ten. Do you have that?

22 A. I don't.

23 (Document handed to witness.)

24 Q. Were you attempting to summarize the risk that  
25 S&P placed in their press release, which is identified as

1 BCB-1, Exhibit BCB-1?

2 A. Let me read it.

3 Q. Okay.

4 (Witness perusing document.)

5 A. Yes.

6 Q. So to the extent that you did not include all  
7 of those risk factors, that was just an oversight on your  
8 part?

9 A. That's correct.

10 Q. Now, on the one dealing with the decision by  
11 the PUC in December to decline to revise upward PGW's  
12 authorized rate increase from \$33.6 million, are you  
13 making reference there to the poor liquidity position  
14 that S&P announced in its press release?

15 A. That is certainly part of it, yes.

16 Q. Now, you do recognize, do you not, that in the  
17 S&P report they made a reference or a concern about the  
18 temporary borrowing that was done by PGW in January,  
19 2002? Do you have that exhibit?

20 A. Yes. Well, what they explicitly say in here,  
21 if I am reading the same place you are, is that they are  
22 concerned that they will be unable to reimburse their  
23 capital fund. And then they go on to say that S&P will  
24 seek -- I'm sorry -- that PGW will also seek a deferral  
25 of the \$45 million working capital loan due in January of

1 2003.

2 Q. I believe we are reading from --

3 A. A different place.

4 MR. SIMMS: May I approach the witness, Your Honor?

5 THE WITNESS: The beginning of the paragraph?

6 MR. SIMMS: Yes.

7 (Witness perusing document.)

8 A. I believe that what they are referring to in  
9 this sentence that starts the poor liquidity position is  
10 in June of 2001 PGW sold bonds, series 2001 revenue  
11 bonds, and it has been spending the money for capital  
12 improvements but not all of the money has been expended.  
13 And in January of 2002 in order to make the debt service  
14 payment that was due on January 1st of 2002 PGW borrowed  
15 from its bond fund to make that debt service payment. I  
16 don't believe that that reference there is to the \$45  
17 million loan from the city.

18 BY MR. SIMMS:

19 Q. Would I also be correct that the reference is  
20 also not to the base rate case? Would that be correct?

21 A. This sentence in here?

22 Q. Yes.

23 A. This sentence in here refers to the lack of  
24 liquidity and the fact that rates weren't sufficient to  
25 pay debt service, which they normally would be, so they

1 had to dip into the capital account because they were in  
2 an illiquid position on January 1st of 2002.

3 Q. Do you know or in your discussions with S&P did  
4 they know when rates went into effect for PGW in the last  
5 base rate case?

6 A. Yes. Yes. They have followed it very closely  
7 and they know that each time rate relief has been granted  
8 by the PUC that PGW has taken immediate steps to put that  
9 into effect, you know, as soon as legally possible after  
10 the order from the PUC. So they know that.

11 Q. Based upon your knowledge when did rates go  
12 into effect for this last base rate case?

13 A. I don't know the specific day. I know the  
14 order was in, I guess, in November and then there -- or  
15 October. I'm not certain. And then there was an appeal  
16 of that. And this refers to the action in December of  
17 that appeal -- regarding that appeal.

18 Q. From PGW's standpoint who has discussion with  
19 S&P regarding all of these types of matters? Is it you?

20 A. I do to an extent. Mr. Knudsen principally and  
21 Mr. Bogdonavage.

22 Q. Will you assume for the purposes of this  
23 question that rates went into effect in October on one  
24 day's notice for the last base rate case?

25 A. I don't know that to my own knowledge.

1 Q. Was that information referred to S&P?

2 A. I believe so, yes.

3 Q. Do you know whether or not based upon that one  
4 day's notice whether or not there was any -- whether or  
5 not PGW was overcollecting?

6 A. I don't know that.

7 Q. Was that information relayed in any discussion  
8 with Standard & Poors?

9 A. It may have been relayed by Mr. Bogdonavage or  
10 Mr. Knudsen.

11 Q. Would I be correct that the three rating  
12 agencies are Moody's, Fitch and S&P?

13 A. That's correct.

14 Q. Would I be correct that these three rating  
15 agencies do not rely upon the same criteria for credit  
16 ratings?

17 A. They would tell you that they don't but I  
18 believe that generally they do. There is not going to be  
19 an enormous difference between them. One may place more  
20 emphasis on one factor than another but they are not  
21 going to be materially different.

22 Q. In the ten years that you have been advising  
23 PGW is it my understanding that S&P prior to July, 2000,  
24 did not issue any type of credit watch?

25 A. That's correct.

1 Q. So for that period of -- well, since you have  
2 been there, 1992 through June of 2000, S&P was satisfied  
3 with the performance of PGW?

4 A. I don't remember if there was a downgrade  
5 during that time. There may have been one downgrade  
6 during that time period.

7 Q. You don't recall?

8 A. I don't recall.

9 MR. SIMMS: That concludes my cross-examination,  
10 Your Honor.

11 JUDGE FORDHAM: Thank you.

12 Mr. Gray.

13 MR. GRAY: I'm sorry?

14 JUDGE FORDHAM: Do you have anything for this  
15 witness?

16 MR. GRAY: Usually the OCA would go before me.

17 JUDGE FORDHAM: Ms. McCloskey.

18 MS. McCLOSKEY: Thank you, Your Honor.

19 CROSS-EXAMINATION

20 BY MS. McCLOSKEY:

21 Q. Good morning, Ms. Bisgaier.

22 A. Good morning.

23 Q. I would like to go back to page four of your  
24 testimony, beginning on line 17 through the bottom of the  
25 page where you are indicating that S&P has been

1 consistent in enunciating the standard by which it  
2 measures PGW. Now, Ms. Bisgaier, before February of this  
3 year were you aware of the formula which has been  
4 referred to as the fixed coverage ratio that S&P utilized  
5 in evaluating PGW?

6 A. Not explicitly in those terms. What I was  
7 aware of and they had raised it on a number of occasions  
8 -- and to go back to Mr. Simms' question somewhat  
9 differently than the other two rating agencies, who had  
10 never explicitly raised this -- they viewed the \$18  
11 million payment to the city as a contractual obligation  
12 and they worked that into their calculation. The other  
13 agencies have never overtly expressed that point as  
14 strongly as S&P does. So when they were talking to PGW  
15 over the years they often brought up the fact that all of  
16 -- that when they looked at the credit all of PGW's costs  
17 went into their calculation.

18 Q. But the exact BCB-3, what is now your Exhibit  
19 BCB-3, I believe you --

20 A. Had never seen that before.

21 Q. And I believe you did confirm with Mr. Simms  
22 that to your understanding this was not a formal standard  
23 that had been committed to in writing and it's not a  
24 published standard, is that correct?

25 A. That's correct. It was clear, however, from

1 the importance they placed on it that this calculation  
2 was the basis of their thinking.

3 Q. Now, again, you have testified that under this  
4 formula they are seeking a fixed coverage ratio of  
5 between 1.2 times and 1.3 times. Would you agree with me  
6 that under that test PGW would not have achieved an 1.2  
7 times or an 1.3 times coverage since at least 1998?

8 A. Yes, I would agree.

9 Q. And PGW was not downgraded in any of those  
10 years prior to 2000, is that correct?

11 A. That's correct.

12 Q. And then only in 2000 was it put on credit  
13 watch, is that correct?

14 A. That's correct.

15 Q. And to the best of your knowledge, do you know  
16 if PGW would have met this test in 1997 or 1996?

17 A. I don't know. I don't know off-hand.

18 Q. Now, am I also correct that under this formula  
19 if the commercial paper is paid down the S&P formula  
20 would produce a much higher ratio for PGW?

21 A. If it had been previously paid down?

22 Q. Yes. If it had been paid down.

23 A. Right.

24 Q. And going forward, if it is paid down in the  
25 next year, for example, for the subsequent years, it will

1 show a higher ratio in those subsequent years, all else  
2 being equal?

3 A. Yes, although -- yes. The interest component  
4 that they are charging will go down. But in any year  
5 that there is a pay down that would negatively impact the  
6 formula.

7 Q. But you would agree with me that if your  
8 commercial paper had been paid down in the past and there  
9 wasn't what is now the \$20 million pay down requirement  
10 for this year, that \$20 million pay down requirement  
11 would not have appeared in the formula?

12 A. That's correct.

13 Q. And the coverage, then, would have been higher?

14 A. That's correct.

15 Q. Now, if you could turn to BCB-3. And you also  
16 describe that on page five of your testimony, lines five  
17 to 12. In your exhibit and testimony you mention that  
18 S&P has added the \$20 million reduction in the commercial  
19 paper program. It was unclear to us. Do you mean for  
20 both 2002 and 2003?

21 A. Yes.

22 Q. At this time have you negotiated the terms of  
23 the commercial paper program for 2003?

24 A. No.

25 Q. And the \$20 million pay down was part of the

1 terms that were negotiated for 2002, is that correct?

2 A. Yes. That is a contractual arrangement with  
3 the syndicate of banks.

4 Q. Now, on page five of your testimony, lines 10  
5 through 11, you are quoting there from a S&P analyst.  
6 And that would be the quote from Aneesh Prabhu, correct?

7 A. That's correct.

8 Q. How long has Mr. Prabhu been the S&P analyst  
9 that has been handling PGW matters?

10 A. I am not certain. It is a relatively short  
11 time. I would say no more than a year. I can't tell you  
12 for certain, though.

13 Q. And does PGW work with an analyst that has  
14 handled their matters for a longer period of time?

15 A. Yes. Jodi Hecht.

16 Q. And has she been involved in these matters  
17 regarding the PGW downgrade?

18 A. Yes, she has.

19 Q. Was she involved over the last year in those  
20 matters?

21 A. She has been involved for a number of years.  
22 She was out on maternity leave for a segment of the past  
23 year. I am not sure of the exact months. So there have  
24 been some substitutes while she was out. She was  
25 involved, for example, in 2000 when they were put on

1 credit watch. So she goes back to that.

2 Q. And I believe you confirmed this with  
3 Mr. Simms, but bear with me if I ask this in a slightly  
4 different way. You would agree with me that the level of  
5 PGW's rate relief that was granted by the Commission in  
6 its 2001 base rate case has been known since the  
7 October-November timeframe?

8 A. That's correct.

9 Q. And in fact it was only the \$6 million that  
10 remained in dispute that had not been resolved throughout  
11 that period?

12 MR. CLEARFIELD: I'm sorry. I have to object. I  
13 am not sure which \$6 million you are talking about.

14 MS. McCLOSKEY: I think there was a difference  
15 between the \$39 million in the Commission's original  
16 order and \$33 million in a tentative order and it was  
17 that amount.

18 MR. CLEARFIELD: I am going to have to object. We  
19 filed a petition for reconsideration and asked the  
20 Commission to reinstate the entire amount.

21 A. Right. It was that -- they deferred any action  
22 until the petition for reconsideration was denied.

23 BY MS. McCLOSKEY:

24 Q. When, then, did Mr. Prabhu first contact PGW to  
25 indicate that S&P was considering an action?

1           A. I believe it was the week prior to the February  
2 12 report.

3           MS. McCLOSKEY: Your Honor, I would like to have  
4 marked for identification OCA Cross-Examination Exhibit  
5 No. 1.

6           JUDGE FORDHAM: It shall be so marked.

7           (Whereupon, the document was marked as OCA  
8 Cross-Exam. Exhibit No. 1 for identification.)

9           BY MS. McCLOSKEY:

10          Q. Ms. Bisgaier, this is your response to an OSBA  
11 interrogatory, Set II, numbers five, six and seven. And  
12 it is the attached Moody's Investor Service rating  
13 analysis from February, 2002. Do you want to take a  
14 moment to review that, or are you familiar with that?

15          A. I have not read it in the last day or two.

16          Q. Okay.

17          (Witness perusing document.)

18          Q. Just let me know when you are ready. I just  
19 have some very general questions.

20          A. Okay.

21          (Witness perusing document.)

22          A. Okay.

23          Q. Would you agree with with me that in this  
24 report Moody's affirmed its ratings of PGW, its current  
25 ratings of PGW?

1 A. Yes, I would.

2 Q. And you would agree with me that it leaves the  
3 credit outlook as a negative but it also specifically  
4 cites the failure to appoint permanent management as  
5 leaving open the door for another change in direction?

6 A. Yes.

7 Q. Now, if you also have the S&P announcement,  
8 which is your BCB-1 updated as well, I believe in your  
9 rebuttal testimony you indicated that both Moody's and  
10 S&P as well as Fitch will look at a number of factors in  
11 considering their rating. Would you agree with me that  
12 both the Moody's and the S&P reports identify a number of  
13 both strength and weaknesses for PGW?

14 A. Yes.

15 MR. CLEARFIELD: Your Honor, I have to object  
16 because it assumes a fact which is not the same as my  
17 recollection of the testimony. What Ms. Bisgaier said  
18 was that S&P has already looked at a number of factors  
19 and made a determination, not that they will be looking  
20 at. They have already made a determination and decided  
21 what they are going to do if certain things don't happen.

22 MS. McCLOSKEY: Well, that is the point we are  
23 going to probe at the moment. We are going to discuss  
24 the strengths and weaknesses and the factors that are  
25 being considered by S&P.

1 MR. CLEARFIELD: Well, there was an assumption in  
2 the question. If Ms. McCloskey wants to rephrase it and  
3 ask about that, that's fine.

4 MS. McCLOSKEY: I think, Your Honor, the question  
5 is would you agree with me that the Moody's report and  
6 the S&P report, these two reports, OCA Cross-Examination  
7 Exhibit No. 1 and BCB-1 updated both list a number of  
8 strengths and weaknesses of PGW. I think that is a basic  
9 factual question.

10 JUDGE FORDHAM: Do you have an objection?

11 MR. CLEARFIELD: No. That is a different question.

12 MS. McCLOSKEY: That is the question I asked.

13 JUDGE FORDHAM: You may answer, Ms. Bisgaier.

14 A. Yes.

15 BY MS. McCLOSKEY:

16 Q. Thank you.

17 Now, Ms. Bisgaier, have you analyzed what the  
18 effect would be on PGW if some of the other factors  
19 listed as weaknesses by Moody's or by S&P were actually  
20 changed or addressed by PGW?

21 A. Yes. I think that is -- yes.

22 Q. And have you addressed whether PGW's status  
23 would change if permanent management were appointed?

24 A. Yes.

25 Q. And have you evaluated whether PGW's status

1 would change if a collection strategy was implemented  
2 that produced additional cash to the company?

3 A. Yes.

4 Q. And have you discussed your analysis with  
5 either S&P or Moody's?

6 A. Through the presentations to the rating  
7 agencies, yes.

8 Q. Was it your analysis or your presentation that  
9 those positive changes would positively affect the  
10 ratings of PGW?

11 A. I believe those are positive, both positive  
12 factors. I don't think that in either instance they  
13 would change the rating.

14 Q. And did you analyze whether the rating may be  
15 affected positively if PGW has its full \$100 million  
16 worth of commercial paper available to draw on?

17 A. That I believe would be a very strong positive  
18 in their rating.

19 MS. McCLOSKEY: Now I would like to have marked for  
20 identification OCA Cross-Examination Exhibit No. 2.

21 JUDGE FORDHAM: It shall be so marked.

22 (Whereupon, the document was marked as OCA  
23 Cross-Exam. Exhibit No. 2 for identification.)

24 BY MS. McCLOSKEY:

25 Q. Ms. Bisgaier, this was an e-mail that was

1 produced in response to OCA Set I, questions two, four  
2 and six. The response was provided by Mr. Bogdonavage,  
3 but I wanted to discuss this e-mail which you are a  
4 recipient of. It explains the rating process. Are you  
5 familiar with this e-mail to discuss it?

6 A. Yes, I am.

7 Q. Now, in the second paragraph there -- this is  
8 an e-mail from Mr. Prabhu, is that correct?

9 A. That's correct.

10 Q. And in the second paragraph he explains the  
11 rating process that S&P goes through, is that correct?

12 A. That's correct.

13 Q. And does that paragraph or explanation comport  
14 with your understanding of the rating process for PGW?

15 A. Yes, it does.

16 Q. Now, in informal discovery you explained there  
17 was also an additional step to this process where  
18 information was provided to a committee to be reviewed.  
19 Can you explain that second step of the process a little  
20 bit further?

21 A. Yes. The analysts, Mr. Prabhu and Ms. Hecht,  
22 prepare -- and I am not privy to the report they prepare  
23 -- but they prepare a report. That report is reviewed by  
24 the credit committee at S&P who is comprised of senior  
25 members. It's not always the same. You don't know who

1 is on any given credit committee. It is kept secret.  
2 And it is that committee based on the recommendation of  
3 the analysts but may be contradicting that recommendation  
4 that makes the final determination as to the credit  
5 rating or any potential credit action.

6 Q. Now, at this point, and I believe we also  
7 discussed this in informal discovery, S&P has not  
8 provided PGW any guarantee that if it gets the rate  
9 relief that it has requested that it will not downgrade  
10 the bonds, is that correct?

11 A. That's correct.

12 Q. You will agree with me that the ratings  
13 agencies do not provide such guarantees before something  
14 happens?

15 A. Correct.

16 Q. Now, Ms. Bisgaier, I think you also mentioned  
17 in your rebuttal testimony that you advised the City of  
18 Philadelphia on its bond issuances?

19 A. Yes, that is true.

20 Q. If PGW bonds are downgraded do you anticipate  
21 that there will be any negative effect on the city's  
22 bonds?

23 A. Not immediately, no.

24 Q. But you do anticipate there would be some  
25 future effect?

1           A. I think there will be a very bad climate and  
2 the rating agencies will be interested and concerned as  
3 to whether the city itself and its general fund which  
4 supports its bonds will be drawn on to support PGW. So  
5 it will become a watch factor, if you will, on the city's  
6 rating.

7           MS. McCLOSKEY: Thank you, Ms. Bisgaier.

8           Your Honor, I would like to move into evidence OCA  
9 Cross-Examination Exhibits Nos. 1 and 2.

10          JUDGE FORDHAM: Any objection?

11          MR. CLEARFIELD: No objection.

12          JUDGE FORDHAM: They are entered into evidence.

13          (Whereupon, the documents marked as OCA  
14 Cross-Exam. Exhibits Nos. 1 & 2 were received in  
15 evidence.)

16          JUDGE FORDHAM: Thank you.

17          Mr. Gray.

18          MR. GRAY: Thank you, Your Honor.

19                           CROSS-EXAMINATION

20          BY MR. GRAY:

21          Q. Good morning, Ms. Bisgaier.

22          A. Good morning.

23          Q. Just to follow up on your oral rebuttal this  
24 morning, you said something -- and correct me if I am  
25 paraphrasing you wrong -- you said it is clear what S&P's

1 intention are in this matter. You used that in a  
2 response, I believe, when one of the attorneys asked you  
3 or maybe in your rebuttal itself about what is in the OCA  
4 testimony about the \$18 million sort of matching with the  
5 city foregoing the 18 million for three years. And of  
6 course the OTS has testimony about a \$25 million  
7 proposal. And your reaction was we know what S&P's  
8 intentions are, they would not go for that. Am I  
9 correctly summarizing what you said?

10 A. Yes.

11 Q. Have you actually discussed the proposals, if  
12 you will, set forth in the OCA or OTS testimony with  
13 anyone from S&P?

14 A. I have not. I do know, however, that on  
15 various occasions the granting back of the \$18 million by  
16 the city has been discussed, not in the context of the  
17 testimony but just generally. And they have made it very  
18 clear that that is not -- they do not consider that  
19 acceptable as a permanent solution to PGW's liquidity  
20 problems.

21 Q. I see. And it would be your understanding with  
22 the additional infusion of cash that both the OTS and the  
23 OCA are suggesting, even that level of cash would be  
24 insufficient?

25 A. I don't believe it would be sufficient.

1 MR. GRAY: Thank you.

2 Thank you, Your Honor. That is all I have.

3 JUDGE FORDHAM: Thank you.

4 Mr. Bertocci.

5 MR. BERTOCCI: Yes.

6 CROSS-EXAMINATION

7 BY MR. BERTOCCI:

8 Q. The discussions that you have had concerning  
9 the \$18 million have been on the basis of an one-time  
10 only waiver, isn't that right? Or a grantback?

11 A. It has been in the context of an one-time  
12 grantback not related to any specific year. If we did  
13 this -- in the nature of if we did this how would you  
14 view that. And they said an one-time fix doesn't count  
15 as permanent rate relief -- doesn't count as a permanent  
16 solution, rather.

17 MR. BERTOCCI: Thank you. That is all I have.

18 JUDGE FORDHAM: Ms. Burak.

19 MS. BURAK: I have nothing, Your Honor. Thank you.

20 JUDGE FORDHAM: Thank you.

21 Do you have anything else?

22 MR. CLEARFIELD: Yes, Your Honor.

23 REDIRECT EXAMINATION

24 BY MR. CLEARFIELD:

25 Q. Ms. Bisgaier, is a grantback of the \$18 million

1 for three years different than a grantback of the \$18  
2 million for one year in your view? Or would S&P consider  
3 it differently?

4 A. No. It would be, again, at the discretion of  
5 the city to do that and anything that was discretionary  
6 and not mandatory they would not take as a permanent  
7 solution.

8 Q. Do you have any doubt at all that S&P would not  
9 accept that as an acceptable solution to PGW's current  
10 liquidity problems?

11 A. I have no doubt about that.

12 Q. You mentioned that the S&P formula was  
13 different from the formula that PGW utilizes to calculate  
14 its bond coverages for its bond covenants because the S&P  
15 includes the grant of the city fee. That is not the only  
16 thing that S&P includes that is not included in the  
17 calculation made by PGW, is it?

18 A. I think what I said was that S&P's was  
19 different than what the other rating agencies have  
20 expressed as how they do it. I don't think I commented  
21 on versus how PGW did it. Maybe I misunderstood the  
22 question and answered the wrong question.

23 Q. All right. I may have misunderstood.

24 You also mentioned that BCB-3 included the \$20  
25 million pay down for 2003.

1 A. That's correct.

2 Q. Do you have an opinion as to why they include  
3 that?

4 A. They include that because they believe it is  
5 very important for PGW to remove the commercial paper  
6 from their permanent capital structure and return it to  
7 the status of being a cashflow facility that would  
8 provide them with liquidity. So they think it is  
9 important that it be paid down and they have made it  
10 quite clear and included it in their formula because they  
11 see that as an important standard.

12 Q. In answer to questions from, I believe,  
13 Ms. McCloskey you mentioned that you had discussed  
14 several other factors or positive steps that PGW could  
15 take such as appointing permanent management and an  
16 aggressive collections program. Standing alone would the  
17 company taking those steps prevent a downgrade if the  
18 company's equity position was not improved sufficient to  
19 meet the S&P formula in your opinion?

20 A. It would not prevent a downgrade. Either or  
21 both of those happening today, you know, would not change  
22 S&P's intention. Right now they are concerned about the  
23 liquidity cashflow position of the company. Permanent  
24 management would certainly be viewed as a positive. They  
25 are hoping that an aggressive collections effort will

1 begin on April 1st. But they are still worried about the  
2 cashflows.

3 Q. Are there any set of non-financial steps that  
4 the company could take that would prevent the downgrade  
5 in your view if the liquidity position was not improved?

6 A. I do not believe there are any.

7 MR. CLEARFIELD: That is all I have.

8 JUDGE FORDHAM: Thank you.

9 Does anyone else have anything?

10 MR. GRAY: Just one follow-up.

11 JUDGE FORDHAM: Go ahead.

12 RE CROSS-EXAMINATION

13 BY MR. GRAY:

14 Q. Just so we are clear, Mr. Clearfield asked you  
15 about the OCA position, which is the 18 million grantback  
16 for three years and 18 million of matching funds from the  
17 ratepayers. It was your opinion that that would not  
18 satisfy S&P, is that correct?

19 A. That's correct.

20 Q. Have you put that proposal in front of them,  
21 though?

22 A. No.

23 MR. GRAY: Thank you.

24 That's all I have.

25 JUDGE FORDHAM: Ms. McCloskey, do you have a

1 question?

2 MS. McCLOSKEY: No, Your Honor. That was my  
3 question. Thank you.

4 JUDGE FORDHAM: Thank you.

5 (Witness excused.)

6 MR. CLEARFIELD: I move the admission, Your Honor  
7 -- or should we do that at the end of the presentation?

8 JUDGE FORDHAM: We can do it now.

9 Are there any objections to the admission of PGW  
10 ERP Statement 4, the testimony of Barbara Bisgaier?

11 (No audible response.)

12 JUDGE FORDHAM: Hearing none, it is admitted.

13 MR. CLEARFIELD: And the accompanying exhibits.

14 JUDGE FORDHAM: And the three exhibits that  
15 accompany it.

16 (Whereupon, the documents were marked as PGW  
17 ERP Statement No. 4 and Exhibits Nos. BCB-1, BCB-2  
18 and BCB-3 for identification, and were  
19 received in evidence.)

20 MR. CLEARFIELD: Your Honor, we would like to move  
21 to Mr. Bogdonavage at this time.

22 Whereupon,

23 JOSEPH R. BOGDONAVAGE

24 having been duly sworn, testified as follows:

25 JUDGE FORDHAM: Would you state your name and your

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1 business address for the record, please? And please  
2 spell your last name.

3 THE WITNESS: The name is Joseph R. Bogdonavage,  
4 800 West Montgomery Avenue, Philadelphia, Pennsylvania,  
5 B-O-G-D-O-N-A-V-A-G-E.

6 JUDGE FORDHAM: Thank you.

7 You may proceed, Mr. Clearfield.

8 MR. CLEARFIELD: Thank you, Your Honor.

9 Your Honor, Mr. Bogdonavage is sponsoring PGW ERP  
10 Statement 2 and as you mentioned, two exhibits, JRB-1 and  
11 JRB-2.

12 DIRECT EXAMINATION

13 BY MR. CLEARFIELD:

14 Q. Mr. Bogdonavage, do you have any corrections or  
15 additions that you would like to make or point out?

16 A. I would like to point out that during the  
17 process of the discovery sessions we did find a formula  
18 problem in my JRB Exhibit 2 and we reissued, I think on  
19 March 15, a revision to that schedule which cleaned up  
20 the Standard & Poors calculation. It was pointed out  
21 that there was a formula driven mistake that improperly  
22 used PGW funds available and not the calculation that  
23 Standard & Poors had used and we rectified that situation  
24 by reissuing JRB-2.

25 MR. CLEARFIELD: The copy that we have distributed,

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1 Your Honor, has the JRB-2 corrected as of March 15  
2 included.

3 JUDGE FORDHAM: .Okay.

4 MR. CLEARFIELD: I would just note that  
5 Mr. Bogdonavage is also sponsoring BRP Statement 1 in  
6 Volume II that were stipulated into the record. He is  
7 responsible for those, although there won't be any  
8 questions, I assume on those.

9 And we have some short rebuttal for  
10 Mr. Bogdonavage.

11 BY MR. CLEARFIELD:

12 Q. Mr. Bogdonavage, Mr. Lelash claims that PGW's  
13 owner, the City of Philadelphia, isn't doing enough in  
14 his opinion to help PGW out of its present crises. Would  
15 you explain your understanding of the financial  
16 commitment the city has already agreed to make and what  
17 that will mean from a financial standpoint?

18 A. Yes, I will.

19 Working with Janice Davis, the finance director of  
20 the city, just going back a little over a year, the city  
21 stepped forward and made a \$45 million working capital  
22 loan interest free to PGW which currently is scheduled to  
23 be repaid no later than January of 2003. We have asked  
24 the finance director to approach City Council on an  
25 ordinance to have that deferred until August of 2003 to

1 allow PGW more liquidity during its process of the rate  
2 hearings that we are currently undergoing.

3 The city has also put on the table for earnings and  
4 debt service coverage this year as a backstop up to \$18  
5 million of the city fee if in fact it is required for PGW  
6 to meet its mandated coverage requirements. This was  
7 brought about by the extraordinarily warm weather that  
8 PGW has experienced in this current winter which is  
9 approaching 25 percent warmer than normal, unprecedented  
10 in PGW's service territory.

11 In addition to that we are now proposing to do a  
12 forward purchase agreement on PGW's restricted accounts  
13 associated with the bond proceeds and the sinking fund as  
14 a possible way of also providing some liquidity back into  
15 the company to offset the earnings shortfall we have had  
16 as a result of the warmer weather.

17 In my most recent projections that we have it  
18 appears that PGW will be asking the city-- and again this  
19 can change, it's only a projection at this time -- for  
20 about \$8 million of the city fee as a backstop to meet  
21 earnings and debt service coverage. However, also  
22 included in this is that PGW prevails on the \$44 million  
23 base rate increase at this time.

24 Q. Mr. Bogdonavage, do you have an exhibit that  
25 shows those calculations?

1           A. Yes, I do. I have PGW Bogdonavage Rebuttal  
2 Exhibit 1.

3           MR. CLEARFIELD: Your Honor, we have distributed  
4 that to the parties prior to the beginning of the  
5 hearing. I have handed two copies to the reporter and to  
6 Your Honor and I would ask that it be marked for  
7 identification.

8           JUDGE FORDHAM: It shall be so marked.

9           (Whereupon, the document was marked as PGW  
10 Bogdonavage Rebuttal Exhibit No. 1 for  
11 identification.)

12          A. Just further going through what the city's  
13 commitment has been over the last year, they also prepaid  
14 their gas bill for the period in January of 2001 to the  
15 tune of four or five million dollars to provide  
16 liquidity. They have deferred the payment of the city  
17 fee which is due to be paid in April of four-and-a-half  
18 million dollar installments in February, March, April and  
19 May of each year. They have allowed us to defer that  
20 until June of the last three fiscal years.

21          In addition to that PGW has also gotten the  
22 interest free loan on the \$45 million. This is has  
23 allowed us to better manage our commercial paper notes so  
24 that we are putting out interest laden money at this time  
25 and using the city loan as the working capital loan as

1 needed during the fiscal year.

2 If I could, just to go through my rebuttal exhibit,  
3 JRB, the middle two columns on this spreadsheet under the  
4 projected income are the original filing that PGW had  
5 prepared in its extraordinary petition. What I have  
6 included to the left of the current estimate is our most  
7 recent estimate of where we expect to be for the current  
8 year, taking into account some known factors. And now  
9 that we have six months of actual experience we also have  
10 a further deterioration in the weather conditions that we  
11 have experienced in this current year. So if I may just  
12 walk down that schedule, PGW originally had expected  
13 about a \$25 million margin loss as a result of the  
14 weather during this fiscal year. We are now looking at  
15 about a \$32 million reduction in firm gas sales in  
16 margin.

17 In addition to that, at the point in time that the  
18 schedule was prepared we were looking at about a \$16.8  
19 million over-recovery on the gas cost rate that is  
20 currently in effect. On an accounting treatment of this  
21 we would have to match revenue and expenses so \$16.8  
22 million will be removed from revenues and set up as a  
23 liability to be return to ratepayers in the prospective  
24 period.

25 BY MR. CLEARFIELD:

1 Q. Mr. Bogdonavage, is that shown on your schedule  
2 as the \$48.8 million?

3 A. That's correct.

4 In addition to that --

5 Q. The two items together?

6 A. Yes. It's the \$32 million associated with  
7 weather and the projection of \$16.8 million in the gas  
8 cost rate over-recovery.

9 In addition to that I have now line itemed the  
10 proposed base rate increase. If the \$44 million goes  
11 into effect shortly thereafter the April 11 decision date  
12 PGW expects to bill somewhere around \$8 million over the  
13 remaining part of this fiscal year. Your Honor, as you  
14 know, the bulk of PGW's sales occur during the winter  
15 process. Between April and August there are very little  
16 firm volumes outstanding to be billed. And that results  
17 in the \$8 million only being billed from the April  
18 through August time span.

19 In addition to that PGW does have some exposure on  
20 its bad debt expense. Projections that we had initially  
21 included for a reduction in bad debt expense were  
22 associated with receiving a substantial portion of crisis  
23 grants for our low income program. Last year PGW  
24 received almost \$18 million in grants for low income  
25 delinquent bills through the crisis program. We are

1 probably looking at only about one-third of that being  
2 received this year. So there would be some pressure on  
3 our bad debt expense as a result of that. The drop in  
4 natural gas prices that has occurred has also helped in  
5 the bad debt expense but in our low income customers we  
6 expect that the loss of the crisis grants will more than  
7 offset the reduction in bad debt that could be projected  
8 at year end as a result of the lower gas prices.

9 In addition we have had ongoing discussion with our  
10 actuaries regarding PGW's pension plan. We had a study  
11 performed in May of 2001. At that point in time it  
12 showed that the actuarial contribution would be about two  
13 to two-and-a-half million dollars because at that point  
14 in time PGW's pension fund was overfunded and we were  
15 amortizing that overfunding over a period of years.  
16 Subsequent to the report being issued and also the events  
17 of 9/11 and the subsequent market decline PGW's position  
18 now is that it is probably underfunded. So that in a  
19 worst case scenario right now our normal cost component,  
20 which would be those individuals that have not been  
21 vested, it looks like it would be around \$6 million or  
22 about a three-and-a-half million dollar or \$4 million  
23 increase from what we had projected earlier.

24 In addition to that what I have included in my line  
25 other income is 27-and-a-half million dollars of

1 infusions by the owner, the City of Philadelphia, which  
2 reflect two items, one being a \$20 million forward  
3 purchase on our restricted account which is taking about  
4 a \$60 million chunk of those proceeds and getting the net  
5 present value of that earnings stream over the next seven  
6 to ten years and granting that back to PGW.

7 In addition to that we have --

8 Q. Is that an one-time event?

9 A. PGW currently has a forward purchase agreement  
10 that was done in 1995 for about that value of proceeds.  
11 That expires in 2004. This would now be an addition to  
12 that that we would take that \$60 million and get the net  
13 present value of that earnings stream in this fiscal  
14 period, unfortunately to the detriment of the earnings  
15 potential in the next seven to ten years. So that PGW at  
16 this point in time is using that \$20 million as an offset  
17 of the lost margins of firm sales as a result of the  
18 weather.

19 In addition, to make PGW's mandatory debt coverage  
20 on the bonds, the 1975 and 1998 ordinance bonds, it  
21 appears at this point in time -- and again this is  
22 projection at this moment -- that PGW will require about  
23 a seven-and-a-half million dollar infusion from the city  
24 as a grantback of the city fee between now and August of  
25 2002.

1           Just moving to the right side of the page, looking  
2           at the debt service coverage ratios you will notice on  
3           the 1998 senior debt that PGW is at the bare minimum of  
4           about 1.51 as we speak. Just going further down, which  
5           is not part of PGW's debt service calculation but as has  
6           been referred to a little earlier, the Standard & Poors  
7           fixed charge coverage ratio where they take the aggregate  
8           debt service of principal and interest, include PGW's  
9           city fee payment of \$18 million and also include the  
10          mandatory reduction in our commercial paper program from  
11          100 million down to 80, or that \$20 million payment, and  
12          as a result of the deterioration this year because of  
13          weather PGW's fixed rate coverage ratio on all of that  
14          aggregate debt service is .83 or substantially below what  
15          the Standard & Poors had purported to be an investment  
16          grade grading, which would be in the 1.2 to 1.3 of fixed  
17          charges.

18           Q. When you show the 1.51 in the revised estimate  
19          does that include the infusions from the city that you  
20          mentioned?

21           A. Yes, it does. As I pointed out earlier, we  
22          have 27-and-a-half million dollars of infusions -- of  
23          funds. As I pointed out, it was between the forward  
24          purchase agreement and also the grantback of the city fee  
25          in conjunction with the rate increase that was going to be

1 billed subsequent to a decision by the Public Utility  
2 Commission.

3 Q. Do you have an end of year cash balance either  
4 with or without the city infusions that this analysis  
5 would produce?

6 A. As part of the original exhibits that were  
7 filed, I think it was JRB-1, we had a projection if  
8 nothing was done. And looking at our receipts and  
9 disbursements over the remaining six months, that PGW  
10 would be in about a \$21 million negative position. With  
11 the infusion of this 27-and-a-half million dollars and,  
12 again, assuming that we improve our collection activity  
13 and also one of the things that has helped a little bit  
14 is the reduction in natural gas prices that PGW pays, we  
15 are looking at somewhere around a \$7 million or \$8  
16 million cash balance. Unfortunately all of the city loan  
17 is anticipated to be outstanding and the bulk of the  
18 commercial paper program will be outstanding at year end.  
19 So that even though we have \$8 million of fungible cash  
20 at the end of the year we will have outstanding almost  
21 \$142 million of short-term debt.

22 Q. Turning to another subject, Mr. Bogdonavage,  
23 Mr. Lelash has testified that the Commission should grant  
24 a \$18 million rate increase in the form of a capital  
25 surcharge and he has also suggested some mandatory

1 grantbacks of the city fee to supplement that. Putting  
2 aside the city fee grantbacks for a moment have you  
3 calculated what coverages using the S&P coverage formula  
4 will be produced on a fully forecasted test year basis,  
5 the same basis as in JRB-2, on Mr. Lelash's  
6 recommendation?

7 A. Yes. That would be the far right column of  
8 both the income statement and coverage. As you see,  
9 there is a reduction from 44 million down to 18. The  
10 only adjustments that were made to any of the ancillary  
11 items that might be reflected as a result of the base  
12 rate increase reduction. They would be in other  
13 revenues, bad debt expense and other income. As a result  
14 of that PGW would make its mandatory coverage of 1.5.  
15 However, it would fall short. The far right-hand column  
16 at a very bottom, the fixed rate coverage ratio including  
17 all debt service, the city fee and the \$20 million tax  
18 exempt commercial paper repayment would produce about an  
19 1.08 coverage ratio. And to get back to about an 1.25 we  
20 would need about 22 million dollars in additional rates  
21 to attain somewhere between the mid-ground of 1.2 and 1.3  
22 which Standard & Poors has said is an investment grade  
23 rating.

24 Q. Now, Mr. Bogdonavage, if in fact the Commission  
25 were to order PGW to in effect utilize the city fee as an

1 infusion of capital to produce the coverage ratios that  
2 S&P is requiring rather than obtain it from revenues,  
3 does your experience from this year provide an additional  
4 reason why that would be inappropriate?

5 A. Absolutely, because right now that is the only  
6 safety net the company has in the way of backfilling any  
7 lost margins as a result of weather and other unforeseen  
8 events at the moment. In addition to that, in  
9 discussions with the finance director, Janice Davis, we  
10 have never been given any guarantees that the city fee is  
11 available beyond this year as an one-time event.

12 Q. Finally, with respect to Mr. Lelash, he  
13 suggests at page six, I believe, that -- I'm sorry. This  
14 is the penultimate question with respect to Mr. Lelash.  
15 He mentions the \$10.8 million GCR overcollection  
16 grantback that the PUC very graciously provided to us in  
17 January. Just to make sure the record is clear, does  
18 your analysis either on JRB-2 or your cashflow analysis,  
19 do they include the positive effects of that grantback?

20 A. First of all, the grantback or the use of the  
21 reserve account that the PUC had allowed was \$10.6  
22 million. That was associated with the 2001 gas cost  
23 rate. On an accounting basis that revenue stream or that  
24 overcollection that did not have to be returned to  
25 ratepayers was matched up against expenditures in 2001

1 and so for an earnings potential it is not available  
2 beyond 2001.

3           However, in JRB-2, my cashflow exhibit for fiscal  
4 year 2002, we did incorporate into our projections of  
5 receipts over the remaining part of the year that PGW  
6 would not be returning to ratepayers that \$10.6 million  
7 and was included as a projection of what was available as  
8 a result of the PUC allowance of the reserve account to  
9 be used to meet the debt service payments that were made  
10 in January. So we have included that in my overall  
11 assumption of \$8 million of ending cash.

12           Q. On page 33 of Mr. Lelash's testimony he  
13 suggests that the present \$100 million or so of  
14 short-term debt outstanding could be attributed to the  
15 city taking its mandatory city payments since 1996. Do  
16 you believe that that is an accurate characterization?

17           A. I do not. Over the last five fiscal years or  
18 five heating seasons PGW has experienced four  
19 substantially warmer than normal winter heating seasons.  
20 Going back to 1998, that year was about a 12 percent  
21 warmer than normal year, which resulted in about \$17  
22 million of lost margins. In 1999 we were about 15  
23 percent below or roughly about \$20 million in lost  
24 margin. 2000 was the third consecutive warmer than  
25 normal. That was about 13 percent warmer than normal.

1 That resulted in about an \$18 million reduction in our  
2 operating margins. The 2001 year was basically normal so  
3 there was no necessary loss of margins.

4 However, the 2002 fiscal period, as I pointed out a  
5 little earlier, was unprecedented in its degree days and  
6 the relative warmth of the winter. We are looking at  
7 right now about a 23 percent reduction in degree days  
8 which would equate to about \$32 million in lost operating  
9 margin.

10 So over that five year horizon we are looking at 85  
11 to 90 million dollars in lost margin which I think is  
12 substantially the reason why PGW had to rely upon its  
13 commercial paper program to fund its lost margins, to pay  
14 its ongoing liabilities.

15 Q. Have you prepared or had prepared an exhibit  
16 showing the lost margin in fiscal year 2002?

17 A. I think that was prepared, yes.

18 MR. CLEARFIELD: Your Honor, if I could have marked  
19 for identification PGW Bogdonavage Rebuttal Exhibit 2.

20 JUDGE FORDHAM: It shall be so marked.

21 (Whereupon, the document was marked as PGW  
22 Bogdonavage Rebuttal Exhibit No. 2 for  
23 identification.)

24 MR. CLEARFIELD: And copies have been distributed  
25 to the parties previously.

1 BY MR. CLEARFIELD:

2 Q. Do you have that, Mr. Bogdonavage?

3 A. I don't have it.

4 (Document handed to witness.)

5 Q. Do you have a copy of that exhibit?

6 A. Yes, I do.

7 Q. Would you please explain what that shows?

8 A. Basically what we are trying to accomplish here  
9 -- and we have done it in several different formats -- is  
10 to look at what actual temperatures have done to PGW's  
11 projections for its natural gas sales to firm customers.  
12 What we are looking at at the moment is about an 8.9 or  
13 roughly nine billion cubic foot reduction in natural gas  
14 sales to firm customers. And we equated that to the  
15 non-fuel component of PGW's base rates. This is the  
16 operating margin that PGW utilizes to pay all of its  
17 operating and maintenance expenses and also to service  
18 its debt service. And as a result of that calculation  
19 basically the nine Bcf reduction in firm sales equates  
20 out to the lost margin that I had previously discussed of  
21 about \$32.4 million.

22 This is substantially higher than about a month ago  
23 when PGW had prepared its original filing and exhibits,  
24 which at that point in time was about \$25 million. So we  
25 have continued to have an erosion in lost margin as a

1 result of the substantially warmer weather patterns that  
2 we are experiencing.

3 Q. Turning to the OTS witness Mr. Deardorff and  
4 his recommendation, I believe he has recommended a \$25  
5 million extraordinary rate relief based on his  
6 calculation of the coverages needed to obtain an 1.25  
7 coverage using your JRB-2 with some adjustment. Are you  
8 familiar with that testimony?

9 A. Yes.

10 Q. He claims that there were two errors that you  
11 made in your calculation that justify a reduction in the  
12 rate relief. The first is that you failed to add back  
13 capital leases in the calculation of the funds available  
14 to pay these various obligations. Have you had an  
15 occasion to review that, your schedule and that claim?

16 A. Yes, I have. On what was handed out to the  
17 parties before the proceeding had started we did find a  
18 mathematical formula driven mistake. That was corrected  
19 on JRB Exhibit 2 as part of the the extraordinary relief  
20 petition.

21 Where Standard & Poors utilizes total revenue  
22 streams less natural gas and O&M expenses, being  
23 operating and maintenance expenses, gets a funds  
24 available and adds to that the capital lease. And that  
25 schedule has now been corrected, which now produces this

1 \$100.2 million net available to service the aggregate  
2 debt service.

3 Q. Are you referring to a specific line on JRB-2  
4 corrected?

5 A. That's correct. On the right-hand side of the  
6 page there is a description in the bottom right-hand  
7 corner, revised Standard & Poors fixed charge coverage  
8 ratio. Looking at the second column in from the left,  
9 that was the original projection. That is where the  
10 mathematical mistake had occurred. We used the number of  
11 about 101 million.

12 As a result of this revision to the schedule we are  
13 now purporting to show that this is how Standard & Poors  
14 had calculated the fixed-charge coverage ratio and have  
15 fixed that mathematical mistake. So that the Office of  
16 Trial Staff's assumption that PGW did not add back the  
17 lease has been corrected. So that is not something  
18 that --

19 Q. Would it justify a reduction in our request by  
20 \$5.9 million in your view?

21 A. Yes.

22 Q. No. Does it justify a reduction in our  
23 request?

24 A. Not in our request, but it would add to the OTS  
25 -- well, I shouldn't say that it will add to their

1 recommendation. But it does need to be adjusted to take  
2 into account that PGW did not err by not adding back the  
3 5.9 million.

4 Q. And the second adjustment that Mr. Deardorff  
5 took issue with was the bottom one, the add back of the  
6 \$20 million TXCP, which is tax-exempt commercial paper  
7 payments. Mr. Deardorff suggested that rather than using  
8 the \$20 million figure you show there that an \$11 million  
9 figure would be more appropriate. Do you recall that?

10 A. Yes, I do.

11 Q. Do you have a comment on that?

12 A. I think unfortunately there is a little bit of  
13 confusion where the Office of Trial Staff was also  
14 looking a little bit forward into the base rate  
15 proceeding. PGW filed as part of the base rate  
16 proceeding a request for \$60 million of rates. But PGW  
17 at the moment, and as has been acknowledged by S&P, is  
18 mandated to reduce its commercial paper program by only  
19 \$20 million at this point in time. The OTS  
20 recommendation looked at what was happening in the base  
21 rate case, the \$60 million request, and in that case PGW  
22 is looking for about a \$31 million reduction in its  
23 outstanding commercial paper program. That is not part  
24 of Standard & Poors projections here. The only mandated  
25 reduction that PGW is under right now is the credit

1 agreement that is in place with the bank now and that  
2 calls for a reduction of only \$20 million. So the \$11  
3 million is actually in addition to the \$20 million that  
4 it mandated.

5 Q. Is that the \$31 million that you referenced?

6 A. That's correct.

7 Q. Would you find that precise number in your base  
8 rate testimony, Volume II?

9 A. Yes, you would. It would be Exhibit A-3 and  
10 just to qualify the number 31, I think it purports to  
11 show 30.

12 Q. So would not find that precise number?

13 A. You would not find \$31 million precisely. The  
14 number that we referenced was \$31 million which is an  
15 additional 10 over and above the mandated requirement as  
16 part of the credit agreement.

17 Q. Would it be appropriate to reduce our  
18 extraordinary rate relief request by the \$9 million, the  
19 difference between the \$20 million that you used and the  
20 \$11 million that Mr. Deardorff used?

21 A. In my view it is inappropriate.

22 Q. Is there a difference remaining between our  
23 position of 44 and Mr. Deardorff's if those two errors  
24 are corrected?

25 A. If those two errors are corrected we are

1 probably looking at still a reduction for PGW of 44 with  
2 you getting close to \$40 million all things else being  
3 equal.

4 Q. Using JRB-2 as you understand it?

5 A. That's correct.

6 MR. CLEARFIELD: That is all I have, Your Honor.

7 Mr. Bogdonavage is available for cross.

8 JUDGE FORDHAM: Mr. Simms.

9 MR. SIMMS: Thank you, Your Honor.

10 CROSS-EXAMINATION

11 BY MR. SIMMS:

12 Q. Let me refer you to your Rebuttal Exhibit

13 No. 1. Do you have that before you?

14 A. Yes, I do.

15 Q. Looking at the third column, it shows the  
16 income statement at the company's proposed \$44 million  
17 increase, correct?

18 A. I see that.

19 Q. And the total revenue number is 638 million,  
20 correct?

21 A. Not under the 44 -- yes, I see your number.

22 Q. Is that the weather normalized figure?

23 A. Yes, it is. That is a fully forecasted 4,555  
24 degree day heating season for PGW.

25 Q. Staying with your Rebuttal Exhibit No. 1, I

1 believe in your rejoinder you indicated that you have not  
2 added back the capital lease of 5.9 million for the  
3 calculation of the S&P filing charge coverage at the  
4 bottom of the page, correct?

5 A. Yes. The original exhibit that was prepared  
6 for the extraordinary rate petition did not have the  
7 \$102.5 million, and that has been corrected.

8 Q. Now, when I look at the 1975 debt service  
9 coverage ratio for the test year budget 2001-2002, you  
10 didn't appear to add back the capital lease for the  
11 capitalization of the 1975 debt service, would that be  
12 correct?

13 MR. CLEARFIELD: I'm sorry. I got confused. Are  
14 we still looking at --

15 MR. SIMMS: We are looking at Rebuttal Exhibit  
16 No. 1. I'm under the column 44 million test year budget,  
17 2001-2002.

18 BY MR. SIMMS:

19 Q. If you come down under debt service calculation  
20 you see 1975 debt service coverage ratio.

21 A. Yes. You are now talking about PGW's mandatory  
22 debt service coverage calculation and the capital lease  
23 does not get added back for that purpose. The capital  
24 lease was added back in S&P's calculation, not in the  
25 mandated coverage calculation that is prepared on an

1 annual basis to attest to the 1.5 coverage ratio.

2 Q. Now, do you have before you PGW Exhibit A-3?

3 A. Yes, I do.

4 Q. In the base rate case.

5 A. Yes.

6 Q. And if I look at the last column I see -- do  
7 you see that?

8 A. Yes, I do.

9 Q. Line 14, added back lease cost, I see you added  
10 that there.

11 A. Correct. But if you go above that to line ten  
12 you see that the same number was added as an expenditure.  
13 So the net effect of that was to be neutral. So the \$183  
14 million does not have the effect of the capital lease on  
15 the coverage calculation.

16 Q. Now, in your rejoinder testimony you indicated  
17 that for lack of a better word that OTS was guilty of  
18 looking forward, would that be correct, dealing with the  
19 \$11 million?

20 A. I think we were looking at two different  
21 scenarios. One was the JRB Exhibit 2 was prepared for  
22 the extraordinary rate petition which PGW had asked for  
23 \$44 million and that required a -- in this fiscal year  
24 PGW is only mandated to repay \$20 million of its  
25 outstanding commercial paper.

1           In the \$60 million base rate case that PGW is  
2 filing there is an additional expenditure level for some  
3 additional expenses, and in addition to that as a result  
4 of the \$60 million we had earmarked additional monies to  
5 be utilized to pay down the short-term commercial paper  
6 program.

7           So if you are looking forward PGW in its \$60  
8 million rate increase proposal was going to use some of  
9 those additional funds to help lower the commercial paper  
10 program.

11           Q. But you are not required to do so?

12           A. That's correct.

13           Q. And your intent was to do it in this fiscal  
14 year or in the next fiscal year?

15           A. This being a fully forecasted test year when  
16 rates would be in place, PGW is looking forward to doing  
17 that in 2003.

18           Q. But no papers, no contract, has been signed  
19 between PGW and lending institutions to mandate that  
20 additional money?

21           A. That's correct.

22           Q. And S&P has not required that in their  
23 analysis, have they?

24           A. Looking at the analysis that was done by their  
25 analysts it appears that as a result of looking at a

1 couple different documents, one being the Black & Veatch  
2 feasibility study that was prepared in support of PGW's  
3 most recent bond sale in June of this past year, they  
4 were looking for in that report a reduction in its  
5 outstanding position of commercial paper. So I think S&P  
6 had that information available.

7 In addition to that they had a projection that PGW  
8 had also filed as part of its ongoing operating budget  
9 before the Philadelphia Gas Commission which included a  
10 five year forecast. That also showed that with PGW  
11 receiving the bulk of its requested at that point in time  
12 \$65 million rate increase that we would be able to pay  
13 that down.

14 So I think Standard & Poors, not knowing full well  
15 what happened, I think that they were aware that PGW was  
16 going to, as a result of the rate increases being asked  
17 for, reduce the outstanding position of its commercial  
18 paper. So I think they were aware of that.

19 Q. And that is for the base rate case and this is  
20 for extraordinary relief that PGW is seeking here?

21 A. This proceeding is for the extraordinary,  
22 correct.

23 MR. SIMMS: That concludes my cross-examination,  
24 Your Honor.

25 JUDGE FORDHAM: Thank you.

1 Ms. McCloskey.

2 MS. McCLOSKEY: Thank you, Your Honor.

3 CROSS-EXAMINATION

4 BY MS. McCLOSKEY:

5 Q. Good morning, Mr. Bogdonavage.

6 A. Good morning.

7 Q. In your oral rebuttal you indicated that you  
8 were expecting to receive less of the crisis grants from  
9 LIHEAP than you had received last year?

10 A. That's correct.

11 Q. To what do you attribute the reduction in the  
12 LIHEAP crisis grants?

13 A. My information is that the funding source from  
14 the state level will not be anywhere near the amount that  
15 was available last fiscal year. As I pointed out, PGW  
16 had received about 25,000 to 30,000 applications which  
17 totaled almost \$18 million of crisis grants. Our  
18 information from the people that work in our low income  
19 program is that funding level at the moment is not  
20 available at the statewide level.

21 Q. But PGW has assisted the customers in  
22 processing the same level of applications or about the  
23 same level of applications as last year? It's a funding  
24 issue with the state, is that correct?

25 A. Well, I think the crisis program requires a

1 shutoff notice and as a result of the moratorium that is  
2 in place until the end of March PGW is in the process of  
3 getting its billing system up to produce all of the  
4 necessary paperwork that would be required. To answer  
5 your question, yes, we will be assisting all participants  
6 that received one last year and, furthermore, if  
7 available even more than that. We are going to contact  
8 as many low income participants to make sure they apply  
9 for the crisis grants.

10 Q. Also in your oral rebuttal you indicated that  
11 four of the past five years have been substantially  
12 warmer than normal heating seasons. And that takes us  
13 back to 1998 or 1997?

14 A. Yes. That takes us back to 1998.

15 Q. And did the company seek base rate relief  
16 through the Philadelphia Gas Commission in 1998 or 1999?

17 A. No, they did not.

18 Q. Did the city grant back any of its 18 million  
19 in those five years to backstop PGW's loss of margin due  
20 to the warm winters?

21 A. They did not grant it back but the finance  
22 director at the time had made it known that the city  
23 would step forward to fund any shortfall in earnings and  
24 resulting debt service requirements.

25 Q. Now, if you would turn to your JRB Rebuttal

1 Exhibit 1, in the fourth column, the 18 million test year  
2 budget 2001-2002. If I understand correctly, this is  
3 your fully forecasted test year, is that correct?

4 A. That is correct.

5 Q. And where you show the 18 million proposed base  
6 rate increase, that is under the OCA's recommendation but  
7 is only the amount to be provided by ratepayers, is that  
8 correct?

9 A. That is correct.

10 Q. You did not show the effect of the city  
11 grantback in that column?

12 A. That is correct.

13 MS. McCLOSKEY: Thank you, Your Honor. That is all  
14 I have.

15 JUDGE FORDHAM: Thank you.

16 Mr. Gray.

17 MR. GRAY: Thank you, Your Honor.

18 CROSS-EXAMINATION

19 BY MR. GRAY:

20 Q. Good morning.

21 A. Good morning.

22 Q. Staying right where Ms. McCloskey left off in  
23 that Rebuttal Exhibit No. 1, you did not remove the \$18  
24 million city payment and Mr. Clearfield asked you  
25 essentially why not. And you gave what I thought was

1 kind of an interesting answer. You said something about  
2 that \$18 million is there to backfill. Now, are you  
3 using that term backfill -- I would say the word  
4 backstop. In other words, is that 18 million there as  
5 sort of an emergency source of funding of last resort?

6 A. To answer your question, the reference to the  
7 \$18 million as a backstop that I referred to is that we  
8 are aware right now that Janice Davis as the finance  
9 director of the city is prepared to grant back whatever  
10 needs to be done to assure that PGW makes its mandatory  
11 coverage requirements. That would be in, you know, the  
12 actual 2002 fiscal period. I am not aware that the city  
13 has the wherewithal to continue to grant that back on an  
14 ongoing basis.

15 So my answer would be if in fact PGW needed to  
16 receive the full \$18 million to assure that it makes its  
17 mandated coverages, it would not be available in  
18 subsequent periods. So at this point in time once we  
19 have used up the \$18 million it's not available as a  
20 backstop against any vagaries of either weather or  
21 unforeseen expenditures.

22 Q. So your understanding is that the \$18 million  
23 -- let me make sure I get this correct -- the \$18 million  
24 is an one-time option you might have at this point, is  
25 that correct?

1           A. That is the information that we have received  
2 from Ms. Davis, correct.

3           Q. Do you know if anyone in PGW has approached  
4 Ms. Davis on the OCA proposal?

5           A. I don't know that anyone has been approached on  
6 the OCA proposal. I mean, there have been discussions  
7 with Janice Davis on what can be done to backstop PGW but  
8 I don't know that anybody has directly approached  
9 Ms. Davis on whether or not she could grant back \$18  
10 million over multiple years.

11           MR. CLEARFIELD: Well, actually, she has rebuttal  
12 testimony, Your Honor.

13           JUDGE FORDHAM: Okay.

14           MR. GRAY: That is all I have. Thank you, Your  
15 Honor.

16           JUDGE FORDHAM: Anyone else? Mr. Bertocci.

17           MR. BERTOCCI: Yes.

18                           CROSS-EXAMINATION

19           BY MR. BERTOCCI:

20           Q. Good morning.

21           A. Good morning.

22           Q. On the question of the 18 million, you were  
23 talking about things that the city was prepared to do and  
24 you mentioned the deferment of the \$18 million. The  
25 payment are generally due in March, April, May and June.

1 The city has agreed to defer those payments until the end  
2 of June with interest, though, isn't that right?

3 A. At the moment with interest, correct.

4 Q. Has there been a request to the city to waive  
5 that interest?

6 A. We will make that request of the city, yes.

7 Q. But it has not been made up to now?

8 A. We have had discussions with Ms. Davis and at  
9 this point she is not prepared to grant that back without  
10 interest.

11 Q. And that is the sum of \$200,000?

12 A. Probably this year a little bit less than that  
13 because of interest rates.

14 Q. You mentioned that the company was prepared to  
15 request a deferment of the payback of the \$45 million  
16 city loan. Has that legislation actually been filed with  
17 City Council?

18 A. No, it has not. We are in the process of  
19 preparing draft resolutions and ordinances to be  
20 submitted to the city administration.

21 Q. Has the PFMC board approved a resolution at  
22 this point?

23 A. It is my understanding I think that the PFMC  
24 board has approved a resolution asking that the deferred  
25 city loans be moved from January to August of 2003.

1 Q. You made mention of a potential forward  
2 purchase agreement.

3 A. Yes.

4 Q. And a forward purchase agreement is based, as I  
5 understand it, on essentially the present value of the  
6 interest on the sinking fund reserve, is that right?

7 A. Future interest, yes, over multiple years.

8 Q. Anticipated interest on the sinking fund  
9 reserve?

10 A. Correct.

11 Q. And the infusion would be an infusion of  
12 interest which is backed up by ratepayer funds, isn't  
13 that true?

14 A. To the extent that the ratepayers pay PGW debt  
15 service, correct, through rates.

16 Q. Aren't the ratepayers under the management  
17 agreement obligated to pay debt service through rates?

18 A. Absolutely.

19 Q. Principal and interest?

20 A. Yes.

21 MR. BERTOCCI: That is all I have. Thank you very  
22 much.

23 JUDGE FORDHAM: Anyone else?

24 (No audible response.)

25 JUDGE FORDHAM: Anything else, Mr. Clearfield?

1 MR. CLEARFIELD: Just one question.

2 REDIRECT EXAMINATION

3 BY MR. CLEARFIELD:

4 Q. Mr. Bogdonavage, if one were to adjust your  
5 JRB-2 so that you would show the effect of paying down  
6 the commercial paper not just for the mandatory \$102  
7 million but also the additional amount that we have  
8 projected in the base rate case and we believe S&P is  
9 requiring us to do, what would the \$20 million --

10 MR. SIMMS: Objection, Your Honor. It's not on the  
11 record that S&P is requiring PGW to pay down that amount.  
12 I haven't seen it.

13 MR. CLEARFIELD: Well, it's in the schedule.

14 BY MR. CLEARFIELD:

15 Q. Is it your view that S&P is looking to PGW to  
16 pay down the additional amount in 2003?

17 A. I think, you know, not speaking for Standard &  
18 Poors, they are aware that PGW needs to reduce its  
19 reliance on the short-term commercial paper program and  
20 to get back to its original use, which was to be used as  
21 a working capital loan and not as a semi-permanent part  
22 of its capital structure. So I think S&P is looking to  
23 see that as low as possible.

24 Q. And is there an indication on their worksheet,  
25 DCP-3, to that effect?

1           A. It appears that in 2003 they did use an  
2 additional \$20 million reduction to the outstanding  
3 commercial paper program.

4           Q. Now, going back, if we were going to adjust  
5 JRB-2 to reflect both the reduction from the current \$100  
6 million level to 69 million, I guess, the 20 million plus  
7 the 11 million we pro formaed in the base rate case, what  
8 would that number on the bottom of JRB-2 have to look  
9 like?

10          A. Is this the rebuttal exhibit?

11          Q. No. This is JRB-2 corrected, your schedule.  
12 You can use the rebuttal exhibit if you want.

13          A. Obviously it would probably be below one.  
14 Probably about, I would say, .96 or .97. It is about an  
15 11 or 12 million dollar reduction per tenth of a point.

16          Q. So to bring our coverage back up to the 1.25  
17 level if we included that additional adjustment, what  
18 would we have to do?

19          A. To bring it back to an 1.25? We are probably  
20 looking at somewhere around about a \$20 million increase.

21          Q. Over and above the 44 we have asked for?

22          A. That's correct.

23          MR. CLEARFIELD: That is all I have.

24          JUDGE FORDHAM: Anything further?

25          MS. McCLOSKEY: I do have one.

1 JUDGE FORDHAM: Ms. McCloskey.

2 RECROSS-EXAMINATION

3 BY MS. McCLOSKEY:

4 Q. Mr. Bogdonavage, if I understand this  
5 correctly, the additional paydown would not be in the  
6 fully forecasted test year of 2001-02. That is the \$20  
7 million. That would be in the subsequent year. I  
8 believe that is how it is shown on BCB-3. In 2003, it  
9 would be in that year, is that correct?

10 A. That's correct. PGW had prepared the test year  
11 to be representative, obviously, of the year when rates  
12 would be in effect, being 2003. We are not mandated to  
13 pay that down in 2002.

14 Q. So when you responded to Mr. Clearfield you  
15 were actually assuming that there would be approximately  
16 \$40 million worth of paydown in the 2001-2002 fully  
17 forecasted year, not the \$20 million that is required, is  
18 that correct?

19 A. That's correct.

20 MS. McCLOSKEY: Thank you.

21 JUDGE FORDHAM: Anyone else?

22 FURTHER REDIRECT EXAMINATION

23 BY MR. CLEARFIELD:

24 Q. She said \$40 million in the last question. Is  
25 that --



1 we have stipulated to, we have stipulated to its  
2 admission in the record in accordance with that  
3 stipulation.

4 JUDGE FORDHAM: That will also be admitted.

5 (Whereupon, the documents were marked as PGW BRP  
6 Statements Nos. 1 and 3 and Volume II for  
7 identification, and were received in evidence.)

8 MR. CLEARFIELD: Would it be a good time to take a  
9 short break?

10 JUDGE FORDHAM: I was going to mention lunch.  
11 Because we are almost at the 12 o'clock hour and we want  
12 to be back by 1:30 to deal with Ms. Davis. So what is  
13 your pleasure with respect to lunch?

14 MR. GRAY: Why don't we take a short lunch, Your  
15 Honor, so we can keep going.

16 MR. CLEARFIELD: That's okay with us.

17 JUDGE FORDHAM: Since we have not had a break, why  
18 don't we take the lunch now. What do you call short? A  
19 half-hour? Forty-five minutes?

20 MR. GRAY: A half-hour.

21 MR. CLEARFIELD: Do a half-hour.

22 JUDGE FORDHAM: We will go back on the record at  
23 12:30. Thank you.

24 (Whereupon, at 11:55 a.m., the hearing was  
25 adjourned, to be reconvened at 12:30 p.m. this same day.)

(12:35 p.m.)

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## AFTERNOON SESSION

JUDGE FORDHAM: We are back on record.

We had a lunch break after the second witness and now we are prepared for the third witness from PGW.

MR. CLEARFIELD: Mr. Krellenstein is our third witness, Your Honor.

Whereupon,

## GARY KRELLENSTEIN

having been duly sworn, testified as follows:

JUDGE FORDHAM: Would you state your name and business address for the record, please? And please spell your last name.

THE WITNESS: Gary Krellenstein,  
K-R-E-L-L-E-N-S-T-E-I-N. The business address is 270  
Park Avenue, New York, New York 10017.

JUDGE FORDHAM: Thank you.

You may proceed, Mr. Clearfield.

MR. CLEARFIELD: Thank you, Your Honor.

Mr. Krellenstein is sponsoring PGW Statement 3.

## DIRECT EXAMINATION

BY MR. CLEARFIELD:

Q. Mr. Krellenstein, do you have any corrections you would like to make to Statement 3?

A. No, I don't.

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1 MR. CLEARFIELD: We have one question, one line of  
2 questioning, on rebuttal.

3 BY MR. CLEARFIELD:

4 Q. Mr. Krellenstein, have you reviewed the  
5 testimony of Mr. Lelash for the OCA?

6 A. I have looked at it.

7 Q. And he has recommended that in order to prevent  
8 the S&P from downgrading PGW it would be sufficient to  
9 permit the company to charge a capital surcharge of \$18  
10 million for three years along with the city's mandatory  
11 grantback of the \$18 million per year city payment. Are  
12 you aware of that recommendation?

13 A. I am aware of that, yes.

14 Q. Do you have an opinion as to whether this plan  
15 would be sufficient to prevent Standard & Poors from  
16 downgrading the company?

17 A. In my opinion that would not be sufficient for  
18 Standard & Poors to avoid downgrading.

19 Q. Have you had specific conversation with S&P  
20 about these kinds of ways of avoiding a downgrade?

21 A. Yes. I have talked to both of the analysts  
22 that are on the report that was submitted earlier last  
23 week and I spent several hours with Jodi down in Atlanta  
24 on Tuesday.

25 Q. Jodi?

1 A. Hecht.

2 Q. Jodi Hecht is one of the analysts responsible  
3 for Standard & Poors?

4 A. That's correct. The particular proposal that  
5 was presented there is not the type of solution they are  
6 looking for in general.

7 Q. Would you tell us why?

8 A. As a general rule when there is a problem of  
9 this nature they are looking for a solution that will  
10 come not from non-operating revenues or one shot deals  
11 but from ongoing business operations. That would mean  
12 they would be looking for something that would probably  
13 be taken by the Public Utility Commission as a rate  
14 increase. In the normal course of business they would  
15 collect it, not something they can just count on for a  
16 short period of time.

17 It is actually not as mystical as it sounds. I  
18 know somebody here mentioned the black box, about how the  
19 rating process works. But it is actually fairly well  
20 defined how the rating process works. It is just  
21 somewhat less numerical than people might be aware of.

22 Q. At the present time do you believe if they were  
23 going to err on the side of being conservative or  
24 basically providing additional leeway to PGW, which way  
25 would they tend and why?

1           A. The past year has been particularly bad for  
2 rating agencies and investors also. The rating agencies  
3 in just the past week have been taken to task by Congress  
4 for their lax review of entities such as Enron and Global  
5 Crossing. In the last year they have seen a tremendous  
6 number of credits being adversely impacted by the  
7 downturn in the economy. They clearly have gone to a  
8 much more conservative bent in the last several months as  
9 has the investment community also.

10           Q. And what would that mean in terms of their  
11 evaluation of PGW at the end of this proceeding?

12           A. While no rating is absolute in terms of what  
13 will occur I would tend to say that they would give less  
14 credence to any patchwork efforts put on by the  
15 Philadelphia Gas Works and that they really want a  
16 solution, one that they can understand is encompassing  
17 and long-term in nature, and they will be less tolerant  
18 of something that they might have accepted just a year or  
19 two ago in a better economic environment where there was  
20 not such keen scrutiny of their actions.

21           Q. And just for clarification of the record, you  
22 were here when Ms. Bisgaier provided her rebuttal  
23 testimony, were you not?

24           A. Yes.

25           Q. Do you recall that she indicated that in the

1 course of her professional duties she had occasion to  
2 regularly consult with the rating agencies in general and  
3 S&P in particular?

4 A. Uh-huh.

5 Q. Do you conduct the same kinds of consultation  
6 with S&P and the other rating agencies on a regular  
7 basis?

8 A. In an average month I probably see the rating  
9 agencies 10 or 15 times. I cover 400 different utilities  
10 and I am constantly bringing one of them or more to the  
11 rating agencies or preparing them for meetings with the  
12 rating agencies

13 MR. CLEARFIELD: Thank you.

14 That is all I have on rebuttal, Your Honor.

15 JUDGE FORDHAM: Thank you.

16 The only party that indicated previously that they  
17 wanted to cross-examine the witness was Mr. Gray.

18 MS. McCLOSKEY: Your Honor, I do have some cross on  
19 the oral rebuttal we just heard. But if Mr. Gray wants  
20 to go ahead, that's fine.

21 MR. GRAY: What is your preference?

22 MS. McCLOSKEY: Go ahead.

23 MR. GRAY: Okay.

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## CROSS-EXAMINATION

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BY MR. GRAY:

Q. Good afternoon, Mr. Krellenstein.

A. Good afternoon.

Q. Can I turn you to page four of your testimony?

A. Okay.

Q. Take a look at lines seven through nine.

A. Okay.

Q. You state while no customer wants to see rates increase it seems clear that an emergency rate hike granted now would be the lowest cost option for maintaining a functional gas utility that can adequately meet the needs of its customers. Do you see that statement?

A. Yes, I do.

Q. It seems clear, you say. Let's look at that phrase first. What various options have you explored or analyzed to reach the conclusion that it seems clear that this is required for maintaining a functional gas utility?

A. It has more been a matter of the experience that I have with other utilities that have failed to receive adequate relief and have been shut out of the market or have had supplies unwilling to deliver to them without a guaranteeing third party. I have worked with a

1 number of credits, just recently the American Energy  
2 Power Agency in Nebraska which was buying its gas from  
3 Enron Gas Marketing and ran into a significant liquidity  
4 problem there. I have spent a number of years working  
5 with the Washington Public Power Supply System, which  
6 ended up defaulting and was cut out of the market for a  
7 period of seven years. I have spent a number of years  
8 working with the Massachusetts Municipal Wholesale  
9 Electric Company, another entity where there has been an  
10 ongoing debate and again the market punished them by  
11 placing them out of the investment capital accumulation  
12 market and forcing them to pay cash on the barrel head  
13 for purchases of electricity and fuel oil.

14 The situation that you are having now, while not as  
15 draconian as those are, has the potential to turn to that  
16 too. If you go below investment grade in the current  
17 environment you will be penalized significantly by the  
18 market. It is likely that an S&P move will also cause  
19 not only the investment community but the other rating  
20 agencies to re-review their current ratings. A loss of  
21 their ratings would further compound the situation.  
22 Suppliers of natural gas might insist on either  
23 exorbitant prices or guarantees before they would deliver  
24 gas to the utility. And the bank syndicators, which we  
25 are the agent bank, some or all of them may not want to

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1 renew the facility in that light.

2           You have to be aware right we are experiencing what  
3 is referred to as a liquidity crisis. There is far  
4 greater demand in the financial markets for financial  
5 liquidity from banks than there is actually available.  
6 So if we were to not renew Philadelphia Gas Works we  
7 would have no problem reselling that facility to other  
8 entities of a higher credit quality. It's not a concern  
9 that we would lose money not renewing it.

10           They are an ongoing client, one that we are  
11 interested in supporting to the best that we can, but  
12 also -- and I have to say I speak here now as an analyst  
13 and not as a member of JP Morgan -- I find that it would  
14 be far and away in their best interests to fix things now  
15 before they go out of control and incur a manageable  
16 expense versus the potential that would occur if  
17 downgrades and loss of liquidity facility were to occur.

18           Q. Okay. So if it seems clear to you that it  
19 would be an excellent idea to fix things now what other  
20 options have you considered or suggested to PGW that they  
21 could pursue above and beyond or in place of this  
22 extraordinary rate relief?

23           A. I should perhaps step back and talk about the  
24 rating agencies and analysts. We don't actually  
25 recommend courses of action as much as we will evaluate

1 what is presented to us. We are not there to be  
2 consultants. We are there to analyze what is brought to  
3 us.

4 In this particular case, if they could get a  
5 sweetheart deal for gas at way below market price and  
6 keep the current rates that would work fine. If they  
7 could somehow guarantee that they would sell a far larger  
8 number of units of gas than they did in the current year  
9 that would also work fine. Since neither of those  
10 options seem to be viable they are really going to have  
11 to count on the traditional method of recovering their  
12 costs through sales in a means sufficient to maintain  
13 financial stability and to encourage investors and their  
14 suppliers to continue providing them with gas and capital  
15 so they can go onward as an ongoing entity.

16 Q. You mentioned two options there. What about,  
17 say, significantly reducing the bad debt expense that PGW  
18 has? That is 50 million plus right now.

19 A. That has been a chronic problem. It has to do  
20 more with the socio-economics of the city than anything  
21 else. Unless you can figure out a way to cure the  
22 poverty rate at a phenominally fast rate over the next  
23 few year it is an unlikely scenario that that would be  
24 available to them.

25 Q. So then when you say lowest cost option, and

1 you have mentioned a few things here, can you explain to  
2 me your analysis for determining that this extraordinary  
3 rate relief is the lowest cost option?

4 A. If they were to get just an one-shot deal, and  
5 even three years is considered an one-shot deal as a  
6 non-recurring revenue, that probably would not be  
7 sufficient for them to avoid a downgrade. The cost of  
8 getting downgraded in terms of additional interest costs,  
9 purchase costs, lack of investor appetite for their  
10 bonds, would be so large as to dwarf the rate increase  
11 they are looking for right now. I can't think of any  
12 other mechanism short of the traditional rate increase  
13 based on my discussions with the rating agencies over the  
14 years that would satisfy them at this point in time.

15 Q. One last question, and this might be somewhat  
16 redundant from what Mr. Clearfield said but just so I  
17 understand it and we are on the same page here, when you  
18 talk about statements from S&P and what they are looking  
19 for and the extraordinary rate relief they are looking  
20 for, there is no guarantee like we have -- there is no  
21 guarantee -- the PUC awards all 44 million to the penny,  
22 there is no guarantee they are not going to downgrade the  
23 bonds anyway.

24 A. There is no guarantee but it would be an  
25 extremely low probability of that, that they would

1 downgrade them after getting the full rate increase they  
2 had requested and which they have explicitly stated is  
3 what would be necessary. They talk about they will  
4 review whatever is given in terms of adequacy. Since I  
5 assume the mathematics have been done reasonably  
6 straightforward and they have asked for an amount that  
7 will meet the criteria mathematically that S&P has put  
8 forward it would be extremely hard for me to believe that  
9 they would downgrade them if they were to get the full  
10 rate relief requested.

11 Q. Since you are obviously the expert and you say  
12 low probability, can you explain to us laymen how you  
13 figure that there is a low probability?

14 A. Just based on my experience in the past, having  
15 worked with a number of utilities over the past 20 years.  
16 It is extremely uncommon -- I cannot actually think of a  
17 single event -- where a utility was downgraded because it  
18 got the rate relief it had sought. There were times when  
19 utilities have been downgraded coincidentally in time with  
20 that because other events had occurred, but not because  
21 they received all the rate relief they had requested.

22 Q. Yet it still remains a possibility?

23 A. Everything is possible. I mean, I could not  
24 guarantee you 100 percent. But I suspect that if you  
25 were able to get the people from the rating agencies here

1 on the witness stand they would tell you that it would be  
2 a very rare occurrence in their history that they would  
3 downgrade an entity after they got the rate relief they  
4 were attempting to receive.

5 MR. GRAY: Thank you, Your Honor.

6 JUDGE FORDHAM: Ms. McCloskey.

7 MS. McCLOSKEY: Thank you, Your Honor.

8 CROSS-EXAMINATION

9 BY MS. McCLOSKEY:

10 Q. Mr. Krellenstein, you mentioned that you work  
11 with rating agencies on a regular occasion, particularly  
12 in regard to utility accounts, is that correct?

13 A. That's correct.

14 Q. And in your experience is it unusual for a  
15 utility that is facing a severe liquidity crisis to  
16 continue to pay dividends to its shareholders?

17 A. It is not unusual but it is not the preferred  
18 mechanism. For an investor-owned utility generally they  
19 would cut the common stock and even the preferred  
20 dividend payments before they would force themselves in a  
21 position where they might default on their bonds. There  
22 have been times when we have seen companies that have  
23 kept it because they felt that only by keeping that were  
24 they supporting their stock price and as such they needed  
25 that to sell additional stock to gain capital. So it is

1 unusual. It's not unheard of.

2 In the case of PGW, there is no actual equity  
3 holders nor dividends paid to any shareholder, so I am  
4 not sure of the pertinence of the question.

5 Q. My question was general, just in your  
6 experience with utility accounts.

7 You indicated that you had conversations with  
8 several rating analysts regarding Mr. Lelash's  
9 recommendation.

10 A. No. That is not verbatim correct. I said I  
11 talked to them regarding Philadelphia Gas Works and we  
12 talked generically not just in this utility but in many  
13 others about the use of one-shot patches versus ongoing  
14 revenue items.

15 Q. I'm sorry. I may have misunderstood. So the  
16 record is clear, did you not specifically ask them  
17 regarding Mr. Lelash's recommendation of a three year  
18 proposal to remedy the commercial paper program?

19 A. No. Based on the experience I have had with  
20 them in the past I did not feel it was necessary to know  
21 what their response would be.

22 Q. So you did not specifically ask them regarding  
23 a three year program to reduce the commercial paper?

24 A. That's correct.

25 Q. Would you agree with me, though, that if the

1 commercial paper is paid down PGW's concerns regarding  
2 its liquidity are reduced?

3 A. If the commercial paper is used in the correct  
4 form. And most of it for most companies is not  
5 outstanding all the time and is there to be drawn on.  
6 When you say pay down, I don't know if you refer to paid  
7 down but remain outstanding as a draw or paid down and  
8 remove the facility.

9 Q. No. Paid down and then utilized in the  
10 appropriate fashion as you described.

11 A. That would be expeditious for them if they had  
12 sufficient cashflow for them to do that. We have seen in  
13 reviewing them that it appears they do not have adequate  
14 cashflow and in fact are not using this credit facility  
15 the way it is typically designed, which is just for  
16 seasonal fluctuations revenue streams. Instead, they are  
17 using it on an outstanding basis almost continuously  
18 because their liquidity position is so weak.

19 Q. Are you aware and have you made the rating  
20 analysts aware that following the conclusion of this  
21 extraordinary proceeding the company's general base rate  
22 case will continue to a resolution?

23 A. I'm not sure I understand your question. I did  
24 talk to Jodi and Aneesh and they are all aware that there  
25 is an extraordinary rate session going on right now.

1 Q. And are they aware that following that that the  
2 general base rate case will proceed?

3 A. I did not ask them that so I do not know the  
4 answer.

5 Q. Are you aware that the base rate increase that  
6 was awarded to Philadelphia Gas Works last year by this  
7 Commission was the first base rate increase that it had  
8 received since 1992?

9 A. I was.

10 MS. McCLOSKEY: Thank you, Your Honor. I have  
11 nothing further.

12 JUDGE FORDHAM: Does anyone else have any questions  
13 of this witness?

14 (No audible response.)

15 JUDGE FORDHAM: Mr. Clearfield.

16 MR. CLEARFIELD: May I have just a moment, Your  
17 Honor?

18 JUDGE FORDHAM: Yes.

19 (Pause.)

20 MR. CLEARFIELD: We don't have any redirect, Your  
21 Honor.

22 JUDGE FORDHAM: Thank you.

23 Thank you, Mr. Krellenstein.

24 THE WITNESS: Thank you.

25 (Witness excused.)

1 JUDGE FORDHAM: Do you want to admit this  
2 statement?

3 MR. CLEARFIELD: Yes, Your Honor. I would move for  
4 the admission of PGW ERP Statement No. 3.

5 JUDGE FORDHAM: Any objection?

6 (No audible response.)

7 JUDGE FORDHAM: The statement is admitted.

8 MR. CLEARFIELD: Thank you.

9 (Whereupon, the document was marked as PGW  
10 ERP Statement No. 3 for identification, and  
11 was received in evidence.)

12 MR. CLEARFIELD: Mr. Knudsen.

13 Whereupon,

14 THOMAS E. KNUDSEN

15 having been duly sworn, testified as follows:

16 JUDGE FORDHAM: Would you state your name and  
17 business address for the record and please spell your  
18 last name?

19 THE WITNESS: My name is Thomas E. Knudsen,  
20 K-N-U-D-S-E-N. I am interim chief executive officer of  
21 Philadelphia Gas Works, it 800 West Montgomery,  
22 Philadelphia, Pennsylvania.

23 JUDGE FORDHAM: Thank you.

24 You may proceed, Mr. Clearfield.

25 MR. CLEARFIELD: Thank you, Your Honor.

1 Mr. Knudsen is sponsoring ERP Statement 1 and the  
2 accompanying Exhibit TEK-1.

3 DIRECT EXAMINATION

4 BY MR. CLEARFIELD:

5 Q. Mr. Knudsen, do you have any additions or  
6 corrections that you would like to make to the statement  
7 or the exhibit at this time?

8 A. I don't, no.

9 MR. CLEARFIELD: We have a couple of short  
10 questions on rebuttal, Your Honor.

11 BY MR. CLEARFIELD:

12 Q. Mr. Knudsen, in Mr. Lelash's testimony, pages  
13 six and seven and again on pages 14 and 15, he says that  
14 even with a bond downgrading the company appears to  
15 acknowledge that it could take proactive measures in  
16 order to respond to the ensuing crisis and continue to  
17 operate and that it has not prioritized its operating  
18 expenses and construction fund expenditures. Are you  
19 familiar with that claim?

20 A. Yes.

21 Q. And then on page 14 and 15 he says that for PGW  
22 to meet the section 1308(e) criteria it would have to  
23 have its bonds downgraded and then not respond to the  
24 crisis. Is he correct in his characterizations of what  
25 you testified to?

1           A. I don't believe so. In fact, I think the  
2 opposite is true. The implication is that we could take  
3 proactive steps to avoid a 1308(e) -- the consequences of  
4 1308(e) action -- and that is just not the case at all.

5           Q. Have you had occasion to describe or to detail  
6 exactly how we would respond if in fact we are  
7 downgraded, or PGW is downgraded?

8           A. Yes. There were several responses to  
9 information requests that were provided that specifically  
10 went to this particular topic.

11           MR. CLEARFIELD: Your Honor, I have handed to the  
12 court reporter two copies and to Your Honor answers to  
13 three interrogatories that that were propounded upon PGW  
14 and to which we responded during the discovery phase.  
15 They are PGW's answers to OTS-RS-1, OTS-RS-6 and OCA Set  
16 II, No. 3. I would ask that they be marked as Knudsen  
17 Rebuttal Exhibit No. 1 for identification.

18           JUDGE FORDHAM: They shall be so marked.

19           (Whereupon, the documents were marked as PGW  
20 Knudsen Rebuttal Exhibit No. 1 for  
21 identification.)

22           BY MR. CLEARFIELD:

23           Q. Mr. Knudsen, do you have before you what we  
24 have marked as Knudsen Rebuttal Exhibit 1?

25           A. I do.

1 Q. Using that would you explain how PGW has  
2 identified the steps it would take and the consequences  
3 of a downgrade?

4 A. Yes. I think there are -- if we start with OCA  
5 Set II-3, which is the last of the responses. It is the  
6 last three pages of the handout. Were we to be  
7 downgraded then it seems to me that the issues of 1308(e)  
8 kick in. In other words, we have then to lay off, we  
9 then compromise our service and so forth.

10 I want to be very clear with the Court and the  
11 parties as to where we go with this. And that is, and  
12 looking at OCA Set II-3, if we are downgraded there is no  
13 specific end of the problem. We don't know what that  
14 workout ultimately would be. But for planning purposes  
15 what I have said to management is that we have to  
16 identify or put together a resource of about \$100  
17 million --

18 Q. Is that annually or one time?

19 A. This would be one time. As I said, looking  
20 forward to -- I think my quotation is here to operate PGW  
21 as long as possible until some solution of undetermined  
22 origin presents itself. In other words, once we start  
23 down this track I don't know what the answer is. But in  
24 order to keep the company active and moving forward for  
25 as long as possible for the greatest number of customers,

1 we have to have some resources.

2 I have talked with Ms. Davis and it is very clear  
3 that we have to be first in developing this program of an  
4 ability to sustain the company and then the city will  
5 presumably step in on some basis. We are not clear yet  
6 because the resources are not there at the city either.

7 This 100 million has several components to it.  
8 First of all, we have about \$40 million to \$45 million in  
9 the construction fund right now. I got a problem because  
10 as there was earlier discussion we have already borrowed  
11 substantially against the construction fund. So by  
12 August under any circumstances we have to either spend up  
13 to the \$53 million that we have borrowed or we have to  
14 find the resources to put back into the construction  
15 fund. So that represent a fairly major problem for  
16 management at the outset.

17 But assuming we have that \$40 million to \$45  
18 million available to us, then you start to look at what  
19 has to happen because we must preserve the ability to  
20 finance the company. And to do that we must be able to  
21 service the debt. And to do that we must meet debt  
22 service requirements in the summer and then going into  
23 January.

24 So looking on page two there were a number of  
25 actions that are essentially summarized in subject point

1 (e), which is that we would immediately seek to lay off  
2 400 to 500 people. And I want to come back to the  
3 prioritization of this because I think Mr. Lelash did not  
4 understand what my intention was here. We would look to  
5 save 24 to 30 million dollars through layoffs. That is  
6 offset by the fact that we are self-insuring on  
7 unemployment. And then try to find an additional five to  
8 ten million dollars beyond that which we have already  
9 committed to in the operating state. So that we put a  
10 fund there of about \$30 million or so together.

11 So that is 40 to 45 plus another 30. And then we  
12 have already committed to reduce receivables by 20 with  
13 really extraordinary efforts, and I will come back to  
14 that in a second. We would hope to increase the fund by  
15 another \$20 million of essentially getting funds from our  
16 customers who owe us the funds and have not paid yet.

17 So that is essentially the intent of OCA Set II-3.

18 Q. You said there is \$100 million. Your answer  
19 indicates that there is about 35 to 40 million of annual  
20 construction that you must do. So in that respect is  
21 that an one-time or is that an annual?

22 A. Well, that is an annual requirement. But as I  
23 say, we need to do that because we need to keep the  
24 system safe. But the construction budgets for the next  
25 few years are in the high 50's and low 60's. We simply

1 would not be able to spend that money. To the extent  
2 that the system were at risk we would have to apply that  
3 35 to 40 million to the most severe problems that would  
4 represent a threat to the system.

5 If we then turn to OCA -- I'm sorry -- RS-6, which  
6 is the second, this was really the sequence, this was the  
7 prioritization of the program. And I think Mr. Lelash at  
8 18 and 19 suggests that we have not prioritized our  
9 operating expenses and construction budgets. I hope that  
10 this might put some of that concern to bed.

11 We are in fact seeking a deferral on the city loan.  
12 That is first. Immediately he would we would stop what I  
13 call non-essential spending. If we are downgraded we  
14 then have to strip the company of any extraneous spending  
15 that does not do one of three things: it doesn't get gas  
16 through the pipe, it doesn't address billing, it doesn't  
17 address collection. Anything else that the company does,  
18 consulting, protection of systems, anything else has to  
19 go by the board. We have to pull this \$35 million to \$40  
20 million out of the operation and we only have about \$100  
21 million of discretionary spending in the budget that we  
22 have of approximately \$500 million to \$550 million a  
23 year.

24 We would deplete the gas storage inventory, which  
25 we have already done to the extent that we can this year.

1 And then, (d) -- in fact, I have already had this letter  
2 drafted and we are deciding how to handle it from a legal  
3 perspective, and that is request to Commission to invoke  
4 the regulatory exemption clause in the collective  
5 bargaining agreement. In order to lay people off I must  
6 have the PUC step forward and say this is allowed, this  
7 is an appropriate action at this time.

8 Q. To lay all people off?

9 A. To lay off the four or five hundred people I  
10 referred to.

11 Q. Do you need to have PUC approval for any  
12 layoffs?

13 A. Not for any layoffs but for the extraordinary  
14 level that we would require here. We have the ability to  
15 lay off amongst the non-union or unrepresented groups,  
16 which we have about 325 employees. And we have another  
17 75 employees who we hired after 1998 and they fit into a  
18 special category. So amongst those two groups we could  
19 begin to lay off. But to lay off amongst the union ranks  
20 we would need this special permission. Thank you,  
21 Mr. Clearfield.

22 We would then ask the Commission also to allow us  
23 to suspend, alter, tariff rules that would allow us to go  
24 after our customers more aggressively and get this  
25 additional \$20 million of which I was speaking and

1 committing to.

2 As I said in the introduction to this answer, this  
3 is not necessarily a priority but we would certainly be  
4 implementing our change in collection practices, the  
5 program being in place. All systems development and  
6 special initiatives would be suspended, deregulation,  
7 BCCS modifications, cost reduction initiative and so  
8 forth. They would all go by the board.

9 We would suspend the efforts the file the  
10 restructuring proceeding. We simply would not have the  
11 resources to do that, nor could we undertake it in a  
12 timely way given those circumstances.

13 We would then lay off or furlough the necessary  
14 personnel and redispach the remaining personnel  
15 according to the plan, and then I give a list of how we  
16 would do that.

17 We would of course eliminate non-payroll spending.  
18 We would cancel all contracts if we can invoke a force  
19 majuer. And then lastly, and this goes to Mr. Lelash's  
20 point on the capital fund expenditures, we would set and  
21 have set a priority of replacements, of repairs of the  
22 system. Where there are breaks or leaks those would come  
23 first. We would probably have to finish what is left of  
24 the LNG refurbishment. That will not take a lot more  
25 money but what it do is it will not permit us to do phase

1 two. So we will have a kind of combination system of the  
2 partially refurbished LNG but we would still have the old  
3 system needed at particular times of the year.

4 So to that point I think we have given a great deal  
5 of thought to what has to happen and I will tell you very  
6 candidly it scares me.

7 Q. Would there be degradations of customer service  
8 as a result of this response, and if so have you detailed  
9 them?

10 A. That is the response to RS-1.

11 Q. Okay.

12 A. Again, what does one maintain or not maintain  
13 in this situation? Again, we don't have the money to  
14 operate. We must preserve the ability to just deliver  
15 gas, bill and collect. So what goes by the boards?  
16 Well, parts and labor and the appliance repair is very  
17 clear. The call center, we will have to substantially  
18 modify the operations there. District offices are gone.  
19 Collection offices, we would shift whatever resources we  
20 could and focus on the collection effort in order to get  
21 the money in to the company in an appropriate timeframe.  
22 All of this stuff with the PUC, the dispute resolution  
23 and the customer response units, I don't know how we  
24 could sustain those. The low income outreach programs at  
25 least for the time being are behind us so that would be a

1 problem in the fall although we very well might not have  
2 the resources to do that, although that is an important  
3 issue and a collection-related function. I don't know  
4 what we would do with new customer service line  
5 installations. We would have to look at that but we  
6 would probably suspend all non-safety-related  
7 construction including new hookups. The restructuring  
8 would be gone. The PMO would be gone. PMO is integral  
9 both to further perfecting the BCCS as well as  
10 implementation of the choice act. I don't see how we  
11 sustain that.

12 Q. Shifting from that to another statement  
13 Mr. Lelash made and just in summary, Mr. Lelash says that  
14 PGW should reevaluate its operations and determine what  
15 could be deferred without harming reliability and  
16 customer service and to take other steps even if the  
17 company is not downgraded, and that is in essence to  
18 prepare to reduce any unnecessary spending. Has the  
19 company taken those steps?

20 A. Your reference?

21 Q. Page 33 and 34, Mr. Knudsen.

22 A. Well, I think the issue here is -- to answer  
23 that question I think we have to look at what has been  
24 done. The prioritization of everything that we have done  
25 thus far has been directed almost exclusively to customer

1 service to date. We have perfected the computer system.  
2 We have completely overhauled customer service  
3 deliveries. Customer access, in case Your Honor is not  
4 aware, is now above the state standard that is assigned  
5 to us. That piece of it is, I think, well designed and  
6 working well and I think is as efficient as we can  
7 possibly make it given the workload that we have. And in  
8 fact we will be later on reducing the number of people in  
9 customer service because we don't need as many people  
10 because of the progress we have made.

11 That being said, we have then swung the pendulum a  
12 little bit further along and we picked up field services.  
13 We have had an evaluation done of the parts and labor and  
14 appliance repair programs and we are looking to eliminate  
15 25 positions, or more accurately shifting those 25  
16 positions to work that the PUC is going to require of us.  
17 It is sort of a saved expense but now we have to incur a  
18 new expense in order to comply with the PUC mandates.

19 And then thirdly we are now looking at a total  
20 overhaul of the distribution function. That has three  
21 elements. It has the field services, which is now in  
22 distribution. It has the traditional distribution work  
23 of laying pipe and services in the field. And then the  
24 third part of that department is, or the third element of  
25 that department, is the gas processing, our LNG function.

1 We have presently under way I would say 15 or 20 separate  
2 activities designed to restructure that area of the  
3 business completely. Obviously some of that would have  
4 to be discontinued under these potential changes. But we  
5 have reevaluated. We are determining what is  
6 appropriate. We are cutting costs. We are substantially  
7 down on the number of people that were forecast for this  
8 year. All of these things we are doing in the  
9 appropriate way to reach the goal of safe and reliable  
10 service at the lowest possible price to customers.

11 Q. Have you taken specific steps in light of this  
12 emergency to reevaluate and try to determine where we can  
13 cut costs and save money?

14 A. Right. In the response to, I think, RS-7 we  
15 identified about a million dollars of immediate action we  
16 took when this problem started two or three weeks ago,  
17 which is outside of the sort of core mission  
18 requirements. We are not hiring. We are cutting costs.  
19 We are suspending payments on -- or suspending activities  
20 that would lead to additional outlays of any sort. We  
21 have identified one million dollars of potential savings  
22 in the short-term.

23 Q. And with respect to the items that Mr. Lelash  
24 characterizes as cashflow-related initiatives that he  
25 shows on page 35, can you comment briefly as to whether

1 we have undertaken those steps?

2 A. Yes. The gas storage management, we have moved  
3 to essentially utilize our inventories in a manner that  
4 might not be completely economic but which generate cash  
5 for us. So we have already started to look at that  
6 problem seriously and took some action on that.

7 If I understand point two, utilization of asset  
8 management agreements, I think Mr. Lelash, if I  
9 understand his intent here, is talking about new  
10 mechanisms, financial mechanisms, to allow us to maximize  
11 our assets. I have asked our chief counsel to look into  
12 this as a possibility. We are not free to do everything  
13 we would like to do or that an investor-owned utility  
14 would be able to do. So we have certain constraints but  
15 she is looking at that now.

16 In terms of increased customer sign-up for the  
17 external low income assistance programs, we are now in  
18 excess of the subscriptions that we had last year, which  
19 was at that time an all-time record, and we are  
20 continuing to sign up people through this week. I don't  
21 know if anybody saw the six o'clock news last night but  
22 we had a very nice piece of coverage that got our message  
23 out very clearly. So I don't know what more we could do  
24 on this point.

25 And then deferral if feasible of special projects

1 and a phase-in of the restructuring contemplated by the  
2 act, I appreciate his giving me some wiggle room with if  
3 feasible. Coming back to the earlier discussion about  
4 what we have underway right now, I would certainly like  
5 to continue with those things that have a fairly  
6 substantial payoff. This whole field services initiative  
7 is one. The distribution department initiative is two.  
8 The collections initiative is three. So I would be  
9 perfectly willing to look at special projects but most of  
10 the special projects that we have ongoing right now are  
11 designed to effect economies or increase customer  
12 service. So we would have to look carefully at what he  
13 has in mind there.

14 MR. CLEARFIELD: That's all the rebuttal we have,  
15 Your Honor.

16 JUDGE FORDHAM: I have a couple of questions.  
17 Maybe I can ask my questions and then we can go to  
18 Ms. Davis.

19 Going back to the Rebuttal Exhibit 1, on page two  
20 of the exhibit, some of the activities that you mention  
21 on page two, the suspending activities involving  
22 restructuring, has PGW starting working on the  
23 restructuring filing?

24 THE WITNESS: Oh, yes. We are required right now  
25 to file on July 1st. And right now we are on target to

1 make that filing. But if we were downgraded and had to  
2 look seriously at what we could afford going forward, I  
3 don't see how we could continue to make that investment.  
4 We are looking at a potential five, six, seven million  
5 dollar investment to make this happen and a lot of that  
6 money gets spent fairly soon. I don't know how we would  
7 come up with the resources to do that.

8 JUDGE FORDHAM: The other two at the bottom, the  
9 AMR battery replacement and the gas theft investigation,  
10 it seems that if you suspend all activity on the AMR  
11 battery replacement and rely on estimated billing you are  
12 going backwards because that is one of the problems that  
13 existed before, that people were getting estimated bills  
14 and therefore either paid too low or they didn't pay at  
15 all because they wanted an actual bill. So wouldn't that  
16 put you in deeper debt as opposed to solving any  
17 problems?

18 THE WITNESS: Well, it could. Again, I am not  
19 saying that this is permanent. What I am saying is it is  
20 out in the future for some period of time. These are  
21 things that we would have to suspend until something  
22 happened to allow us either to get back into the  
23 financial markets, get us some kind of financial relief  
24 from some source. So these are things that have to go to  
25 away for a period of time.

1 I absolutely agree with you. I do not want to do  
2 this. I do not want to go back to relying on estimated  
3 bills. But understand what is sort of the principal  
4 directive here, which is to keep the gas flowing, to get  
5 the bills out and collect the bills as rendered. Now,  
6 people may take exception to an estimated bill. But by  
7 and large that portion of the BCCS works well. Yes,  
8 there will be some people that are unhappy and we have to  
9 try to take care of them in some way but we would be  
10 billing and collecting for the accounts, again, for some  
11 period of time. I don't want to do this. That is why we  
12 don't want to be downgraded. But we must maintain the  
13 financial flexibility to keep all of these programs  
14 alive. As Mr. Lelash said in his testimony at the very  
15 end, we do need the relief because we don't want to be  
16 forced into a position of losing ground, losing the  
17 ground that we have built on so far. And that is your  
18 point. In fact, we would have -- retro -- regression is  
19 the word I am looking for rather than a progression in  
20 our activities.

21 JUDGE FORDHAM: Does anybody else have real short  
22 cross of Mr. Knudsen?

23 MR. SIMMS: I have more questions but I can --

24 JUDGE FORDHAM: We can stop. If it goes over we  
25 can stop and go to Ms. Davis and come back.

1 MR. SIMMS: Okay.

2 CROSS-EXAMINATION

3 BY MR. SIMMS:

4 Q. Good afternoon, Mr. Knudsen.

5 A. Good afternoon, Mr. Simms.

6 Q. Mr. Knudsen, you made a reference to RS-7. I  
7 assume that reference was to the company's response to  
8 OTS-Set I-RS-7.

9 A. That's correct.

10 Q. Just so I understand your answer and your  
11 remarks regarding RS-7, am I to understand that the  
12 company has actually implemented the no new hiring, no  
13 new promotions, no contracting for new services, no  
14 contracting for new materials, to contracting for  
15 training sessions and reduction of routine expenditures?  
16 Is that in effect today?

17 A. That is in effect today. There are a few  
18 exceptions but that is essentially in effect today.

19 Q. And based upon that implementation of the  
20 company as we speak today is saving roughly \$1 million  
21 monthly?

22 A. Not monthly. This is moving forward. This is  
23 more of a six to eight month look.

24 Q. The reason I phrased the question monthly, you  
25 said that the types of expenditures anticipated and a

1 monthly saving estimate is the following.

2 A. Yes, you're right.

3 Q. That was your response to the interrogatory.

4 So are you revising that response?

5 A. No, I am not. I am linking that with some of  
6 the other things we are doing.

7 This would have the effect of saving us substantial  
8 money during the year. This would be millions of dollars  
9 in savings if we have to continue with this program.

10 (Pause.)

11 A. As I said, there are a couple of exceptions.  
12 Mr. White and I reserve our privilege to hire when we  
13 need to. We have a lot of people that have left in the  
14 last three to four to five weeks. We may be replacing  
15 one for every three that are leaving right now.

16 Q. Let me now get a fuller understanding of the  
17 collective bargaining agreement and the relationship with  
18 the Commission with layoffs. I believe we asked for a  
19 copy of that provision and I don't recall whether we have  
20 it. But nevertheless, my understanding of that is that  
21 in order for you to implement the layoffs of the union  
22 bargaining employees it must be an order from the  
23 Commission ordering you to lay off. Can you further  
24 explain that?

25 A. My understanding of the law is that the

1 Commission must allow us to suspend those portions of the  
2 collective bargaining agreement that inhibit our laying  
3 off or furloughing people in the company. It would  
4 simply be a suspension of certain provisions of the  
5 collective bargaining agreement. They don't order us to  
6 do that. We then have the freedom and flexibility to  
7 take the action that we must.

8 Q. So in order to institute that provision of the  
9 contract that would require a petition from PGW to the  
10 Commission?

11 A. And as I indicated that is what we are  
12 preparing right now.

13 Q. Was the Commission at the bargaining table when  
14 this new provision was instituted?

15 A. This has been a provision of the collective  
16 bargaining agreement for a number of years. It predates  
17 the movement to the Pennsylvania Public Utility  
18 Commission. It was a provision that was in place for the  
19 Gas Commission as well.

20 Q. Okay. So what essentially occurred was instead  
21 of the Gas Commission, the Pennsylvania Public Utility  
22 Commission was substituted in its place?

23 A. It steps in the place in the Gas Commission in  
24 the law as written -- or in the collective bargaining  
25 agreement as written.

1 Q. Now, I would like to refer you to your response  
2 so OTS-Set III-RE-20.

3 MR. SIMMS: Your Honor, I am going to have that  
4 response marked, or request that that response be marked  
5 as OTS Cross-Examination Exhibit No. 1.

6 JUDGE FORDHAM: It shall be so marked.

7 (Whereupon, the document was marked as OTS  
8 Cross-Exam. Exhibit No. 1 for identification.)

9 BY MR. SIMMS:

10 Q. Do you have that before you?

11 A. I do.

12 Q. This response provides PGW's comprehensive  
13 collection plan, does it not?

14 A. Yes. This is an outline of that plan.

15 Q. The response indicates that as of January 15,  
16 2002, PGW's gas accounts receivable was over \$159  
17 million, of which \$90 million was 90 days past due,  
18 correct?

19 A. That is what it says, yes.

20 Q. When I looked at your base rate case filing  
21 dealing an accounts receivable there seemed to be  
22 approximately \$258 million as accounts receivable. Was  
23 that a projected number?

24 A. No. I think Mr. Bogdonavage is the more  
25 appropriate party here. There is a difference in

1 recognizing whether it is a reserve number or the  
2 unreserved number. I think this is the unreserved  
3 number.

4 Q. Now --

5 A. I'm sorry. Turn it around. This is the  
6 reserved number.

7 Q. This is the reserved number. What is the  
8 difference between the unreserved and the reserved number  
9 as you understand it?

10 A. Well, the gross number for receivables is  
11 fairly substantial because we have not written off any of  
12 those accounts for three years. So that the provision  
13 for uncollectible has grown fairly substantially. And it  
14 is the net of the difference that is really the amount of  
15 money that we can go after effectively. I think that is  
16 what this number is here.

17 Q. Just so I understand from a historical  
18 perspective, the Commission assumed jurisdiction of PGW  
19 in July of 2000?

20 A. Right.

21 Q. So PGW the first time it was subject to the  
22 moratorium, at least under the PUC's regulation, was  
23 December 1, 2002, through March 31, 2001, correct?

24 A. I'm sorry?

25 Q. The moratorium under the PUC regulation was in

1 effect for PGW for the first time beginning December 1,  
2 2000, through March 31, 2001?

3 A. Correct.

4 MR. CLEARFIELD: Are you talking about the  
5 moratorium on shutoffs?

6 MR. SIMMS: Yes, shutoffs.

7 MR. CLEARFIELD: Actually, under the PUC there was  
8 a moratorium that existed prior to PUC regulatory  
9 takeover in our own tariff.

10 MR. SIMMS: I understand that. I am talking about  
11 under the Commission.

12 MR. CLEARFIELD: I'm sorry.

13 BY MR. SIMMS:

14 Q. Is that correct?

15 A. Correct.

16 Q. Do you recall, again, April 1 how many  
17 terminations occurred, if any?

18 A. Shutoffs?

19 Q. Yes, shutoffs.

20 A. We have not made that a matter of public record  
21 but for our purposes here, if memory serves, it is about  
22 10,000 to 12,000.

23 Q. 10,000 to 12,000?

24 A. Shutoffs.

25 Q. And that was based on customers who are 90 days

1 or more past due in their accounts?

2 A. Yes, that's correct. That is a small fraction  
3 of those who qualify for shutoffs.

4 Q. And what is the reason for the small fraction  
5 of those that qualify for shutoffs?

6 A. Because we were stopped last spring from sort  
7 of a proactive position by both BCS and the Gas  
8 Commission and members of City Council because a year ago  
9 the billing system was only then being corrected and  
10 there was discomfort on a lot of people's parts that the  
11 information in the system might be incorrect and  
12 therefore people who we might shut off would be  
13 inappropriately identified as such.

14 Q. Now, if I recall there was a great deal of  
15 advertisement around the March 31 time period regarding  
16 shutoffs and terminations.

17 A. Yes.

18 Q. An educational campaign by PGW.

19 A. Yes. We had our famous rusty wrench  
20 advertisement.

21 JUDGE FORDHAM: I didn't hear that.

22 THE WITNESS: I said we had our famous rusty wrench  
23 advertisement.

24 BY MR. SIMMS:

25 Q. As a result of that advertisement did the

1 accounts receivable or customers paying increase?

2 A. Yes.

3 Q. Do you know by how much?

4 A. I don't recall exactly, no. But I could get  
5 you that number.

6 MR. SIMMS: I would like to make an on the record  
7 data request to receive that information.

8 MR. CLEARFIELD: I'm sorry. Do you understand  
9 that?

10 THE WITNESS: Yes. It is the impact in the first  
11 several weeks following the advertising campaign, what  
12 was the impact on accounts receivable or what activity  
13 did we have with regard to collections.

14 BY MR. SIMMS:

15 Q. Now, do you anticipate conducting that same  
16 type of campaign this year?

17 A. It is underway right now. It is called cold  
18 shower.

19 Q. Is that an internal name?

20 A. No, no, no. That is operation cold shower.  
21 This is what is occurring right now. You may have driven  
22 in and listened to it on KYW.

23 Q. Now, in your response to what has been marked  
24 for identification as OTS Cross-Examination Exhibit No. 1  
25 you make a reference to the unprotected population. In

1 this case it is over 84,000 customers owing \$70 million.  
2 How are you defining unprotected?

3 A. Well, I think what we are saying there is that  
4 they are not on agreements and they are not the elderly.

5 MR. CLEARFIELD: What kind of agreement?

6 THE WITNESS: Well, this would be either CRP or an  
7 actual payment agreement that has already been  
8 negotiated.

9 BY MR. SIMMS:

10 Q. And what status do they have with the company  
11 as we go forward?

12 A. They are our least favorite customer. They are  
13 the people that we want to get the money from. These are  
14 the people who can afford to pay and should pay.

15 Q. Has there been any discussion with BCS, the Gas  
16 Commission, City Council, as to whether or not they are  
17 going to allow PGW to proceed in a shutoff program for  
18 this upcoming year beginning, I guess, next week?

19 A. All members of City Council, all members of the  
20 Harrisburg delegation, BCS, any agency that might be  
21 impacted has been consulted and notified as to our  
22 program. We have received no push back from anybody.

23 JUDGE FORDHAM: Mr. Simms, are you finished with  
24 this line of questioning?

25 MR. SIMMS: Yes. I could stop.

1 JUDGE FORDHAM: Thank you.

2 We will stop Mr. Knudsen's testimony at this time  
3 and go to Ms. Davis.

4 (Witness temporarily excused.)

5 JUDGE FORDHAM: Good afternoon Ms. Davis.

6 MS. DAVIS: Good afternoon.

7 MR. CLEARFIELD: We have already authenticated your  
8 testimony. So for the record would you state your full  
9 name and business address?

10 MS. DAVIS: Yes. My name is Janice D. Davis. My  
11 business is 1401 JFK Boulevard, Philadelphia,  
12 Pennsylvania 19102.

13 JUDGE FORDHAM: I need to swear you in, Ms. Davis.  
14 Whereupon,

15 JANICE D. DAVIS

16 having been duly sworn, testified as follows:

17 DIRECT EXAMINATION

18 BY MR. CLEARFIELD:

19 Q. Ms. Davis, we have already distributed to the  
20 parties and had authenticated your two statements, which  
21 are PGW ERP Statement 5, which was your direct testimony,  
22 and then your rebuttal testimony, which we have marked as  
23 PGW ERP Statement 5.1. Are you familiar with those?

24 A. Yes, I am.

25 Q. Do you have any additions or corrections you

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1 would like to make at this time?

2 A. No additions or corrections.

3 MR. CLEARFIELD: Then Ms. Davis is available. We  
4 completed our rebuttal through the written testimony that  
5 we have submitted. Thank you.

6 JUDGE FORDHAM: Thank you.

7 Mr. Simms.

8 CROSS-EXAMINATION

9 BY MR. SIMMS:

10 Q. Ms. Davis, good afternoon. This is Johnnie  
11 Simms with the Office of Trial Staff.

12 A. Hello.

13 Q. Hello. I just have a few questions for you.

14 A. All right.

15 Q. The issue regarding the \$18 million, under what  
16 circumstances is the city willing to grant back the \$18  
17 million?

18 A. As I said in my testimony, the city really is  
19 in no position to just willy-nilly grant the money back.  
20 If it becomes necessary to ensure that the company meets  
21 its coverage we would in that case grant back part of the  
22 18 million.

23 Q. Are you aware that PGW is projecting a negative  
24 cash balance at the end of this fiscal year, that being  
25 August 31, 2002?

1 A. Yes.

2 Q. Under that circumstance is the city willing or  
3 is the city going to continue to require PGW to pay the  
4 18 million city fee?

5 A. We will only grant back part of the fee if it  
6 is necessary for PGW to make coverage. The city already  
7 has in PGW's possession \$45 million of city funds and to  
8 go beyond that would create a problem for the city.

9 Q. Now, am I not correct that the Philadelphia  
10 Intergovernmental Corporation Authority is a state agency  
11 set up to ensure that Philadelphia remains fiscally  
12 solvent?

13 A. Yes, you are correct.

14 Q. Am I also correct that, I think it is PICA for  
15 short, is required by state law that fully certify that  
16 the city's budget plan guarantees solvency for a five  
17 year period?

18 A. Yes.

19 Q. What is your relationship to the city budget  
20 director?

21 A. The budget director reports to me.

22 Q. Would I be correct that there is some  
23 disagreement between PICA and the city as to the city's  
24 reserve fund, the amount that is going to be -- the  
25 estimates for the city's reserve fund?

1           A. There is, but it is to be expected. We have  
2 the benefit of being closer to the estimates and closer  
3 to what our expenditures and revenues are than they do.  
4 We have to live with the results; they don't. So we tend  
5 to be ever watchful and mindful of what is going on. It  
6 is a luxury that we don't have, to ignore our  
7 circumstances. They have that luxury. They don't have  
8 to live within our budget.

9           Q. Isn't it correct that the city reserve fund is  
10 now \$127 million this year?

11          A. How much?

12          Q. \$127 million.

13          A. I don't believe that is a correct number.

14          Q. What is the correct number? Do you know?

15          A. We ended last fiscal year at \$230 million. The  
16 fund balance or surplus, as you call it, is officially  
17 measured at the end of a fiscal year. There may be  
18 projections of it and at this point I do not believe that  
19 our current projection is the number that you just  
20 stated.

21          Q. Now, would I be correct that the city has  
22 historically underestimated its tax revenues in preparing  
23 its budgets?

24          A. There have been in the past underestimations,  
25 yes.

1 MR. SIMMS: That concludes my cross-examination,  
2 Your Honor.

3 JUDGE FORDHAM: Thank you.

4 THE WITNESS: Thank you.

5 JUDGE FORDHAM: Mr. Gray.

6 MR. GRAY: Thank you, Your Honor.

7 CROSS-EXAMINATION

8 BY MR. GRAY:

9 Q. Good afternoon, Ms. Davis.

10 A. Good afternoon.

11 Q. This is Steve Gray from the Small Business  
12 Advocate office.

13 First question. Let me talk about or ask you about  
14 the possible sale of PGW. What has been your involvement  
15 in regards to any considerations involving the sale of  
16 PGW?

17 A. I have attended meetings where that among other  
18 options have been discussed.

19 Q. Can you give us a status of those meetings as  
20 of today?

21 A. No determination has been reached. We are  
22 still investigating options.

23 Q. When did the discussions begin about the  
24 possibility of selling PGW?

25 A. I really don't remember the exact time. It

1 would have been sometime last year.

2 Q. Who else is involved in those discussions?

3 A. The chief of staff for the mayor, and -- let's  
4 see, chief of staff, myself, at one point or another the  
5 mayor. And Bill Martin on behalf of the city. And the  
6 Lehman firm.

7 Q. Do you have an opinion on whether PGW should be  
8 sold or turned into an authority or into a not-for-profit  
9 organization?

10 A. No, I don't. I don't have enough information.

11 Q. Has there been any discussion or analysis of a  
12 potential sale price?

13 A. Nothing that would rise to an official number.  
14 There have been talks about what we would like to see.  
15 And of course when valuing something like PGW the total  
16 outstanding debt is usually the first place you begin  
17 when setting a price. So the outstanding debt and other  
18 liabilities would sort of set a floor for their price.

19 Q. Let me speculate for a moment. If PGW is sold  
20 to an investor-owned utility on or about August 31 of  
21 this year one of the exhibits shows that there would be  
22 about 200 to 210 million in city equity at that time. Is  
23 it your understanding that if PGW was sold to such an  
24 investor-owned utility that the city would keep that \$210  
25 million?

1           A. We have not gotten to that point in any  
2 discussions.

3           Q. Thank you.

4           One last question. An interesting point was raised  
5 by Mr. Weakley. He is an Office of Trial Staff witness.  
6 He said at page eight, lines seven and eight, of  
7 Mr. Weakley's testimony that the City of Philadelphia  
8 should, and I will quote here, permit PGW to pursue  
9 collections of its accounts receivable with the same  
10 vigor as other utilities, unquote. I am going to ask  
11 Mr. Weakley about this, but I am wondering if you agree  
12 with his implication, that there is some constraint  
13 placed upon PGW by the City of Philadelphia to collect  
14 its bills?

15           A. The administration of the City of Philadelphia  
16 encourages PGW to collect its bills. We place no  
17 constraint on it at all.

18           MR. GRAY: Thank you very much, Ms. Davis.

19           JUDGE FORDHAM: Thank you.

20           Mr. Bertocci.

21           MR. BERTOCCI: Thank you, Judge

22                                   CROSS-EXAMINATION

23           BY MR. BERTOCCI:

24           Q. Hello, Ms. Davis.

25           A. Hello.

1 Q. Philip Bertocci for CEPA, et al.

2 A. Okay.

3 Q. Just a couple of small points.

4 In your testimony, page two, line 15, you said that  
5 you were speaking about the \$45 million city advance and  
6 you said that the cost of such a loan would be about two  
7 to three million dollars annually if PGW had to obtain it  
8 conventionally, and you also opined that PGW would not be  
9 able to obtain it conventionally. My question goes to  
10 the cost of the city advance to the city, not what PGW  
11 would have to pay elsewhere. You would agree that it's  
12 not two to three million dollars annually, wouldn't you?

13 A. It is whatever interest we forego as a result  
14 of having it outstanding. And if for whatever reason it  
15 is not repaid on a timely basis it will have to be  
16 included and probably is included, if I think more  
17 carefully. When we borrow in order to cashflow the city  
18 from July until we begin to get our real estate taxes in  
19 the spring there is a certain amount of interest that  
20 will be attributable to the fact that we don't have that  
21 45 million within our cashflow.

22 Q. Have you tried to calculate that amount?

23 A. No, I have not.

24 Q. The terms of the loan are such that for the  
25 time that PGW is not using the 45 million or any part of

1 it it is sitting back in the fund drawing interest for  
2 the city, is that right?

3 A. That is how it is supposed to operate. But  
4 because ours is an interest-free loan ours tends to be  
5 more fully drawn on than any other sources which is the  
6 last thing for PGW. So that we are finding more and more  
7 that it is fully utilized.

8 Q. Also on page three, line 13, you said that the  
9 city does not have the capacity for additional subsidies  
10 to PGW. I was interested in the use of the word subsidy.  
11 Do you consider a waiver or grantback of the 18 million  
12 to be a subsidy?

13 A. Yes, it is.

14 Q. What other transfers would you include within  
15 your reference to subsidies?

16 A. The fact that we have in fact made them that  
17 loan of 45 million and the interest on that loan that we  
18 are foregoing, plus the interest that it costs us to  
19 borrow for our cashflow. Those are subsidies.

20 MR. BERTOCCI: Thank you very much.

21 THE WITNESS: Thank you.

22 JUDGE FORDHAM: Does any other party have any  
23 cross-examination for Ms. Davis?

24 (No audible response.)

25 MR. CLEARFIELD: May I try one question on

1 rebuttal, Your Honor?

2 JUDGE FORDHAM: Yes.

3 REDIRECT EXAMINATION

4 BY MR. CLEARFIELD:

5 Q. Ms. Davis, this is Dan Clearfield. Can you  
6 hear me all right?

7 A. Yes, Dan.

8 Q. In terms of your expectation of the interest  
9 rate that you are going to incur for the cashflow loan  
10 that you expect later on this year, do you have an  
11 estimate of what that level might be?

12 A. Probably in the neighborhood of five percent.  
13 Four-and-a-half to five.

14 MR. CLEARFIELD: Thank you. Let me just take a  
15 moment to congratulate you on your new grandchild, if not  
16 for your testimony. I will do that later. Thank you  
17 very much.

18 THE WITNESS: Thank you.

19 JUDGE FORDHAM: Thank you very much, Ms. Davis, for  
20 taking time out to participate.

21 THE WITNESS: Glad I could be of assistance.

22 JUDGE FORDHAM: Thank you.

23 (Witness excused.)

24 JUDGE FORDHAM: Off the record for a moment.

25 (Discussion off the record.)

1 JUDGE FORDHAM: We are back on the record.

2 We have completed the testimony of Ms. Davis. At  
3 this time, Mr. Clearfield, do you want do move for the  
4 admission --

5 MR. CLEARFIELD: Yes. May I move for the admission  
6 of Statement 5 and Statement 5.1?

7 JUDGE FORDHAM: Any objections?

8 (No audible response.)

9 JUDGE FORDHAM: They are admitted.

10 (Whereupon, the documents were marked as PGW  
11 ERP Statements Nos. 5 and 5.1 for  
12 identification, and were received in evidence.)

13 JUDGE FORDHAM: We are going back to Mr. Knudsen's  
14 cross-examination by Mr. Simms.

15 MR. SIMMS: Thank you, Your Honor.

16 Whereupon,

17 THOMAS E. KNUDSEN

18 having previously been duly sworn, testified further as  
19 follows:

20 CROSS-EXAMINATION (RESUMED)

21 BY MR. SIMMS:

22 Q. Just one follow-up question, Mr. Knudsen, on  
23 the cold shower campaign.

24 A. Yes.

25 Q. Has there been an estimate by PGW as to what it

1 anticipates to be able to recover from this campaign in  
2 terms of revenues?

3 A. Well, we would not be recovering revenues.

4 Q. Well, the past due amounts. I'm sorry.

5 A. In terms of cashflow, yes, I think the general  
6 number as I understand Mr. Gyory, who prepared this, the  
7 objective is to garner an additional \$20 million from the  
8 campaign specifically.

9 Q. And I believe before the break in your  
10 cross-examination you said no parties have expressed an  
11 objection to pursuing this campaign?

12 A. No. That's correct.

13 Q. Let me refer you to page 12 of your direct  
14 testimony. I am referring to lines 17 and 18. You make  
15 a reference to a social contract. Can you define that  
16 for me?

17 A. Yes. There are two aspects to what we discuss  
18 internally and with the owner as a social contract. The  
19 first is obviously to the people that Mr. Bertocci  
20 represents. PGW services a territory that has 50 percent  
21 of the low income residents in Pennsylvania. It is a  
22 substantial burden for us, and obviously for them. So  
23 the social contract, then, is to do everything that we  
24 can to attempt to keep them comfortable and in their  
25 homes. That is as simple as I can stay say it.

1           We also have a compact with the businesses of  
2 Philadelphia that we try to do those things that support  
3 the wellbeing of the business environment here and  
4 supports people being employed in the City of  
5 Philadelphia.

6           So there are two aspects to how we approach our  
7 customers in this regard.

8           Q.   Would I be correct that the social contract  
9 would not apply to the 84,000 customers owing \$7 million  
10 as identified in OTS Cross-Examination Exhibit No. 1?

11          A.   Well, I don't think it is quite that cut and  
12 dried. I think of that group, if they come and in fact  
13 are in such straits that they need agreements or they  
14 need some kind of additional consideration -- these are  
15 citizens of Philadelphia. They are the citizen owners of  
16 this utility. We are there to provide service. We are  
17 not interested in having them discontinue their service.  
18 We are interested in encouraging them to pay.

19          But to the spirit of your question, yes, these are  
20 people who have received a good, have not paid for that  
21 good and we expect them to pay. But we will do  
22 everything we can to make it possible for them to pay it  
23 within their ability.

24          Q.   And you have in fact contacted these  
25 individuals, have you not?

1           A. Everybody has received notices at this point,  
2           yes. I don't know the specific timetable but they will  
3           have received some type of notice of payment due.

4           Q. Would I be correct that this class of  
5           customers, the unprotected population, is receiving  
6           service as we speak today?

7           A. I would think most of them would be receiving  
8           services. They have not, other than the commercials --  
9           the commercials we do have a continuing shutoff policy  
10          throughout the year. But as far as residential, if they  
11          have not paid we are not in a position, other than to  
12          give them notice, we are not in a position to turn them  
13          off. So presumably they are still on the system.

14          Q. Just in a snapshot in dealing with this  
15          unprotected population, on April 1 what process is PGW  
16          going to institute regarding this class of unprotected  
17          population?

18          A. It is the process that is dictated by our  
19          tariff. There are a series of notices, reminders,  
20          demands for payment and then ultimately there is a notice  
21          for shutoff. And forgive me, I don't know the technical  
22          sequence of this but that is the intention. I think  
23          there are three or four notices before shutoff.

24          Q. Earlier I had raised a question about the  
25          collective bargaining agreement. As I understand in your

1 response to OTS-Set I-RS-5, this lay off provision, the  
2 Commission can either expressly prohibit the layoff or  
3 expressly allow the layoff to go forward under a petition  
4 from PGW, is that correct?

5 A. The current agreement has a provision -- let me  
6 read it. It is agreed by the union and the company that  
7 all provisions of this agreement shall be effective  
8 unless and until expressly prohibited by any regulatory  
9 body which has or may acquire jurisdiction over the  
10 company. That was the Gas Commission and would be the  
11 PUC now. So they have to look at the specific provision,  
12 which would be the no layoff clause here, and  
13 specifically say we suspend the implementation or the  
14 requirement embodied in this portion of the collective  
15 bargaining agreement. That then leaves us free to take  
16 whatever action we need to.

17 Now, if they choose not to allow us to do that then  
18 we cannot proceed with the layoff or furlough program in  
19 the event of a downgrade, again, for the union  
20 represented people.

21 Q. But in order to start that process there would  
22 have to be some filing by PGW with the Commission?

23 A. That's correct. And that is what is underway  
24 right now. We are considering filing that later this  
25 week.

1 Q. You are considering filing it later this week  
2 in the event that you do not receive extraordinary rate  
3 relief? Or are you considering filing it as a part of  
4 this answer to the S&P credit watch?

5 A. If we are downgraded we must move immediately  
6 -- immediately -- to implement the program that I was  
7 describing. I don't want to be in the position of  
8 waiting until the 12th or 13th of April in order to get  
9 the whole program going. We need to move immediately.

10 Q. So you anticipate filing that petition this  
11 week?

12 A. And then hopefully either in anticipation of  
13 April 11 or as quickly thereafter as possible the  
14 Commission could move and essentially say in the event  
15 that PGW is downgraded PGW is free to take whatever  
16 action it must relative to the collective bargaining  
17 agreement.

18 Q. Now, on page 11 of your direct testimony you  
19 testified that all vice-presidents have been told to  
20 place a hold on any unnecessary spending. Just so I  
21 understand it, the only unnecessary spending that has  
22 actually been put on hold is the one that you identified  
23 earlier which has a saving of about a million dollars a  
24 month?

25 A. Let me be more clear about that. Let me give

1 you an example of what has happened and supports that.  
2 We had an ongoing study of the field services department  
3 that should have had a follow-on piece of work that would  
4 probably cost us in consulting fees \$100,000 in order to  
5 effectively reach the conclusion of the study, implement  
6 the study and we would have had annual savings of one  
7 million five. We are not going ahead with that right  
8 now. So within that million dollars of savings is that  
9 kind of expenditure.

10 Now, the million a month includes a whole program  
11 of cost reduction that we already have ongoing and these  
12 are kind of incremental pieces as well. It was an  
13 attempt to try to characterize for the parties, you know,  
14 where we are and what we are attempting to do here. But  
15 we have already committed ourselves to the \$7 million of  
16 savings already.

17 MR. SIMMS: Thank you. That concludes my  
18 cross-examination.

19 JUDGE FORDHAM: Thank you.

20 Ms. McCloskey.

21 MS. McCLOSKEY: Thank you.

22 CROSS-EXAMINATION

23 BY MS. McCLOSKEY:

24 Q. Good afternoon, Mr. Knudsen.

25 A. Good afternoon, Counsel.

1 Q. I would like to start with just a discussion  
2 about the S&P announcement. Since the company received  
3 the S&P announcement or press release what assistance or  
4 direction has PGW received from the city?

5 A. Since the announcement?

6 Q. Since the announcement in February. Have you  
7 received any specific directions from the city?

8 A. With regard to...?

9 Q. With regard to addressing the situation brought  
10 about by the announcement.

11 A. Well, I think the most direct would be the  
12 reaffirmation on the part of Ms. Davis that with regard  
13 to the problems that we are having that the city would  
14 backstop us up to the limit of the \$18 million. That has  
15 been reaffirmed since that date.

16 Q. When you had the plan to file for extraordinary  
17 rate relief did you have to seek the approval of the city  
18 to make that filing or to go forward with that plan?

19 A. We sought approval of the board, of our own  
20 board. On that board is Janice Davis, who is the  
21 financial director, and Ms. Joyce Wilkerson, who is chief  
22 of staff to the mayor. The board approved it. We know  
23 that Ms. Davis and Ms. Wilkerson essentially reviewed the  
24 situation with the mayor and we proceeded. What the  
25 formality was, I am not clear. But our board was

1 essentially the agent to set the path.

2 Q. Now, do you have available to you the S&P  
3 announcement that was attached to Ms. Bisgaier's  
4 testimony? It was in her updated exhibit.

5 MR. CLEARFIELD: That should be right here.

6 (Document handed to witness.)

7 MS. McCLOSKEY: It would be the updated one. Do  
8 you have that?

9 MR. CLEARFIELD: We should.

10 MS. McCLOSKEY: I can share mine with him.

11 MR. CLEARFIELD: I believe they are identical.

12 THE WITNESS: I have one.

13 BY MS. McCLOSKEY:

14 Q. At the bottom of the first page there is a  
15 bullet point and it refers to the temporary borrowing  
16 from the capital fund. And I believe you did discuss  
17 this a little bit in your rebuttal testimony.

18 Am I correct that this is not the first time that  
19 PGW has borrowed from its capital accounts on a temporary  
20 basis?

21 A. That is correct. It's not the first time.

22 Q. And am I correct that PGW has over the past  
23 several years made such temporary borrowings and then  
24 repaid that account or completed an equivalent amount of  
25 capital improvements as you described in your rebuttal

1 testimony?

2 A. Yes. Certainly last year we did. I think  
3 prior to about 1999 it was not a regular practice. But  
4 because of the exigencies of the situation we had no  
5 choice but to do that.

6 MR. CLEARFIELD: Can you keep your voice up?

7 THE WITNESS: Yes. I'm sorry.

8 BY MS. McCLOSKEY:

9 Q. I believe that when Mr. Gray was  
10 cross-examining Ms. Davis they referred to the  
11 approximate 210 million of city equity in PGW. Were you  
12 familiar with that?

13 A. That is the fund balance? Yes.

14 Q. And am I correct that that city equity is now a  
15 little bit less than 20 percent of PGW's total  
16 capitalization.

17 A. That's correct.

18 Q. And would you agree with me that as a general  
19 matter a low level of equity capital increases the  
20 financial risk of an operation?

21 A. That's correct.

22 Q. Now, at the top of page two of your testimony  
23 you indicate there that the company had provided notice  
24 to the Commission that it was going to file for a base  
25 rate case in January of 2002.

1 A. Yes.

2 Q. And why did the company delay that filing?

3 A. We had so much going on that it just wasn't  
4 physically possible to get through, you know, the  
5 necessary requirements.

6 Q. Were you aware at that time that S&P was  
7 considering an action regarding PGW's bonds?

8 A. Absolutely not.

9 Q. Now, at page three of your testimony, lines  
10 seven through 12, you list a number of factors that S&P  
11 actually listed such as the poor liquidity, the reliance  
12 on restricted funds and the weak fixed charge coverage.  
13 Would you agree with me that these factors have been in  
14 existence for PGW for approximately the past four to five  
15 years?

16 A. Well, as I said, I don't think the reliance on  
17 restricted funds goes back that far, nor was liquidity an  
18 issue. I think the last tranch of the commercial paper  
19 was taken down in 2000. So they would have been looking  
20 at -- they would have been looking at a circumstance  
21 where PGW would have had some flexibility in that period  
22 of time. But, yes, by and large I mean one only has to  
23 look at the financials to see it is on a downward slope  
24 from the '95-'96 period to the present.

25 Q. Would you agree with me that over the past

1 eight years or so PGW's net earnings have not exceeded  
2 \$17 million?

3 A. I will accept that subject to check. That is  
4 certainly correct.

5 Q. Are you aware that their net earnings have been  
6 negative in some years?

7 A. Yes.

8 MS. McCLOSKEY: Your Honor, can I just have a  
9 moment?

10 JUDGE FORDHAM: Sure.

11 (Pause.)

12 BY MS. McCLOSKEY:

13 Q. Mr. Knudsen, if the company is awarded the 44  
14 million of extraordinary rate relief how will the company  
15 utilize those additional revenues?

16 A. Well, they will be applied much in the manner  
17 in which Mr. Bogdonavage reflects them in his schedules.  
18 I mean, we will end the year with a reasonable amount of  
19 cash as opposed to a negative balance. We will have paid  
20 down the short-term debt. And at least according to the  
21 present forecasts paid off some portion -- paid off the  
22 45 million by the end of August, 2002.

23 Q. With that in place what would be the coverage  
24 under the company's bond indenture as a result of a \$44  
25 million increase?

1           A. I don't know. I think that is in  
2 Mr. Bogdonavage's area.

3           MR. CLEARFIELD: It is on his schedule,  
4 Ms. McCloskey.

5           MS. McCLOSKEY: I was going to say, was that  
6 reflected on --

7           MR. CLEARFIELD: Yes. It is on JRB-2.

8           MS. McCLOSKEY: And that would be under the third  
9 column of JRB-2?

10          MR. CLEARFIELD: Well, you are thinking of the  
11 cross-examination exhibit.

12          MS. McCLOSKEY: I'm sorry.

13          MR. CLEARFIELD: Well, you can look at either one.  
14 The 1975 debt service coverage ratio for the test year  
15 budgeted of 44 million would be 3.02, for example. '98  
16 would be a 3.43.

17          MS. McCLOSKEY: Thank you very much, Mr. Knudsen.  
18 I have nothing further, Your Honor.

19          JUDGE FORDHAM: Thank you.

20          Mr. Gray.

21          MR. GRAY: Thank you, Your Honor.

22                                   CROSS-EXAMINATION

23          BY MR. GRAY:

24          Q. Good afternoon, Mr. Knudsen.

25          A. Good afternoon, Mr. Gray.

1 Q. Page one, lines four and five. I am interim  
2 president and chief executive officer of Philadelphia Gas  
3 Works. Why interim?

4 A. Because I have not been appointed permanently.

5 Q. Are you going to be appointed permanently?

6 A. I am a nominee at the present time, yes.

7 Q. What is the status of that situation?

8 A. The status, I think, my understanding is that  
9 the mayor probably will come to some resolution of this  
10 in the next two week period of time. I think it has been  
11 a very difficult process for the mayor for the reasons  
12 that he has wanted to seek qualified leadership. He has  
13 promised to do a nationwide search. I think the  
14 candidates who have come and been interviewed are  
15 confronted with the problems here as well as the  
16 potential for a sale. This is a highly fluid situation  
17 and I know that he has interviewed or that the panel has  
18 interviewed maybe 15 people so far. So I am given to  
19 understand by Ms. Wilkerson, the chief of staff, that  
20 this problem will get resolved shortly.

21 Q. Very good. You used a phrase a few minutes ago  
22 answering one of Mr. Simms' questions, something I think  
23 I have heard before. The phrase is citizen owners of the  
24 utility.

25 A. Yes.

1 Q. The first question. Who owns the equity in  
2 PGW?

3 A. The City of Philadelphia holds ownership to an  
4 agglomeration of assets. Technically and I think legally  
5 the entity of the City of Philadelphia owns PGW.

6 Q. In what sense if any are ratepayers  
7 shareholders of the utility?

8 A. Well, I don't think they are technically  
9 shareholders. I do refer to them as citizen owners  
10 because they are the taxpayers and the supporters of this  
11 asset as well the city activity. So it is in that spirit  
12 and in that sense that the term was used.

13 Q. Let me turn you to page four, lines five  
14 through seven. Your sentence reads, in short, having  
15 waited 19 months for the financial fundamentals of the  
16 company to improve, S&P will not wait any longer.

17 A. Yes.

18 Q. Will you tell us what the City of Philadelphia  
19 has done over those 19 months to provide any type of  
20 permanent fundamental improvement to PGW's balance sheet?

21 A. Let's be clear. What the City of Philadelphia  
22 has done is stood behind the utility to the tune of \$45  
23 million of a loan and in both of the end of fiscal year  
24 periods represented by that 19 months the city has  
25 essentially said that they would backstop any shortfall

1 in earnings that would preclude our meeting our bond  
2 coverages. So that is what the city has done.

3 I think on the other side during the same period of  
4 time the company has been in pretty much constant filings  
5 before the PUC in anticipation of getting various amounts  
6 of rate relief that would rationalize our financial  
7 situation. So I think the city has done its part,  
8 management has done its part and the Commission has seen  
9 to do what it can do. We are back here because we need  
10 additional help.

11 Q. So there is no sense on your part that S&P,  
12 having waited these 19 months they have not lost patience  
13 in the City of Philadelphia itself?

14 A. I don't think so. It is very clear S&P looks  
15 -- one has to only look at BCB-3 to understand that S&P  
16 looks at the process, looks at the requirements, looks at  
17 the ordinances and says this is a business that must be  
18 conducted in a specific way in accordance with law. And  
19 they would be derelict if they didn't view us that way.  
20 So when they start their evaluation it is very clear that  
21 everything in their computation is a matter of ordinance,  
22 is a matter of agreement, is a matter of law, except for  
23 the 20 million that they have shown for 2003 which is  
24 their judgement as to what ought to happen. But  
25 everything else on that piece of paper basically

1 represents a requirement.

2 Q. Page eight, lines one through 12. You mention  
3 in here as shown in Exhibit TEK-1 for the last several  
4 year PGW's construction program is 100 percent externally  
5 financed. Is that 100 percent debt financing?

6 A. Yes.

7 Q. So there has been no equity contribution by the  
8 city?

9 A. Nor is one expected.

10 Q. Because?

11 A. Because the City of Philadelphia is not an  
12 investor of risk capital. The way PGW is structured it  
13 is a form of enterprise. It is anticipated that the  
14 revenues for operation would be sufficient to cover the  
15 cost of operation and to essentially fund over time the  
16 capital needs of the company. That is the way PGW is  
17 designed. It is not designed to assume that we would go  
18 into -- as an IOU you would go into the market and raise  
19 some amount of equity. That is not the way PGW is  
20 structured.

21 The equity that is on the balance sheet, it is  
22 really a fund balance. The municipal account is the sum  
23 of prior past net earnings that are reflected on the  
24 balance sheet. That's it. I don't think --  
25 Mr. Bogdonavage might be able to correct me, but I don't

1 think in its 165 year history there has been any material  
2 contribution directly from the city to fund assets of  
3 PGW.

4 MR. CLEARFIELD: Mr. Bogdonavage has only been  
5 there half the time.

6 (Pause.)

7 MR. GRAY: I am just making sure I'm not  
8 duplicating some of the cross, here, Your Honor. Sorry  
9 for being a little slow.

10 JUDGE FORDHAM: Take your time.

11 BY MR. GRAY:

12 Q. Let's go to page 12, line 14. That continues  
13 to page 13, line two. You say somewhere in the middle of  
14 that range at the very minimum if we have reason to  
15 believe that a party has not paid for gas in the past we  
16 should not be required to reinstate that customer or  
17 someone in that household going forward. And it appears  
18 if I am reading this correctly as part of your overall  
19 plan here there is an interest in taking a more  
20 aggressive stance in collecting unpaid bills and not  
21 reinstating customers along the lines of what you  
22 discussed with Mr. Simms. Is that a correct  
23 characterization?

24 A. Yes.

25 Q. Is it your testimony or are we to take an

1 inference that there is some entity out there that is  
2 inhibiting that activity, that further aggressive stance?

3 A. I think it is a common complaint of most of the  
4 utilities of Pennsylvania that the provisions of Chapter  
5 56 allow the reinstatement of accounts at residences  
6 without the bill being paid as long as there are certain  
7 conditions met. Most directly there is a six month  
8 period between, say, a turnoff or activity being  
9 suspended at a location and potentially having that  
10 location turned back on, presumably when the fall or cold  
11 weather comes. That is a common phenomenon.

12 Q. Well, then, let me refer you to the same  
13 question I asked Ms. Davis. In Mr. Weakley's testimony  
14 he suggests that the City of Philadelphia should permit  
15 frankly a more vigorous collection. Do you agree with  
16 Mr. Weakley's --

17 A. I don't think it is the City of Philadelphia  
18 allowing anything. We are now under the purview of the  
19 Pennsylvania Public Utility Commission. It is a question  
20 of the Commission allowing the more aggressive position.

21 And to the point that I raised back on one of the  
22 data responses where I talk specifically about going to  
23 the Commission and asking BCS for broader latitude in  
24 approaching these issues, there will have to be a change  
25 of some kind for us to not have to adhere to regulations

1 that essentially continue to create problems for the  
2 company.

3           Going to the social compact issue, the company and  
4 the city have an interest in maintaining people in their  
5 homes. So that this has gone on in the past and  
6 presumably would continue to go on in the future. But  
7 under these circumstances, again, this is last, if a  
8 downgrade occurs, we must supply gas to the greatest  
9 number of people as long as we can. That is the position  
10 that management is taking on this issue. So we would  
11 need some accommodation not to turn people on who we know  
12 may not be able to pay ultimately.

13           Q. Just so I'm clear, your testimony is that the  
14 City of Philadelphia itself, that entity, is not  
15 hindering your collection whatsoever?

16           A. Not at this point, no.

17           Q. Not at this point?

18           A. Let me answer that. Were we to go into this  
19 kind of scenario there is no question that there would be  
20 an enormous problem created and that the members of the  
21 City Council as well as the mayor presumably himself  
22 would be confronted with customers saying I must have my  
23 heat, I must have my gas. And yet we can't afford to  
24 provide gas at highly discounted rates or gas at all  
25 because we are not going to get paid for it. And we need

1 the cashflow in order to keep buying gas certainly  
2 through the winter period.

3 This is not a pretty picture. And, again, I come  
4 back to we feel very seriously about the social compact  
5 question. But there are circumstances that I see coming  
6 down the pike if this were to happen that we just could  
7 not continue the way we have.

8 Q. Let me turn to one last subject, the sale of  
9 PGW. How involved are you with any and all issues  
10 involving the sale of PGW to any other party?

11 A. I am not involved at all. The only way that  
12 PGW has been involved is that the evaluators, who are  
13 Lehman Brothers, have asked Mr. Bogdonavage and  
14 Mr. Golden for information and for interpretation of  
15 financial statements and for other explanations of  
16 various sorts. But we are not involved in the process  
17 beyond that kind of vetting of data.

18 Q. So as far as the financial statements go, the  
19 \$210 million in city equity, it would then be at least  
20 from your side of the fence your understanding would be  
21 if five months from now the city sells PGW to an  
22 investor-owned utility the city would be entitled to keep  
23 that \$210 million?

24 A. I have no view on that at all. What will  
25 happen will be there will be a price fixed for PGW.

1 Whether that includes the surplus or doesn't include the  
2 surplus that will be the issue when some buyer steps  
3 forward and says I am willing to put so much money down  
4 for this utility. I have no view as to whether that will  
5 or will not include some or all of the fund balance.

6 MR. GRAY: Thank you, Your Honor.

7 JUDGE FORDHAM: Let's take a ten minute break.

8 (Recess.)

9 JUDGE FORDHAM: We are back on the record.

10 We are continuing with the cross-examination of  
11 Mr. Knudsen.

12 Mr. Bertocci.

13 MR. BERTOCCI: Thank you, Your Honor.

14 CROSS-EXAMINATION

15 BY MR. BERTOCCI:

16 Q. Good afternoon, Mr. Knudsen.

17 A. Good afternoon.

18 Q. You earlier said that, if I understood you  
19 correctly, that PGW was planning to file a petition  
20 before April 11 to waive the labor agreement, is that  
21 right?

22 A. Waive the portions of the labor agreement that  
23 deal with the no layoff clause.

24 Q. That is what I meant, yes.

25 Are you also planning to file a petition for waiver

1 of specified provisions in Chapter 56?

2 A. That is under consideration right now, yes.

3 Q. But no decision has been made?

4 A. Well, we are working on it right now. It is  
5 not as far along as the other.

6 Q. Earlier we had quite a bit of discussion about  
7 the various reductions that you were projecting should  
8 you be downgraded.

9 A. Yes.

10 MR. CLEARFIELD: This is on the rebuttal exhibit?

11 MR. BERTOCCI: Yes. PGW Knudsen Rebuttal Exhibit  
12 No. 1.

13 BY MR. BERTOCCI:

14 Q. Have those reductions been subject to a board  
15 resolution by the PFMC board?

16 A. Which ones?

17 Q. The reductions that you set forth.

18 A. The ones that we would anticipate putting in  
19 place?

20 Q. Yes.

21 A. They have not formally been endorsed by the  
22 PFMC yet. They have been discussed in some detail. We  
23 did not move it to a resolution as such. We have a board  
24 meeting almost right on top of April 11 where we will  
25 deal with all of these issues.

1 JUDGE FORDHAM: Would you state the date again?

2 THE WITNESS: Well, the ruling will be April 11 and  
3 the board meeting is shortly thereafter and we would hope  
4 to get some indication from S&P based on what the PUC  
5 does what S&P will do and then the board -- we will have  
6 a whole program before the board as to how to proceed.

7 JUDGE FORDHAM: Thank you.

8 MR. BERTOCCI: Thank you, Mr. Knudsen.

9 That is all I have.

10 JUDGE FORDHAM: Does anyone else have anything?

11 (No audible response.)

12 JUDGE FORDHAM: I have one more question.

13 On page four of your testimony, lines 17 to 29, you  
14 indicate that you want to assure the Commission and the  
15 parties that management has done everything it could over  
16 the last 19 months to sustain the rating at the current  
17 level. But there are no examples. Can you give me some  
18 examples of what has been done?

19 THE WITNESS: We met with all of the agencies --  
20 well, I came in March of 2000, so this would have been  
21 mid-May of 2000 -- where we laid out a program. I think  
22 we called it the transition to excellence at the time.  
23 But it dealt with the financial restructuring, rebuilding  
24 the computer system, getting customer service revamped  
25 and functioning correctly and there were three or four

1 others. We then reported regularly either directly or  
2 through Ms. Bisgaier to the agencies as to what we were  
3 doing and then after each of the fiscal year ends a more  
4 detailed report was given to them by Mr. Bogdonavage.

5 Just so you are clear, the present rating that we  
6 have, the negative outlook, the credit watch, is only to  
7 be applied per our understanding of S&P's procedures for  
8 a 90 day period. We sustained that for 19 months always  
9 by being in touch, letting them know and then holding out  
10 in front of them the progress that was being made so that  
11 they saw what they called the credit improving in quality  
12 as an organization through this period of time. It was  
13 only after we met with them on, I think, December 20, it  
14 was only after that period of time where they then  
15 started to see that unless there was a full  
16 reconsideration of the 65 million request, of which we  
17 had gotten 36, unless there was a full reconsideration we  
18 didn't have enough cash to operate. And it was in  
19 January that they did whatever they did and came forth on  
20 the 4th of February to essentially say this is where we  
21 are and you need to get more money in the house or you  
22 will be downgraded.

23 It will be 22 months or so between the initial  
24 action on the part of S&P until the time that the  
25 Pennsylvania Public Utility Commission acts that they

1 will have kept us in a classification that was only  
2 intended for 90 days. So we have done everything we can  
3 possibly do to sustain this rating. And in all candor,  
4 Your Honor, when we left S&P on the 20th of December we  
5 fully expected that the story that we had told, that the  
6 answers that we had to the problems that we had, that the  
7 fact we were seeking additional rate relief that would be  
8 issued in November, that that was going to satisfy them.  
9 And it didn't. And justly so. I mean, one only has to  
10 look at the financials and Mr. Bogdonavage's projections  
11 and schedules and say you're right, this is not an  
12 investment grade utility under these assumptions.

13 JUDGE FORDHAM: Thank you.

14 Mr. Clearfield, do you have any questions?

15 MR. CLEARFIELD: Yes, Your Honor. I have a few  
16 questions on redirect.

17 REDIRECT EXAMINATION

18 BY MR. CLEARFIELD:

19 Q. Just a clarification. The savings or the  
20 additional cash that the company is anticipating or  
21 hoping to achieve through its aggressive collections  
22 policy, has that been accounted for in the company's  
23 fully forecasted test year results, if you know?

24 A. Yes. The additional \$20 million that this  
25 program is structured to bring about is included in

1 Mr. Bogdonavage's projections.

2 Q. And you had some discussion about the  
3 projection of savings of \$1 million a month that we  
4 thought we could -- that PGW thought it could achieve to  
5 anticipate the potential of the downgrading. Is that a  
6 sustainable level of savings?

7 A. No. I viewed the problem in two pieces when we  
8 started to approach this thing. What could we do  
9 immediately that didn't compromise the manner in which  
10 the company was moving forward but at the margins we  
11 could slice away costs that we could argue we will come  
12 back to them at some time or so forth. And that was the  
13 million dollars. We were looking at that money in terms  
14 of getting started, getting launched, in anticipation  
15 then that if the downgrading came then that set of  
16 assumptions would slide into the much more draconian  
17 actions that we would be required to take. That million  
18 dollar savings which is underway is not intended to be  
19 some kind of sustained level. It's the example that I  
20 gave Mr. Simms. There is no reason why we should not  
21 spend \$100,000 for an \$1.5 million return. We must spend  
22 that money.

23 Q. So how long could you sustain that without  
24 having service degradations and other cutbacks in service  
25 quality?

1           A. Well, I think it is a matter of a couple, three  
2 or four months max, in the sense that if we don't do this  
3 consulting piece we will not be providing the level of  
4 service we could be providing through our field forces  
5 because that is what this is intended to do. It is  
6 intended to get people out in the field, do more work and  
7 do it more effectively and more satisfactorily to the  
8 customer. So in that regard customer satisfaction,  
9 customer service is already degraded. But more to the  
10 point, when would we have to start pulling people out,  
11 phones and so forth? That is just a matter of time.

12           Q. In answer, I think, to Mr. Gray you indicated  
13 that from your standpoint the process under which the  
14 company has operated heretofore is that revenues would  
15 come from ratepayers to provide over time for the capital  
16 needs of the company.

17           A. Right.

18           Q. Does that have a name, that process?

19           A. Yes. It is called the cashflow method of  
20 ratemaking. I mean, that is the conventional way that  
21 this company has been dealt with historically and I don't  
22 see any reason for us to depart from that going forward.

23           Q. Is it an unusual way of raising --

24           A. No.

25           Q. Well, let me finish.

1 -- for setting rates for a municipal utility?

2 A. No, it's not an unusual way for setting rates.  
3 It's a relatively standard way for municipal utilities to  
4 be regulated.

5 MR. CLEARFIELD: Thank you. That is all I have.

6 JUDGE FORDHAM: Does anyone else have anything for  
7 this witness?

8 (No audible response.)

9 JUDGE FORDHAM: Thank you very much.

10 THE WITNESS: Thank you, Your Honor, very much.

11 (Witness excused.)

12 MR. SIMMS: Your Honor, I would like to move for  
13 the admission of OTS Cross-Examination Exhibit No. 1 into  
14 the record.

15 JUDGE FORDHAM: Is there any objection?

16 MR. CLEARFIELD: No.

17 JUDGE FORDHAM: It is admitted into the record.

18 (Whereupon, the document marked as OTS  
19 Cross-Exam. Exhibit No. 1 was received in  
20 evidence.)

21 MR. CLEARFIELD: And I would correspondingly move  
22 for the admission of PGW Statement ERP-1 and the  
23 accompanying exhibit as well as Knudsen Rebuttal Exhibit  
24 No. 1.

25 JUDGE FORDHAM: Any objection?

1 (No audible response.)

2 JUDGE FORDHAM: Hearing none, they are admitted.

3 (Whereupon, the documents were marked as PGW

4 ERP Statement No. 1 and Exhibit TEK-1 for

5 identification, and were received in evidence

6 along with previously marked Knudsen Rebuttal

7 Exhibit No. 1.)

8 JUDGE FORDHAM: That concludes your case,

9 Mr. Clearfield?

10 MR. CLEARFIELD: Yes, Your Honor.

11 JUDGE FORDHAM: Mr. Simms.

12 MR. SIMMS: Thank you, Your Honor. I call

13 Mr. Weakley to the stand.

14 Whereupon,

15 CHARLES T. WEAKLEY, III

16 having been duly sworn, testified as follows:

17 JUDGE FORDHAM: Would you state your name and  
18 business address for the record and please spell your  
19 last name?

20 THE WITNESS: My name is Charles T. Weakley,  
21 W-E-A-K-L-E-Y. My address is P. O. Box 3265, Harrisburg,  
22 Pennsylvania 17105.

23 JUDGE FORDHAM: Thank you.

24 You may proceed, Mr. Simms.

25 MR. SIMMS: Thank you, Your Honor.

1 Under the stipulation, Your Honor, the testimony  
2 and exhibits of Mr. Weakley have been authenticated.  
3 Mr. Weakley's testimony is identified as OTS Statement  
4 No. 1. His exhibits are identified as OTS Exhibit No 1.  
5 I have provided under separate cover to Your Honor and to  
6 the parties and provided copies to the court reporter  
7 errata sheets for pages six, seven and eight to  
8 Mr. Weakley's direct testimony.

9 JUDGE FORDHAM: Thank you.

10 DIRECT EXAMINATION

11 BY MR. SIMMS:

12 Q. Mr. Weakley, do you have any other corrections  
13 or modification to your direct testimony or to your  
14 exhibits?

15 A. Well, I have one correction in my direct  
16 testimony on page three, line 16. The cite there should  
17 be Exhibit No. 2, Schedule 2.

18 MR. SIMMS: Mr. Weakley is available for  
19 cross-examination, Your Honor.

20 JUDGE FORDHAM: Thank you.

21 JUDGE FORDHAM: Mr. Clearfield.

22 MR. CLEARFIELD: Thank you, Your Honor. Just a few  
23 questions.

24 CROSS-EXAMINATION

25 BY MR. CLEARFIELD:

1 Q. Good afternoon, Mr. Weakley.

2 A. Good afternoon.

3 Q. Mr. Weakley, your testimony essentially  
4 calculates or estimates the cash year at year end for PGW  
5 if it were granted \$25 million in extraordinary rate  
6 relief, is that correct?

7 A. That's correct.

8 Q. If the Commission were to modify that upward --  
9 we will just talk about upward for the moment -- is there  
10 a rule of thumb or a shorthand way that we could adjust  
11 your cashflow analysis so that we could determine how  
12 much cash the company would have on hand at the even of  
13 the year based on your calculations?

14 A. Yes. You could do it on an annual basis or a  
15 year end basis.

16 Q. So would it be a dollar for dollar?

17 A. Not exactly. It depends on what kind of  
18 revenues you are talking about.

19 Q. Is there any way we can estimate it or is that  
20 something you would pretty much have to recalculate?

21 A. Well, Mr. Bogdonavage used a collection  
22 percentage of 94 percent. So if it is what I would term  
23 new revenues the company would receive approximately 94  
24 percent.

25 MR. CLEARFIELD: Thank you very much.

1 That's all the questions I have.

2 JUDGE FORDHAM: Mr. Gray.

3 MR. GRAY: Thank you, Your Honor.

4 CROSS-EXAMINATION

5 BY MR. GRAY:

6 Q. Good afternoon, Mr. Weakley.

7 A. Good afternoon.

8 Q. On page three, lines three through seven, you  
9 state that PGW has demonstrated an immediate need for  
10 extraordinary rate relief in order to maintain financial  
11 stability. Is it your expert opinion that PGW has no  
12 other options for avoiding this need for extraordinary  
13 rate relief? In other words, this is it? They need rate  
14 relief and that is the only option available to them?

15 A. As far as I know at this time, yes.

16 Q. Did you consider any other options that PGW  
17 might be able to engage in to get them out of the  
18 situation other than the rate relief?

19 A. No.

20 Q. Let me turn you to page -- I believe it is page .  
21 eight. It is the question I referred to and asked  
22 Ms. Davis and Mr. Knudsen. It is lines seven and eight,  
23 where you state earlier in my opinion the city can do the  
24 following, permit PGW to pursue collection of its  
25 accounts receivable with the same vigor as other

1 utilities. Can you explain to me what you mean by the  
2 same vigor?

3 A. Well, just to follow the guidelines in Chapter  
4 56.

5 Q. So if I am reading this correctly you are  
6 suggesting that somehow the City of Philadelphia has  
7 inhibited PGW from pursuing that with the same vigor?

8 A. As Mr. Knudsen stated, last year City Council,  
9 the Gas Commission and BCS all combined to stop their  
10 collection efforts. And what I am saying is that the  
11 company should be allowed to proceed to collect their  
12 receivables under the Chapter 56 guidelines.

13 MR. GRAY: Thank you, Mr. Weakley.

14 Thank you, Your Honor. That is all I have.

15 JUDGE FORDHAM: Does anyone else have anything for  
16 Mr. Weakley?

17 MR. CLEARFIELD: Your Honor, can I do a follow-up?

18 JUDGE FORDHAM: Yes.

19 FURTHER CROSS-EXAMINATION

20 BY MR. CLEARFIELD:

21 Q. Mr. Weakley, do you have any evidence that PGW  
22 is not following the Chapter 56 procedures as they are  
23 set out and as BCS instructs that they be followed?

24 A. No.

25 Q. And with respect to your statement that we have

1 justified extraordinary rate relief, is it your view or  
2 your understanding that there is an element whereby the  
3 company is required to find or demonstrate there is no  
4 other way to avoid the consequences that are set forth in  
5 section 1308(e)?

6 A. No.

7 MR. CLEARFIELD: That is all I have.

8 JUDGE FORDHAM: Anything, Mr. Simms?

9 MR. SIMMS: No, Your Honor. I have no redirect,  
10 Your Honor.

11 I would just ask for the admission of OTS Statement  
12 No. 1 and OTS Exhibit No. 1 and the errata sheets, pages  
13 six, seven and eight, into the record.

14 JUDGE FORDHAM: Any objection?

15 (No audible response.)

16 JUDGE FORDHAM: Hearing none, they shall be  
17 admitted.

18 (Whereupon, the documents were marked as OTS  
19 Statement No. 1 and Exhibit No. 1 for  
20 identification, and were received in evidence.)

21 JUDGE FORDHAM: Thank you. You may be excused from  
22 the stand.

23 (Witness excused.)

24 MR. SIMMS: Your Honor, at this time I call to the  
25 witness stand Kevan Deardorff.

1 Whereupon,

2 KEVAN DEARDORFF

3 having been duly sworn, testified as follows:

4 JUDGE FORDHAM: Would you state your name and  
5 address for the record, and please spell your name?

6 THE WITNESS: My name is Kevan Deardorff,  
7 D-E-A-R-D-O-R-F-F. My business address is P.O. Box 3265,  
8 Harrisburg, Pennsylvania. The zip code is 17105.

9 JUDGE FORDHAM: Thank you.

10 MR. SIMMS: Your Honor, Mr. Deardorff's Statement  
11 No. 2 and Exhibit No. 2 has been authenticated through  
12 the stipulation. Additionally, Your Honor, I provided to  
13 the parties and Your Honor and have provided copies to  
14 the court reporter of OTS Exhibit No. 2, Schedule 3.

15 DIRECT EXAMINATION

16 BY MR. SIMMS:

17 Q. Mr. Deardorff, do you have any corrections or  
18 additions to your Statement No. 2 or to your exhibits?

19 A. No.

20 Q. Mr. Deardorff, did you have the opportunity to  
21 hear the rebuttal testimony of Mr. Bogdonavage?

22 A. Yes.

23 Q. Based upon Mr. Bogdonavage's rebuttal testimony  
24 it appears that the company acknowledges that a 5.9  
25 million capital lease was not mathematically added back.

1 Do you recall that testimony?

2 A. Yes, I recall that.

3 Q. Do you recall the testimony that the company  
4 added back the 5.9 million but the company also changed  
5 its methodology from the original filing to conform with  
6 Standard & Poors' methodology?

7 A. Yes. They acknowledged that to adhere to the  
8 Standard & Poors fixed charge coverage ratio calculation  
9 that they had to add that back in. But they also changed  
10 their methodology to conform to their's also. So that  
11 the net impact was a difference of 1.47 million.

12 Q. Are you prepared to change your schedule to  
13 reflect the change in methodology that has been utilized  
14 by Standard & Poors?

15 A. No. I am not going to change my schedule.  
16 However, I did do the calculations just as a what if and  
17 if I did use their methodology it would only change the  
18 coverage ratio by .03, which would still leave the  
19 coverage ratio still in the range of 1.2, 1.3.

20 Q. That change of .03, for the record, that change  
21 is between using your numbers and company's S&P  
22 methodology, is that correct?

23 A. That's correct. The bottom line on my schedule  
24 number two would change from -- it would be a little bit  
25 lower, from 1.25 down to 1.22.

1 Q. Now, Mr. Deardorff, did you have the  
2 opportunity to hear the rebuttal testimony of  
3 Mr. Bogdonavage regarding the payment towards PGW's  
4 commercial paper?

5 A. Yes, I did.

6 Q. Has the rebuttal of Mr. Bogdonavage changed  
7 your position on the payment of the commercial paper for  
8 the future test year?

9 A. No, it has not. I chose to use the \$11 million  
10 because it conforms to what appears on schedule A-2 of  
11 the company's base rate filing. That \$11 million is the  
12 paydown which my understanding is a going forward -- on a  
13 going forward basis. It is my understanding that this  
14 extraordinary rate relief proceeding is that we are  
15 trying to determine the minimum amount necessary to  
16 maintain the financial stability of this company so that  
17 Standard & Poors does not downgrade them. By putting  
18 some number other than \$11 million in there I think is  
19 overinflating that number and is not a minimum number.  
20 While we would like to have the company pay it down by  
21 \$30 million I do not believe that that is a minimum  
22 number at this point in time. As a matter of fact, on a  
23 going forward basis there is no -- at this point in time  
24 there is no contractual agreement between PGW and the  
25 banks that have loaned them the commercial paper.

1 MR. SIMMS: Your Honor, Mr. Deardorff is available  
2 for cross-examination.

3 JUDGE FORDHAM: Mr. Clearfield.

4 CROSS-EXAMINATION

5 BY MR. CLEARFIELD:

6 Q. Mr. Deardorff, let me ask you some questions  
7 about your last surrebuttal. You are saying that you  
8 think that using a \$30 million paydown would be  
9 overstated. Do I understand your testimony?

10 A. It would overstate the necessary number to be  
11 placed in the formula. The formula is designed to only  
12 show debt or default risk. And default risk by the  
13 nature of it only considers contractual agreements. That  
14 is why the \$18 million dividend is included. It's only  
15 included because it is defined by law.

16 Q. Do you have JRB-2 corrected before you?

17 A. Yes.

18 Q. Do you see at the bottom there it says revised  
19 Standard & Poors fixed charge coverage ratio?

20 A. Yes.

21 Q. The very last item.

22 A. Yes.

23 Q. That says fixed rate coverage ratio including  
24 \$18 million city fee and \$20 million tax exempt paper.

25 A. Yes.

1 Q. And you said that it would be overstated if we  
2 used the \$30 million tax exempt paper, didn't you?

3 A. Yes.

4 Q. In fact Mr. Bogdonavage didn't use 30 million.  
5 He used \$20 million, didn't he?

6 A. He testified to 30 million on  
7 cross-examination. However, he shows 20 million there.  
8 He shows 30 million in the base rate case. All of which  
9 are non-contractual.

10 Q. Well, do you understand that the 20 million  
11 that he has listed here is actually a requirement of the  
12 credit agreement as it stands now to reduce it from --  
13 let me finish the question because the record will get  
14 very messy I don't -- reduce it from \$100 million to \$80  
15 million? Do you recall that testimony?

16 A. Are you done?

17 Q. Yes. I didn't mean to be rude.

18 A. That contractual agreement is only until August  
19 of 2002. The \$11 million is on an ongoing basis, forward  
20 looking.

21 Q. Okay. So we have \$20 million we have to do by  
22 the end of August, 2002?

23 A. That was already reflected in the cashflow.  
24 Based upon that cashflow statement it will be paid up to  
25 August 31 of 2002. And the \$11 million is going forward,

1 on a forward looking basis.

2 Q. Where is the paydown of the \$20 million  
3 mandatory amount reflected on JRB-2? Can you just list  
4 the title or the line? As you understand it. This is  
5 the mandatory payment.

6 A. That schedule is not a forward looking -- he is  
7 not looking at it on a forward looking basis. That is  
8 looking backwards, the \$20 million that was going to be  
9 paid.

10 Q. But we have to include that, don't we?

11 A. No.

12 Q. We don't include the \$20 million paydown at the  
13 end of 2002 to figure out what our coverages are?

14 A. Standard & Poors is not looking at what is  
15 going to be happening in the historical period. They are  
16 looking at a going forward basis.

17 Q. But if you have a line of credit that is at  
18 \$100 million and you have to get it down to \$60 million  
19 you have to go from 100 to 80 first and then the  
20 discretionary paydown 80 to 69, wouldn't you?

21 A. Correct. But that is not contractual yet.

22 Q. The first \$20 million is contractual.

23 A. That is contractual.

24 Q. And that is reflected on the bottom here under  
25 fixed charge coverage for \$20 million, isn't it?

1           A. But it is supposed to be what is going forward  
2 from the 80 to the 60 or whatever will be contractual.

3           Q. Okay. That would be the total \$31 million,  
4 wouldn't it?

5           A. No.

6           Q. The total, now. We have the contractual and  
7 the discretionary.

8           A. That is not going forward. You are adding  
9 historical figures to going forward figures and therefore  
10 it's not going forward anymore.

11          Q. Mr. Deardorff, don't you have to get past the  
12 mandatory \$20 million paydown first so that you can then  
13 do the next traunch, the next paydown, that is  
14 discretionary? We agree that it is not absolutely  
15 mandated. But you have to pay it down from 100 to 80  
16 before you can pay it down from 80 to 69, don't you?

17          A. Correct.

18          Q. Okay. So that in total, if you are going to  
19 show that total thing, if Mr. Bogdonavage was going to  
20 show on JRB-2 that total paydown he would be showing \$31  
21 million of a paydown, wouldn't he?

22          A. No. Much the same way that Standard & Poors  
23 looks at -- what Ms. Bisgaier put into her schedule, they  
24 break it down, they put the \$20 million in the historical  
25 test year and then they go forward and have another \$20

1 million. They bifurcate it. Mr. Bogdonavage wants to  
2 add it all together and just put it all in one year.

3 Q. That is not what Mr. Bogdonavage is doing.

4 A. Well, that is what it appears to me he is  
5 doing. It is overly aggressive and it's not required.  
6 It's not a minimum necessary in this case.

7 Q. If you just reduce it by \$11 million how much  
8 commercial paper --

9 A. I am reducing it by 9 million to 11 million.

10 Q. I'm sorry. But you are saying we should use a  
11 \$11 million --

12 A. That is what the company budgeted for in their  
13 base rate case.

14 Q. So at the end of that period how much of the  
15 line of credit will be outstanding if you use your  
16 methodology?

17 A. Well, based upon the cashflow schedule in  
18 Mr. Bogdonavage's testimony, the ending balance for this  
19 year will be 77 million. A paydown of 11 more million  
20 would put it at 66 million by the end of August of 2002.

21 Q. So how much is that in total from 100 to 66?

22 A. Thirty-one million for a two year period.

23 Q. Right. So wouldn't you have to show \$31  
24 million on this schedule if Mr. Bogdonavage was trying to  
25 show both the mandatory and the discretionary paydown?

1           A. No. That is not correct. You are putting two  
2 year payments in an one year future test year and that is  
3 not correct ratemaking.

4           Q. Do you understand the concept of pro forma  
5 adjustments, Mr. Deardorff?

6           A. I understand a forward looking basis. What is  
7 known and measurable.

8           Q. Right. So if the company is projecting and it  
9 believes it is going to have to make a known and  
10 measurable change that goes to the end of the future test  
11 year, for example, it is common that you would then  
12 include that adjustment in your future test year  
13 calculations?

14           A. They will not be making a \$31 million payment  
15 for the future test year that rates will be in effect.  
16 As of this point in time there is no contractual  
17 agreement to pay anything on that.

18           Q. \$31 million?

19           A. There is only a contractual agreement to pay it  
20 down 20 million from 100 to 80. And that is for the  
21 historical test year 2001 to 2002.

22           Q. Doesn't he need to show that on his schedule,  
23 on the test year budget 2001-2002, to reflect what the  
24 cashflow effects of paying that down from 100 to 80 will  
25 be?

1           A. To look at it on a historical basis, that is  
2 correct. But that is not looking at it on a forward  
3 going basis.

4           Q. But he's got that on the schedule for test year  
5 budget 2001-2002, doesn't he? He has it paid down from  
6 100 to 80 million, doesn't he?

7           A. Yes. That is a historical basis.

8           Q. And out of \$44 million that produces 1.28 times  
9 coverage, right? I mean, that is what the schedule says.

10          A. That is what the schedule says.

11          Q. Maybe this is the best way to do it. Instead  
12 of assuming that we are going to pay down 20 million at  
13 that point we only pay 11 million you would adjust that  
14 by -- you would add \$9 million of available funds so that  
15 this coverage would go up and you would not need to  
16 increase PGW's rates by the \$44 million. Is that --

17          A. That is not what I am testifying to. I am  
18 testifying to a future test year that includes only \$11  
19 million of paydown of the debt from 77 million down to 66  
20 million.

21          Q. I am just going to ask you one more time. On  
22 your schedule where does it show the first paydown from  
23 100 million to 80 million?

24          A. That is not included in the future test year.

25          Q. Is it included in your schedule?

1 A. No. It's not included in the future test year.

2 MR. CLEARFIELD: May I have just a moment, Your  
3 Honor?

4 JUDGE FORDHAM: Sure.

5 (Pause.)

6 BY MR. CLEARFIELD:

7 Q. I just want to ask you a couple of questions  
8 about the other adjustment. I just want to make sure I  
9 understand your testimony.

10 Do you recall Mr. Bogdonavage testifying that in  
11 his corrected JRB-2 he did in fact add back the capital  
12 leases that he had originally inadvertantly left out of  
13 his original schedule?

14 A. That's correct. He did two things. He added  
15 back \$5.9 million and then he deducted certain cashflow  
16 items that he apparently says that S&P does not recognize  
17 as part of their formula.

18 Q. Are you talking about on his revised schedule?

19 A. Yes.

20 Q. So you agree that the error that you pointed  
21 out in your testimony has been corrected in  
22 Mr. Bogdonavage's corrected statement?

23 A. That's correct.

24 Q. Wouldn't that in fact require you then to  
25 increase the rate increase that you have been

1 recommending in order to hit the same coverage levels  
2 that you testified would be appropriate -- and we  
3 appreciate that testimony, by the way -- that you  
4 testified would be appropriate in your direct testimony?

5 (Pause.)

6 Q. Wouldn't you have to increase the revenue  
7 requirement to hit the same levels?

8 A. No. The effect it has on my calculation is to  
9 lower -- I am keeping my recommended rate increase at 25  
10 million but with a change in the methodology it would  
11 lower the funds available by 4.4 million and has the  
12 effect of just lowering the coverage ratio slightly down  
13 to 1.22.

14 Q. If the funds available are lowered by 4.1  
15 million --

16 A. 4.5 million.

17 Q. I'm sorry. 4.5 million. And you are still  
18 trying to hit the same coverage level wouldn't he have to  
19 get 4.5 million of additional revenue to hit that same  
20 coverage level?

21 A. That is the nice thing about Standard & Poors.  
22 They are very wishy-washy about what you are trying to  
23 hit. They said 1.2 to 1.3. The recommendation  
24 regardless of which type of methodology I used, it is  
25 still within the range.

1 Q. I hear you. But just hypothetically if we were  
2 going to stick to your original testimony that we should  
3 go for 1.25 we would have to increase the rate increase  
4 that you are recommending by that \$4.5 million?

5 A. If you want to split hairs about it, that is  
6 correct.

7 Q. Well, however we characterize it, that is what  
8 we have to do.

9 MR. CLEARFIELD: That's all the questions I have.  
10 Thank you.

11 JUDGE FORDHAM: Does anyone else have any questions  
12 for this witness.

13 (No audible response.)

14 JUDGE FORDHAM: Mr. Simms.

15 MR. SIMMS: May I have a brief moment, Your Honor?

16 JUDGE FORDHAM: Sure.

17 (Pause.)

18 MR. SIMMS: Your Honor, I have no redirect.

19 I would at this time ask for the admission of OTS  
20 Statement No. 2 and OTS Exhibit No. 2 with schedules one,  
21 two and three be admitted into the record.

22 JUDGE FORDHAM: Any objection?

23 (No audible response.)

24 JUDGE FORDHAM: Hearing none, they are admitted.  
25

1 (Whereupon, the document were marked as OTS  
2 Statement No. 2 and Exhibit No. 2 for  
3 identification, and were received in evidence.)

4 JUDGE FORDHAM: Thank you.

5 (Witness excused.)

6 JUDGE FORDHAM: Ms. McCloskey.

7 MS. McCLOSKEY: Thank you, Your Honor.

8 The Office of Consumer Advocate would call  
9 Richard W. Lelash to the stand.

10 Whereupon,

11 RICHARD W. LELASH

12 having been duly sworn, testified as follows:

13 MS. McCLOSKEY: Your Honor, I would like to have  
14 marked for identification OCA Statement No. 1-ERP which  
15 is the direct testimony of Richard W. Lelash.

16 JUDGE FORDHAM: It shall be so marked.

17 (Whereupon, the document was marked as OCA  
18 Statement No. 1-ERP for identification.)

19 MS. McCLOSKEY: I believe we have stipulated to the  
20 authenticity of the testimony.

21 JUDGE FORDHAM: Let me ask him to state his name  
22 for the record.

23 Would you state your name and your business address  
24 for the record, please?

25 THE WITNESS: Yes. My name is Richard W. Lelash,

1 L-E-L-A-S-H. My business address is 18 Seventy Acre  
2 Road, Redding, Connecticut.

3 JUDGE FORDHAM: You may proceed.

4 MS. McCLOSKEY: Thank you, Your Honor.

5 DIRECT EXAMINATION

6 BY MS. McCLOSKEY:

7 Q. Mr. Lelash, do you have any corrections to your  
8 prefiled testimony?

9 A. Not at this time.

10 MS. McCLOSKEY: With that, Your Honor, Mr. Lelash  
11 is available for cross-examination.

12 JUDGE FORDHAM: Thank you.

13 Mr. Clearfield.

14 MR. CLEARFIELD: Thank you, Your Honor.

15 CROSS-EXAMINATION

16 BY MR. CLEARFIELD:

17 Q. Good afternoon, Mr. Lelash.

18 A. Good afternoon.

19 Q. On page 25 of your direct testimony you  
20 indicate that to achieve an 1.2 times coverage level  
21 using the S&P calculation the company requires an  
22 additional \$35.4 million of project revenue as you  
23 calculate it, is that correct?

24 A. Yes.

25 Q. Now, would you agree, Mr. Lelash, that

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1 presently to maintain PGW's financial health it in fact  
2 needs that \$35 million?

3 A. It needs approximately \$35 million on a going  
4 forward basis.

5 Q. And our dispute, if there is a dispute, is  
6 where that \$35 million comes from, whether it comes  
7 entirely from an increase in rates or whether it comes  
8 partially from an increase in rates and a grantback of  
9 the city fee, isn't that correct?

10 A. Yes, that's correct.

11 Q. Let me ask you a second question. As I read  
12 your testimony, you don't dispute that if PGW is in fact  
13 downgraded to junk status that will result in the company  
14 experiencing the customer service degradation, the  
15 maintenance cutbacks and the layoffs that section 1308(e)  
16 requires in order to justify extraordinary rate relief?  
17 Requires be shown.

18 A. You are premising it on several things and let  
19 me just address them. If the company were to be  
20 downgraded and if the actions that Mr. Knudsen talked  
21 about today were taken there would be then at that point  
22 in time the potential for customer service to decline and  
23 for other actions to be taken.

24 Q. You don't have any reason to dispute that PGW  
25 would be forced to take those types of actions that he

1 has articulated or set forth in his Rebuttal Exhibit 1,  
2 do you?

3 A. Under the premises that he makes, that with the  
4 downgrade you would not be able to negotiate the forward  
5 agreement, that you would not be able to renew the  
6 commercial paper line or go out on a long-term basis,  
7 actions such as that would be required.

8 Q. And you have not challenged those assumptions  
9 in your direct testimony?

10 A. No, I have not.

11 Q. Now, again, the project revenues that you have  
12 recommended, \$35.4 million, you suggest be derived both  
13 from a rate increase -- you call it a capital surcharge,  
14 is that correct?

15 A. That's correct.

16 Q. And a grantback of the city fee for three  
17 years.

18 You were here this morning when Mr. Bogdonavage  
19 testified on rebuttal, weren't you?

20 A. Yes.

21 Q. You heard his testimony that the company is now  
22 projecting it's going to lose some \$32 million in margin  
23 as a result of the unusually warm weather?

24 A. Yes.

25 Q. And you also heard the testimony that this

1 fiscal year the company is going to be forced to utilize  
2 the city's offer of a partial grantback of the city fee  
3 so that it would be able to make its debt service  
4 coverage requirements and its bond covenants?

5 A. Yes. I mean, I listened to what he said, yes.

6 Q. Now, your recommendation does not provide any  
7 protection to the company if it were to experience  
8 another winter like the one we are just finishing, does  
9 it?

10 A. My recommendation really is based on capital  
11 sufficiency. It really does not go to addressing the  
12 coverage of operating expenses for the company, which I  
13 presume will be adequately addressed in the base rate  
14 case itself.

15 Q. But one way that a gas utility like PGW could  
16 receive some protection from the vagaries of weather and  
17 correspondingly that the customers would receive some  
18 protection from the harm to the company financially when  
19 that occurs is through the establishment of some kind of  
20 weather normalization clause, isn't that right?

21 MS. McCLOSKEY: Your Honor, I object. The company  
22 did not present a weather normalization clause as part of  
23 its request for extraordinary rate relief. They have  
24 done so in the context of the base rate case and that is  
25 where that matter will be considered. It's not contained

1 in the testimony of Mr. Lelash nor related to the  
2 testimony of Mr. Lelash's capital surcharge.

3 JUDGE FORDHAM: Mr. Clearfield.

4 MR. CLEARFIELD: Your Honor, Mr. Lelash is  
5 proposing that we use our only backstop to meet the  
6 coverage requirements that S&P requires. What I am  
7 exploring is what happens when that backstop, if in  
8 future years that backstop is needed just to meet the  
9 kind of losses we have experienced this year from weather  
10 and whether there is any protection in his recommendation  
11 as a result of that.

12 JUDGE FORDHAM: But doesn't that go to the base  
13 rate case as opposed to the emergency case?

14 MR. CLEARFIELD: No, Your Honor, I don't think so.  
15 Because he is recommending a \$18 million increase and  
16 that we would have to entirely use the city payment, the  
17 grantback, just to make the coverages that S&P is  
18 requiring. So I am exploring what happens, if the  
19 Commission were to do that what would happen to the  
20 company in the next year. I mean, my questions, I only  
21 have a few in this regard but I am trying to explore how  
22 the company would deal with that issue once the safety  
23 net was utilized so to speak.

24 JUDGE FORDHAM: Ms. McCloskey.

25 MS. McCLOSKEY: Your Honor, I would also say that

1 that was asked and answered. He specifically asked him  
2 if the company would have any protection and Mr. Lelash  
3 responded that there is a pending base rate case and that  
4 is where those issues will be addressed.

5 MR. CLEARFIELD: This is cross-examination, Your  
6 Honor.

7 Secondly, saying that something is going to be  
8 addressed in the pending rate case does not answer  
9 whether the company will have protection.

10 JUDGE FORDHAM: I will allow a little latitude.

11 MR. CLEARFIELD: Thank you.

12 BY MR. CLEARFIELD:

13 Q. You have testified in the past in favor of  
14 weather adjustment clauses, haven't you?

15 A. Yes.

16 Q. And a weather adjustment clause simply would  
17 adjust the company's margin recovery up or down depending  
18 on whether the company experiences warmer or colder  
19 weather than normal?

20 A. There are a variety of weather clauses. Some  
21 of them do adjust margins. Some adjust the fixed  
22 component of the gas costs. There are a variety of  
23 different mechanisms.

24 Q. And you are aware that the company has in fact  
25 proposed such a clause in the base rate case at least?

1 A. Yes.

2 Q. But you have not proposed that here along with  
3 your extraordinary rate relief recommendation, have you?

4 A. I have not.

5 Q. Now, without such a clause and if PGW were  
6 forced to use its only backstop, that is, the city  
7 payment, just to meet the coverage levels that S&P is  
8 requiring how would it maintain its bond coverages if in  
9 the future it suffered a winter like we have just  
10 experienced, that is, \$32 million in lost margin?

11 A. Well, your question is predicated on the  
12 statement that the company by using the 18, or receiving  
13 the 18 and using it for coverage, will have exhausted all  
14 of its backstops. I think there was adequate testimony  
15 today that there are other things that can supply  
16 additional capital to the company. You are taking a  
17 situation where in the future there would be again a mild  
18 winter, again the company would have a margin shortfall  
19 and there would be no other actions that the company  
20 could take to meet those shortfalls. Well, it is equally  
21 plausible that the weather may be colder than normal and  
22 the company will have excess revenues under that. Which  
23 is the reason why it is appropriate to evaluate that in  
24 the context of a base rate case.

25 Q. But just so the record is clear, if in fact we

1 have weather the same or, you know, similar and we have  
2 already used the \$18 million just to meet the ongoing  
3 coverage requirements of S&P we would have to look  
4 somewhere else for support for our bond coverages. We  
5 couldn't look to the \$18 million city fee as a grantback  
6 in that context, could we?

7 A. If the money has been used for something else  
8 you would not have it available to do that.

9 Q. And when you said there were other things  
10 mentioned that could be used were you thinking of the  
11 forward purchase as one of them?

12 A. Well, I mean, we have discussed asset  
13 management, the potential of asset management. The  
14 company, I know, is looking at, which would be a summer  
15 type of benefit of asset management contracts for  
16 storage. But I am thinking more on programs to get  
17 better collection of accounts receivable. Mr. Knudsen  
18 mentioned a number of things that I think some of them  
19 hopefully would not be necessary. But in the first year  
20 of my proposed program, yes, I mean, we have designed it  
21 to fulfill what we believe is necessary to bring the  
22 company back to financial health and it really gets  
23 progressively better year by year.

24 Q. But in those first years it is going to be very  
25 short of any kind of backstop that they could readily

1 call on, wouldn't it?

2 A. I would not agree. Because I think there are  
3 actions that can be taken. I mean, Mr. Knudsen suggests  
4 that he can make the company survive without anything,  
5 with the downgrade and without the forward purchase  
6 agreement, without the credit line. I believe that my  
7 recommendation is sufficient to maintain the bond ratings  
8 and under that circumstance the company will have the  
9 ability hopefully to make the forward purchase agreement,  
10 to keep the tax exempt commercial paper line at perhaps  
11 80 or at least at 60. I think there are things that the  
12 company can do to manage in a circumstance that you are  
13 suggesting. But we don't set rates that way. And we are  
14 not even setting rates in this proceeding. What we were  
15 looking for is a solution to a liquidity problem.

16 Q. You heard Mr. Knudsen's rebuttal where he  
17 indicated that the responses to the downgrade would in  
18 fact bring on the actions, the reductions in maintenance  
19 schedules, the customer service degradations and layoffs  
20 that are all sought to be avoided by the 1308(e)  
21 standard, didn't you?

22 A. Yes.

23 Q. So that is the response that you were referring  
24 to in your last answer?

25 A. I am getting a little confused on where we are

1 here.

2 Q. We are talking about if there was a downgrade  
3 what would the company do.

4 A. Well, I presume that we are talking in a  
5 hypothetical. I have proposed something that hopefully  
6 would be able to be put in place which will forestall the  
7 downgrading.

8 Q. Your surcharge for three years, would be that  
9 separate from the company's \$69 million base rate case?

10 A. Yes.

11 Q. So that means that whatever we got we could go  
12 to the base rate proceeding and we could still get a \$69  
13 million rate increase under your view?

14 A. I don't know whether you have adequate noticing  
15 things but it would be my expectation that this would be  
16 seen as money as I recommend to be utilized to reduce the  
17 short-term borrowing levels of the company and therefore  
18 it would not be available -- as a surcharge with a  
19 specified use it would not be available to meet the  
20 operating expenses of the company.

21 Q. When you say be available to meet the capital  
22 needs of the company -- I'm sorry. Was that what you  
23 said?

24 A. The operating needs. The operating expenses.

25 Q. You are not restricting it in terms of the

1 cashflow availability, are you?

2 A. No.

3 Q. And would it be reconcilable?

4 A. Would it be reconcilable in what way?

5 Q. Well, if we set 18 million for FY 2000 starting  
6 in May 1st, for a year, and after a year we looked back  
7 to see much of the \$18 million we actually recovered and  
8 we only recovered, let's say, \$15 million, would you  
9 support the notion that we would be able to recover the  
10 additional \$3 million?

11 A. No. I mean, that would not be how it is  
12 intended to work.

13 Q. The gas cost recovery is reconcilable, correct?

14 A. Yes.

15 Q. On page ten of your testimony you said that no  
16 utility in the country would continue to pay dividends to  
17 its owner were it facing the liquidity problems that PGW  
18 is facing. Would they stop paying their municipal taxes,  
19 would you think?

20 A. I don't understand what the application of  
21 municipal taxes is to the issue.

22 Q. Would they stop paying fees for using  
23 rights-of-way in city streets, Mr. Lelash, if they were  
24 in a liquidity crunch?

25 A. If you're trying to equate that to the \$18

1 million amount I think that that is an incorrect  
2 corollary. That is not what this is. In concept it's a  
3 payment by the utility to, I believe, facilities  
4 management for its management of the corporation. That  
5 is the basis on which the 18 million is paid, I believe.  
6 There isn't a mention of municipal taxes or anything  
7 else.

8 Q. Well, do you recall the management audit that  
9 was conducted by the PUC, by a consultant for the PUC,  
10 and that was discussed in the last base rate proceeding?

11 A. Yes.

12 Q. Do you recall an analysis in that management  
13 audit that did say that if the city fee was equated to a  
14 payment in lieu of taxes it would just barely cover the  
15 property taxes that PGW would have to pay if it were  
16 privately owned?

17 A. Well, we are not --

18 Q. Just for the record, do you recall that?

19 A. Yes, I recall the statements that were made in  
20 that and the context of that report. What I am  
21 suggesting to you, and in fact there is a quote in my  
22 testimony, is that the director of finance for the city  
23 herself said that this is the equivalent of a dividend  
24 payment. It is the return to the owner of -- it is a  
25 return to the owner. I don't want to badger you or

1 anything but this is what your own director of finance  
2 says it is.

3 Q. If we determine whether we have indices of  
4 reasonableness and one indice of reasonableness would be  
5 if the company was paying its taxes to the city as any  
6 other privately held entity would, would it be paying  
7 more or less than \$18 million to the city? If you have  
8 an opinion.

9 A. Mr. Clearfield, if the city wants to do that it  
10 should restructure the relationship it has with the  
11 utility. It should collect its municipal taxes. But I'm  
12 not seeing anybody making those kinds of suggestions.

13 The issue is very narrow. It is a question of  
14 whether or not a utility in a circumstance where they are  
15 making a payment to the owner as a dividend would or  
16 would not make that payment if they had a problem with  
17 liquidity and had a highly leveraged capital structure.  
18 I'm saying most utilities, any utilities I know, would  
19 not pay dividends in those circumstances.

20 Q. When PGW has a very good year does the \$18  
21 million payment go up? When it actually has earnings,  
22 which I think they actually had in --

23 A. Effectively, yes, it does.

24 Q. It does?

25 A. Yes.

1 Q. They actually get -- the city gets more than  
2 \$18 million paid to them that year?

3 A. Not paid to them but credited to them. They  
4 would receive the \$18 million dividend and their equity  
5 account in the utility would go up.

6 Q. And who has use of the equity, the dollars --  
7 it is a paper transaction, isn't it, the increase in the  
8 equity?

9 A. I don't think that is how they look at it. I  
10 would guess that the city carries that equity balance as  
11 an asset.

12 Q. Could you show me anything that indicates that?

13 A. I would just say if they have got -- if the  
14 fund balance, the city equity account goes up by \$10  
15 million I suspect somewhere on the books of the city they  
16 reflect that.

17 Q. But you don't have any --

18 A. I'm just saying I suspect that. I'm not saying  
19 I know it as a fact. But if the value of an equity  
20 holding that I have goes up in value typically then my  
21 net worth has gone up in value.

22 Q. But doesn't PGW show the city equity as an  
23 asset on its balance sheet?

24 A. PGW?

25 Q. Yes.

1           A. The city equity is owned by the city, not by  
2 PGW.

3           Q. But it shows it as a fund balance on its  
4 balance sheet, doesn't it? PGW.

5           A. It shows the city's investment -- the city  
6 equity is shown as an asset on PGW's books?

7           Q. Well, it is shown as retained earnings.

8           A. Yes. That is not an asset. That is on the  
9 liability side.

10          Q. I misspoke. I apologize.

11          A. Right-hand side, not left-hand side.

12          Q. But it is on the balance sheet of PGW?

13          A. As a liability of the utility to its owner, the  
14 city.

15          Q. Retained earnings?

16          A. Yes.

17          Q. And do you know if the company earns more money  
18 than the \$18 million does the city have the ability to  
19 simply draw those dollars out, complete discretion to  
20 draw those dollars out?

21          A. I do not believe the city does. I believe that  
22 the monies, however, the residual monies, would be  
23 credited to the city's equity account.

24          Q. In your testimony you discuss the Bond Buyer  
25 article that we have had some discussion about. Do you

1 have a copy of that?

2 A. Yes.

3 Q. What was the headline in that Bond Buyer  
4 article?

5 (Pause.)

6 Q. Well, the headline is Warm Winters, Debt  
7 Burdens Push Philadelphia Gas Works to Brink, isn't it?

8 A. Let me just get it.

9 MR. CLEARFIELD: Your Honor, let me mark as PGW  
10 Cross-Examination Exhibit 1 a copy of that Bond Buyer  
11 article. I am giving two copies to the reporter.

12 JUDGE FORDHAM: It shall be so marked.

13 (Whereupon, the document was marked as PGW

14 Cross-Exam. Exhibit No. 1 for identification.)

15 A. I now have it. You correctly cited the title  
16 of the article.

17 BY MR. CLEARFIELD:

18 Q. And if you turn to the second page the article  
19 is continued with a heading that says Highly Leveraged  
20 Philadelphia Gas Works Threatens to Tumble into Junk  
21 Territory, is that correct?

22 A. That's correct.

23 Q. The writer of this article seemed to think  
24 there was a serious potential that PGW was going to be  
25 downgraded to junk bond. Wouldn't that be a fair

1 characterization?

2 A. You know, I think the article speaks for  
3 itself.

4 Q. And there was discussion about the fact that  
5 the S&P representative is quoted as saying given the  
6 current financial profile they don't look investment  
7 grade. Do you see that?

8 A. Yes. However, it is worth noting that that S&P  
9 analyst does not make a determination whether or not S&P  
10 will downgrade.

11 Q. Mr. Lelash, have you discussed your  
12 recommendation that you have made here with anybody from  
13 S&P?

14 A. No, I have not.

15 Q. You have never worked for a company that issues  
16 municipal bonds, have you?

17 A. I have worked for companies that issue bonds,  
18 not municipal bonds.

19 Q. Have you worked as part of your professional  
20 duties advising clients on buying and selling municipal  
21 bonds?

22 A. No, I have not.

23 Q. And you have never worked for a credit agency  
24 like S&P, have you?

25 A. No, I have not.

1 MR. CLEARFIELD: That is all I have, Your Honor.

2 JUDGE FORDHAM: Mr. Gray.

3 MR. GRAY: Thank you, Your Honor.

4 CROSS-EXAMINATION

5 BY MR. GRAY:

6 Q. Good afternoon, Mr. Lelash.

7 A. Good afternoon.

8 Q. Can I ask you to turn to page ten of your  
9 testimony, item number nine?

10 A. Well, I think -- I have item ten in front of  
11 me.

12 Q. It is item nine.

13 A. I now have item nine in front of me.

14 Q. Thank you.

15 You indicate in item nine that the forecasts -- and  
16 I'm quoting here -- have not been analyzed or evaluated  
17 in the context of a general rate investigation. As such  
18 it is impossible to make any comprehensive evaluation of  
19 the reasonableness of the company's derived \$44 million  
20 amount. Do you see that?

21 A. Yes.

22 Q. Is it a fair statement to say that your \$18  
23 million increase suffers the same deficiency?

24 A. There is really a dual purpose to the  
25 recommendation that I make here. Obviously the company

1 has contended that it needs a certain amount of revenues  
2 to forestall the downgrade. I looked at the issue more  
3 on how the liquidity problem could be addressed to the  
4 point of getting what I would consider a far more  
5 permanent solution to the liquidity problem. And I did  
6 that by looking at both the requirement, the minimum  
7 requirement by S&P, but also looking at the balance sheet  
8 of the utility and determining what it would take over  
9 about a three year period to liquidate or substantially  
10 liquidate its short-term debt position and at the same  
11 time hopefully augment the equity position. Therefore  
12 the 18 come 36 if matched by the city really was  
13 predicated on that liquidity and capital need more than  
14 on the P&L analysis that will take place in a base rate  
15 proceeding.

16 Q. Along similar lines let me turn to -- I was  
17 going to say page 27.

18 A. Well, let's give it a try.

19 Q. The title of the section is capital versus  
20 revenue need.

21 A. Yes.

22 Q. And you state in your answer, I guess the third  
23 full sentence, accordingly it is my belief that the  
24 section 1308(e) provisions are not applicable to PGW's  
25 rate relief request. Do you see that?

1 A. Yes.

2 Q. Then sort of the same question. Is that also a  
3 fair statement about your \$18 million proposal, that  
4 1308(e) is also not applicable to your proposed \$18  
5 million increase?

6 A. Strictly speaking you are really raising a  
7 legal issue which I am quite confident all the lawyers  
8 will brief considerably. I consider this to be outside  
9 of the provisions of section 1308 because it really is  
10 predicated on a capital requirement as opposed to an  
11 operating expense. The company has not come in here and  
12 predicated its \$44 million on the basis that it has now  
13 looked at the operating expenses it's going to have over  
14 the next 12 months and it needs \$44 million. I guess  
15 parenthetically it is saying it needs \$60 million. But  
16 here it is saying we have run this S&P formula on  
17 liquidity and coverages and it is telling us we need \$44  
18 million. That is a different kind of thing.

19 I honestly don't believe the drafters of 1308 -- I  
20 have no way to know, but I don't think the drafters there  
21 were considering that it would be used as the basis to  
22 seek capital from ratepayers. And I don't think it has  
23 ever been used to do that. And so I think we are sort of  
24 in new ground here and I think the Commission has to  
25 evaluate on the basis of what the company claims is the

1 requirement on the basis of liquidity, what the formulas  
2 show, what actually the balance sheet accounts show and  
3 make a determination on that basis. I don't think 1308  
4 is applicable. At least I will tell from you a finance  
5 point of view I think it is a different animal.

6 MR. GRAY: Thank you.

7 Thank you, Your Honor. That's all I have.

8 JUDGE FORDHAM: Does anyone else have anything for  
9 this witness?

10 MR. CLEARFIELD: Your Honor, I am going to have a  
11 few follow-ups, but I can wait.

12 JUDGE FORDHAM: Ms. Burak.

13 MS. BURAK: Thank you, Your Honor.

14 CROSS-EXAMINATION

15 BY MS. BURAK:

16 Q. Good afternoon, Mr. Lelash.

17 A. Good afternoo.

18 Q. If you would turn to pages 13 and 14 of your  
19 testimony, it is actually paragraph number 17.

20 A. Yes.

21 Q. This is where you make the proposal for the \$18  
22 million surcharge. And I believe you just previously  
23 indicated to Mr. Clearfield that this \$18 million  
24 surcharge would be separate and apart from the company's  
25 current base rate proceeding, is that correct?

1 A. That's correct.

2 Q. But it is my understanding that as part of your  
3 testimony you do not provide any proposal as to how this  
4 \$18 million would be allocated, is that correct?

5 A. Allocated to what purpose it will be paid or to  
6 who will pay it?

7 Q. Who will pay it.

8 A. It is my understanding that who will pay it has  
9 been determined by stipulation and has already been  
10 decided.

11 Q. Thank you.

12 And also, Mr. Lelash, in that same paragraph you  
13 discuss the company's restructuring proceeding and you  
14 suggest a phase-in of certain restructuring initiatives  
15 over time. Is it correct to assume, then, that you are  
16 not suggesting that the entire restructuring be held in  
17 abeyance at this time?

18 A. No. My understanding is that the company is  
19 obviously required to make a filing. There are then a  
20 variety of things in that filing they have to address,  
21 such as the Chapter 56 provisions, to change the tariff.  
22 I am merely suggesting really pragmatically based on what  
23 the company is saying as well that they may have with or  
24 without the rate increase may have difficulty in  
25 comprehensively restructuring and opening access to all

1 customers. So I think that down the road there needs to  
2 be a discussion of whether there are certain phases of  
3 the restructuring that could be done on a pilot basis.  
4 There have been some actions already on addressing, if  
5 you will, the restructuring for commercial and industrial  
6 accounts. I had in mind, really, when I was doing that  
7 thinking that there may be a similar phase-in for  
8 residential and that it may not be something that they  
9 would do on an immediate basis but would in fact phase in  
10 a program that would allow them a longer time period to  
11 develop the infrastructure that was required. That was  
12 really the thrust of my recommendation.

13 MS. BURAK: Thank you.

14 That is all I have, Your Honor.

15 JUDGE FORDHAM: Mr. Bertocci.

16 CROSS-EXAMINATION

17 BY MR. BERTOCCI:

18 Q. Good afternoon, Mr. Lelash.

19 A. Good afternoon.

20 Q. We began kind of quickly so I wanted to make  
21 sure I understood what I thought I heard. It is my  
22 understanding that the \$35 million, 35.4 I believe  
23 million dollars that was mentioned at the beginning, was  
24 what you think the S&P formula if done correctly would  
25 yield, is that right?

1           A. Not really done correctly. The principal thing  
2 was to develop a revenue requirement for the lower end of  
3 the stated S&P range. And the range was 1.2 to 1.3  
4 coverage. And the company's target at 44 was mid-range,  
5 so to speak. So I wanted to just see what would be  
6 hypothetically -- not hypothetical, but what was a good  
7 estimate of the lowest required revenue requirement. And  
8 that came up, I believe it is done correctly, at about  
9 35, 36 million.

10           Q. Is it fair to say that you are agnostic as to  
11 whether 35 to 36 million is really required? And the  
12 reason I say that is your proposal is really that a  
13 surcharge would be in an amount which would match what  
14 would be contributed by the city. If the city was  
15 willing to put up \$16 million I imagine that the  
16 surcharge, if I'm correct in understanding your proposal,  
17 would be \$16 million on the other side. Is that right?

18           A. Certainly one was not dependent on the other,  
19 but I had in mind because of a lot of the statements made  
20 by the city that if it were to be persuaded to give any  
21 money the 18 probably would be sort of the target level.  
22 Because the city at that time when I was writing the  
23 testimony appeared to have pledged the 18 million. Now I  
24 understand they will make it available up to 18. But the  
25 18 was sort of, we will say, in play. So when the

1 calculation at the 1.2 times coverage level came about,  
2 yes, that was confirming that what I thought might be  
3 possible and fair to the ratepayers of a splitting of the  
4 revenue responsibility, it would appear fulfilled the  
5 lowest level of the S&P requirement.

6 MR. BERTOCCI: Thank you very much.

7 JUDGE FORDHAM: Anyone else? Mr. Clearfield.

8 FURTHER CROSS-EXAMINATION

9 BY MR. CLEARFIELD:

10 Q. With respect to your calculation which appears  
11 on Schedule 2, Mr. Lelash, you reached the conclusion  
12 that the company can justify an additional 35.4 million  
13 of project revenues by trying to hit a 1.2 times coverage  
14 using the S&P formula, would that be fair to say?

15 A. Yes.

16 Q. And your last calculation there shows that you  
17 took account of the payment of the city fee and the \$20  
18 million tax exempt commercial paper payment, is that  
19 right?

20 A. Yes.

21 Q. Now, do you understand that payment to be the  
22 reduction from 100 million to 80 million that is mandated  
23 by the credit facility?

24 A. Yes. This was shown on the test year budget  
25 basis during that interval. In the S&P formula as I

1 interpreted it there would be a requirement to reflect  
2 the 20 million drop from 100 to 80.

3 Q. Right. Now, if I wanted --

4 A. Well, let me finish.

5 I would not disagree with OTS that theoretically if  
6 you moved to the next period of time on a fully  
7 forecasted basis the \$20 million would not be appropriate  
8 to show in that calculation.

9 Q. You would have to show an additional  
10 calculation, though. You would have to include the 20  
11 million and then include an additional paydown of the  
12 short-term paper, wouldn't you?

13 A. Well, now that you asked that question, it  
14 really was my idea in the plan that I had put up that by  
15 having the city pledge the 18 million for three years and  
16 the S&P formula, in essence the 18 would be suspended, if  
17 you will, for the three year period because it would not  
18 be a legal obligation, and by the time that suspension  
19 was over there would have been sufficient paydown of the  
20 commercial paper line that the 20 million would not be  
21 justified within the equation either, certainly by the  
22 second or third year of that timeframe. And that was  
23 really why I thought and I still think that the  
24 recommendation that is made here would be sufficient to  
25 show S&P that there was going to be a permanent fix not

1 looking necessarily on a year by year basis but what  
2 happens when this three year period is over. When this  
3 three year period is over the company basically does not  
4 have a material amount of short-term debt. That is its  
5 liquidity problem. This plan over three years would  
6 remove the liquidity problem. And assuming that in the  
7 base rate case a fair and reasonable level of ongoing  
8 rates would be set for the company, it was my opinion  
9 that this would address the S&P concern and would  
10 stabilize and then improve the financial situation of the  
11 company.

12 Q. I understand your testimony.

13 A. Okay.

14 Q. And I understand you're trying to make a fair  
15 recommendation. But I just want to get to the technical  
16 calculation of this coverage calculation.

17 A. Okay.

18 Q. If in fact we wanted to determine what the  
19 coverage would be if the company was going to pay down  
20 not 20 million but 20 million plus the next level,  
21 another 11 million, the coverage calculation that is  
22 shown in the test year budget there would be lower,  
23 wouldn't it?

24 A. No. I mean -- no. The answer is no, Danny,  
25 and let me tell you why. They are obligated, the company

1 is obligated, to pay down 20. And that is correctly  
2 reflected.

3 Q. That is what is shown on that \$20 million of  
4 the mandatory paydown.

5 A. There is no knowledge or no ability for us to  
6 know whether or not the next renegotiation of the  
7 commercial paper lines will require an additional  
8 exemption -- an additional reduction.

9 Q. Granted. Granted, Mr. Lelash. But I am saying  
10 hypothetically let's just assume if you were to show  
11 that, if we all agree that that was going to happen and  
12 the company was going to pay that down so we had to come  
13 up with dollars to pay that down, then the funds  
14 available would be less and the coverage levels that  
15 would be shown there would be less, wouldn't they? I  
16 mean, that is mathematic.

17 A. Well, what are we talking about? Are we  
18 talking about they make the 20 payment which is reflected  
19 here and you are saying then next year they will do what?

20 Q. Just pro forma if we wanted to show this test  
21 year budget to show not only the mandatory payment but an  
22 additional payment let's say hypothetically we were going  
23 to make --

24 A. Well, but an additional payment you are  
25 hypothetically going to make should not be included in

1 the S&P formula.

2 Q. I understand.

3 A. I don't think you do.

4 Q. And it's not included in the formula, is it?

5 A. What?

6 Q. I'm just trying to ask you technically if you  
7 did reflect this additional \$11 million what would happen  
8 to that coverage assuming you kept the \$35 million of  
9 additional project revenue constant?

10 A. For what time period? On the test year basis  
11 here or --

12 Q. The test year basis. You assume hypothetically  
13 that you are now not only going to pay down the mandatory  
14 amount but you are going to make an additional payment  
15 and you are going to show the effect of that on our  
16 coverages at the end of --

17 A. The additional payment would not enter into the  
18 S&P formula as I understand it.

19 Q. If you decided you were going to do it and --

20 A. If you decided you were going to do it you  
21 could decide three minutes later you were not going to do  
22 it. It is not a mandated payment. My understanding is  
23 that the S&P formula is the contractual obligations that  
24 the city has to meet. If you are talking discretionary,  
25 well, we might put 11 million more in and knock it down

1 or maybe we won't, that is not the kind thing that they  
2 are seeking to measure in their formula.

3 Q. Do you know if the additional 20 million paydown  
4 of the short-term credit line is included in their  
5 worksheet that is shown as BCB-3 for the 2003 period?

6 A. Yes.

7 Q. Is it or isn't it?

8 A. It is.

9 Q. If they are including that non-mandatory  
10 payment --

11 A. Incorrectly they are including it. Now that  
12 you have raised it, I will tell you. That is wrong. By  
13 their own definition that \$20 million in 2003 should not  
14 be in there.

15 Q. Whether in your view it is wrong or not, they  
16 have included it and they are calculating S&P's coverages  
17 with that assumption for the year 2003, aren't they? .

18 A. It is not a mandated payment --

19 Q. Mr. Lelash, come on.

20 MR. CLEARFIELD: Your Honor, I asked a simple  
21 question.

22 BY MR. CLEARFIELD:

23 Q. Are they or aren't they calculating it with the  
24 assumption that that is going to be for 2003 --

25 A. What do they say, asked and answered? I

1 already told you that the 20 million was in there.

2 Q. Then all you had to say was yes.

3 A. I said it already to you.

4 Q. Well, you could say it a few more times. It's  
5 not going to kill you.

6 I am just going to try one more time.

7 Mathematically if we superimposed an additional paydown  
8 of the short-term payment on the test year, and I  
9 understand that that is going to happen in 2003, but if  
10 we pulled that into this calculation that is shown on  
11 your Schedule 2 as if it were going to happen, not just  
12 the 20 million but now an additional \$11 million payment,  
13 everything else being equal what would happen to that  
14 coverage?

15 A. If there was a mandate for \$31 million that was  
16 plugged into this thing it obviously would lower the  
17 coverage.

18 MR. CLEARFIELD: Thank you.

19 That's all the questions I have.

20 JUDGE FORDHAM: Does anyone else have anything?

21 (No audible response.)

22 JUDGE FORDHAM: Ms. McCloskey.

23 MS. McCLOSKEY: Your Honor, may we have a moment?

24 JUDGE FORDHAM: Sure.

25 (Pause.)

1 JUDGE FORDHAM: Ms. McCloskey.

2 MS. McCLOSKEY: Yes, Your Honor. As much as  
3 everyone would like to discuss the \$11 million again, the  
4 OCA has no redirect.

5 We would move into admission OCA Statement  
6 No. 1-ERP.

7 JUDGE FORDHAM: Any objection?

8 MR. CLEARFIELD: No objection.

9 JUDGE FORDHAM: It is admitted.

10 (Whereupon, the document marked as OCA  
11 Statement No. 1-ERP was received in evidence.)

12 MR. CLEARFIELD: I would move into admission PGW  
13 Cross-Examination Exhibit 1.

14 JUDGE FORDHAM: Any objection?

15 (No audible response.)

16 JUDGE FORDHAM: It is admitted into evidence.

17 (Whereupon, the document marked as PGW  
18 Cross-Exam. Exhibit No. 1 was received in  
19 evidence.)

20 JUDGE FORDHAM: Do we have anything further?

21 MR. CLEARFIELD: Your Honor, I don't believe so.

22 JUDGE FORDHAM: I'd like to thank the parties for  
23 making sure we did this in one day and acting very  
24 civilized.

25 We have another issue with respect to the base rate

1 proceeding that I would like to talk to you about but we  
2 can do that off the record.

3 As I indicated before, we know that the transcript  
4 will be an one day transcript and memos are due by noon  
5 on April 3rd. I would have to get some guidance as to  
6 whether there is going to be a page limitation or not on  
7 the memoranda and I will try to get that and get that to  
8 you by tomorrow.

9 JUDGE FORDHAM: Mr. Bertocci.

10 MR. BERTOCCI: Your Honor, is that in-hand by noon  
11 on April 3rd? If it is in Harrisburg --

12 JUDGE FORDHAM: It is to be e-mailed -- Mr. House,  
13 could you clarify that?

14 MR. HOUSE: I believe it is expected to be in-hand.

15 JUDGE FORDHAM: Yes.

16 MR. BERTOCCI: In-hand? So not even e-mailed?

17 MR. HOUSE: Well, transmitted so that it is  
18 received by the appropriate Commission bureaus. It must  
19 be received, legibly, retrievable, readable, without  
20 viruses.

21 JUDGE FORDHAM: Is there anything else?

22 (No audible response.)

23 JUDGE FORDHAM: Thank you.

24 We are off the record in this proceeding.

25 (Whereupon, at 4:00 p.m., the hearing was concluded.)

C E R T I F I C A T E

I hereby certify, as the stenographic reporter,  
that the foregoing proceedings were taken  
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