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COMMONWEALTH OF PENNSYLVANIA

PUBLIC UTILITY COMMISSION

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: Joint Application of PECO Energy Company :
: and Public Service Electric & Gas Company : Docket No.
: for approval of merger of Public Service : A-110550F0160
: Enterprise Group, Incorporated with and :
: into Exelon Corporation.

Further Hearing

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Pages 448 through 517

Hearing Room 1
State Office Building
Broad and Spring Garden Streets
Philadelphia, Pennsylvania

Friday, September 23, 2005

Met, pursuant to adjournment, at 10:08 a.m.

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P R O C E E D I N G S

1
2 JUDGE CHESTNUT: This is the further hearing at
3 Docket A-110550F0160. For the record, let me state that I'm
4 Administrative Law Judge Marlane R. Chestnut. I'll note the
5 following appearances for the record: Thomas Niesen
6 representing the Philadelphia Gas Works, David Kleppinger
7 representing the City of Philadelphia, Daniel Cantu-Hertzler
8 also representing -- and Darlene Heep -- excuse me
9 -- also representing the City of Philadelphia, Denise
10 Adamucci representing PGW, Sharon Webb representing the
11 OSBA, Charles McPhedran representing PennFuture Parties,
12 Jesse Dillon representing PPL Companies, Paul Bonney and
13 Kent Murphy representing PECO, Mike Naeve and Matt Estes
14 representing PECO, Dan Clearfield representing PSE&G, Tanya
15 McCloskey and Aron Beatty representing the OCA, and Thu Tran
16 representing Action Alliance.

17 Are there any preliminary matters before we get
18 going?

19 MR. KLEPPINGER: Thank you, Your Honor, and good
20 morning. By virtue of stipulation, Your Honor, the direct
21 and supplemental testimonies of Kent Miller have been agreed
22 to be stipulated into the record --

23 JUDGE CHESTNUT: Excuse me. Can I clarify something
24 here?

25 MR. KLEPPINGER: Yes.

1 JUDGE CHESTNUT: You can stipulate that you don't
2 need to present a witness to authenticate a document. You
3 can stipulate that you won't have any cross on that
4 testimony, but you can't stipulate something into the
5 record. That's something I have to do. Okay?

6 MR. KLEPPINGER: That's what we're going to be asking
7 you to do today.

8 JUDGE CHESTNUT: Thank you.

9 MR. KLEPPINGER: We would like to have marked for
10 identification as City of Philadelphia Statement No. 1
11 revised direct testimony of Kent Miller, which consists of
12 13 pages, as well as bound Exhibits KRM-1 through KRM-3, and
13 it is a redacted version based on the stipulations reached
14 with the company.

15 Could we have that marked for identification?

16 JUDGE CHESTNUT: It will be so marked.

17 (Whereupon, the documents were
18 marked as City of Philadelphia
19 Statement No. 1 and City of
20 Philadelphia Exhibits Nos. KRM-1
21 through KRM-3 for identification.)

22 MR. KLEPPINGER: Second, I'd like to have marked for
23 identification City of Philadelphia Statement No. 1
24 Supplemental, the supplemental testimony of Kent R. Miller
25 consisting of seven pages. I'd like to have that so marked.

1 JUDGE CHESTNUT: That also will be so marked.

2 (Whereupon, the document was marked
3 as City of Philadelphia Statement
4 No. 1 Supplemental for
5 identification.)

6 MR. KLEPPINGER: And, Your Honor, I have provided two
7 copies to the court reporter and one is on your bench in
8 front of you.

9 JUDGE CHESTNUT: Okay.

10 MR. KLEPPINGER: At this time, Your Honor, I'd like
11 to move for the admission of City of Philadelphia Statement
12 No. 1 and Exhibits KRM-1 through 3 and City of Philadelphia
13 Statement No. 1 Supplemental.

14 JUDGE CHESTNUT: Obviously, they're admitted. Thank
15 you.

16 MR. KLEPPINGER: Thank you.

17 (Whereupon, the documents marked as
18 City of Philadelphia Statements
19 Nos. 1 and 1 Supplemental and City
20 of Philadelphia Exhibits Nos. KRM-1
21 through KRM-3 were received in
22 evidence.)

23 JUDGE CHESTNUT: And just to be clear, you're
24 withdrawing Mr. --

25 MR. KLEPPINGER: Yes. We are not offering the

1 testimony of Tumar Alexander. It has not been admitted, so
2 it's not being withdrawn. It's just not being offered.

3 JUDGE CHESTNUT: Okay. That's fine. Thank you.

4 Anybody else want to take care of some -- yes, Ms.
5 Tran.

6 MS. TRAN: Good morning, Your Honor.

7 JUDGE CHESTNUT: Good morning.

8 MS. TRAN: Thu Tran for Action Alliance. We'd like
9 to mark for identification the direct testimony of Harry S.
10 Geller for Action Alliance, TAG and ACORN. We have two
11 copies for the court reporter. Along with the direct
12 testimony are Exhibits A through K.

13 And I'd like to mark for identification the
14 surrebuttal testimony of Harry S. Geller for the same party.

15 JUDGE CHESTNUT: Can you hold on just a second?

16 MS. TRAN: Yes.

17 JUDGE CHESTNUT: Okay. I have it here. That's 1-SR?

18 MS. TRAN: Yes, Your Honor. Action Alliance
19 Statement 1 is the direct testimony and Action Alliance
20 Statement 1-SR is the surrebuttal testimony.

21 JUDGE CHESTNUT: It will be so marked.

22 (Whereupon, the documents were
23 marked as Action Alliance
24 Statements Nos. 1 and 1-SR and
25 Action Alliance Exhibits A through

1 K and 1-SR through 10-SR for
2 identification.)

3 MS. TRAN: There have been no revisions since the
4 time we filed it with Your Honor or sent you a copy, and
5 right now we'd like to move for admission into the record by
6 stipulation.

7 JUDGE CHESTNUT: Obviously, they're admitted. Thank
8 you very much, Ms. Tran.

9 MS. TRAN: Thank you.

10 (Whereupon, the documents marked as
11 Action Alliance Statements Nos. 1
12 and 1-SR and Action Alliance
13 Exhibits A through K and 1-SR
14 through 10-SR were received in
15 evidence.)

16 JUDGE CHESTNUT: Yes.

17 MR. MCPHEDRAN: Your Honor, Charlie McPhedran from
18 PennFuture Parties. We'd like to have marked for admission
19 PennFuture Statements 1, 2 and 3, and we seek their
20 admission by stipulation. This includes Exhibit PF-JP-1 and
21 PF-JP-2 with Statement No. 2 of John Plunkett, and PF-DH-1
22 with Statement No. 3 of David Hill.

23 JUDGE CHESTNUT: The documents will be so marked.
24 I'm sorry. Did you say 1, 2, 3?

25 MR. MCPHEDRAN: 1, 2, 3.

1 JUDGE CHESTNUT: But not 1-S?

2 MR. McPHEDRAN: That's correct.

3 JUDGE CHESTNUT: Okay.

4 (Whereupon, the documents were
5 marked as PennFuture Statements
6 Nos. 1, 2 and 3 and PennFuture
7 Exhibits Nos. PF-JP-1, PF-JP-2 and
8 PF-DH-1 for identification.)

9 MR. McPHEDRAN: We're giving two copies to the
10 reporter, and they're unchanged from previously distributed.

11 JUDGE CHESTNUT: Okay. They're admitted.

12 (Whereupon, the documents marked as
13 PennFuture Statements Nos. 1, 2 and
14 3 and PennFuture Exhibits Nos.
15 PF-JP-1, PF-JP-2 and PF-DH-1 were
16 received in evidence.)

17 JUDGE CHESTNUT: Anybody else?

18 MR. MURPHY: Yes, Your Honor; Kent Murphy for the
19 Joint Applicants. In accordance with the agreement not to
20 cross-examine Kent R. Miller, the City of Philadelphia's
21 witness, the parties, the City and the Joint Applicants,
22 have agreed to allow the entry of two PECO Cross-Examination
23 exhibits, the first of which is PECO Cross-Examination
24 Exhibit 1, which is a response by Kent R. Miller to a data
25 request from Set III of the Joint Applicants' Interrogatory

1 No. 2; and the second exhibit is PECO Cross-Examination
2 Exhibit No. 2, which is Mr. Miller's response to
3 Interrogatory Set IV, No. 4.

4 The agreement between the Joint Applicants and the
5 City was to allow us to move this into the record without
6 objection and, of course, Your Honor's authorization.

7 JUDGE CHESTNUT: Okay. The documents are admitted,
8 PECO Cross-Examination Exhibits 1 and 2.

9 (Whereupon, the documents were
10 marked as PECO Cross-Examination
11 Exhibits Nos. 1 and 2 for
12 identification, and were received
13 in evidence.)

14 JUDGE CHESTNUT: Yes, Mr. Dillon.

15 MR. DILLON: Your Honor, at yesterday's hearing, Your
16 Honor allowed PPL the opportunity to review in greater
17 detail PECO Statement No. 3-R Revised and PECO Statement No.
18 9-R Revised, which were received late in the hour to see if
19 we had any objections. We have none.

20 JUDGE CHESTNUT: Great. Thank you very much. Then
21 those documents were admitted conditionally, and the
22 condition is satisfied.

23 Ms. McCloskey -- or Ms. Tran.

24 MS. TRAN: Your Honor, I'm sorry. Just to be clear
25 for the record, Action Alliance Statement No. 1 has Exhibits

1 A through K, and Action Alliance Statement 1-SR has Exhibits
2 1-SR through 10-SR, which were moved into the record.

3 JUDGE CHESTNUT: Yes.

4 MS. TRAN: Thank you.

5 JUDGE CHESTNUT: Thank you.

6 Ms. McCloskey.

7 MS. McCLOSKEY: Good morning, Your Honor. I'd like
8 to have marked for identification a number of OCA Statements
9 beginning with OCA Statement 1 proprietary and redacted
10 version, which is the direct testimony of Richard LaCapra;
11 and OCA Statement 1 non-proprietary and redacted version,
12 which is the non-proprietary version of Mr. LaCapra's
13 testimony; OCA Statement 1-R, the rebuttal testimony of
14 Richard LaCapra; OCA Statement --

15 JUDGE CHESTNUT: Excuse me for just a second.

16 (Pause.)

17 JUDGE CHESTNUT: Thank you.

18 MS. McCLOSKEY: OCA Statement 1-S redacted version,
19 the surrebuttal testimony of Richard LaCapra; OCA Statement
20 1-Supp, the supplemental testimony of Richard LaCapra.

21 JUDGE CHESTNUT: Hold on a second while I find that.

22 (Pause.)

23 JUDGE CHESTNUT: Okay.

24 MS. McCLOSKEY: OCA Statement 3, the direct testimony
25 of Jerome D. Mierzwa; OCA Statement 3-S, the surrebuttal

1 testimony of Jerome D. Mierzwa.

2 JUDGE CHESTNUT: Okay.

3 MS. McCLOSKEY: OCA Statement 4 with the attached
4 Exhibit BA-1, the direct testimony of Barbara R. Alexander.

5 JUDGE CHESTNUT: I'm sorry. Hold on just a second
6 while I go through my list here. This is chronological, not
7 by party. Okay. So that's Statement 4 and Exhibit BA-1;
8 right?

9 MS. McCLOSKEY: Correct.

10 JUDGE CHESTNUT: Okay. And then?

11 MS. McCLOSKEY: OCA Statement 4-S, the surrebuttal
12 testimony of Barbara R. Alexander.

13 JUDGE CHESTNUT: 4-S. Okay. I got that.

14 MS. McCLOSKEY: And OCA Statement 4-Supp, the
15 supplemental testimony of Barbara R. Alexander.

16 JUDGE CHESTNUT: Okay. They'll all be so marked.

17 (Whereupon, the documents were
18 marked as OCA Statements Nos. 1,
19 1-R, 1-S, 1-Supplemental, 3, 3-S,
20 4, 4-S and 4-Supplemental and OCA
21 Exhibit No. BA-1 for
22 identification.)

23 MS. McCLOSKEY: Your Honor, at this time I'd like to
24 move for the admission of the OCA statements that have been
25 marked.

1 JUDGE CHESTNUT: They're admitted.

2 (Whereupon, the documents marked as
3 OCA Statements Nos. 1, 1-R, 1-S,
4 1-Supplemental, 3, 3-S, 4, 4-S and
5 4-Supplemental and OCA Exhibit No.
6 BA-1 were received in evidence.)

7 MS. McCLOSKEY: And, Your Honor, we are not offering
8 OCA Statement 2, which is the direct testimony of Douglas
9 Smith and Richard Hahn, and we are also not offering OCA
10 Statement 2-S, which was the surrebuttal testimony of
11 Douglas Smith and Richard Hahn.

12 JUDGE CHESTNUT: Okay. Thank you very much.

13 MS. McCLOSKEY: Thank you, Your Honor.

14 JUDGE CHESTNUT: Anybody else?

15 (No response.)

16 JUDGE CHESTNUT: Okay. Then we'll get to our first
17 witness. Are we going to take -- I'm sorry. Yes?

18 MS. McCLOSKEY: I'm sorry, Your Honor. I have the
19 copies for the court reporter and additional copies of the
20 redacted version for you. I'd like to distribute them at a
21 break.

22 JUDGE CHESTNUT: Redacted in terms of your original
23 redaction?

24 MS. McCLOSKEY: Yes.

25 JUDGE CHESTNUT: Then I don't need another copy.

1 Thank you.

2 Carpenter, Morris? Who are we doing first?

3 MR. NIESEN: If Your Honor pleases, the first witness
4 today is Dr. Carpenter, the Philadelphia Gas Works witness
5 in this matter. We would call him.

6 JUDGE CHESTNUT: Dr. Carpenter, stand please and
7 raise your right hand.

8 Whereupon,

9 PAUL R. CARPENTER

10 having been duly sworn, testified as follows:

11 JUDGE CHESTNUT: Please sit down and give and spell
12 your name for the record.

13 THE WITNESS: Paul Carpenter, C-a-r-p-e-n-t-e-r.

14 JUDGE CHESTNUT: Go ahead, Mr. Niesen.

15 MR. NIESEN: Thank you, Your Honor. If Your Honor
16 pleases, Dr. Carpenter has three statements of testimony,
17 and I'd like to have them marked for identification.

18 First is Dr. Carpenter's direct testimony. It bears
19 a date of June 27, 2005; and with your permission, I'd like
20 to have that marked as PGW Statement No. 1.

21 JUDGE CHESTNUT: It will be so marked.

22 (Whereupon, the document was marked
23 as PGW Statement No. 1 for
24 identification.)

25 MR. NIESEN: Dr. Carpenter also has surrebuttal

1 testimony in this matter. It bears a date of August 26,
2 2005. The surrebuttal testimony, there are two versions to
3 it, a confidential and a public version; and with your
4 permission, I'd like to have the confidential version marked
5 as PGW Statement No. 1-SR Confidential.

6 JUDGE CHESTNUT: Well, we don't use the word
7 "confidential." We usually use the word "proprietary." So,
8 can we do that?

9 MR. NIESEN: Certainly. May it be identified in that
10 manner then?

11 JUDGE CHESTNUT: Yes.

12 MR. NIESEN: Thank you.

13 (Whereupon, the document was marked
14 as PGW Statement No. 1-SR
15 Proprietary for identification.)

16 MR. NIESEN: And then in respect to the public
17 version of the surrebuttal testimony, I would ask that that
18 be marked as PGW Statement No. 1-SR Public Version. May
19 that be so identified?

20 JUDGE CHESTNUT: Yes.

21 (Whereupon, the document was marked
22 as PGW Statement No. 1-SR Public
23 Version for identification.)

24 MR. NIESEN: Dr. Carpenter, in addition, has a
25 statement of supplemental testimony in opposition to the

1 Joint Settlement Petition; and with Your Honor's permission,
2 I'd like to have that marked as PGW Statement No. 1-S.

3 May that be so identified?

4 JUDGE CHESTNUT: Yes. It will be so marked.

5 (Whereupon, the document was marked
6 as PGW Statement No. 1-S for
7 identification.)

8 MR. NIESEN: And if Your Honor pleases, the form of
9 PGW Statement No. 1-S that I've had identified has a revised
10 calculation on page 6 of the testimony. It concerns a
11 calculation of the typical residential customer reduction as
12 a result of the Joint Settlement Petition.

13 The revision was made after a discussion with the
14 Consumer Advocate and the Joint Applicant. Again, I have
15 marked the revised version as PGW Statement No. 1-S. I
16 provided the revised version to the court reporter. I've
17 also given Your Honor a copy of that revised version.

18 I have some additional copies of the revised
19 statement for the parties if they do not have one. I also
20 have a copy of the corrected page that I can distribute to
21 others here this morning.

22 JUDGE CHESTNUT: Okay. Thank you. I think we all
23 have that.

24 MR. NIESEN: And then, if Your Honor pleases, there
25 is an errata sheet concerning Dr. Carpenter's direct

1 testimony that I would like to have marked as PGW Exhibit
2 No. 1. May that be so --

3 JUDGE CHESTNUT: I'd prefer that we not mark it as an
4 exhibit. It's an errata to your testimony, so it would be
5 like him just saying it. I'm not comfortable marking it as
6 an exhibit.

7 MR. NIESEN: Very good.

8 **DIRECT EXAMINATION**

9 BY MR. NIESEN:

10 Q. Please state your name and your business address
11 for the record.

12 A. Paul Carpenter, 44 Brattle Street, Cambridge,
13 Massachusetts, 02138.

14 Q. Dr. Carpenter, how are you employed?

15 A. I'm a principal of the Brattle Group.

16 Q. Have you prepared a statement of direct
17 testimony for use in this proceeding?

18 A. I have.

19 Q. I'm showing you a copy of what has been marked
20 as PGW Statement No. 1. Is this the direct testimony which
21 you have prepared?

22 A. Yes.

23 Q. Are there any additions or corrections which you
24 would like to make to PGW Statement No. 1?

25 A. Yes. There was an errata sheet prepared that

1 covered mostly some typographical errors and a few changes
2 in numbers.

3 Q. Would you take the court through the specific
4 errata by page and line number, please?

5 A. Yes. On page 4, line 19, what was originally
6 2.6 billion cubic feet should be changed to 2.51 billion
7 cubic feet.

8 Page 4, line 28, a correction to the spelling of the
9 word "divestitures." Page 5, line 4, a correction to the
10 word "The" at the beginning of the sentence. It should be
11 "There."

12 Page 4, line 28, removed an extraneous comma.

13 Q. Page 4 or page 5?

14 A. Page 5 -- I'm sorry -- line 28. Page 19, line
15 3, change the word "upstream" to "downstream." Page 20,
16 line 6, change the word "upstream" to "downstream." Page
17 21, line 16, change the word "upstream" to "downstream."
18 Page 21, footnote 42, change the word "upstream" to
19 "downstream."

20 Page 22, line 7, the figure "2.6 Bcf/d" should be
21 "2.51 Bcf/d." And on page 24, footnote 43, the reference to
22 page 10 should be page 14.

23 Q. Now, if I were to ask you the questions set
24 forth in PGW Statement No. 1, would you give the answers as
25 stated therein as corrected?

1 A. Yes, I would.

2 Q. Are those answers true and correct to the best
3 of your knowledge, information and belief?

4 A. Yes.

5 Q. Dr. Carpenter, have you also prepared a
6 statement of surrebuttal testimony for the purpose of this
7 proceeding?

8 A. Yes.

9 Q. I'm showing you a copy of both the proprietary
10 and public versions of what has been marked as PGW Statement
11 No. 1-SR. Is this the surrebuttal testimony which you have
12 prepared?

13 A. Yes, it is.

14 Q. Are there any additions or corrections which you
15 would like to make to your surrebuttal testimony?

16 A. I have two corrections. On page 9, footnote 14,
17 the figure in the first line, "100 MMcf/d" should be "252
18 MMcf/d."

19 Then secondly, on page 7, footnote 29, in the first
20 line at the end, the word "twelve days" should be "fourteen
21 days."

22 Q. If I were to ask you the questions set forth in
23 PGW Statement No. 1-SR, would you give the answers as stated
24 therein as corrected?

25 A. Yes.

1 Q. Are those answers true and correct to the best
2 of your knowledge, information and belief?

3 A. Yes.

4 Q. Have you also prepared a supplemental statement
5 of testimony in opposition of the Joint Settlement Petition?

6 A. Yes.

7 Q. I'm showing you a copy of what has been marked
8 for identification as PGW Statement No. 1-S. Is this the
9 supplemental testimony which you have prepared?

10 A. It is.

11 Q. Are there any additions or corrections which you
12 would like to make to PGW Statement No. 1-S?

13 A. Yes. There's the correction you were referring
14 to earlier to page 6.

15 MR. NIESEN: That change is reflected in the version
16 of the testimony that has been marked, Your Honor.

17 BY MR. NIESEN:

18 Q. If I were to ask you the questions set forth in
19 PGW Statement No. 1-S, would you give the answers as stated
20 therein?

21 A. I would.

22 Q. Are those answers true and correct to the best
23 of your knowledge, information and belief?

24 A. Yes.

25 MR. NIESEN: If Your Honor pleases, at this time I

1 would move into the record PGW Statement No. 1; PGW
2 Statement No. 1-SR; the proprietary version, PGW Statement
3 No. 1-SR, the public version; and PGW Statement No. 1-S,
4 subject to cross-examination.

5 JUDGE CHESTNUT: Any objection?

6 MR. ESTES: No, Your Honor.

7 JUDGE CHESTNUT: The documents are admitted.

8 (Whereupon, the documents marked as
9 PGW Statements Nos. 1, 1-SR
10 Proprietary, 1-SR Public Version
11 and 1-S were received in evidence.)

12 JUDGE CHESTNUT: Let me just suggest a little advice
13 for people here. If you are going to have revisions to
14 written testimony, obviously, the errata sheet will be
15 included with Dr. Carpenter's statement and he has made
16 changes on the record, but just in terms of making it easier
17 for any staff people who might want to read the testimony, I
18 would suggest that for the copies that you provide to the
19 Commission you incorporate those changes into the documents.

20 You don't have to, of course, but just from my own
21 experience in working with people, it's a good idea just to
22 give them the version right there. Okay? But, again, that
23 was just my comment here.

24 So, let's get to any cross of Dr. Carpenter.

25 MR. ESTES: Yes, Your Honor. That's going to be me.

1 JUDGE CHESTNUT: That's you.

2 CROSS-EXAMINATION

3 BY MR. ESTES:

4 Q. Good morning, Dr. Carpenter.

5 A. Good morning.

6 Q. I'm Matt Estes. I'm representing PECO in this
7 proceeding. Dr. Carpenter, one of your primary claims in
8 your testimony is that the Joint Applicants can exercise
9 market power in natural gas markets and raise natural gas
10 prices in PJM East above competitive levels; isn't that
11 correct?

12 A. Yes.

13 Q. Now, you're not claiming that the Joint
14 Applicants can raise gas prices throughout the United
15 States, are you?

16 A. No.

17 Q. For example, the Joint Applicants could not
18 raise prices in the natural gas producing regions to the
19 south and west of PJM East.

20 A. That's correct.

21 Q. Instead, the market power that you're testifying
22 to is limited to PJM East?

23 A. That's correct.

24 Q. To the extent that natural gas prices in PJM
25 East are elevated above competitive levels, a purchaser of

1 natural gas in the gas producing regions would still be able
2 to purchase gas in those regions at a competitive price;
3 isn't that correct?

4 A. That's correct.

5 Q. And, similarly, a purchaser of natural gas
6 located in PJM East that held firm transportation rights
7 could purchase the gas in the producing region at a
8 competitive price and transport it to PJM East; is that
9 correct?

10 A. That's correct.

11 Q. So if for some reason the prices in PJM East
12 were elevated above competitive levels, that purchaser could
13 purchase its gas outside of PJM East at a competitive price;
14 is that correct?

15 A. Correct, assuming he held firm transportation
16 capacity back to the basin.

17 Q. And it is true, is it not, that PGW has firm
18 transportation rights to transport gas from the producing
19 regions to Philadelphia; is that correct?

20 A. I believe that's correct.

21 Q. So, to the extent that prices were elevated in
22 PJM East above competitive levels, PGW would be able to
23 purchase gas at competitive prices and avoid the elevated
24 levels in PJM East?

25 A. Yes, to the extent of their rights on the

1 interstate pipelines.

2 Q. Now, do you know whether PGW has contract rights
3 that allow it to satisfy its demand during peak load
4 periods?

5 A. I believe they do.

6 Q. So, as a result, they should be able to purchase
7 gas in the producing regions even during their peak periods?

8 A. That's correct.

9 Q. As a result, even if the Applicants were able to
10 elevate the price of natural gas in PJM East above
11 competitive levels, PGW and PGW's retail sales customers
12 wouldn't be paying a higher price than the competitive price
13 in the producing region; is that correct?

14 A. That's correct, but for their electricity
15 purchases, they may well be paying a higher price, as I've
16 indicated in my testimony.

17 Q. Okay. I'll get to that, but you agree with me
18 that the natural gas prices would not be affected?

19 A. Again, to the extent of their holdings of
20 interstate pipeline capacity and to the extent they continue
21 to have those holdings. Obviously, if the world changed and
22 they had to recontract, then there could be an effect.

23 Q. Now, it's generally true that the other local
24 distribution companies, which you refer to as LDCs, in PJM
25 East also have firm contract rights that allow them to bring

1 gas into PJM East from the producing regions; is that
2 correct?

3 A. That's correct.

4 Q. So, again, to the extent that prices were
5 elevated in PJM East, those LDCs and their retail sales
6 customers would not have to pay the elevated natural gas
7 price.

8 A. Yes, but only to the extent that they're
9 purchasing in the basin using transportation rights. To the
10 extent they're making purchases at the PJM East delivery
11 points, they would pay a higher price.

12 Q. But, in general, the other LDCs also have rights
13 sufficient to satisfy their loads on peak days; isn't that
14 correct?

15 A. I think in general that's correct, but I can't
16 categorically say that for every LDC in the region, because
17 I haven't simply looked at that.

18 Q. Okay. Now, you mentioned elevated electric
19 prices. It's correct, is it not, that PGW's -- the price
20 that PGW pays for electricity to PECO is subject to a price
21 cap? Is that correct?

22 A. That's correct.

23 Q. And that price cap will remain in effect through
24 the end of 2010?

25 A. That's what I understand, yes.

1 Q. So, at least for the next five years, even if
2 the Applicants were able to increase electric prices in PJM
3 East, that increase would not affect PGW; is that correct?

4 A. I believe that's correct.

5 Q. Now, your analysis of the market concentration
6 is based on data as of 2006; is that correct?

7 A. Two thousand four.

8 Q. Two thousand four, is that what your --

9 A. I believe it's index of customer data -- you're
10 talking about the HHI calculation?

11 Q. Yes.

12 A. It would be 2004.

13 Q. There are a number of things that could change
14 between 2004 and 2011, would you agree with that, with
15 respect to the natural gas concentration?

16 A. Well, you can always speculate that things could
17 change, sure.

18 Q. Certainly we may not know how they're going to
19 change, but we can almost know for certainty that things
20 will be different in some way?

21 A. I don't think we can know anything with
22 certainty in this market.

23 Q. Let's turn to your direct testimony, I believe
24 that's PGW Statement 1, at page 12. Are you there?

25 A. Yes.

1 Q. And in particular I'd like to direct your
2 attention to your discussion at lines 4 to 16 where you're
3 describing contract rights held by an affiliate of PSEG,
4 which is called -- it's PSEG ER&T, and I'm going to refer to
5 that company as ERT. It's correct, is it not, that ERT
6 holds the contract rights used to serve PSEG's natural gas
7 requirements?

8 A. Yes.

9 Q. And if you look starting at line 10, you're
10 describing natural gas storage rights held by ERT; is that
11 correct?

12 A. Correct.

13 Q. This 82 Bcf of storage capacity that you
14 reference there, that storage capacity is located outside of
15 PJM East; is that correct?

16 A. I believe that's correct.

17 Q. And in order to transport that storage gas from
18 that storage capacity into PJM East, ERT would have to use
19 its natural gas transportation contract rights; is that
20 correct?

21 A. That's correct.

22 Q. And I believe at your deposition, when I asked
23 you about that, you said that you had accounted for that in
24 your calculations, you were not double counting. Do you
25 recall that?

1 A. Yes.

2 Q. And by double counting, I take it what you meant
3 was that you were not including these gas withdrawal rights
4 referred to here in ERT's market share; is that correct?

5 A. Correct. For example, the 1.6 Bcf a day of
6 capacity that goes into the HHI calculation includes storage
7 withdrawal and transportation rights.

8 Q. And those rights are based on the transportation
9 contract rights that ERT holds?

10 A. Yes. I mean, when they make a decision to
11 withdraw from storage, effectively when they make that
12 decision they are using their transportation capacity to get
13 that gas from the storage field to the city gate.

14 Q. Now, in the next question and answer you have a
15 similar conversation about PECO, and on page 13 you refer to
16 21 Bcf of storage held by PECO. Do you see that?

17 A. Yes.

18 Q. And again, that storage is located outside of
19 PJM East?

20 A. I believe so, yes.

21 Q. And again, in order to transport that into PJM
22 East, PECO would need to use its interstate transportation
23 capacity rights; is that correct?

24 A. That's correct.

25 Q. Now let's turn to your surrebuttal testimony at

1 page 26. Are you there, Dr. Carpenter?

2 A. I am.

3 Q. At the bottom of 26 and the top of 27 you're
4 discussing what you assert is flexibility by PSEG to use its
5 storage capacity, and I guess first a foundational question.
6 When you talk about PSEG here, you're really referring to
7 ERT; is that correct?

8 A. That's correct.

9 Q. I'd like to focus to the phrase you have at the
10 top of page 27 where you say, "these restrictions still
11 grant PSEG a great deal of daily flexibility as to whether
12 it withdraws gas from storage or uses its interstate
13 pipeline transportation capacity contracts to meet its
14 needs." Do you see that?

15 A. Yes.

16 Q. In fact, as you just testified even if PSEG
17 withdraws its gas from storage, it is still going to need to
18 use its interstate pipeline transportation capacity
19 contracts; isn't that what you just testified to?

20 A. Well, what I testified to was when it withdraws
21 from storage, it uses its transportation capacity. What I'm
22 saying here is that there's other transportation capacity
23 from the basin to the city gate that we talked about before
24 that doesn't involve storage withdrawal that it can make a
25 daily decision to flex on as to whether to use that

1 transportation or whether to use the transportation out of
2 storage.

3 Q. But in either event, it's transportation
4 capacity from outside PJM East into PJM East; isn't that
5 correct?

6 A. Yes. The discretion to inject and withdraw from
7 storage creates much more flexibility than what you'd call a
8 baseload pipeline transportation contract from the basin,
9 and to the extent that you're in a period of time during the
10 winter when you're not at your absolute peak day, so you
11 don't need to use all of your storage withdrawal capability
12 on that date, you could make a decision to not withdraw as
13 much as you otherwise would, you could make a decision to
14 transport more on your baseload contracts, or you could make
15 a decision to purchase gas at the city gate, which would
16 have a similar effect. So ER&T has discretion with respect
17 to all of those actions.

18 Q. You mentioned three alternatives in your answer.
19 The alternative of purchasing natural gas at the city gate,
20 that is an alternative that -- or let me ask you, you're
21 saying purchasing from a third party?

22 A. Correct.

23 Q. Now, any purchase from a third party, that third
24 party is going to need to get the gas from outside of PJM to
25 the city gate; isn't that correct?

1 A. That's correct. The sale will be made at that
2 point. But if you make a purchase instead of withdrawing
3 from storage, you are forcing the market to move more gas
4 into PJM East at that location than it otherwise would.
5 There are locational differences between where these things
6 come in. So your discretion with respect to storage
7 withdrawal would enable you to create congestion at one
8 point and satisfy it, and create congestion with a purchase
9 at another point, and those kinds of flexibilities is what
10 we've seen in other markets when things get tight.

11 Q. But just to be clear, under all three of your
12 alternatives, it's natural gas being transported into PJM
13 East using somebody's firm natural gas transportation
14 rights; is that correct?

15 A. That's correct.

16 Q. And the same is correct with respect to your
17 next question and answer regarding PECO's use of storage
18 capacity?

19 A. That's correct.

20 Q. Dr. Carpenter, you and Dr. Hieronymus have each
21 prepared an analysis of concentration of market power based
22 on contract rights; is that correct?

23 A. That's correct.

24 Q. And probably not surprisingly, you each reached
25 different results?

1 A. We do appear to reach different results.

2 Q. Dr. Hieronymus concluded that the market is
3 moderately concentrated, and you concluded that the market
4 is highly concentrated; is that correct?

5 A. That's correct.

6 Q. And just to define what we mean by moderately
7 concentrated and highly concentrated, you each performed a
8 calculation based on the HHI index; is that correct?

9 A. That's correct.

10 Q. And HHI stands for Hirschmann-Herfindahl Index;
11 is that correct?

12 A. Actually, I think Herfindahl goes first.

13 Q. Herfindahl-Hirschmann?

14 A. We used to refer to it as just the Herfindahl
15 Index, and then somehow Hirschmann got his name attached to
16 it.

17 MR. ESTES: Now, unlike Mr. Kaplan yesterday, I don't
18 know how to spell those, but I'll ask the court reporter to
19 look at the spelling from yesterday.

20 BY MR. ESTES:

21 Q. Now, the reason that the two of you reached
22 different results is that you each chose different contracts
23 to include in the analysis; is that correct?

24 A. Well, when I started my analysis I started with
25 Dr. Hieronymus' analysis and I made some corrections to his

1 analysis based on some contracts that he had missed or
2 contracts that he included that should have been excluded,
3 but I also employ a different methodology for defining the
4 size of the market, the denominator, as it were, in the
5 share calculations.

6 Q. But at least one of the differences is that you
7 were using different contracts in the calculation. Would
8 you agree with that?

9 A. I would agree with that, yes.

10 Q. I want to ask you some questions about those
11 differences, and in to maybe help us conceptualize this I'm
12 going to pass out an exhibit, which I'd like to have marked
13 as Joint Applicants Cross Exhibit No. 1.

14 JUDGE CHESTNUT: Well, we have PECO Cross-Examination
15 Exhibits 1 and 2.

16 MR. ESTES: I'm sorry, Your Honor. Then I --

17 JUDGE CHESTNUT: Do you want to make this PECO Cross-
18 Examination Exhibit 3?

19 MR. ESTES: Yes, Your Honor.

20 JUDGE CHESTNUT: That's fine.

21 MR. ESTES: I didn't realize that we were going to
22 have these other two. Should I mark these on what I gave
23 the court reporter?

24 JUDGE CHESTNUT: Yes, please.

25 (Whereupon, the document was marked

1 as PECO Cross-Examination Exhibit
2 No. 3 for identification.)

3 MR. ESTES: I'm sorry, Your Honor.

4 JUDGE CHESTNUT: That's all right.

5 BY MR. ESTES:

6 Q. Dr. Carpenter, I sent a copy of this to your
7 counsel yesterday evening. Have you seen this schematic
8 drawing?

9 A. Yes.

10 Q. It's not an effort to define exactly where the
11 pipelines are, but just a schematic to give us a feel for
12 physically what we have involved here. Would you agree that
13 this exhibit shows, first, the four pipelines that start
14 south and west of PJM East and can move through it, which
15 are the Columbia Gas Transmission, Tennessee Gas Pipeline,
16 Texas Eastern Pipeline and Transcontinental Pipelines?

17 A. I'm sorry; the question was can I do what?

18 Q. Would you agree that this shows those pipelines?

19 A. It shows the pipelines. I can't vouch that it
20 shows correctly where they cross or intersect, but it shows
21 the pipelines.

22 Q. And you would agree that whether the pipelines
23 follow those exact routes, you would agree those are the
24 four pipelines that move through PJM East?

25 A. Yes.

1 Q. And it also shows the Algonquin Gas Transmission
2 pipeline, which the line should have been extended a bit
3 further. It interconnects with Texas Eastern in New Jersey
4 and then flows northward to New England?

5 A. Correct.

6 Q. And you agree that, in fact, the Algonquin
7 pipeline does that?

8 A. Yes.

9 Q. Now, you and Dr. Hieronymus both include
10 contracts that have delivery points in PJM East, is that
11 correct, contracts on these pipelines?

12 A. Correct.

13 Q. However, one difference between you and
14 Dr. Hieronymus is he has included in his analysis contracts
15 that have a delivery point here at the beginning of the
16 Algonquin Gas Transmission Pipeline in which shippers have
17 corresponding rights to transport their gas northward on the
18 Algonquin Gas Transmission Line, and your analysis excludes
19 those contracts; is that correct?

20 A. That's correct.

21 Q. And you've excluded them because you believe the
22 shippers under these contracts have the rights to deliver
23 the gas to New England?

24 A. Well, and because under my analysis and my
25 understanding of the market, those contracts would not be a

1 competitive substitute for pipeline capacity serving
2 delivery points in PJM East.

3 Q. Now, I'm going to ask you some questions about
4 that in a little bit. I just want to first just see if we
5 can all have a common understanding of what's at issue here,
6 so I will get back to that.

7 Now, in his rebuttal testimony, Dr. Hieronymus also
8 included contracts on the four pipelines running through PJM
9 East where the delivery points under those contracts are in
10 New York and New England; is that correct?

11 A. Yes. As I understand his rebuttal testimony, he
12 expanded the size of the relevant market beyond PJM East.

13 Q. And again, you would exclude those contracts
14 from your calculation?

15 A. Yes. I do not believe that he's got the right
16 relevant market in his rebuttal testimony.

17 Q. Now I want to ask you a few questions to see if
18 we can pinpoint exactly where the disagreement is between
19 you and Dr. Hieronymus regarding these contracts. I'd like
20 to ask you first if you would agree that, as a physical
21 matter, the natural gas transported under the contracts that
22 Dr. Hieronymus includes and you exclude is transported
23 through these pipelines through PJM East, even if they
24 didn't have rights to transport it further? Do you agree
25 with that?

1 A. Yes. The gas physically flows through the pipes
2 through the region.

3 Q. And would you also agree that under FERC's open
4 access regulations, the shippers under these contracts have
5 the right to deliver that gas in PJM East instead of using
6 their rights to deliver it in New York or New England?

7 A. Yes, I would agree that they contractually have
8 that right. The issue is whether it makes economic sense
9 for them to do that during peak periods.

10 Q. And the reason you believe that they may not
11 deliver that gas in PJM East is because you believe that
12 market prices for gas would be higher in New York or New
13 England?

14 A. Well, we have observed historically that a price
15 separation occurs between New York, New England and PJM East
16 during significant periods of time in the winter, and we've
17 seen it happen in the summer as well.

18 Q. Now, it's the case that I take it from your
19 answer that there are also time periods when there are not
20 significant price differences between PJM East and New York
21 and New England; is that correct?

22 A. That's correct.

23 Q. And at least during those instances when there
24 are not significant price differences, then, even as a
25 matter of economics, the shippers could deliver their gas in

1 PJM East if the prices were to be elevated as a result of
2 the withholding strategy?

3 A. Yes. Again, assuming that the withholding
4 strategy did not create a constraint that otherwise didn't
5 exist.

6 Q. Another difference between what Dr. Hieronymus
7 did and what you did I believe is that Dr. Hieronymus, at
8 least in his rebuttal testimony, included the capacity from
9 the Leidy line -- that's spelled L-e-i-d-y -- is that
10 correct?

11 A. Well, as we discussed earlier, the capacity from
12 the Leidy line, which is referred to as the Leidy line, is
13 from storage, and that was included in my original analysis.
14 As I understand, what Dr. Hieronymus did in his rebuttal was
15 to modify his geographic market to include that line that he
16 had not included originally.

17 Q. So to make sure I understand, you have in your
18 calculation capacity on the Leidy line where you believe
19 that gas is delivered into PJM East, but you have excluded
20 some capacity for the same reason you've excluded capacity
21 for other contracts; is that correct?

22 A. I believe that's correct. I'd have to check to
23 see whether there were particular contracts on the Leidy
24 line that served outside of PJM East. There probably are,
25 and if there were, we excluded those.

1 Q. But to the extent they included capacity in PJM
2 East, you would agree that they're properly included?

3 A. Yes, and they were included in my original
4 analysis.

5 Q. Let's turn to your direct testimony at page 20.
6 Are you there, Dr. Carpenter?

7 A. I'm there.

8 Q. On page 20 here you have a table entitled
9 Algonquin Delivery Rights, and as I understand it, these are
10 contracts that you removed from Dr. Hieronymus' market
11 calculation?

12 A. Yes, that's correct.

13 Q. And below this table starting at line 3, you
14 assert that these entities are largely New England and New
15 York LDCs. Do you see that?

16 A. Yes.

17 Q. In fact, there's no reason to exclude shippers
18 from the market calculation just because they're LDCs, is
19 there?

20 A. No, but the fact that they're LDCs is an
21 indication that that capacity is likely contracted for the
22 purpose of meeting LDC type service and is not the kind of
23 capacity that you would expect to see in peak periods being
24 marketed in an upstream region like a marketer would do.

25 Q. Let's turn a couple pages ahead to page 17.

1 A. Pages back you mean?

2 Q. Whichever way that is. Whichever direction page
3 17 is, turn to it.

4 A. I've got it.

5 Q. Now, this table shows the contract rights of the
6 entities you believe should be included in the calculation;
7 is that correct?

8 A. That's correct.

9 Q. This table also includes several LDCs; is that
10 correct?

11 A. That's correct.

12 Q. Assuming that there are no price differences
13 between PJM East and New England, for example, there's no
14 more reason to believe that an LDC located in PJM East would
15 sell gas in PJM East than there is to assume that an LDC in
16 New England, is there?

17 A. Well, you prefaced the question with assuming no
18 price differences, which, of course, is in part what this is
19 all about. It's what happens in these markets during peak
20 periods when prices separate, what kind of competition do
21 you get from other capacity. So if you ask me to assume
22 there's no price differences, you assume away the problem.

23 Q. Well, but you've testified that for a number of
24 days during the year there are no significant price
25 differences, haven't you?

1 A. Yes, there are periods of time when these
2 markets do not see price separation, but those aren't the
3 time periods that we need to be concerned about.

4 Q. Dr. Carpenter, you have proposed two remedies
5 for the market power problems that you claim to have
6 identified; is that correct?

7 A. Correct.

8 Q. The first of those is the divestiture of the
9 Applicants' gas operations; is that correct?

10 A. Correct.

11 Q. I'd like to focus on that for a minute. You're
12 not claiming, are you, that there is any market power
13 problem that results from the combination of the Applicants'
14 physical gas assets, are you?

15 A. Physical gas assets meaning the distribution
16 pipes?

17 Q. That's correct.

18 A. No.

19 Q. So the divestiture of those physical assets will
20 not address the problem that you've identified in your
21 testimony, will it?

22 A. Well, you can't have a distribution pipe without
23 having the gas that goes in it, and so the contracts that
24 they use to provide service to their distribution customers
25 is inherently linked to the distribution service. So in the

1 first remedy suggestion, it said the cleanest way to deal
2 with this is just simply divest the utilities, and then
3 you've got the incentives right, the contracts handle
4 themselves, just like traditional utility regulation. In
5 the second remedy I looked at a slightly different version
6 that wouldn't involve the distribution pipes.

7 Q. But to answer my question, the divestiture of
8 these physical assets is not going to address the problem
9 that you've identified?

10 A. Well, it would, because the gas goes with the
11 pipes and the incentive to exercise the market power with
12 respect to the gas contracts would then be isolated from the
13 electricity market incentives.

14 Q. If, for example, the gas operations were
15 divested but the contract rights on the upstream contracts
16 were not divested, then that would not solve the problem
17 you've identified, would it?

18 A. No, and that would make no sense.

19 Q. Well, would it be possible to divest those
20 assets and retain the contracts with the Joint Applicants
21 and enter into an asset management agreement with the
22 divested entity?

23 A. So you're suggesting divest the pipes,
24 distribution pipes, but have the Applicants keep the
25 contracts?

1 Q. I'm asking if that happened, that would not
2 satisfy the problem that you've identified?

3 A. No.

4 Q. Really, what you're getting at is the contract
5 rights, not the physical assets; is that correct?

6 A. I said the source of the market power is the gas
7 contracts that they hold. The pipes are the means for
8 delivering that. It seemed to me a clean way of handling
9 the problem, to divest the utility operations, including the
10 contracts. It makes for an easier regulatory solution and
11 it eliminates the incentive problem.

12 Q. But again, to answer my question, it's the
13 contract rights, not the physical assets; is that correct?

14 A. Contract rights create -- is a source of market
15 power, yes.

16 MR. ESTES: Your Honor, could I have one or two
17 minutes to see if I have any more questions?

18 JUDGE CHESTNUT: Yes, that's a good idea.

19 (Pause.)

20 MR. ESTES: I have just a couple of short follow-ups,
21 Your Honor.

22 BY MR. ESTES:

23 Q. First, Dr. Carpenter, I had asked you a question
24 about whether an LDC located in New England could make gas
25 sales in PJM East and you said they could, but because they

1 have their load obligations, it's unlikely that that's what
2 they would do, at least during peak conditions; is that
3 correct?

4 A. I'm not sure I said it exactly that way, but
5 something to that effect.

6 Q. Isn't it true that the same thing applies to the
7 joint applicants when they are supplying their LDC
8 obligations?

9 A. Well, they're supplying their LDC obligations
10 but they have more transportation and storage capacity and
11 peaking capacity on any given day with the exception of a
12 peak day than they need to satisfy those obligations, so
13 that's what gives them discretion.

14 Now, in New England, that is also the case of the
15 LDCs in New England, but their decision to sell in New
16 England versus PJM East is going to be dictated by prices.
17 They will not use their discretionary capacity to sell into
18 PJM East if prices are higher in their own market.

19 Q. But that has nothing to do with them being an
20 LDC, does it? It just has to do with their rights to go to
21 New England?

22 A. Well, I think you have to look slightly
23 differently at LDCs who have obligations to serve versus,
24 say, marketers whose business it is to try to arbitrage
25 these kinds of situations. So I would make that

1 distinction.

2 And the fact is that the holders of contracts on
3 Algonquin that Dr. Hieronymus had included as being in PJM
4 East turned out to be largely New England LDCs.

5 Q. Now, PSEG and PECO are also LDCs that have
6 different incentives from marketers in PJM East; is that
7 correct?

8 A. Yes, but they're serving load in the PJM East
9 market, which is a distinction.

10 Q. I'd also like to follow up on your testimony
11 about the use of storage and how you suggested that the
12 applicants could use their storage instead of bringing gas
13 up from the Gulf Coast.

14 I'm assuming your suggestion is they would do that in
15 a way that economics otherwise would not dictate; is that
16 correct?

17 A. I'm not sure I understand the question.

18 Q. Well, you're not asserting that when it would be
19 cheaper for the joint applicants to withdraw their gas from
20 storage to serve their load instead of transporting it from
21 the Gulf Coast, that there's anything improper about that,
22 are you?

23 A. I guess I'll say no but with a qualifier, and
24 that is that whether one is cheaper or not, the fact is both
25 of those sources of gas can be delivered into the same

1 market and achieve the same market price, so the opportunity
2 costs of the two would be the same whether one is cheaper on
3 an inventory basis than another.

4 But what distinguishes storage from basin purchases
5 is this ability to fluctuate your withdrawal strategy day to
6 day, and that discretion creates volatility, potential
7 volatility on the transport pipe from that field.

8 Q. But that's only an anti-competitive or
9 uncompetitive activity if it's something that the applicants
10 wouldn't do for least cost competitive reasons; is that
11 correct?

12 A. Well, it's anti-competitive if it has the
13 potential to raise price, which is what the HHI statistics
14 are telling us, there is a risk in this market that that
15 could happen.

16 Q. So you believe it's anti-competitive whether or
17 not it's something that they would do to serve their own
18 customers at the lowest cost?

19 A. Well, there's multiple -- they're serving
20 multiple objectives. They're trying to serve their
21 customers at low cost to the extent that there's a
22 regulatory obligation and that the regulator can see what
23 their doing, and that's difficult with PSEG ER&T as I
24 indicated in the testimony.

25 But second, they're also trying to satisfy their

1 shareholders' desire for profits. And to the extent they
2 have the incentive to exercise market power, if there's a
3 risk there, what economics says is that profit maximizing
4 people will do that.

5 Q. Well, with respect to PECO, at least, if they
6 were to withdraw natural gas from their storage in a
7 situation when that wasn't the least cost alternative,
8 that's going to be detected by this Commission, isn't it?

9 A. Well, potentially, but I have to say it's very
10 difficult to do after the fact, to look at a storage
11 withdrawal strategy and say, "Gee, you know, you should have
12 withdrawn a little bit more yesterday than you did," because
13 it's impossible to know what prices would have been had they
14 used the other strategy.

15 So it's something that theoretically regulators can
16 do, but I think it's better in the context of a merger to
17 structurally fix the problem so that you don't put the
18 burden on regulators after the fact to try to handle it.

19 MR. ESTES: Those are all the questions I have, Your
20 Honor.

21 JUDGE CHESTNUT: Okay. Redirect? Do you want a few
22 minutes?

23 MR. NIESEN: Yes, if we may.

24 JUDGE CHESTNUT: Sure.

25 (Recess.)

1 JUDGE CHESTNUT: Mr. Niesen?

2 MR. NIESEN: If Your Honor pleases, we have no
3 redirect for Dr. Carpenter.

4 MR. ESTES: Your Honor, I realized I forgot to move
5 the admission of PECO Cross-Examination Exhibit No. 3.

6 JUDGE CHESTNUT: Okay. Thank you, Dr. Carpenter.
7 You're excused.

8 (Witness excused.)

9 JUDGE CHESTNUT: You have no objection, I assume, or
10 do you?

11 MR. NIESEN: I have no objection with the
12 restrictions about the exhibit noted by Dr. Carpenter on the
13 record.

14 JUDGE CHESTNUT: Okay. That's fine. It's fine for
15 me.

16 (Whereupon, the document marked as
17 PECO Cross-Examination Exhibit
18 No. 3 was received in evidence.)

19 JUDGE CHESTNUT: Okay. That takes us to Dr. Morris,
20 I guess.

21 MR. ESTES: Yes. We have a brief oral rejoinder for
22 Dr. Morris. And before we start, to move things along, I
23 have one really demonstrative exhibit for him to look at.
24 The first page is the same one that we've just done, to
25 provide a context.

1 JUDGE CHESTNUT: Okay. Mr. Estes, can you hold on
2 just a second while I get Dr. Morris' testimony.

3 MR. ESTES: Certainly.

4 (Pause.)

5 MR. ESTES: Your Honor, I was just going to say, this
6 was given to Mr. Niesen yesterday evening and we also
7 provided him with a list of potential points on oral
8 rejoinder yesterday.

9 JUDGE CHESTNUT: All right. Now, Dr. Morris, you've
10 already been sworn. That oath continues.

11 MR. MORRIS: Yes.

12 Whereupon,

13 JOHN R. MORRIS

14 having previously been duly sworn, testified further as
15 follows:

16 JUDGE CHESTNUT: And I think at this point all your
17 exhibits and statements have been moved in, right?

18 THE WITNESS: Correct.

19 JUDGE CHESTNUT: Okay.

20 **DIRECT EXAMINATION**

21 BY MR. ESTES:

22 Q. Dr. Morris, could you turn to 16 of Dr.
23 Carpenter's surrebuttal testimony?

24 A. Okay.

25 Q. And at lines 7 through 12 there, Dr. Carpenter

1 states that he believes there are separate geographic
2 markets for New England and New York as opposed to PJM East
3 during peak demand periods. In your view, does this
4 represent a change in Dr. Carpenter's theory from his direct
5 testimony?

6 A. Yes. In his direct testimony, he did not
7 exclude his market to the peak periods and in his
8 surrebuttal testimony he focused on the peak periods.

9 Q. In your view, does this change narrow the
10 differences between the parties?

11 A. Yes. As Dr. Carpenter testified earlier this
12 morning, he said when the prices are similar, which is 90
13 percent of the year or more, the market's broader, so we're
14 really only talking about the ten percent of the year where
15 the prices separate.

16 Q. In your view, based on this testimony, what are
17 the primary differences between the parties on this natural
18 gas issue?

19 A. There are two main differences. The first
20 question is whether PJM East is a separate market from New
21 York and New England for that ten percent of year. And the
22 second issue is, if one were to conclude that New York and
23 New England are a separate market, where would you draw the
24 line, the division between PJM East and the more northern
25 market.

1 Q. Okay. Now, let's briefly discuss that first
2 difference. Dr. Carpenter states in the same part of the
3 testimony that these differences result from their being
4 higher peak period prices in New York and New England. How
5 often is there this price separation?

6 A. If you compare PJM East to New England, it's
7 about ten percent of the days. If you compare PJM East to
8 New York, it's about ten percent of the days based upon the
9 reported mid-point prices. But if you take the interactions
10 that those days aren't all the same days, and the fact that
11 if you look at the incentive to deliver gas to PJM East
12 versus New England, you'd also have to consider the
13 additional transportation costs to move to New England, it
14 turns out it's only about two percent of the days would you
15 have a condition where there would not be a or potentially
16 not an incentive to deliver in PJM East instead of New York
17 or New England.

18 Q. Let's turn to page 15 of Dr. Carpenter's
19 surrebuttal testimony.

20 A. What's that, 15?

21 Q. I'm sorry, 15. And he has a table there that
22 shows average daily gas prices in winter months that I
23 believe he's using to support his price separation
24 testimony.

25 And first of all, does this table indicate that

1 there's price separation between the regions every winter?

2 A. No. For the winter of '01-'02 and '02-'03, the
3 differences in prices are less than five percent, which
4 would indicate a majority of the time, virtually all the
5 time, there would not be price separation.

6 Q. Why do you use five percent as a threshold?

7 A. Five percent is the standard in the Department
8 of Justice and Federal Trade Commission merger guidelines.
9 The standard is whether it would be profitable to raise
10 prices five percent for the foreseeable future.

11 Q. Putting aside the differences in the first two
12 winters are within five percent, do the average price
13 differences shown in this table hold steady for the entire
14 winter?

15 A. No. As I stated, on an annual basis, it's about
16 ten percent. In the winter, it's about 30 percent where the
17 prices are five percent, that the mid-point prices are five
18 percent different. And so it's not the entire winter. It's
19 different episodes throughout the winter.

20 Q. As a result, do you believe that it would be
21 appropriate to consider the PJM East, New York and New
22 England markets as separate markets, even though there are
23 these occasional price separations?

24 MR. NIESEN: Your Honor, I would object to that as an
25 attempt to insert a new analysis at this point in the

1 proceeding. I think it's improper to do that. If this was
2 something that was important to the joint applicants' case,
3 it could have been done before this time.

4 MR. ESTES: Your Honor, there's no new analysis here.
5 Dr. Carpenter has asserted for the first time in his
6 surrebuttal testimony that these markets separate during the
7 peak times, and I'm just asking Dr. Morris if he agrees with
8 that. We have not provided any new prices. We've just
9 looked at the price information that's presented for the
10 first time in Dr. Carpenter's surrebuttal testimony.

11 JUDGE CHESTNUT: I'll allow it.

12 THE WITNESS: In my opinion, the price data in Table
13 2 does not indicate that the PJM East would be a separate
14 market from New York and New England.

15 BY MR. ESTES:

16 Q. And in general, without respect to Table 2, is
17 your opinion those should be separate markets?

18 A. It is my opinion that they should not be
19 considered separate markets.

20 Q. Okay. The second issue that you identified was
21 the definition of the boundary between New York and PJM East
22 markets; is that correct?

23 A. That is correct.

24 Q. And Dr. Carpenter addresses this issue on page
25 17 of his surrebuttal testimony, lines six to 17.

1 A. Yes.

2 Q. Could you explain exactly what the issue is
3 between you and Dr. Carpenter here?

4 A. What the issue is --

5 MR. NIESEN: If Your Honor please, are we at page
6 17, lines three through 17?

7 MR. ESTES: Yes. I said six. I only included the
8 answer. If you include the question, it's three through 17.

9 MR. NIESEN: If Your Honor please, this portion of
10 Dr. Carpenter's testimony addresses something presented by
11 Dr. Hieronymus, not Dr. Morris. It would seem to me that if
12 a rebuttal or rejoinder were appropriate, it would have come
13 from Dr. Hieronymus, not Dr. Morris on this point.

14 MR. ESTES: Your Honor, I don't know that Mr. Niesen
15 gets to decide who my witnesses are on certain issues. If
16 Dr. Morris has the expertise to provide a response to this,
17 I don't know why he should be barred.

18 JUDGE CHESTNUT: I have to say, it's a little
19 unusual, since this question could have been directed -- I
20 mean, Dr. Hieronymus could have addressed this yesterday.
21 Is there some reason he didn't?

22 MR. ESTES: Your Honor, Dr. Morris is more familiar
23 with these natural gas definition issues than Dr.
24 Hieronymus. The main point of Dr. Hieronymus' testimony was
25 to perform these market concentration calculations.

1 JUDGE CHESTNUT: I can't think of any reason not to,
2 but I have to say I don't like it, so I am going to sustain
3 the objection. It seems fundamentally unfair to let a
4 second witness buttress the testimony of a first witness.

5 MR. ESTES: Your Honor, Dr. Morris' entire testimony
6 relates to what the definition is of the natural gas markets
7 at issue. If you look at his rebuttal testimony, that's
8 almost the entire point, so this is not really having him
9 move outside the area of his testimony to address this
10 issue.

11 JUDGE CHESTNUT: Do you have a response?

12 MR. NIESEN: Your Honor, we were addressing something
13 said by Dr. Hieronymus at this portion of the testimony. I
14 think it's inappropriate to use that as a jumping off point
15 at this stage of the proceeding to bring in something from
16 Dr. Morris on the basis that it's a response or it addresses
17 testimony that we submitted in response to Hieronymus.

18 JUDGE CHESTNUT: Is there another way you could do
19 this?

20 MR. ESTES: I'm sorry, Your Honor, what other way
21 other than --

22 JUDGE CHESTNUT: Well, that relates specifically to
23 Dr. Morris' testimony to which Dr. Carpenter responded.

24 MR. ESTES: Well, Your Honor, Dr. Morris' testimony,
25 although Dr. Carpenter refers here just to Dr. Hieronymus,

1 Dr. Morris' testimony also includes a calculation of gas
2 market concentration. This really is within the scope of
3 Dr. Morris' rebuttal testimony.

4 JUDGE CHESTNUT: Did Dr. Carpenter address it in the
5 context of Dr. Morris' testimony?

6 MR. ESTES: Well, this question goes to a statement
7 Dr. Hieronymus made, so I don't want to overstate that exact
8 statement, but Dr. Morris, again, in his testimony talks
9 about market definition. I don't know why it would be
10 improper to have him address this market definition issue.

11 Mr. Niesen is here. He can cross-examine him. He
12 has Dr. Carpenter, his expert, here to advise him if there's
13 any issues. I guess I just don't see any fundamental
14 unfairness, particularly given that this does generally
15 address Dr. Morris' subject of testimony.

16 MR. NIESEN: Your Honor, we're on oral rejoinder.
17 Things are being narrowed down. We have our testimony
18 responding directly to something argued by Dr. Hieronymus.

19 They made the choice about which witness to testify
20 to concerning that particular matter. We simply, we're
21 going to address Dr. Hieronymus. I don't think that allows
22 at this stage of the proceeding Dr. Morris to come in with
23 something else.

24 MR. ESTES: Your Honor, two responses. First, we're
25 not attempting to come in with something else. We are

1 attempting to address directly the point here made by Dr.
2 Carpenter. There's no new analysis. It's just an
3 explanation that I think, if we had filed it as written
4 testimony, everybody would agree would be unobjectionable.

5 The second point is, you had asked, does this relate
6 some way to Dr. Morris' testimony. I would point out that
7 the very next question and answer, which is in support of
8 this statement that Dr. Carpenter is making, addresses the
9 period considered by Dr. Morris. The two testimonies are
10 intertwined.

11 JUDGE CHESTNUT: They are. Now that I'm looking at
12 the other questions and answers here, on page 16, he's
13 specifically referring to Dr. Morris, next question, Dr.
14 Morris, then he talks about Dr. Hieronymus' definition, of
15 course, then he talks about Dr. Morris again.

16 MR. ESTES: Can I point something else out, Your
17 Honor? If you look at Footnote 30, which is in this
18 testimony that we are responding to, Dr. Carpenter is citing
19 from Dr. Morris' testimony on related issues. So this is
20 not -- again, this reinforces my point that their
21 testimonies are intertwined.

22 JUDGE CHESTNUT: Okay. I don't like it at all
23 because I think it's really inappropriate. I think you
24 could have had Dr. Hieronymus address this as well as Dr.
25 Morris, for that matter. But on the other hand, I am going

1 to reverse myself, because I think, now that I look at it
2 more, I think that they are very intertwined, and I guess
3 there really is no unfairness to PGW here since, whether
4 it's Dr. Morris saying it or Dr. Hieronymus, its expert's
5 here. In fact, you could say, since Dr. Carpenter wasn't
6 here yesterday, PGW is in a better position to respond.

7 But I have to tell you, I don't like it, so I expect
8 you to keep it very, very brief and non-controversial.

9 MR. ESTES: Well, it will be brief. It's just a
10 couple questions, Your Honor.

11 BY MR. ESTES:

12 Q. Dr. Morris, exactly what is the difference
13 between you and Dr. Carpenter on this issue?

14 A. In my opinion, the difference is, if there are
15 separate markets as Dr. Carpenter alleges, the question is,
16 where do you draw the line between those markets.

17 Dr. Carpenter draws the line at the border between
18 New Jersey and New York City. And in my opinion, and the
19 position I have taken here, is that if you draw the line,
20 you would draw it at Linden, New Jersey because that's the
21 point of the price separation.

22 Q. And why is that the point of the price
23 separation?

24 A. Okay. There's a constraint on the Transco
25 system at Linden, New Jersey, and Dr. Carpenter has

1 acknowledged that. The price separation is where you get a
2 constraint point on the pipeline system, and that's where
3 the constraint point is.

4 Gas Daily is the industry publication from which Dr.
5 Carpenter and I have used prices and used the pricing
6 analysis. Gas Daily, when it determines the New York price,
7 it includes sales into northern New Jersey past Linden as
8 part of its New York price point.

9 Dr. Carpenter in his surrebuttal testimony examines
10 some of the sales data from PSEG on the days when he claims
11 that the markets separate, and I've examined his workpapers,
12 and what's in those workpapers is that the prices that PSEG
13 receives in northern New Jersey are comparable to the prices
14 that it receives in New York City, indicating that there's
15 no price separation between northern New Jersey and New York
16 City.

17 And finally, when you look at the sales of PSEG on
18 those constraint days, virtually all of the sales are into
19 northern New Jersey, past the Linden constraint point, or
20 they are into New York City, indicating that it's chosen the
21 higher price market and it's not competing elsewhere in PJM
22 East.

23 Q. What are the implications of the fact that the
24 price separation is at Linden as opposed to New York City?

25 A. Well, the implication is, if you were conclude

1 that they're separate markets and if one was to calculate a
2 market concentration, you would exclude the 800 million
3 cubic feet a day capacity that Public Service has that's
4 deliverable north of the Linden constraint point, just as
5 Dr. Carpenter argues you should exclude capacity in New York
6 to New England.

7 Q. Okay. I'm going to move away from that to my
8 final subject, which is on pages 30 and 31, Dr. Carpenter's
9 remedies section. First, could you address Dr. Carpenter's
10 suggestion at lines 10 through 14 that divestiture of the
11 gas operations is the cleanest way to address the market
12 power problem he claims to have identified.

13 A. Pardon me?

14 Q. Do you need the question again?

15 A. Yes, would you, please? I'm sorry.

16 Q. Could you address Dr. Carpenter's assertion that
17 divestiture is the cleanest approach to solving the problems
18 that he claims to have identified?

19 A. Okay. In my opinion, divestiture of the two
20 local distribution companies is not a very clean approach at
21 all, and I think it's analogous of killing the dog in order
22 to kill the fleas on the dog.

23 Dr. Carpenter does not take issues with the gas
24 operations per se, the physical operations of the pipelines,
25 the billing of the --

1 MR. NIESEN: If Your Honor pleases, I'm going to
2 object that the remedies proposed by Dr. Carpenter were
3 apparent in his direct testimony. There's no reason why
4 this kind of analysis couldn't have been presented by Dr.
5 Morris in his rebuttal statement.

6 JUDGE CHESTNUT: Overruled. Why don't you continue
7 with your answer, please.

8 THE WITNESS: Anyway, as I say, the concern is with
9 the pipeline capacity, as Dr. Carpenter just testified this
10 morning. And therefore, to require divestiture and all the
11 incumbent difficulties of separating integrated companies
12 today, I think any remedy would be better tailored to the
13 specific problem.

14 BY MR. ESTES:

15 Q. What about at lines 5 through 8, the second
16 remedy that Dr. Carpenter addresses?

17 A. Once again, the problem is really a narrow one
18 on the days. Even if you accept Dr. Carpenter's analysis,
19 his problem is only about 10 percent of the days of the year
20 at most, perhaps only 2 percent of the days, and so his
21 second remedy covers everything throughout the entire year
22 for a problem that exists only on a relatively few days.

23 Q. Finally, Dr. Morris, Dr. Carpenter accuses you
24 of having failed to suggest any less intrusive remedies. Is
25 there some less intrusive way that Dr. Carpenter's concerns

1 can be dealt with?

2 MR. NIESEN: If Your Honor pleases, I object to that
3 question. If you look at page 51 of Dr. Morris' testimony
4 -- this is his rebuttal statement -- page 51, lines 9
5 through 10, he's referring there to Dr. Carpenter --

6 JUDGE CHESTNUT: Wait, wait. Fifty-one?

7 MR. NIESEN: Page 51 of the rebuttal testimony.
8 That's Dr. Morris' rebuttal testimony, page 51, line 9. In
9 the middle of the line there's a sentence that starts, "Even
10 if his concern had merit, many less intrusive remedies
11 exist." Now, clearly, if he had other remedies in mind,
12 they could have been presented in the rebuttal testimony.

13 JUDGE CHESTNUT: No. No. He made the statement,
14 Dr. Carpenter commented on it, now Dr. Morris can comment on
15 Dr. Carpenter's reference to it.

16 THE WITNESS: In my opinion, the Applicants in
17 essence have offered sufficient mitigation. Essentially
18 what they've stated publicly is that they do not intend to
19 combine the natural gas operations of PECO and PSEG. PECO,
20 we would expect, would be fully operated just as it is
21 today, and because of that, the acquisition really has no
22 effect. It's my understanding that if they were to combine
23 the gas operations, that they would have to seek approval of
24 the Pennsylvania Commission, likely the New Jersey
25 Commission as well.

1 MR. ESTES: Those are all the questions I have,
2 Your Honor.

3 MR. NIESEN: May we have a moment to consider any
4 cross-examination?

5 JUDGE CHESTNUT: Sure.

6 (Pause.)

7 MR. NIESEN: Can we take a short break, Your Honor?

8 JUDGE CHESTNUT: Yes.

9 (Recess.)

10 JUDGE CHESTNUT: Are we ready to resume?

11 MR. NIESEN: We are. I do have a question, maybe
12 two.

13 **CROSS-EXAMINATION**

14 BY MR. NIESEN:

15 Q. Dr. Morris, did Dr. Hieronymus exclude northern
16 New Jersey in his geographic market definition of PJM East?

17 A. Dr. Hieronymus included all the capacity of the
18 pipelines that enter PJM East and all the capacity that
19 flows through PJM East, yes.

20 Q. So the answer to my question: did he exclude
21 northern New Jersey in his geographic market definition of
22 PJM East?

23 A. He included all capacity in and through PJM
24 East.

25 Q. But as far as the geographic definition is

1 concerned, did he exclude --

2 A. He calculated it for the physical area of PJM
3 East. When he calculated it, he included all the capacity
4 that enters PJM East and is delivered in and runs through to
5 New York and New England. That's what he did.

6 Q. I guess I'll ask it one more time. If you can
7 answer it yes or no for me. Did Dr. Hieronymus exclude
8 northern New Jersey in his geographic market definition of
9 PJM East?

10 A. He did not do a calculation that looks at PJM
11 East for just the constraint days, and so to that extent I
12 believe the answer to your question would be no.

13 MR. NIESEN: Thank you, Your Honor.

14 JUDGE CHESTNUT: Redirect?

15 MR. ESTES: No, Your Honor.

16 JUDGE CHESTNUT: Thank you very much, Dr. Morris.

17 You're excused.

18

19 (Witness excused.)

20 JUDGE CHESTNUT: Anything further then today before
21 we adjourn?

22 (No response.)

23 JUDGE CHESTNUT: Let's talk about Monday then.

24 Did you want to say something, Mr. Estes?

25 MR. ESTES: Yes. I had marked an exhibit which we

1 didn't refer to, so I don't know whether you --

2 JUDGE CHESTNUT: That's JRM-4?

3 MR. ESTES: Yes.

4 JUDGE CHESTNUT: Did you want it in the record or
5 not?

6 MR. ESTES: I'm happy to not offer it, Your Honor.

7 JUDGE CHESTNUT: Okay.

8 What time do you want to start on Monday? I had said
9 9:00 because we had a lot of witnesses originally scheduled.
10 Do you want to start at 10:00 again?

11 MR. MURPHY: Ten would be fine.

12 JUDGE CHESTNUT: Since people are coming from out of
13 town. So we'll start at 10:00, yes?

14 MS. McCLOSKEY: Your Honor, that would be fine with
15 us, with the same caveat, 10:00 --

16 JUDGE CHESTNUT: Ten or whenever you come.

17 MS. McCLOSKEY: Assuming the train gets in and the
18 elevator doesn't get stuck.

19 JUDGE CHESTNUT: Anything else then?

20 (No response.)

21 JUDGE CHESTNUT: Hearing nothing, this hearing is
22 adjourned. Thank you all very much -- oh, wait; there is
23 something I wanted to put on the record.

24 I know it's customary that sometimes we'll praise
25 parties for acting reasonably in working together. I wanted

1 to make sure that I thanked all of you personally as
2 counsel. This has really been a very nice case for me to be
3 involved in because you've really kept your procedural
4 disputes to a minimum. I don't think I had to issue any
5 orders on discovery disputes, and the fact that I had to
6 issue a number of pre-hearing orders really relates to some
7 of the directed questions and the scheduling that had to be
8 done. So I want to thank you all and praise your
9 professionalism and tell you that if I get a chance, I will
10 mention it. So thank you.

11 This hearing is adjourned.

12 (Whereupon, at 12:04 p.m., the hearing was adjourned,
13 to be reconvened at 10:00 a.m. on Monday, September 26,
14 2005, in Philadelphia, Pennsylvania.)
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C E R T I F I C A T E

I hereby certify, as the stenographic reporter, that the foregoing proceedings were taken stenographically by me, and thereafter reduced to typewriting by me or under my direction; and that this transcript is a true and accurate record to the best of my ability.

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