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Wilmington, DE 19801
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DOCUMENT FOLDER

ORIGINAL

March 8, 2000

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

RE: Application of PECO Energy Company
Docket No.: A-110550F0147

Dear Mr. McNulty:

Enclosed for filing please find an original and three (3) copies of the Supplemental Prehearing Conference Memorandum of Clean Air Council, et al, in the above-referenced proceeding.

A copy of this document has been served on the parties of record and as required by rule as shown on the attached certificate of service.

Sincerely,

Michael Fiorentino, Esq.
Staff Attorney

Enclosures
cc: The Honorable Charles E. Rainey, Jr.
See Certificate of Service

33

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00 MAR -8 AM 11:41
PA P.U.C.
SECRETARY'S BUREAU

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00 MAR -8 AM 11:41
PA.P.U.C.
SECRETARY'S BUREAU

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

DOCKETED
MAR 09 2000

APPLICATION OF PECO ENERGY COMPANY, PURSUANT TO CHAPTERS 11, 19, 21, 22 AND 28 OF THE PUBLIC UTILITY CODE, FOR APPROVAL OF (1) A PLAN OF CORPORATE RESTRUCTURING, INCLUDING THE CREATION OF A HOLDING COMPANY AND (2) THE MERGER OF THE NEWLY FORMED HOLDING COMPANY AND UNICOM CORPORATION

DOCKET NO. A-110550F0147

ORIGINAL

SUPPLEMENTAL PREHEARING CONFERENCE MEMORANDUM OF CLEAN AIR COUNCIL, et al

Pursuant to the December 28, 1999 Prehearing Conference Order of Charles E. Rainey, Jr., Administrative Law Judge, Clean Air Council, Andrew Altman, Dennis Winters, and Amy Hammersmith filed a Prehearing Conference Memorandum on January 12, 2000. By and through counsel, said parties do hereby submit the following Supplement to that Memorandum:

7. <u>Witnesses</u>

Clean Air Council, et al, have elected to present testimony in this proceeding, and intend to offer as a witness:

DOCUMENT
FOLDER

Bruce E. Biewald
President
Synapse Energy Economics, Inc.
22 Crescent Street
Cambridge, MA 02138

Clean Air Council, et al, reserve the right to identify additional witnesses, and will supplement this Memorandum again should it prove necessary to do so.

8. Issues To Be Addressed By Witnesses

Mr. Biewald will testify as to: 1) Merger Risks including market power effects, environmental impacts, nuclear decommissioning concerns, and merger savings uncertainties; and 2) the Public Interest standard including the benefits of renewable energy and air pollution emissions reductions.

Clean Air Council, et al, anticipate the possibility that other issues may arise or be identified which may also be addressed by Mr. Biewald's testimony, or that of an additional witness, should one be retained.

Respectfully submitted,

Michael Fiorentino, Esquire
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Joseph Otis Minott, Esquire
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Dated: March 8, 2000

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

In re: Application of PECO Energy Company, Pursuant to Chapters 11, 19, 21, 22 and 28 of the Public Utility Code, for Approval of (1) a Plan of Corporate Restructuring, Including the Creation of a Holding Company, and (2) the Merger of the Newly Formed Holding Company and Unicom Corporation	:	Application Docket No. A-110550F0147

CERTIFICATE OF SERVICE

I hereby certify that I have, this 8th day of March 2000, served a true and correct copy of the foregoing Protestants/Intervenors Clean Air Council, et al's Supplemental Prehearing Memorandum on the following parties of record by first-class mail:

The Honorable Charles E. Rainey
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Direct Dial: 215 841-4252

March 8, 2000

Tanya McCloskey
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2000 MAR 13 AM 8:38
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SECRETARY'S BUREAU

RE: Application of PECO Energy Company to Chapters 11, 19, 21, 22 and 28 of the Public Utility Code, for Approval of (1) A Plan of Corporate Restructuring, including the creation of a Holding Company and (2) the Merger of the Newly Formed Holding Company and Unicom Corporation, Docket No. A-110550F0147

Dear Ms. McCloskey:

Enclosed, please find PECO's CONFIDENTIAL response to OCA-VIII-8.

Very truly yours,

Paul Bonney /RHS
Paul R. Bonney
Assistant General Counsel

/rhs

Enclosure

cc: James J. McNulty, Secretary (cover letter & certificate of service only)
Certificate of Service

149891

Certificate of Service

I hereby certify that I have this day served the foregoing document on the following in the matter of PECO Energy Company's Application For Approval of (1) A Plan of Corporate Restructuring, Including the Creation of a Holding Company and (2) The Merger of the Newly Formed Holding Company and Unicom Corporation.

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Dated: March 8, 2000

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March 8, 2000

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RE: Application of PECO Energy Company to Chapters 11, 19, 21, 22 and 28 of the Public Utility Code, for Approval of (1) A Plan of Corporate Restructuring, including the creation of a Holding Company and (2) the Merger of the Newly Formed Holding Company and Unicom Corporation, Docket No. A-110550F0147

200020

Dear Mr. Hamermesh:

Enclosed, please find PECO's CONFIDENTIAL response to MAPSA-V- 11, 12 13.

00 MAR 13 AM 8:39
RECEIVED
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Very truly yours,

Paul Bonney/RHS

Paul R. Bonney
Assistant General Counsel

/rhs

Enclosure

cc: James J. McNulty, Secretary (cover letter & certificate of service only)
Certificate of Service

Certificate of Service

I hereby certify that I have this day served the foregoing document on the following in the matter of PECO Energy Company's Application For Approval of (1) A Plan of Corporate Restructuring, Including the Creation of a Holding Company and (2) The Merger of the Newly Formed Holding Company and Unicom Corporation.

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March 9, 2000

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2009

RE: Application of PECO Energy Company to Chapters 11, 19, 21, 22 and 28 of the Public Utility Code, for Approval of (1) A Plan of Corporate Restructuring, including the creation of a Holding Company and (2) the Merger of the Newly Formed Holding Company and Unicom Corporation, Docket No. A-110550F0147

Dear Ms. McCloskey:

Enclosed, please find PECO's supplemental response to OCA-I-11.

00 MAR 13 AM 8:38
RECEIVED
SECRETARY'S BUREAU

Very truly yours,

Paul Bonney/RHS
Paul R. Bonney
Assistant General Counsel

/rhs

Enclosure

cc: James J. McNulty, Secretary (cover letter & certificate of service only)
Certificate of Service

Certificate of Service

I hereby certify that I have this day served the foregoing document on the following in the matter of PECO Energy Company's Application For Approval of (1) A Plan of Corporate Restructuring, Including the Creation of a Holding Company and (2) The Merger of the Newly Formed Holding Company and Unicom Corporation.

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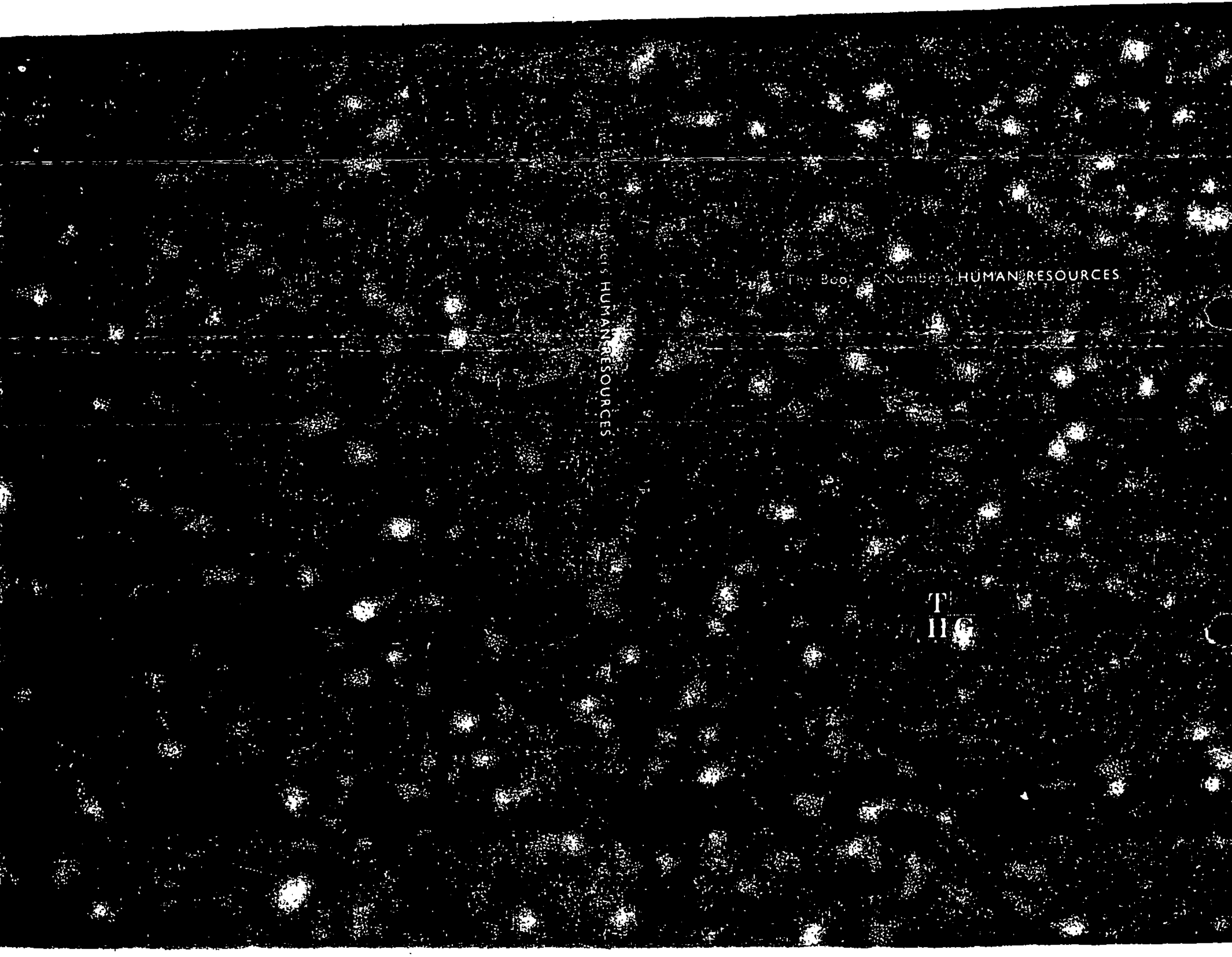
Dated: March 9, 2000

OCA-I-11 - SUPPLEMENT



The Book of Numbers HUMAN RESOURCES

The Book of Numbers HUMAN RESOURCES

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HUMAN RESOURCES

The Hackett Group is the world's foremost benchmarking firm in the knowledge worker field. Since 1991, our studies have helped more than 1,050 leading companies evaluate the efficiency and effectiveness of their staff functions. Our benchmark participants include 80 percent of the Dow Jones Industrials, 40 percent of the Fortune 100 and 25 percent of the Fortune 500.

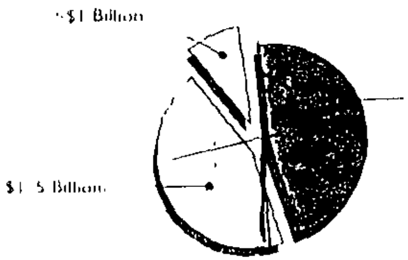
A constantly growing number of companies are benchmarking their human resources (HR) processes, systems and organizations to find comparisons of costs, productivity and effectiveness. This helps [illegible] gain a better understanding of the [illegible] that HR delivers to the organization.

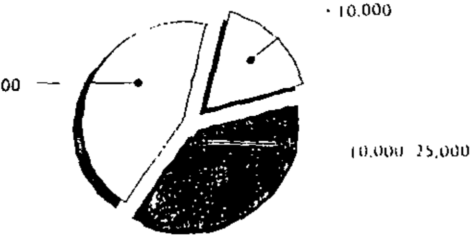
Benchmarking is the starting point for capturing the [illegible] edge and understanding. Benchmark participants use these data to learn about the best practices of world-class HR organizations. They then apply what they've learned in their own organizations [illegible] yield greater value.

STUDY BACKGROUND

Of the companies that are participating in The Hackett Group Best Practices Benchmark Study of HR, about 75 percent are in the goods-producing sector, while about 25 percent are in the services business. A wide variety of industries and organizational structures and sizes is represented. Companies range in size from $200 million in annual revenues to nearly $147 billion, with HR staffs as small as 11 and as large as 3,500.

Participant Demographics


COMPANY REVENUE


EMPLOYEES

Human Resources Processes

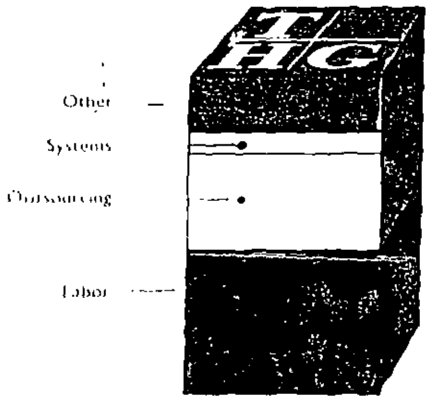
Administration	Risk Management	Employee Development	Decision Support
Health & Welfare Plan	Labor Relations	Employee Selection	Benefit Planning
Pension Plan	Employee Absence Management	Training & Development	Compensation Planning
Savings Plan	Supplier Management	[illegible]	[illegible] Planning
[illegible]	Governmental Compliance	[illegible]	Organizational Planning
[illegible]	Benefits Program Cost Management		[illegible] Planning
Employee Data Management	Internal Compliance & Audit		HR Planning

The Hackett Group Best Practices Benchmark Study of HR collects data across 22 HR processes organized into four broad categories of administration, risk management, employee development and decision support. Our stringent process definitions enable solid comparisons to be made between different sizes of companies and across industries. The study's conclusions are an absorbing, objective portrait of where HR is today and where it is heading.

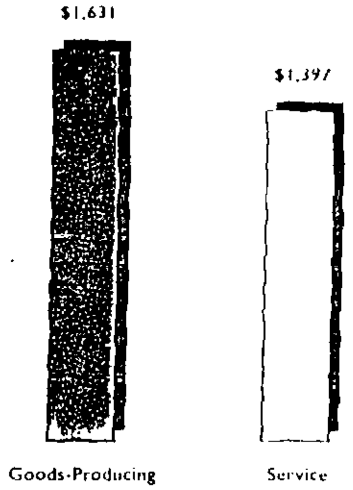
STUDY FINDINGS

HR is an expensive function. It costs the average company *in the study about* $1,500 annually to provide HR services to each employee. This cost includes basic activities *such as health* and welfare plans administration, labor relations, recruiting, training and resource planning. There are *four components* to the cost: fully loaded labor (wages, salaries and benefits), outsourcing, systems (*run time and* maintenance *for* HR systems only) and other (such as facilities, supplies and corporate allocations).

Average Cost per Employee $1,500



Cost per Employee

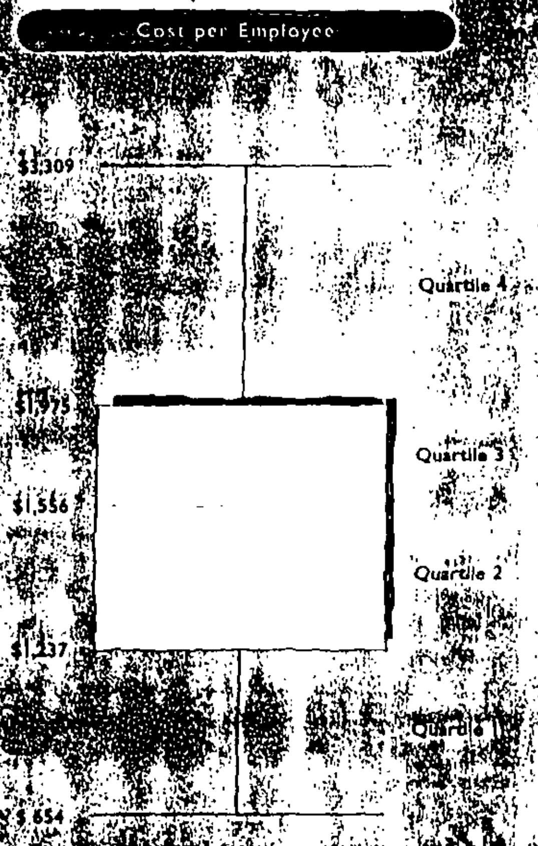


The benchmark reveals that a *major driver of* cost is business type. Service companies have a lower cost. One reason goods producers costs are *higher is because* they are likely to spend more time dealing with organized labor issues. In addition, service companies *have more employees* for an equivalent amount of revenue generated, allowing the fixed costs of HR to be spread over a *larger* base.

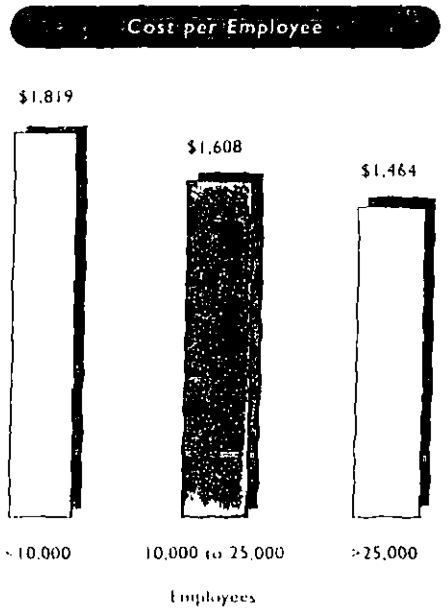
While on average HR costs a company $1,500 per employee, the range between the lowest and highest cost is large. The top 25 percent of companies in the database have per employee costs between $654 and $1,237 annually, and fourth quartile companies have costs in excess of nearly $2,000.

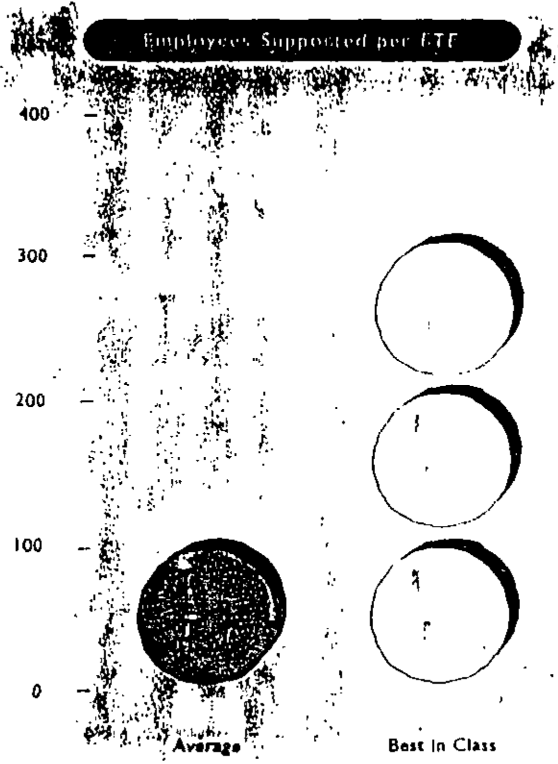
Examination of first quartile companies in the study reveals a number of emerging trends that permit a lower cost per employee to be achieved. These companies have simplified their HR processes by incorporating best practices. In addition, they are employing integrated systems to provide higher quality, more consistent information faster to HR generalists. The top 25 percent of companies are also using employee self-service tools to reduce administrative burdens and improve customer service. Finally, HR in first quartile companies has clearly defined roles and responsibilities to eliminate unnecessary redundancy in decision making.

POOR ORIGINAL



Costs are significantly lower for larger companies, owing to economies of scale. Organizations with more than 25,000 employees have costs that are about 20 percent lower than those organizations with fewer than 10,000 employees. Smaller companies have higher costs, as regulatory and compliance activities cannot be diluted over a larger employee base. Further, larger companies are able to leverage scalable technology investments that drive down costs and improve productivity by replacing labor with systems.





Each HR professional supports 93 employees in the typical company benchmarked by The Hackett Group. But in some of the best HR organizations, the number can be as high as 305 individuals supported.

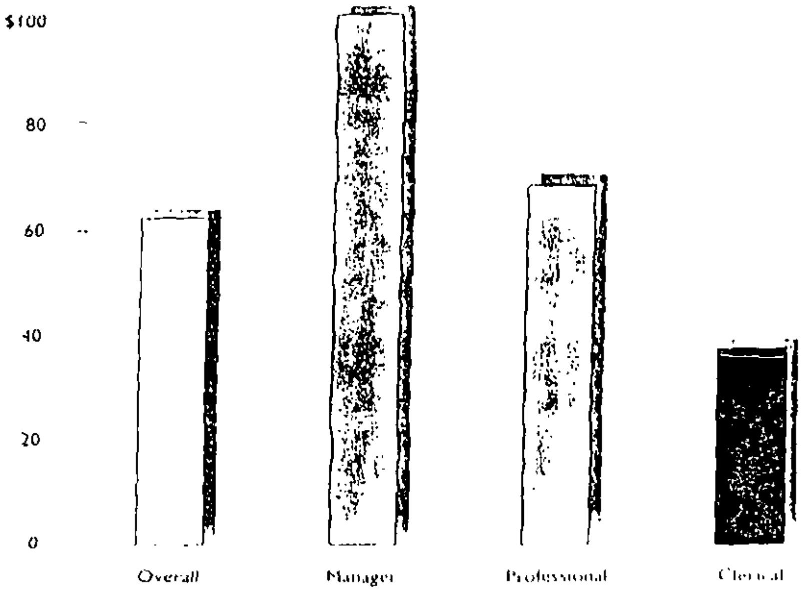
Professionals and managers make up [illegible] percent of the HR staff. These individuals have excellent credentials, with [illegible] percent of professionals and [illegible] percent of managers having advanced degrees. No other staff function benchmarked by The Hackett Group is as well educated.

The HR staff also is highly experienced. The average work experience is 22 years — seven years' tenure with the present employer and 15 years' prior experience. According to The Hackett Group's studies, HR is the most tenured of any company's management or staff functions.

The average fully loaded labor cost in the study is $63,900 per HR full-time equivalent (FTE) employee. Management staff members average $100,900. Professionals cost an average of $67,200, and the average clerical labor cost is $36,800.

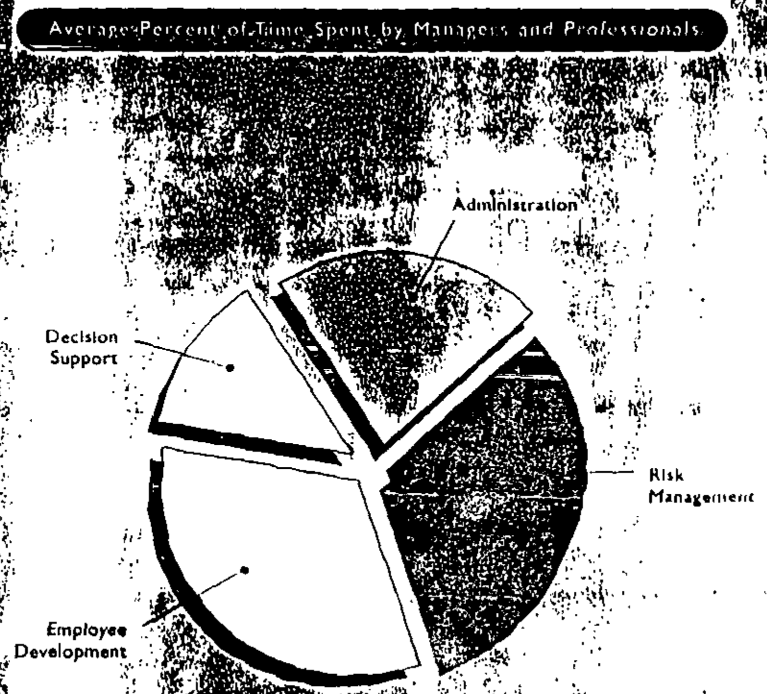
Average Labor Cost by Staff Classification

($ THOUSANDS)



These highly qualified and paid professionals and managers *spend the bulk of their time* on lower value-added, routine activities. Only 32 percent is devoted to the most crucial *employee development* imperatives for the future — hiring the best people, training them to work together in teams, *moving them* through the organization, fostering productivity and motivating them to adapt to a continuously *changing environment*.

Managers spend less than three hours *a day on helping* to acquire, develop and plan the optimal workforce to boost sales, productivity and profits. *While they believe they are* spending their time as effectively as possible, too often managers are drawn into *solving administration problems* that eat away time needed to position the organization for the future.



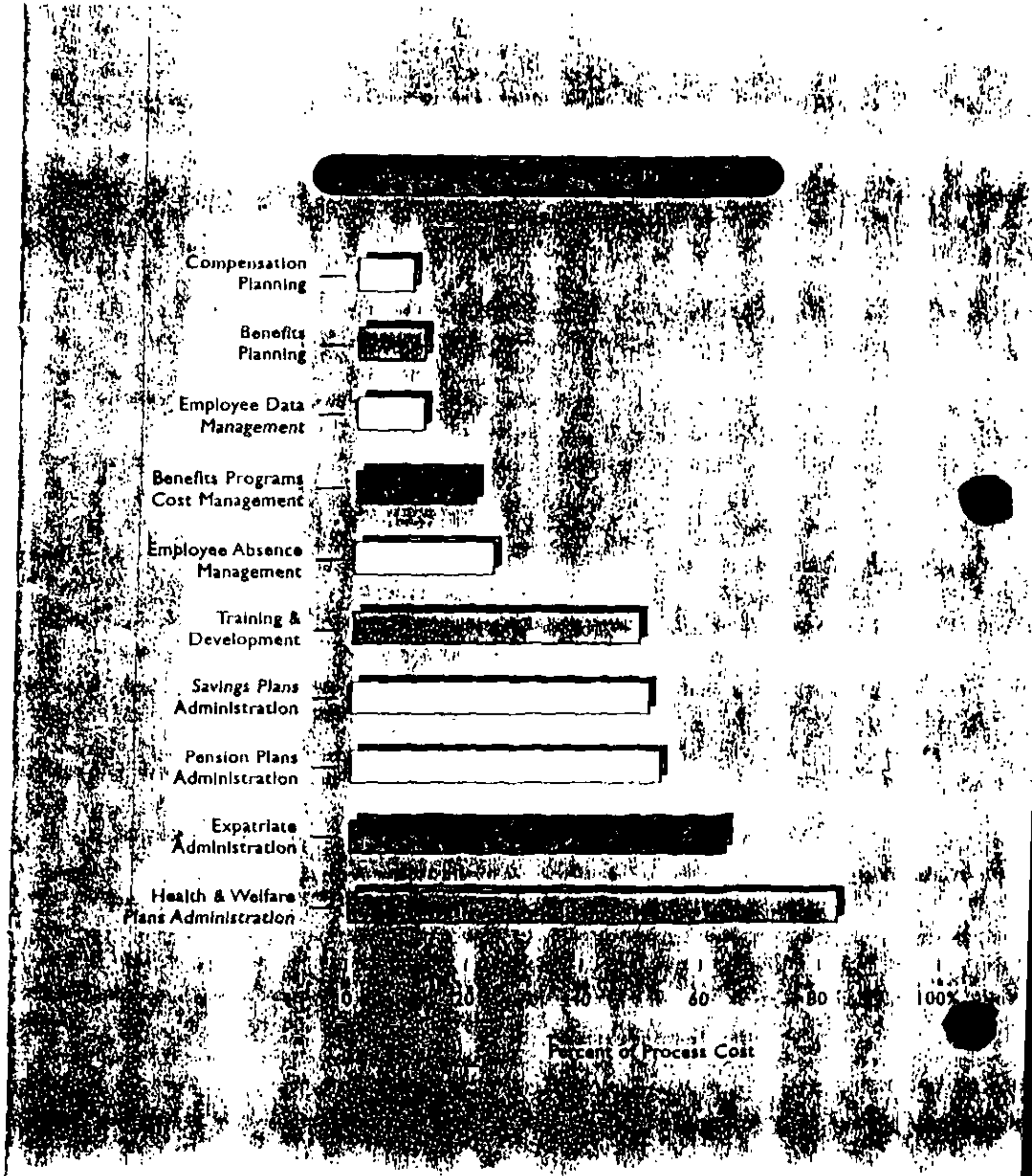
Average Percent of Time Spent by Managers and Professionals

Benefits are accruing to companies that are employing best practices such as integrated technology, employee self service, administrative service centers, streamlined practices and policies and clarified roles and responsibilities. Such companies are seeing benefits in terms of cost savings, better information and higher levels of customer satisfaction according to the [illegible]. There is a [illegible] difference in process cost between companies that have and have not reengineered [illegible] [illegible]

Process Cost per Transaction

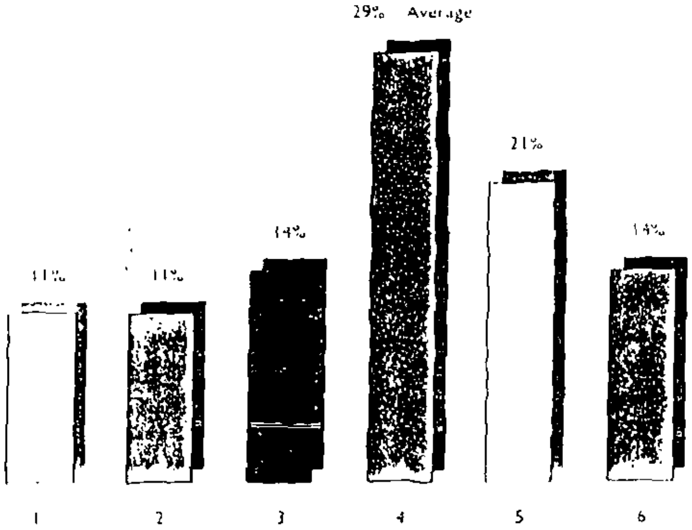
Process	Measure	Average	World Class
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]

The study confirms that *outsourcing* is a major HR cost. The cost to perform outsourced functions can run as high as $615 per employee annually, on average, or 28 percent of total per employee HR costs. However, *only 1.6 percent* of HR time is typically spent managing these third party suppliers. Use *of third parties* to support HR service delivery is most prevalent in health and welfare plans administration.

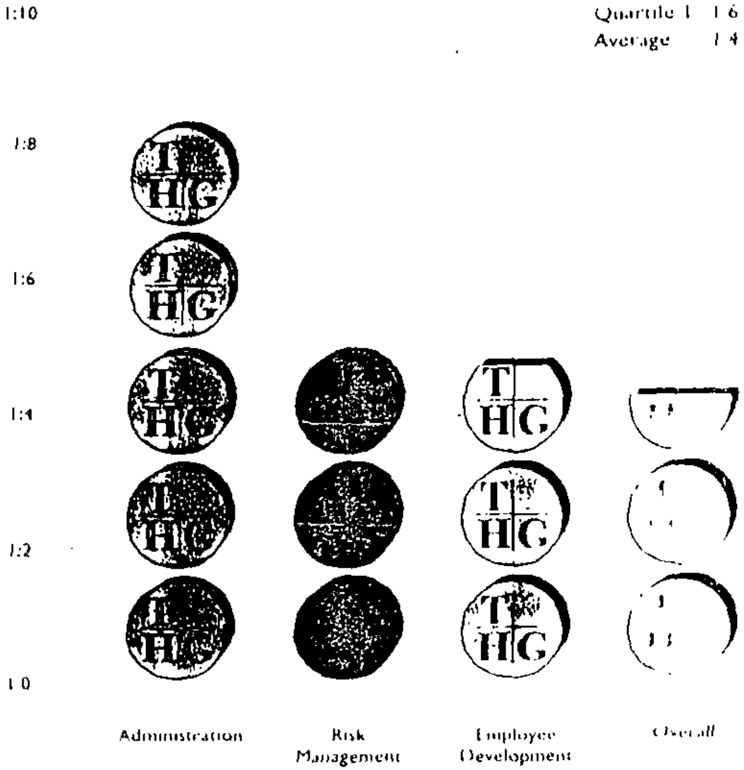


The average HR organization in the study has four *layers of management*. However, more than a third of companies have more layers. Spans of control — the ratio of supervisor to subordinates — average about 1:4 across the corporation. Spans of control are substantially higher in the administration area and lower in the higher value-added areas. According to The Hackett Group's studies, HR has more managers per employee than any other staff function.

Layers of Management



Ratio of Manager to Employees



HR is systems intensive, according to the study. The typical company has almost 10 HR systems per 1,000 employees. These systems tend to be very customized, complex and not highly integrated, and the average age is almost six years. Given that every six to eight years a company typically replaces most of its HR systems, *many* companies are due to update and replace their information infrastructures.

Average HR Systems per 1,000 Employees

Process	Number	Age
Administration	2.3	6.8
Risk Management	3.5	6.4
Employee Development	2.3	4.8
Decision Support	1.3	5.0
	Total 9.4	Weighted Average 5.9

POOR ORIGINAL

Profile of a World-Class HR Organization

	Quartile 1	Average
HR Cost per Employee	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	Integrated	Fragmented
[illegible]	Shared	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	Few & Standardized	[illegible]

New companies are being accepted into the ongoing Hackett Group Best Practices Benchmark Study of Human Resources on a daily basis. Participants collect their data via an easy-to-use, self-administered, computerized tool. We provide extensive up-front training and ongoing support throughout the project. Detailed, custom, confidential results are reported back in about eight weeks, including an on-site results presentation, implications discussion and best practices knowledge transfer session.

For information about participating in the study or about our consulting services, please contact The Hackett Group.

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[illegible]

[illegible]
A.G.
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1995-97 Performance Benchmarks for Natural Gas Utilities

EA 1999-02 April 30, 1999

return to top

Executive Summary

Summary data of gas utility financial profiles and performance appear in this Energy Analysis. The intent is to provide industry participants and observers with relative measures of financial returns and operational efficiencies of natural gas distributors. For this study, the American Gas Association (A.G.A.) collected data from its member companies. The data source for these benchmarking metrics is the Uniform Statistical Report (USR), which is administered annually by A.G.A. on behalf of its member companies.

For study purposes, the gas utility industry is segmented into distinct groups: investor-owned gas-only utilities, investor-owned combination gas and electric utilities, and municipally-owned gas utilities. Summary results are segmented in this sample accordingly. Comprehensive details are provided in the appendices.

From 1995 through 1997, gas utilities were challenged by a number of factors beyond their control.

- Total therms delivered fell 13 percent over the three years, due to customer conservation (therms per account fell 3 percent) and due to warmer than normal weather for two of the three years.
- Gas purchase expenses increased 52 percent from the 1995 average due to a similar rise in wellhead prices during those three years.

Gas utilities increased their operational efficiencies to compensate for these factors, which helped to minimize their impact on customers and investors.

- Despite declining sales, non-gas operating and maintenance costs increased less than two percent from 1995 to 1997 on a per therm basis.
- Customer/employee ratio improved seven percent from 1995.
- Return on assets stayed roughly the same, 6.6 percent in 1997 compared to 6.7 percent in 1995.

The following summarizes the characteristics that distinguish each industry segment from the others based on the 73 companies in the sample. Each comment includes reference to the figures and data tables that follow in the text.

return to top

Gas-Only Utilities

- Have the largest revenue when measured either in absolute values, or per therm delivered (Table 2).
- Posted the fastest revenue growth in both 1996 and 1997 (Table 2).
- Have the highest gross margins per therm of the sectors studied (Table 2).
- Achieved a ROA of 6.8 percent in all three years studied (Table 6).
- Have decreased their long-term debt as a percent of total capitalization from 47.2 percent in 1995 to 44.7 percent in 1997 (Table 5).

return to top

Combination Gas & Electric Utilities

- Have the lowest O&M cost per therm delivered of all of the sectors studied (Table 3).
- Achieved a ROA of 6.8 percent in 1995, which fell slightly to 6.5 percent in1997 (Table 6).
- Have increased their debt financing to 48.5 percent of total capitalization in1997, up from 44.5 percent in 1995 (Table 5).

return to top

Municipal Gas Utilities

- Have decreased their long-term debt financing to 48.6 percent of total capitalization in 1997 down from 56.1 percent in 1995 (Table 5).
- Achieved a ROA of 4.7 percent in 1995, which has increased to 6.4 percent in 1997 (Table 6).

return to top

Background

THE NATURAL GAS DISTRIBUTION INDUSTRY. Approximately 1,700 utilities distribute natural gas to end-use consumers in the U.S. As of 1999, about 200 North American distribution, transmission, gathering, and marketing companies are members of the American Gas Association. For this analysis, a total of 73 companies were studied for 1997, 82 firms were included in the 1996 sample and the 1995 sample comprised 88 firms. They are located across the continental U.S., and each company has a unique combination of scale, load profile, and climatic attributes. In aggregate, the firms included in this study accounted for 34 percent of natural gas consumed in 1997, 43 percent of 1996 consumption and 48 percent of 1995 use. *Given this sample size, any inferences about the sample's depiction of the entire industry are accordingly limited.*

Most of A.G.A.'s member companies are gas only investor owned utilities, as are the majority of the companies in this analysis. These companies earn returns that accrue to their investors. State-level public utility commissions regulate much of their operations, finance, and capital investment activities.

Combination utilities have the franchise rights to transport and/or sell both gas and electric power commodities. These are also investor-owned firms with financial obligations to shareholders. Like the gas-only investor-owned firms, these companies are subject to various state and federal regulations.

Municipal utilities are publicly owned by the citizens of the jurisdictions that the utilities serve. Local governments enjoy tax-free bond-issuing capabilities, usually at interest rates lower than can be obtained by investor-owned utilities. Ultimately, such debt is usually collateralized by these utilities' abilities to secure tax revenue to back up debt commitments. What an investor-owned utility would pay out in dividends accrues instead to the municipal company's citizen-shareholders that are rewarded with lower rates for gas purchases. Municipal utility regulation is performed primarily by local governments as opposed to state-level commissions.

DESCRIPTION OF DATA SOURCES. Financial data about A.G.A. member companies are drawn from the Uniform Statistical Report (USR). Member company staff prepare these standardized forms annually for collection by A.G.A., but companies may choose to withhold any or all of the requested data. Some of the USR repeats the information found in audited end-of-year financial statements, but the USR requests additional information, such as heating degree-day profiles, miles of pipe in service, type of sales by customer class, number of customers served, and various employment profile statistics.

DATA LIMITATIONS. Since the data used for this analysis are annual figures only, a few inferential limitations should be noted. First, a single year's data for gas distribution operations are influenced by weather patterns for that year. For the U.S. as a whole, 1997 was 1.5 percent warmer than normal, 1996 was three percent colder than usual, while 1995 was 1.5 percent warmer than normal. The deviation between actual HDDs vs. historic normals will vary by location, but this national statistic suggests, on average, that slightly more gas volumes were sold during 1996, while one would expect slightly lower gas sales during 1995 and 1997. This in turn suggests that utility benchmarks may slightly overstate or understate overall utility financial performance or efficiency of operations.

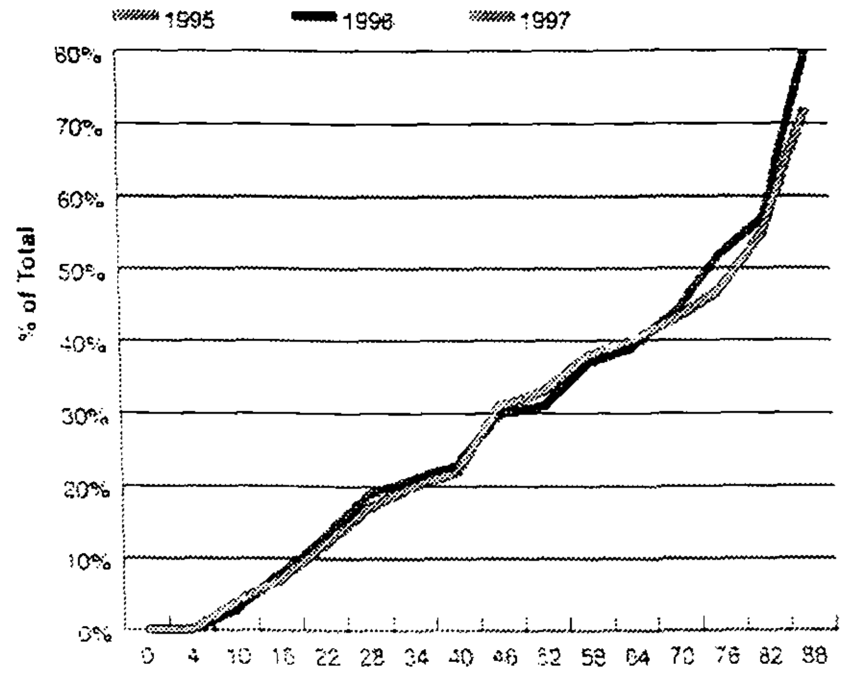
Another limitation is that the ability to perform trend analysis is somewhat limited. While three years worth of data are presented here, comparison of actual values (total revenues for example) from year to year can be distorted by changes in sample size. Also, variances in weather can affect these trends. Finally the data set is limited to three years and this limits the ability to compare longer term trends.

Sample size must also be considered as a potential limitation. The industry segment sample sizes used in this study are not consistently proportional to their respective populations. Additionally, the sample size(measured both in number of companies, and more importantly as percentage of total gas deliveries(has declined over time. This makes annual comparisons of absolute values, such as total number of therms sold, meaningless. However, the purpose of ratio analysis is to remedy this problem and facilitates annual comparisons.

One final consideration that must be addressed is the increased importance of transportation services to gas utilities. In 1997, transportation customers represented less than one percent of total customers, yet these customers accounted for over 40 percent of total gas delivered. Figure 1 illustrates the increased role of natural gas transportation.

FIGURE 1

Transportation Volume as Percent of Total Volume Delivered by Company



return to top

Benchmarking Metrics

Benchmarking metrics created for this study take several forms. Typical accounting ratios based on income statements and balance sheets serve as financial performance indicators. Financial statements are also recast in "same-size" formats, which present line items in percentage terms. Other benchmarks describe numbers of employees, meters, and volumes of gas throughput. All data are summarized so that no individual company statistics are revealed. Additionally, summaries are created which divide the industry into type-of-company segments. These include gas utilities, combination gas & electric utilities, and municipally owned gas utilities. Appendix 2 is a series of charts that display the range of observations for selected benchmarking metrics. Appendix 8 shows the list of companies that were included in this analysis.

- *Utility Operating Profiles - Absolute Values (Section IV-A and Appendix 3a).* System profiles are summarized here by type of company. This data includes information on gas volumes delivered as well as the number of customers by class.
- *Financial Statements - Absolute Values (Section IV-B and Appendix 3b).* Income statement and balance sheet data are summarized here by type of company. Income statement amounts are expressed in absolute dollars in Appendix 3b. Note that these items represent gas operations only.
- *Financial Statements - Same-Size Analysis (Appendix 3c).* The financial statement data shown in absolute values are re-cast in percentage terms for a same-size analysis (See Appendix 3c). Income statement line items are in percentages relative to operating revenue while balance sheet items are expressed as a percentage of total assets. This shows the disposition of a firm's revenue and composition of its asset base without respect to the size of an individual firm.
- *Financial Statements - Per Cost Driver (Section IV-B and Appendix 3d).* Income statements are shown in Appendix 3d in several formats: per therm delivered, per customer served, per dollar value of gas plant in service, and per mile of main and service pipe in operation.
- *Financial Ratios (Section IV-D and Appendix 3e).* These are conventional financial analysis tools, and they compare a company's financial status to other firms or types of firms. Ratios are calculated from group totals or weighted averages (explanations are provided in the Glossary, Appendix 1).
- *O&M Detail Analysis (Section IV-C and Appendix 4).* These cost elements represent major gas delivery activities, starting with purchase or production and continuing sequentially through (for example) transmission, distribution, customer service, sales activities, and administrative and general (A&G) accounting. These results are also arrayed by type of company. Benchmarks for these data are created by expressing each line item on a basis of annual costs per therm delivered. See Table 3 for more detail.
- Debt Analysis - Ratios (Section IV-E). Data is presented to highlight various measures of debt. These include debt as a percent of capitalization and interest coverage ratios. The data in this section necessarily include both gas and electric and electric operations.
- Wages and benefits: Ratios and Same-Size Analysis (Section IV-G and Appendix 5). Data about utility employment and benefits profiles are included. These measures are intended to illustrate the norms for staffing levels and expenses as they vary by type of firm. Appendix 5 shows these results in detail. Benchmark measures include:

- Total compensation as a percentage of total O&M costs
- O&M wages per employee (employees on payroll at year's end)
- Total benefits and pensions per employee
- Ratio of total benefits to total compensation
- Annual therm throughput per employee
- Average annual customers served per employee

- Profitability (Section IV-F and Appendix 6). Profitability is expressed here in terms of return on assets as well as return on common equity. Since ROA measures the returns attributable to operations (prior to finance costs). ROA in used to describe the relative economic efficiency of natural gas distribution by industry segment. This section will examine selected cost drivers-- numbers of therms sold, of customers served, dollars of gas plant utilized, and miles of pipe in service-- to evaluate each in terms of its impact on ROA. Additionally, return on equity indicates the rate of return that a firm earns on its equity base. This section will present ROE for each of the various segments, as well as decompose this measure to gain a better understanding as to what is driving changes in ROE. See Table 6 for more detail.

return to top

Benchmark Discussion

OVERVIEW

Benchmark summaries are presented here in order of accounting process: revenues are discussed first, followed by O&M costs, operating income, debt management, capitalized income values, and profitability. Finally, wage and benefit profiles are discussed. Table 1 summarizes the scope and scale of the companies studied. It is important to emphasize that the following data are meant to illustrate the typical company studied in this sample and absolute values should not be extrapolated to the industry as whole. This is especially true of the average number of customers.

TABLE 1
UTILITY PROFILES
Statistical Summary by Industry Segment
Data Based on Segment Averages

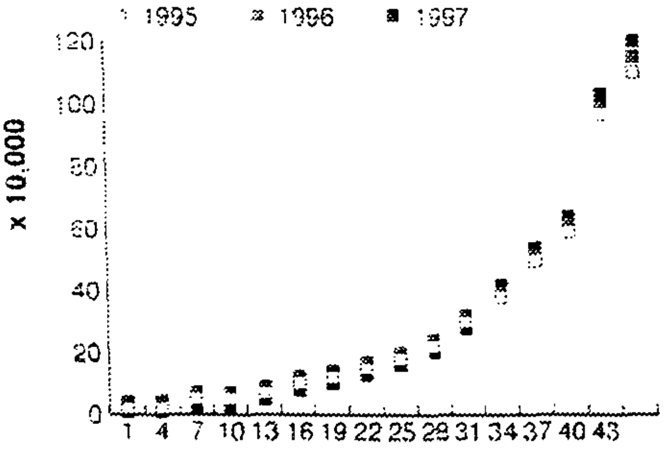
	1995	1996	1997
All Companies	88 Firms	52 Firms	72 Firms
No. of gas customers	478,810	470,868	430,152
Annual therms delivered (000)	1,085,715	1,087,510	968,790
Annual therms delivered per account	2,288	2,267	2,217
Therms delivered per $1000 of gas plant	1,382	1,334	1,248
Density of system²	39.5	40.8	37.7
Firm sales³	87.5%	90.4%	90.2%
Gas utilities	53 Firms	20 Firms	50 Firms
No. of gas customers	521,571	498,427	481,922
Annual therms delivered (000)	1,234,069	1,155,583	1,037,539
Annual therms delivered per account	2,366	2,318	2,153
Therms delivered per $1000 of gas plant	1,425	1,307	1,191
Density of system²	37.5	30.5	37.3
Firm sales³	88.4%	91.7%	93.1%
Comb. Gas & Electric Utilities	27 Firms	25 Firms	14 Firms
No. of gas customers	480,179	510,124	419,001
Annual therms delivered (000)	1,037,292	1,104,704	1,053,652
Annual therms delivered per account	2,160	2,166	2,521
Therms delivered per $1000 of gas plant	1,328	1,385	1,447
Density of system²	44.8	44.5	39.8
Firm sales³	86.2%	87.7%	92.1%
Municipal Utilities	8 Firms	7 Firms	8 Firms
No. of gas customers	190,894	134,172	129,376
Annual therms delivered (000)	378,323	305,679	242,744
Annual therms delivered per account	1,971	2,278	1,876
Therms delivered per $1000 of gas plant	1,105	1,487	1,497
Density of system²	38.9	32.1	33.6
Firm sales³	67.5%	87.7%	82.2%

While Table 1 on implies a decline in customers for gas utilities from 1995 to 1997, in fact the actual number of customers has grown over this period. The decline reflects a change in sample composition, not a decline in the number of customers served by gas utilities. When comparing year to year changes for companies that have reported in all three years, we find that the average number of gas utility customers served grew 1.3 percent in 1997 and 0.6 percent in 1996. During the same time period, combination utility customers grew by 2.0 percent and 1.8 percent during 1997 and 1996 respectively. Figure 2 shows the average number of natural gas customers by company for those that reported in all of the three years studied.

The typical gas utility has historically delivered a higher average annual volume of therms in overall magnitude. However, during 1997 combination utilities were the segment that posted the largest annual volumes. This can partially be attributed to the decrease in the number of natural gas customers. Another characteristic of the combination firm is that they feature the highest average system densities in the industry sample. This reflects the largely urban, operating environment typical of this segment.

FIGURE 2

Natural Gas Customers (Constant Sample - All Firms)



Municipal utilities tend to deliver smaller annual volumes of gas overall, compared to the rest of the industry sample. However, in terms of throughput per dollar of gas plant, municipal utilities delivered the largest volumes in 1997. It is worth noting that the average value of gas plant reported by municipal utilities is less than a quarter of that reported by either of the other segments. return to top

REVENUE PERFORMANCE

Figure 3 shows the allocation of average revenue for the three years studied. Table 2 summarizes average industry revenue performance by segment.

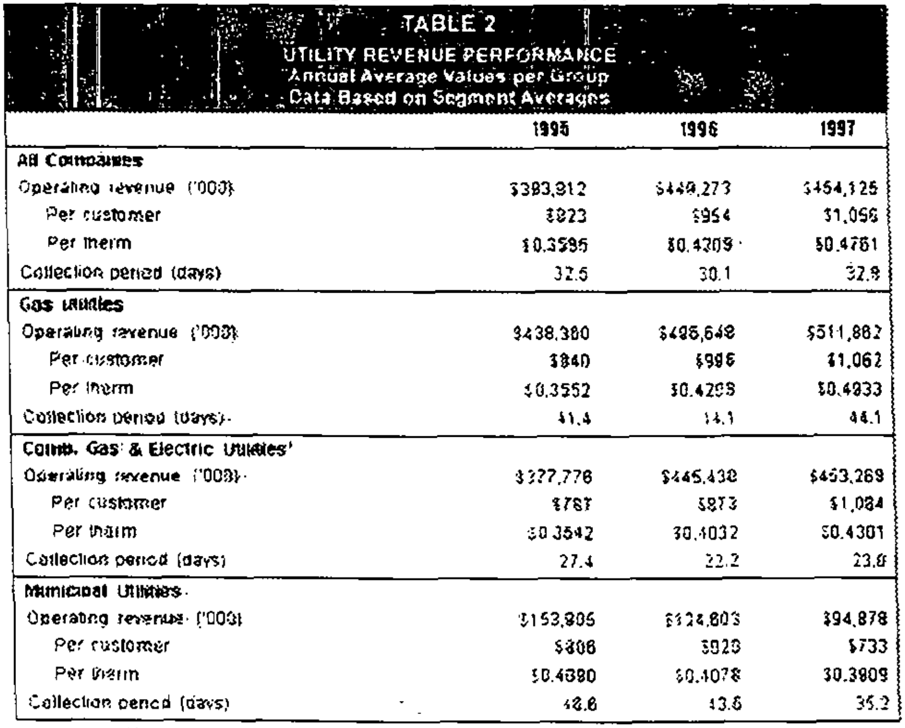


TABLE 2

UTILITY REVENUE PERFORMANCE
Annual Average Values per Group
Data Based on Segment Averages

	1995	1996	1997
All Companies			
Operating revenue ('000)	$383,812	$449,273	$454,125
Per customer	$823	$954	$1,056
Per therm	$0.3595	$0.4209	$0.4761
Collection period (days)	32.5	30.1	32.9
Gas Utilities			
Operating revenue ('000)	$438,380	$486,648	$511,882
Per customer	$840	$986	$1,062
Per therm	$0.3552	$0.4299	$0.4933
Collection period (days)	41.4	44.1	44.1
Comb. Gas & Electric Utilities'			
Operating revenue ('000)	$377,776	$445,438	$453,269
Per customer	$787	$873	$1,084
Per therm	$0.3542	$0.4032	$0.4301
Collection period (days)	27.4	22.2	23.8
Municipal Utilities			
Operating revenue ('000)	$153,905	$124,803	$94,878
Per customer	$806	$928	$733
Per therm	$0.4380	$0.4078	$0.3909
Collection period (days)	48.8	43.6	35.2

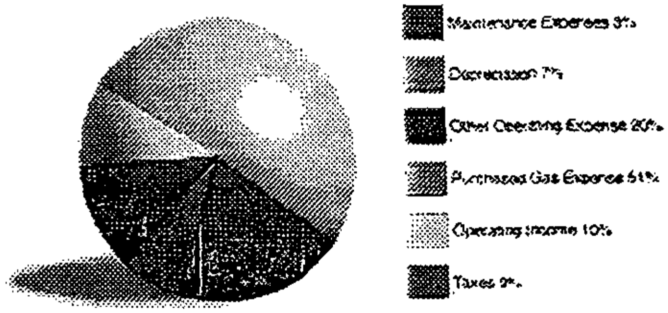
Source: A.G.A.; 'Figures for gas operations only.

The gas utility segment experienced the highest average revenue capture of all industry segments in all three years studied, whether viewed in absolute dollars or dollars per customer, or on a per therm basis. While both gas and combination utilities experienced rapid revenue growth (on a per therm basis) in 1996-21 percent and 15 percent respectively-during 1997 gas utilities increased revenues 15 percent, while combination companies posted an additional seven percent revenue growth.

FIGURE 3

DISPOSITION OF REVENUES

All Utilities (Three Year Average)



Gas revenues accruing to the average combination utility are less than those collected by the average gas utility. Combination utilities' average annual therm loads per account were smaller in both 1995 and 1996, although in 1997 this trend reversed, with combination utilities posting the largest volumes of the sectors studied (see Table 1). Combination utilities feature significantly shorter bill collection periods, compared to the other industry segments.

Municipal utilities collect far less revenue on average, compared to the rest of the sample. This is largely due to the fact that the typical municipal utility serves fewer customers, compared to the other industry segments. They also feature low per-therm receipts. This in part reflects the public purpose and ownership of municipal utilities: without shareholders to repay, revenues are reduced accordingly. Also, to a lesser extent, the low average price per therm may reflect the municipal utilities' high volume of interruptible sales to institutional, industrial, and power generation customers who make up a sizable proportion of the municipals' total throughput.

return to top

O&M ANALYSIS

Operations and maintenance (O&M) expenses are those costs specifically attributable to current-year gas distribution activity. These are cost items that are incurred within an annual time period (as opposed to costs amortized over a period of years as is the case with finance costs and depreciation). A presentation of O&M costs on a per-therm basis will facilitate a comparison of cost efficiencies attained by the various industry segments. Table 3 shows average O&M expense detail for the years studied for the combination and gas utility segments.

All of the segments studied have experienced increased O&M costs per therm from 1995 to 1997. This is largely attributable to an increase in purchased gas expense. In 1996, the average wellhead price of natural gas to rose nearly 40 percent from the 1995 level to $2.15 per Mcf, and an additional seven-percent in 1997 to $2.32. This is reflected in the purchased gas expense in the following table.

Gas utilities have maintained slightly higher gross sales margins compared to the combination utilities. In 1997, the per therm margin was $ 0.2336 for gas utilities, compared to $0.1977 for combination utilities. However, gas utilities exhibited higher O&M costs per therm of throughput in 1997 when compared to combination companies. Gas utilities experienced a lower average purchased gas expense in both 1995 and 1996. However, with the average cost of purchasing gas rising nearly 21 percent during 1997, gas utilities posted a higher purchased gas expense than combination firms.

TABLE 3
UTILITY O&M DETAIL ANALYSIS
Average Margin per Therm Sold

	GAS UTILITIES			COMBO UTILITIES		
	1995	1996	1997	1995	1996	1997
MARGINS PER THERM						
Gas-only revenues	$0.3552	$0.4298	$0.4933	$0.3642	$0.4032	$0.4301
<u>Purchased-gas expense</u>	<u>0.1655</u>	<u>0.2147</u>	<u>0.2598</u>	<u>0.1648</u>	<u>0.2011</u>	<u>0.2324</u>
Gross sales margin	0.1897	0.2151	0.2336	0.1994	0.2021	0.1977
Total production costs²	$0.1683	$0.2227	$0.2682	$0.1692	$0.2028	$0.2448
Storage & LNG	0.0028	0.0021	0.0028	0.0011	0.0025	0.0030
Transmission	0.0050	0.0029	0.0030	0.0100	0.0128	0.0021
Distribution	0.0253	0.0252	0.0298	0.0256	0.0252	0.0213
Customer accounts	0.0157	0.0178	0.0203	0.0149	0.0159	0.0160
Customer svc. & info.	0.0039	0.0038	0.0037	0.0037	0.0038	0.0023
Sales	0.0019	0.0021	0.0026	0.0017	0.0020	0.0018
<u>Admin. & general</u>	<u>0.0340</u>	<u>0.0389</u>	<u>0.0420</u>	<u>0.0329</u>	<u>0.0381</u>	<u>0.0274</u>
Total O&M	0.2567	0.3135	0.3723	0.2591	0.3008	0.3184
SAME-SIZE ANALYSIS						
Gas-only revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
<u>Purchased-gas expense</u>	<u>46.6%</u>	<u>49.9%</u>	<u>52.7%</u>	<u>45.2%</u>	<u>49.9%</u>	<u>54.0%</u>
Gross sales margin	53.4%	50.1%	47.3%	54.8%	50.1%	46.0%
Total production costs²	47.4%	51.8%	54.4%	46.4%	50.3%	56.9%
Storage & LNG	0.8%	0.5%	0.6%	0.3%	0.6%	0.7%
Transmission	1.4%	0.7%	0.6%	2.8%	3.2%	0.5%
Distribution	7.1%	5.9%	6.0%	7.0%	6.2%	5.0%
Customer accounts	4.4%	4.1%	4.1%	4.1%	3.9%	3.5%
Customer svc. & info.	1.1%	0.9%	0.7%	1.0%	0.9%	0.8%
Sales	0.5%	0.5%	0.5%	0.5%	0.5%	0.4%
<u>Admin. & general</u>	<u>9.6%</u>	<u>9.1%</u>	<u>8.5%</u>	<u>9.0%</u>	<u>9.0%</u>	<u>6.4%</u>
Total O&M	72.2%	72.9%	75.5%	72.3%	74.6%	74.0%

Source: A.G.A., USA.

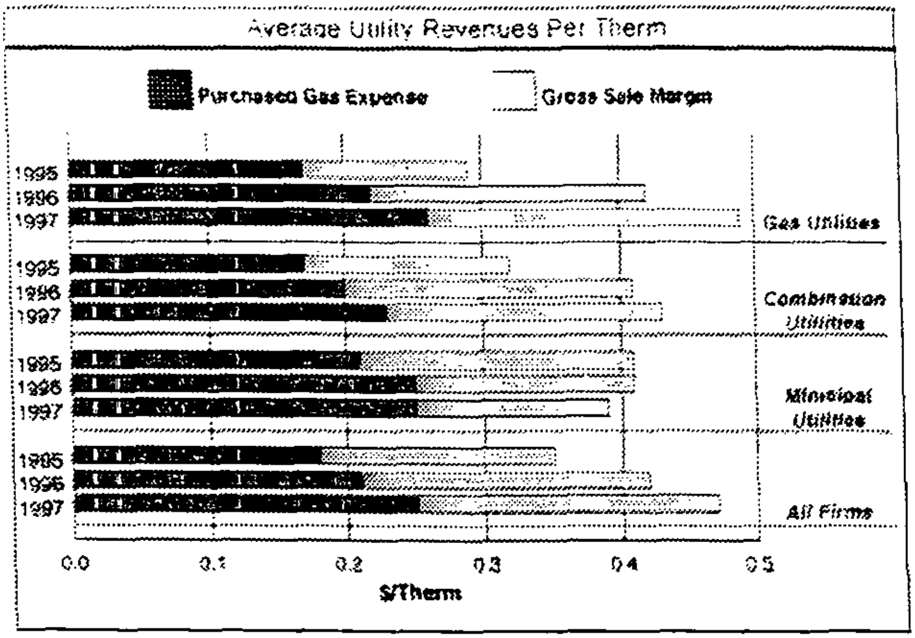
[1] Figures for gas operations only.

[2] Purchased-gas expense is subtracted from total production costs.

NOTE: Figures do not sum precisely due to independent rounding.

The combination utilities have a lower average gross sales margin per therm compared to gas only utilities. This can be attributed to both a higher costs of gas as well as slow revenue growth. Despite the increase in gas costs, this segment was able to reduce total O&M costs in every other line item in 1997-with the exception of customer service and information. When compared to gas only firms, combination utilities may enjoy cost advantages in those activities that reflect economies of scope, i.e., the functions that can be shared across gas and electric divisions. Those include customer account functions, customer service and information activities, sales activity, and A&G expenses.

FIGURE 4



return to top

INCOME ANALYSIS

Operating income, by accounting definition, represents revenues net of operations expenses. Operating income does not net out capital cost- related expenses such as interest and amortization. A summary of operating income, then, allows a comparison of efficiency strictly in gas distribution. Figure 4 shows the dispersion of individual companies' operating income per-therm. Table 4 shows average operating income results by type of firm.

The gas utility segment produces the highest average magnitude of operating income in the industry sample. Operating income for these firms is typically about 10 percent of revenue. Despite increasing revenue, gas utilities experienced a decline in net income during 1997. This is primarily due to increased O&M costs as well as an increase in taxes paid. Historically, this segment's gas plant is the most economically productive, in that the ratio of operating income to value of plant in service is the highest in the sample. However, the decline in net income during 1997 has led to a decline in this ratio, with combination utilities on average increasing their gas plant productivity.

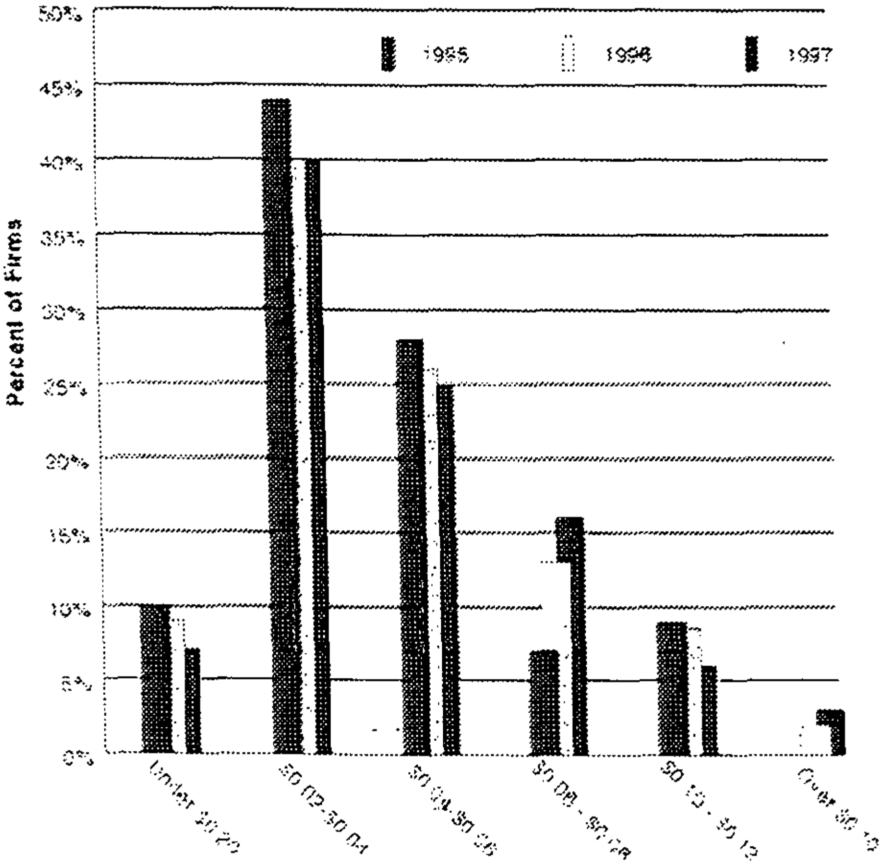
Combination utilities generate less income from gas operations, on average, when compared to gas-only utilities. Combination utilities exhibited the lowest ratio of operating income to gas plant.

TABLE 4
UTILITY INCOME STATEMENT HIGHLIGHTS
Average Values per Group, Gas Operations Only

	GAS UTILITIES			COMBO UTILITIES		
	1995	1996	1997	1995	1996	1997
Operating revenue, $000	$438,360	$498,648	$511,862	$377,776	$445,430	$453,268
Total O&M, $000	316,931	362,297	386,247	268,732	332,273	335,591
Operating income, $000	52,974	52,546	51,100	39,834	41,926	47,599
Percent of Revenue						
Total O&M	72.3%	72.8%	75.5%	71.1%	74.6%	74.0%
Operating income	11.9%	10.5%	10.0%	10.5%	9.4%	10.5%
Per Therm						
Revenue	$0.3552	$0.4298	$0.4933	$0.3642	$0.4032	$0.4301
Total O&M	0.2587	0.3136	0.3723	0.2591	0.3008	0.3184
Operating income	0.0422	0.0451	0.0493	0.0382	0.0380	0.0452
Per Customer						
Revenue	$840	$996	$1,062	$767	$873	$1,084
Total O&M	607	727	901	560	651	803
Operating income	100	105	106	83	82	114
Per Dollar of Gas Plant¹						
Revenue	$0.5960	$0.5619	$0.5077	$0.4828	$0.5584	$0.6223
Total O&M	0.3558	0.4099	0.4434	0.3434	0.4166	0.4607
Operating income	0.0601	0.0590	0.0587	0.0536	0.0526	0.0653
Per Mile of Pipe²						
Revenue	$31,536	$39,407	$39,814	$35,248	$38,855	$43,149
Total O&M	22,793	32,747	29,882	25,074	28,984	31,946
Operating income	3,746	4,136	3,955	3,638	3,657	4,531

Source: A.G.A., USR. ¹ Figures for gas operations only. ² Miles of main and services combined.

OPERATING INCOME PER THERM, All Firms



return to top

DEBT ANALYSIS

Debt instruments and their management are prominent items on the utilities' financial agendas. Debt has traditionally represented a large share of utility capitalization. This is due to the historically regulated environment in which utilities have operated. The presence of regulatory oversight, from an investor's perspective, suggests less risk, more stable cash flow, and generally better debt ratings and interest coverage from cash flow. Historically, this made the utility industries attractive to bond investors. As for utilities, the containment of interest and other debt-related carrying costs can have a decisive impact on the overall profitability of operations.

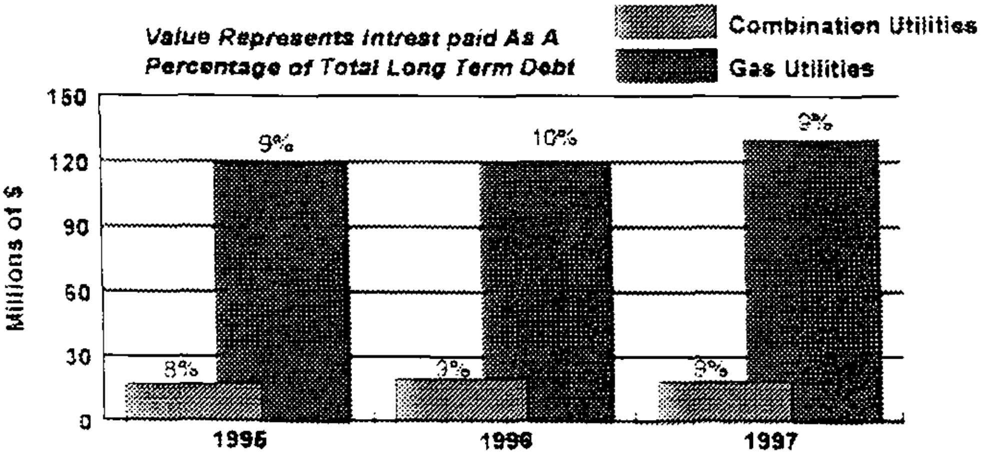
The total cost of capital for a utility reflects the cost of both debt and equity financing. Table 5 shows summary descriptors of capital costs for utilities by industry segment.

TABLE 5
UTILITY DEBT AND DEBT COVERAGE
Average Values

	1995	1996	1997
Gas utilities			
Total LT Debt to Total Assets	29.8%	28.4%	27.7%
LT Debt to Total Capitalization	47.2%	46.2%	44.7%
EBITDA Interest Coverage	6.9x	6.8x	7.1x
Combination Utilities			
Total LT Debt to Total Assets	29.3%	28.3%	30.3%
LT Debt to Total Capitalization	44.4%	44.3%	48.5%
EBITDA Interest Coverage	6.5x	5.3x	6.0x

Source: A.G.A., USR.

' Figures represent combined gas and electric operations.



Gas and combination utilities typically have access to commercial debt markets. Costs of long-term debt for any for-profit utility are driven by the company's bond ratings. These, in turn, are a function of debt market rating criteria-- Wall Street's measure of operating, financial, market, and competitive attr[illegible]es.

Note again that the discussion of combination utility debt and capital structure cannot be limited to gas operations. Therefore, this portion of the analysis necessarily considers combined-commodity financial performance. The combination utilities feature a diversity of commodity sales and stabilized electric base-load operations attributable to base-load (i.e., not weather-driven) sales.

return to top

PROFITABILITY ANALYSIS

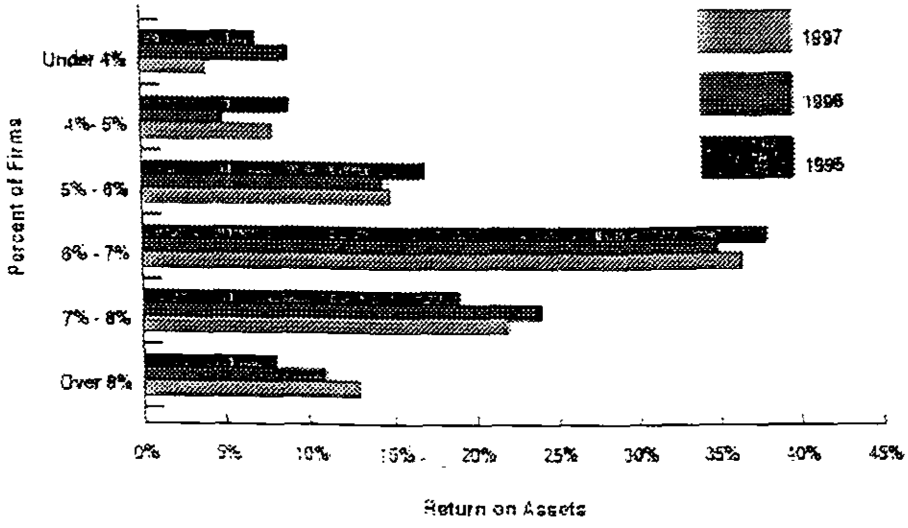
For this study, profitability is expressed in terms of return on assets (ROA), which relates net income to the value of the asset base that generated that income. Stated differently, ROA measures how well a company's assets "work" to generate income from operations. As such, ROA is convenient for comparing the operating results across companies within an industry.

Figure 6 shows the dispersion of individual company ROA results. Average ROA figures by industry segment in 1997 were as follows: 6.8% for gas utilities, 6.5% for combination utilities, 6.4% for municipal utilities, and 6.6% for all 73 firms studied. Table 6 shows profitability measures for both gas and combination utilities for the years studied.

Gas Utilities experienced an average 6.8 percent ROA in all three years studied. Combination utilities have exhibited a slight decline in ROA, but in general their profitability has been stable-ranging from 6.3 to 6.8 percent. While both of these segments have achieved similar, stable returns, this has occurred under different operating circumstances. To examine these differences, it is useful to decompose ROA in two parts, asset turnover and profit margin.

FIGURE 7

RETURN ON ASSETS, All Firms



While ROA is typically measured as the ratio of net income to assets, it can als[illegible]e expressed as asset turnover multiplie[illegible]y profit margin. Asset turnover measures a firm's ability to generate sales from its fixed asset base. From 1995 to 1997, gas utilities have increased their level of sales from their existing asset base from 0.58X to 0.66X, conversely, combination utilities have only increased their asset turnover from 0.37X to 0.40X over the same period. This would imply that in 1997, gas utilities have improved their efficiency of asset utilization by 14 percent from 1995, while combination utilities have increased their efficiency by 8 percent over the same period.

The second component of ROA is profit margin, or return on sales. This measures the operating profit per dollar of sales. From 1995 to 1997, the profit margins for gas only utilities have declined from 11.6 percent to 10.3 percent. During the same period, combination utilities" profit margin has dropped from 18.3 percent to 16.5 percent. The aggregate effect of slower growth in asset turnover coupled with a larger decline in profit margin-0.5 percentage points-resulted in the slightly lower ROA experienced by combination utilities. In general, both of these sectors are maintaining their profitability by gaining increased efficiency from their existing assets base to compensate for declining profits margins.

TABLE 6

UTILITY PROFITABILITY INDICATORS
(Average Values)

	1995	1996	1997
Gas utilities			
Asset Turnover	0.58X	0.63X	0.66X
Financial Leverage	66.4%	66.5%	65.5%
Equity Multiplier	3.25	3.14	3.01
Profit Margin	11.6%	10.6%	10.3%
ROA	6.8%	6.8%	6.8%
ROE	22.0%	21.3%	20.4%
Current Ratio	0.86	0.83	0.80
Current Assets/Total Assets	17.3%	18.2%	18.6%
Combination Utilities			
Asset Turnover	0.37X	0.45X	0.40X
Financial Leverage	63.1%	64.1%	67.4%
Equity Multiplier	3.04	3.08	3.44
Profit Margin	18.3%	14.1%	16.5%
Net ROA	6.8%	6.3%	6.5%
ROE	20.8%	19.5%	22.5%
Current Ratio	0.82	0.70	0.73
Current Assets/Total Assets	8.9%	8.6%	10.1%

Source: A.G.A., USR.

[1] Figures represent combined gas and electric operations.

Another measure of profitability is return on common equity (ROE). This differs from ROA in that it takes into account the impact of a firm's capital structure on its profitability. We can examine the capital structure of a firm in many different ways. The equity multiplier (shown in table 6) measures a firm's assets relative to its common stock equity. An increase in a firms level debt financing will cause a reduction in stockholders equity. This will cause the equity multiplier to decline and thereby decrease total ROE. As table 6 illustrates gas utilities have decreased their debt financing as a percent of their total capitalization. Although the ROA for this type of firm has on average remained constant at 6.8 percent. ROE has declined over the same period, which can partly be attributed a decline in the tax benefits a firm receives from debt financing. Conversely, combination utilities have increased their debt financing, and although their ROA has declined slightly over the period studied, their ROE has increased.

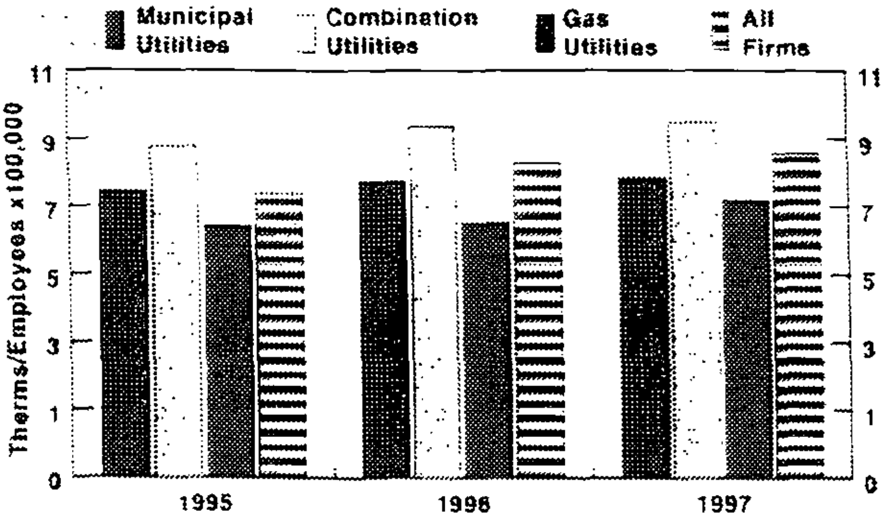
return to top

LABOR PRODUCTIVITY AND WAGE ANALYSIS

Current industry interest in restructuring, efficiency, and cost effectiveness often calls attention to staffing and wage profiles. Table 8 summarizes wage and benefit values by industry segment.

FIGURE 8

Average Therms Delivered Per Gas Employee



Gas utilities feature the highest ratio of benefits as a proportion of total compensation, although the total compensation is not the highest in the industry sample. On average, total compensation is a larger component of gas utilities total O&M expense when compared to combination utilities.

TABLE 8

UTILITY WAGES AND BENEFITS

Average Values per Employee at Year-End

	1995	1996	1997	3 Year Average
All Firms				
Number of employees at year-end	1,186	1,018	910	1,038
O&M wages	$45,040	$40,320	$36,679	$40,680
Total benefits and pensions	11,534	12,313	11,773	11,873
Total salaries, benefits, and pensions	45,377	47,891	50,746	47,938
Ratio of total benefits to total compensation	21.1%	20.2%	20.1%	20.5%
Total compensation as a percent of O&M	22.5%	20.1%	19.6%	21.1%
Therms sold per employee	805,443	934,265	920,762	886,823
Customers per employee	383	384	380	379
Gas Utilities				
Number of employees at year-end	1,386	1,113	1,032	1,177
O&M wages	$49,728	$42,228	$39,847	$43,934
Total benefits and pensions	11,728	13,142	11,744	12,205
Total salaries, benefits, and pensions	43,810	47,801	50,883	47,235
Ratio of total benefits to total compensation	22.2%	21.4%	21.0%	21.5%
Total compensation as a percent of O&M	23.0%	20.6%	19.8%	21.1%
Therms sold per employee	868,571	909,980	879,392	885,318
Customers per employee	340	365	371	359
Combination Utilities				
Number of employees at year-end	952	1,003	757	904
O&M wages	$42,321	$42,902	$37,077	$40,767
Total benefits and pensions	11,925	11,059	12,789	11,911
Total salaries, benefits, and pensions	50,348	50,580	58,602	52,510
Ratio of total benefits to total compensation	18.8%	17.2%	16.7%	17.6%
Total compensation as a percent of O&M	24.2%	19.8%	18.5%	20.8%
Therms sold per employee	940,776	1,049,314	1,193,261	1,061,117
Customers per employee	418	439	473	443
Municipal Utilities				
Number of employees at year-end	654	426	380	486
O&M wages	$23,161	$15,478	$10,404	$16,345
Total benefits and pensions	8,393	10,091	9,774	9,419
Total salaries, benefits, and pensions	38,777	41,324	37,983	39,361
Ratio of total benefits to total compensation	21.9%	24.0%	21.5%	22.4%
Total compensation as a percent of O&M	24.6%	17.8%	20.7%	21.0%
Therms sold per employee	613,137	719,241	698,374	676,917
Customers per employee	335	330	362	342

Source: A.G.A., USR. *Figures for gas operations only.

Combination utilities provided the samples highest average compensation to employees as well as the largest number of customers per employee. This may be in part due to the combination utilities' location in urban markets.

An oft-cited measure of a utility's productivity is the number of therms delivered per employee. From, 1995 to 1997, all of the sectors studied have increased their productivity in terms of this measure. During this period, gas utilities have increased deliveries per employee by 7.2 percent, while combination utilities have grown 8.8 percent and municipal utilities have gained 10.7 percent.

SUMMARY

Segments of the gas distribution industry are highly differentiated with respect to their financial performance and operational efficiency. This analysis of industry metrics illustrates the results for three industry segments: gas utilities, combination utilities and municipal utilities. The findings derived from this sample only suggest the attribute profile of the utility industry as a whole. Benchmarks such as these should not be interpreted as what should be, but instead as what is typical.

return to top

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