

Philadelphia Gas Works
Cost Reduction Potential¹
(Millions of Dollars)

<u>Category</u>	<u>Dollars</u>	<u>Cumulative %</u>
Gas Costs	\$274	48%
Depreciation	42	55%
Interest	57	65%
Bad Debt	30	70%
Labor/Benefits	108	89%
City Payment	18	92%
Other:		
Losses/Insurance/ Utilities/Postage	12	94%
Gen'l Material/ Purchased Svcs.	23	98%
Miscellaneous	8	99.5%
Fund Surplus	<u>2</u>	<u>100.0%</u>
Total	\$574	100.0%

¹ Based on FY 2000 budgeted expenses. With the possible exception of the City payment, 92% of this budget is not susceptible of reduction for 12 – 18 months.

Normal weather 45% degree days
 No rate increase
 No Productivity/Post savings
 Beginning Cash Balance \$ 5 million

BUDGET OF CASH RECEIPTS AND DISBURSEMENTS
 FISCAL YEAR ENDING AUGUST 31, 2001
 (Millions of Dollars)

	BUDGET	TOTAL											
09/1999	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	
OPENING BALANCE - CASH (INCLUDES 97.0 TXCP RECEIPTS)	\$0.5	\$0.0	\$11.1	\$9.8	\$13.1	\$(1.7)	\$7.7	\$30.4	\$48.4	\$56.7	\$32.7	\$1.3	\$0.5
Gas	28.3	29.8	34.1	44.4	54.9	61.4	70.6	66.9	55.4	40.8	35.3	32.7	556.5
Other	6.7	8.7	1.4	1.0	1.3	1.4	1.4	1.6	1.6	1.6	1.5	3.9	32.1
Drawn from Capital Funds - Principal \$34.8	11.6	11.6	11.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	34.8
Drawn from Capital Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drawn from Lease Funds - Principal \$10.3	0.0	0.0	0.0	0.0	6.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.0
Drawn from Lease Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Advance (Repayments) of Capital Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pension Withdrawal	5.0	3.0	0.0	5.5	0.0	0.0	0.0	0.0	0.0	0.0	13.6	0.0	27.1
Rate Increase	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL RECEIPTS	51.6	53.1	47.1	50.9	62.2	64.8	72.0	68.5	57.0	42.4	50.4	36.8	656.5
TOTAL	52.0	61.1	58.2	60.7	75.3	63.1	79.7	98.9	105.3	99.1	82.6	37.9	656.9
DISBURSEMENTS													
Labor	11.5	12.0	13.1	13.2	10.8	10.7	11.2	10.1	11.3	11.0	10.6	11.3	136.8
Natural Gas	22.6	24.0	25.0	21.5	28.1	29.8	28.5	24.8	24.3	25.2	21.9	19.3	295.0
Debt Service	0.0	3.9	0.0	0.1	25.9	2.7	0.0	4.0	1.7	1.4	37.9	13.3	80.9
TXCP Interest	0.0	0.1	0.0	0.1	0.2	0.4	0.2	0.6	0.4	0.2	0.0	0.0	2.2
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.2	0.0	0.0	18.2
Other Disbursements	10.0	10.1	10.3	10.7	12.0	11.8	11.4	11.0	10.9	10.8	10.9	11.0	130.8
TOTAL DISBURSEMENTS	44.1	50.1	48.4	47.6	77.0	55.4	49.3	50.5	48.6	66.8	81.3	54.9	673.9
MONTHLY CASH FLOW	7.5	3.1	(1.3)	3.3	(14.8)	9.4	22.7	18.0	8.3	(24.5)	(30.9)	(18.3)	(17.4)
CUMULATIVE CASH FLOW	7.5	10.6	9.3	12.7	(2.2)	7.3	30.0	47.9	56.2	31.8	0.9	(17.4)	
OPENING TXCP	97.0	97.0											
TXCP ISSUED DURING MONTH	0.0	0.0											
TXCP ISSUED PAID DOWN DURING MONTH	0.0	0.0											
ENDING TXCP	97.0	97.0											
OPENING BALANCE - CASH	0.5	0.0	11.1	9.8	13.1	(1.7)	7.7	30.4	48.4	56.7	32.7	1.3	0.5
MONTHLY CASH FLOW	7.5	3.1	(1.3)	3.3	(14.8)	9.4	22.7	18.0	8.3	(24.5)	(30.9)	(18.3)	(17.4)
NET TXCP ACTIVITY MONTHLY	0.0	0.0											
ENDING BALANCE - CASH	8.0	11.1	9.8	13.1	(1.7)	7.7	30.4	48.4	56.7	32.2	1.3	(18.0)	(18.0)
EST CASH POSITION NET OF TXCP (PEAK DAY)													
CASH POSITION NET OF TXCP	(89.0)	(85.9)	(87.2)	(83.9)	(98.7)	(89.3)	(66.6)	(48.6)	(40.3)	(64.8)	(95.7)	(113.9)	(113.9)

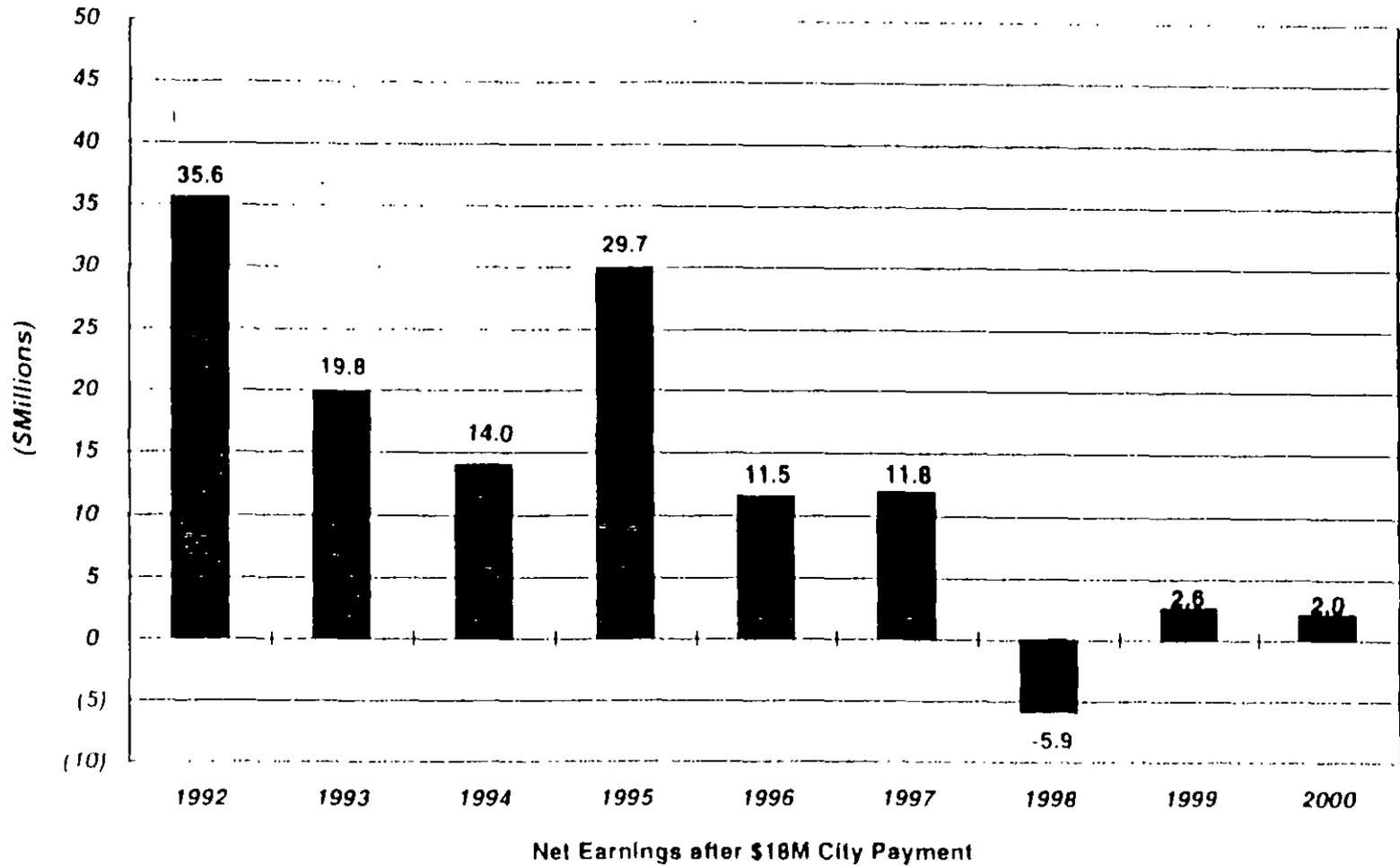
Normal weather 4000 degree days
 Rate increase
 Productivity cost savings

MONTHLY CASH RECEIPTS AND DISBURSEMENTS
 FISCAL YEAR ENDING AUGUST 31, 2001
 (Dollars of Dollars)

	BUDGET	TOTAL											
MONTH	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	
OPENING BALANCE - CASH	\$15	\$10	\$10	\$15	\$10	\$24	\$17	\$67	\$92	\$105	\$86	\$61	\$55
RECEIPTS													
Gas	29.3	29.8	34.1	34.4	54.9	61.4	70.6	66.9	55.4	40.8	35.3	32.7	556.5
Other	6.7	8.7	1.4	1.0	1.3	1.4	1.4	1.6	1.6	1.6	1.5	3.9	32.1
Drawn from Capital Funds - Principal \$34.8	0.0	10.0	14.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	34.8
Drawn from Capital Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drawn from Lease Funds - Principal \$10.3	0.0	0.0	0.0	0.0	6.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.0
Drawn from Lease Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Advance (Prepayment) of Capital Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pension Withdrawal	0.0	0.0	0.0	13.5	0.0	0.0	0.0	0.0	0.0	0.0	13.6	0.0	27.1
Rate Increase	2.4	2.6	2.9	3.8	4.7	5.5	6.1	5.8	4.8	3.5	3.0	2.8	47.9
TOTAL RECEIPTS	47.4	51.1	53.2	62.8	66.9	70.3	78.1	74.2	61.7	45.9	53.4	39.4	704.4
TOTAL	52.0	61.1	63.5	78.1	81.9	81.6	115.1	141.1	153.7	152.2	140.0	99.5	709.9
DISBURSEMENTS													
Labour	11.5	12.0	13.1	13.2	10.8	10.7	11.2	10.1	11.3	11.0	10.8	11.3	136.8
Material Cost	23.6	24.0	25.0	23.5	28.1	29.8	26.5	24.8	24.3	25.2	21.9	19.3	295.0
Debt Service	0.0	3.9	0.0	0.1	25.9	2.7	0.0	4.0	1.7	1.4	12.9	13.3	90.9
FCP - Interest	0.0	0.0	0.0	0.1	0.2	0.4	0.2	0.6	0.4	0.2	0.0	0.0	2.7
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.2	0.0	0.0	18.2
Other Cash Payments	9.8	9.9	10.1	10.2	11.5	10.8	10.4	9.8	9.7	9.5	9.8	9.8	120.8
TOTAL DISBURSEMENTS	44.9	49.9	48.2	47.1	76.5	54.4	48.3	49.3	47.4	61.5	60.0	53.5	663.9
MONTHLY CASH FLOW	7.1	11.2	15.3	31.0	5.4	27.2	66.8	91.8	106.3	90.7	79.2	46.0	34.5
CUMULATIVE CASH FLOW	7.1	18.3	33.6	64.6	70.0	97.2	164.0	255.8	362.1	452.8	532.0	578.0	40.5
OPENING TRCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
TRCP ISSUED DURING MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TRCP ISSUED PAID FROM DURING MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ENDING TRCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
OPENING BALANCE - CASH	5.5	9.0	10.3	15.1	21.0	21.4	37.3	87.1	92.0	108.3	88.6	60.1	5.5
MONTHLY CASH FLOW	3.5	1.3	5.1	15.7	(9.6)	15.9	29.8	24.9	14.3	(19.6)	(26.6)	(14.1)	40.5
NET TRCP ACTIVITY MONTHLY	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ENDING BALANCE - CASH	9.0	10.3	15.3	31.0	21.4	37.3	87.1	92.0	108.3	88.6	60.1	46.0	46.0
EST CASH POSITION NET OF TRCP (PEAK DAY)													
CASH POSITION NET OF TRCP	(88.0)	(86.7)	(81.7)	(66.0)	(75.6)	(59.7)	(29.9)	(5.0)	9.3	(10.4)	(36.9)	(51.0)	(51.0)

Philadelphia Gas Works

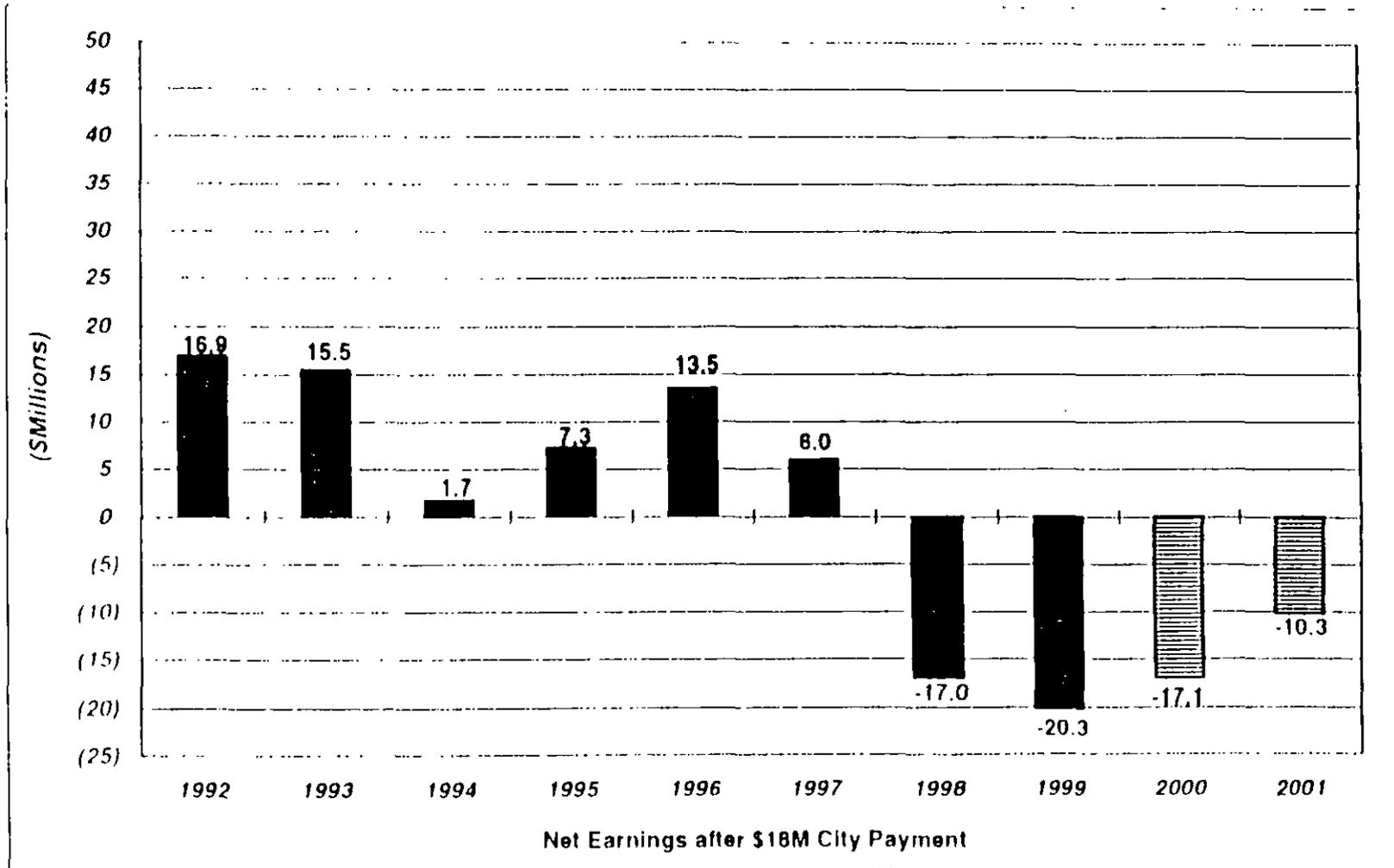
FY92-00 Year End Compliance Budget Net Earnings



August 14, 2000

Philadelphia Gas Works

FY1992 - 99 Actual & Estimated 2000 - 01 Year End Net Earnings



Actual Net Earnings

PHILADELPHIA GAS WORKS
TWO MONTH PROGRESS REPORT

Organization Evaluations - Structure, Staffing, Functions

		<u>Report Due</u>
Information Technology	Andersen Consulting	May 26
Human Resources	Hay Consulting	May 30
Customer Affairs	Vanguard Consulting	June 5
Risk Management	City Risk Management Dept.	May 19
Marketing	Regulatory Consultant	June-Nov.
Operating Departments	PUC Audit Consultants	June-Nov.

Functional Activity - On-going Programs

		<u>Completion</u>
IT - SPL	Billing System Repairs	August
IT - Pinkerton	IT Department Coordination	April-Sept.
IT - Mara	Financial Report Programming	May-June
IT - Steering Committee	IT/Business Project Prioritization	April forward
HR - Hay	Employee Compensation Study	June
HR - Hay	Employee Evaluation Program	June
Call Center - Vanguard	Technology Evaluation	June
Call Center - Sarcom	Training Program Design	May-August
Call Center - Various	Training	May forward
Regulatory Affairs - Inter'l.	PUC/PGC Operating Interface	April forward
Regulatory Affairs - Wolf	PUC Negotiations/Structuring	May forward
Collections - Internal	Collection Task Groups	May forward
Collections - Internal	CRISIS Program Task Group - \$4million	April-May
PGW - River Consulting	Preparation For Management Audit	March-Aug.
PGW - River Consulting	Strategic Planning	May-June

Proposed

Finance - KPMG	Financial Controls	June-July
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Appendix

SUMMARY OF CONSULTING EXPERIENCE

Submission of Testimony

Colorado

Re Public Service Company of Colorado

Docket No. 1330

Delaware

Re Delmarva Power & Light Company

Docket Nos. 923.82-22;82-24;91-20

Idaho

Re Idaho Electric Company

Docket Nos. 100726-28

Re Idaho Water Company

Indiana

Re Flowing Wells Water Company

Docket No. 34739

Maine

Re Central Maine Power Company

Docket No. 92-345

Massachusetts

Re Hingham Water Company

Docket No. 19744

Re American Water Company

Docket No. 19900

New Jersey

Re Atlantic City Electric Company

Docket Nos. 7911-9511; 8399-753
(LEAC); 8410-1079 (LEAC), etc.

Re Commonwealth Water Company

Docket Nos. 784-274; 819-781, etc.

Re Elizabethtown Gas Company

Docket Nos. 789-1319; GR86121374;
GR88080913 (LPGA), etc.

Re Jersey Central Power & Light Company

Docket Nos. 795-427; 797-643, etc.

<i>Re New Jersey Natural Gas Company</i>	Docket Nos. 831-46; 838-687 (LPGA)
<i>Re Public Service Electric and Gas Company</i>	Docket Nos. 812-76; 761-8, etc.
<i>Re Rockland Electric Company</i>	Docket No. 7611-1100
<i>Re Wallkill Valley Hospital</i>	Docket No. 89-XHR-73
<i>Re West Keansburg Water Company</i>	Docket No. 759-993
<u>New Mexico</u>	
<i>Re Public Service Company of New Mexico</i>	Docket Nos. 1536; 1631-32; 1602; 1693; 1804; 1828-29; 1835
<u>Ohio</u>	
<i>Re American Utilities Company (Water)</i>	Case No. 80-999-AIR
<i>Re Dayton Power & Light Company</i>	Case No. 76-823-EL-AIR
<i>Re Columbus & Southern Ohio Electric Company</i>	Case No. 77-545-EL-AIR
<i>Re Ohio Edison Company</i>	Case No. 79-44-EL-AIR
<u>Pennsylvania</u>	
<i>Re Columbia Gas of Pennsylvania</i>	Docket No. R-78120724
<i>Re Media Borough Water Works</i>	Docket No. R-78120724
<i>Re Peoples Natural Gas Company</i>	Docket No. R-78010545
<i>Re Pennsylvania Gas & Water</i>	Docket Nos. R-821961; R-822102
<i>Re Philadelphia Electric Company (Electric)</i>	Docket Nos. R-80061225, etc.
<i>Re Philadelphia Electric Company (Gas)</i>	Docket Nos. R-79040785, etc.
<i>Re Philadelphia Gas Works (Rate Increases)</i>	Dockets 1986; 1988; 1990; 1991
<i>Re Philadelphia Gas Works (Operating Budgets)</i>	Dockets 1993-1999
<i>Re Philadelphia Water Department</i>	Dockets 1985; 1990
<i>Re West Penn Power Company</i>	Docket R-901609

South Carolina

Re South Carolina Pipeline Corporation

Docket No. 88-599-G

Virgin Islands

Re Virgin Island Water and Power Authority

Docket No. 106

Participation in Proceeding (Pennsylvania Only)

Re Natural Fuel Distribution Company

Docket No. R-077110514

Re Equitable Gas Company

Docket Nos. R-78040598, etc.

Re Columbia Gas of Pennsylvania

Docket No. R-80031129

Re Peoples Natural Gas Company

Docket No. 821906

Re Philadelphia Electric Company (Gas)

Docket No. R-860346 - 1307(f)

Re UGI Corporation

Docket No. R-860344 - 1307(f)

1 PREPARED DIRECT TESTIMONY
2 OF
3 JOSEPH R. BOGDONAVAGE
4 ON BEHALF OF
5 PHILADELPHIA GAS WORKS
6

7 Q. Please state your name and business address.

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

10 Q. By whom are you employed and in what capacity?

11 A. I am employed by the Philadelphia Gas Works in the capacity of Director
12 Budget and Financial Forecasting.

13 Q. What are your principal responsibilities as Director - Budget and Financial
14 Forecasting?

15 A. My principal responsibilities include the preparation of the financial areas
16 of the operating and capital budgets, review of operating budgets
17 prepared by the individual departments, and the coordination, analysis,
18 issuance and overall control of the complete annual Operating Budget
19 filing. These activities include the preparation of varied analyses for the
20 purpose of generating alternative financial data to support the
21 company's financial planning and decision-making processes. In
22 addition, documentation is prepared regarding financial initiatives, i.e.,
23 proposed revenue bond and capital lease offerings and base rate case
24 presentations. Finally, I act as a liaison between all department budget
25 representatives regarding budgeting and financial forecasting
26 procedures and variance analysis reporting.

27 Q. Have you previously presented testimony before the Philadelphia Gas
28 Commission?

29 A. Yes, on numerous occasions. I have most recently presented testimony

1 before this commission on matters associated with PGW's 1999-2000
2 Operating Budget proceedings in 1999. Prior to the above occasion, I
3 presented testimony on PGW's proposed annual Operating Budgets and
4 the 1991-92, 1990-91, 1988-89 and 1986-87 fiscal year base rate increase
5 requests.

6 Q. What are your responsibilities in connection with PGW's Consolidated filing
7 that is the subject of these hearings?

8 A. I am responsible for the development and preparation of the financial
9 details, exhibits and part of the supporting documentation included in
10 PGW's proposed 2000-2001 Operating Budget filing.

11 Q. Please describe your involvement in preparing the 2000-2001 Operating
12 Budget.

13 A. My direct involvement has been to facilitate the interaction of all the
14 departments that contribute to PGW's Operating Budget process. This
15 includes the review of all Operating Budgets prepared by the individual
16 departments, updates to that information and the coordination, analysis,
17 control and issuance of the complete 2000-2001 Operating Budget
18 document. I have worked closely with PGW's Senior Team and in
19 particular Mr. Joseph F. Golden, PGW's Treasurer, in developing PGW's
20 financial plan. Basically, we have developed a financing plan for the
21 2000-2001 Operating Budget which takes into account many of the
22 initiatives that the Philadelphia Facilities Management Corporation (PFMC)
23 has developed and directed PGW to implement in an effort to maintain
24 PGW in a position of financial stability and competitiveness. Also, PGW
25 has identified a need for a base rate increase to replace needed
26 operating funds which have been depleted as a result of three
27 consecutive warm winter heating seasons and additional capital
28 requirements for Information Technology improvements to hardware and
29 software applications. PGW replaced or remediated existing legacy

1 systems that were not Y2K compliant. PGW installed a new financial
2 system, mobile dispatching system, gas management system and a
3 customer information and billing system. Due to a failed implementation
4 of PGW's new billing system in July, 1999 a cash flow problem then
5 developed as a result of reduced customer billings and subsequent
6 collections.

7 Q. What is the purpose of your testimony in this proceeding?

8 A. The purpose of my direct testimony is to provide the documentation and
9 supporting methodology for the schedules and exhibits, provide detailed
10 information regarding certain income and expense items and, where
11 necessary, explain the reasons for variations between the fiscal periods.

12 Q. Please describe the financial statements which support the 2000-2001
13 Operating Budget submission.

14 A. The Operating Budget for the 2000-2001 fiscal year has been summarized
15 to indicate the functional expenses incurred similar to previous
16 presentations for comparative purposes. To facilitate an understanding
17 and to illustrate the trend and level of operating expenditures by key
18 functionality, data is provided on the Statement of Income, Exhibit A-1 of
19 the Operating Budget presentation for the 1998-99 Actual, the 1999-2000
20 Estimate and the proposed 2000-2001 Budget periods. The Cash Flow
21 Statement, Exhibit A-2, replaces the more complex Statement of Cash
22 Flow which is included in PGW's normal monthly financial reports. This
23 document reflects the source and use of cash and is the basic document
24 for financial planning at PGW. The Revenue Bond Debt Service
25 Coverage Statement is prepared under the authority of the Rate
26 Covenant of the 1975 General Ordinance, as amended, and the 1998
27 General Ordinance, authorizing the issuance of revenue bonds. In
28 compliance with the provisions of the Ordinances, PGW prepares and
29 forwards to the Director of Finance of the City of Philadelphia, a report

1 within 120 days of the conclusion of each fiscal year detailing compliance
2 with the 150% of the revenue bond debt service requirements for such
3 fiscal year. A calculation for the 2000-2001 Budget year is included with
4 the Company's filing as Exhibit A-3.

5 Q. Who will explain the details of these documents?

6 A. PGW is presenting separate testimony by certain applicable witnesses to
7 supplement my overview of the 2000-2001 Operating Budget. I will
8 present a financial summary of the impacts of the revenue and fuel cost
9 data, which will be presented in the Gas Cost Rate portion of the
10 consolidated filing for fiscal year 2000-2001, and will continue through the
11 Statement of Income and will explain the impacts of financing and other
12 financial considerations on the Cash Flow Statement and Revenue Bond
13 Debt Service Coverage schedules.

14 Q. Would you proceed with your explanation of the Statement of Income.

15 A. The Statement of Income, presented as Exhibit A-1, includes projected
16 operating revenues of \$649.5 million, including a \$52.0 million base rate
17 increase for the 2000-2001 Budget Year.

18 Total Operating Revenues (Line 13) are forecasted to increase by \$112.4
19 million or 21%, compared to the 1999-2000 estimated total of \$537.0
20 million. The major portion of the additional revenues reflects a return to a
21 normal winter heating season and a corresponding rise in firm customer
22 usage. The 2000-2001 Budget represents 4,600 degree days which is a
23 normal heating season level, while the 1999-2000 estimate is expected to
24 produce 3,988 degree days, 612 degree days or 13% below the
25 budgeted level. Also, the 2000-2001 Gas Cost Rate (GCR) factor is
26 projected to increase to \$1.8362 per MCF, a rise of 73.8 cents from the
27 current level of \$1.0982 per MCF. The 1999-2000 fiscal year projected
28 GCR underbilling utilized in this filing was \$0.2 million.

29 Non-Heating Revenues (Line 1) are projected to rise by \$17.2 million or

1 19% reflecting additional firm customer usage, combined with greater
2 demand and higher margins for gas service by interruptible customers.
3 Gas Transportation Revenues (Line 2) are anticipated to increase by less
4 than \$0.1 million or 1% due principally to a slight rise in the volume of gas
5 transported for customers and an increase in the average price per MCF.

6 Heating Revenues (Line 3) during the 2000-2001 fiscal year are expected
7 to total \$463.8 million, a \$40.9 million or a 10% increase over the 1999-2000
8 estimated period. The major factor for this increase in the 2000-2001
9 Budget year is the anticipated return to a normal 4,600 degree day
10 heating season. The 2000-2001 Budget year projects a rise of 2.9 BCF in
11 firm customer usage to a total of 54.0 BCF primarily as a result of the
12 anticipated normal winter heating season. In addition, the GCR is
13 forecasted to rise from the current level of \$1.0982 per MCF to \$1.8362 per
14 MCF a 67% increase in the 2000-2001 fiscal period. When compared to
15 the 1999-2000 budgeted level, the 2000-2001 Budget projects additional
16 firm customer usage of nearly 0.2 BCF. These added sales represent the
17 on-going marketing commitment to attract new firm heating customer
18 growth, while still maintaining PGW's sizeable share of the Philadelphia
19 space heating market.

20 The Proposed Base Rate Increase (Line 4) is anticipated to provide \$52.0
21 million due to an increase in the customer charge and a higher
22 volumetric commodity charge per MCF on all applicable customers during
23 the 2000-2001 Budget Year.

24 The Marginal Revenue Loss - Weather (Line 5) of \$4.0 million reflects
25 approximately 1.25 BCF of lost firm sales and corresponding margins as a
26 result of a warmer than normal winter heating season. The assumption for
27 the 2000-2001 Budget Year equates to a nearly 3% warmer winter
28 heating season.

29 A change in the Senior Citizen Discount (Line 6) totaling \$1.5 million is the

1 result of a budget assumption that a change in the administration of the
2 Senior Citizen Discount program will be implemented.

3 The Unbilled Gas Adjustment (Line 7) is budgeted to rise by \$1.5 million
4 due mainly to a higher projected average price per Mcf, on the volume
5 of gas used but unbilled at August, 2001, reflecting the increase in the
6 GCR and the proposed base rate increase.

7 Q. What are the major components of Appliance Repair & Other Service
8 Revenues?

9 A. The major components of Appliance Repair & Other Service Revenues are as
10 follows:

11 Appliance Repair and Other Service Revenues (Line 10) totaling \$13.2 million
12 reflect charges associated with parts and labor plan contracts for house
13 heaters, automatic water heaters and space heaters and for appliance
14 repairs and service calls reflecting PGW's charge-for-service and paid-for-
15 service policies. Also included in this category are reconnection and shut-off
16 charges generated by customer bill paid turn-ons and shut-offs and a
17 charge for house heater inspections. The additional revenues forecasted in
18 the 2000-2001 budget year totaling \$1.1 million mainly result from an increase
19 in the number of parts and labor plan contracts in effect. The level of
20 customer participation is expected to increase by nearly 5,000 in the 2000-
21 2001 Budget year from the 117,000 plans currently in force during the 1999-
22 2000 fiscal period.

23 The following schedule details appliance repair and other service revenues
24 for the three fiscal years:

1 Appliance Repair and Other Service Revenues

2 (Dollars in Thousands)

3

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>1998-99</u>	<u>1999-00</u>	<u>2000-2001</u>
4 Parts & Labor Plans	\$10,812	\$9,193	\$9,598
5 Paid-for-Service	1,380	1,383	1,424
6 Charge-for-Service	1,197	1,197	1,197
7 House Heater Inspections	-	-	50
8 Gas Recon & Shut-off charges	<u>294</u>	<u>325</u>	<u>964</u>
9 TOTAL	<u>\$13,683</u>	<u>\$12,098</u>	<u>\$13,233</u>

10

11 Other Operating Revenues (Line 11), principally finance charges on
12 delinquent accounts, are expected to increase by \$1.9 million as higher
13 billings reflect the return to a normal heating season, the greater GCR
14 and the proposed base rate increase all contribute to an anticipated rise
15 in outstanding customer receivable balances.
16

17 Q. Would you proceed with your explanation of the Statement of Income?

18 A. The Statement of Income includes projected Operating Expenses (Line 23)
19 of \$529.6 million, a \$40.1 million or 8% increase. The major reasons for the
20 added costs will be explained in detail.

21 Natural Gas (Line 14)- Natural gas costs are forecasted to total \$294.6
22 million in the 2000-2001 budget year, \$41.6 million or 16% greater than the
23 level experienced in the 1999-2000 fiscal period. The increase from the
24 1999-2000 estimate in the Gas Cost Rate calculation is primarily due to the
25 return to a normal 4,600 degree day heating season which is expected to
26 raise demand requirements by 3.4 BCF or \$8.8 million, while higher pipeline
supplier prices of 49.0 cents per MCF totaling \$35.6 million and decreased
pipeline supplier refunds of \$22,000 further contributed to the added

1 expenses. The above increases are expected to be slightly offset by
2 lower pipeline demand charges of \$2.8 million.

3 Contribution Margins (Line 18) - PGW forecasts that the margins to cover
4 fixed overhead and other costs and interest expenses will total \$354.8
5 million in the 2000-2001 Budget year, a rise of \$70.8 million from the level
6 projected in the 1999-2000 estimate. This margin represents the funds
7 (total operating revenues less the cost of fuel) available to meet PGW's
8 operational requirements.

9 Labor and Fringe Benefits (Line 19)- This expense item, the second largest
10 expense that PGW incurs, is budgeted to increase by \$0.5 million. The
11 main factors that contribute to the additional costs are higher pension
12 expenses of \$0.3 million due to the normal cost component of the
13 actuarial expense and employee health and life insurance premiums
14 which are projected to rise by \$0.9 million. The \$0.9 million rise in health
15 insurance has been offset by \$4.0 million in savings reflecting anticipated
16 changes in coverages for both active and retired employees. PGW
17 received preliminary quotes from its primary health insurance providers for
18 the 2000-2001 Budget year totaling \$29.3 million. These increases are
19 partially offset by lower operating labor charges due to a reduced overall
20 payroll that is expected to total \$100.5 million or \$0.6 million less than the
21 current year estimate and reduced payroll taxes totaling \$0.1 million. A
22 more detailed explanation of labor and fringe benefits (Exhibit C-3) will be
23 provided later in my testimony.

24 Bad Debt Expense (Line 20) - PGW will present separate testimony and
25 supporting documentation on the \$46.0 million expense forecasted for
26 the 2000-2001 Budget year and the \$44.0 million estimate in the 1999-2000
27 fiscal period. The substantial rise in this expense reflects PGW's
28 acknowledgement, that due to delayed customer billings as a result of
29 problems with the billing system, the ability to collect a substantial portion

1 of outstanding receivable balances at historical collection levels will be
2 difficult.

3 Other Expenses and Depreciation (Line 21)- The primary reasons for the
4 \$3.9 million decrease in this expense category resulted from the inclusion
5 of \$10.0 million in savings as a result of a forecast of realized productivity
6 improvements in the overall workforce, union contract negotiations and
7 work rule changes and cost saving initiatives as part of the upcoming
8 management audit. In addition, the appropriation for reserves and losses
9 is expected to decline along with lower insurance costs. The above are a
10 result of not renewing PGW's revenue protection (weather) policy and
11 an increased allocation of fringe benefits and administrative and general
12 charges to capital projects reflecting the increase in projected capital
13 spending. These reductions were offset, in part by additional costs for
14 advertising, general material, contracted maintenance, rentals,
15 purchased services, postage, promotion and depreciation. A more
16 detailed explanation of other expenses and depreciation (Exhibit C-4) will
17 be presented later in my testimony.

18 Other Income (Line 25)- PGW expects an \$11.0 million decline in other
19 income during the 2000-2001 Budget Year primarily reflecting the non-
20 recurring \$8.645 in proceeds received in the 1999-2000 estimated period
21 associated with a Swap Option transaction. PGW converted a portion of
22 its current fixed rate long-term debt to variable rate debt. Interest
23 earnings on PGW's restricted capital accounts is projected to decline by
24 \$2.6 million due mainly to the utilization of proceeds from the capital
25 improvement fund to support PGW'S 2001 capital construction program.
26 These decreases are forecasted to be offset somewhat by additional
27 earnings on temporary investments during the upcoming 2000-2001
28 Budget Year reflecting higher investable cash balances.

29 Interest Expense (Line 31)- Total interest expense of \$57.8 million in the

1 2000-2001 Budget year represents a decrease of \$1.6 million from the
2 estimate in the 1999-2000 fiscal period. Long-term debt (Line 27) interest
3 costs are budgeted to decline by \$1.4 million due mainly to the net effect
4 of scheduled long-term debt maturities and the proposed sale in July,
5 2001 of a \$75.0 million Third Series Revenue Bond issue which will be
6 utilized for funding PGW's capital improvement programs. Other interest
7 (Line 28) expense is anticipated to decrease in the 2000-2001 Budget Year
8 primarily as a result of \$0.2 million associated with the deferral of the City
9 payment which is not anticipated in the upcoming fiscal period. The
10 remaining components mainly consist of interest associated with PGW's
11 Tax-Exempt Commercial Paper Program, bond discount, premium and
12 issuance expense and interest on customer deposits. The Loss from the
13 Extinguishment of Debt (Line 30) of \$4.2 million is expected to decrease by
14 \$0.1 million reflecting the on-going amortization of prior years' revenue
15 bond refunding issues.

16 Net Earnings From Operations (Line 34)- The net earnings from Operations
17 are forecasted at \$49.9 million for the 2000-2001 budget year. This reflects
18 a \$62.8 million improvement from the 1999-2000 fiscal period loss of \$12.9
19 million.

20 Q. Proceeding to Exhibit A-2, the Cash Flow Statement, would you please
21 identify the individual items which account for the total sources of \$154.4
22 million for the 2000-2001 fiscal year shown on Line 10?

23 A. The Cash Flow Statement is one of PGW's primary financial planning and
24 control documents. Through this format, the transition from an accrual
25 accounting methodology applied in the Statement of Income is now
26 presented on a cash basis. The principal sources of funds to PGW are net
27 income, borrowings to support capital expenditures, and the tax-exempt
28 commercial paper program.

29 Net Income (Line 1) is a transfer from Line 32, Exhibit A-1, Statement of

1 income. It is the net result of PGW's operations after including revenues
2 and other income, less operating and interest expenses.

3 Depreciation and Amortization (Line 2) are sources of funds, as these items
4 represent those (non-cash) costs chargeable to expense, although the
5 actual cash payments were made primarily in prior periods. In the 2000-
6 2001 Budget Year this category is projected to increase by \$2.2 million as
7 a result of higher depreciable plant balances and amortization costs
8 associated with PGW's capital leases.

9 Earnings on Restricted Funds (Line 3) represents cash withdrawals from
10 restricted funds, namely the revenue bond sinking and capital
11 improvement funds. In the estimated 1999-2000 fiscal period, \$1.0 million
12 more than was earned in the period as interest is expected to be
13 withdrawn from these funds. This resulted from earnings in prior periods
14 not being withdrawn during the fiscal period in which the earnings
15 occurred. During the 2000-2001 Budget year, interest earned on the
16 restricted funds is forecasted to be withdrawn in its entirety before fiscal
17 year end.

18 Increased/(Decreased) Long Term Debt & Other Assets/Liabilities (Lines
19 4&5) reflect a reduction between the 1999-2000 and 2000-2001 fiscal
20 years of \$5.0 million. The main components that are reflected in this
21 source of cash are the regulatory asset amortization, the long-term
22 portion of deferred operating expenses (non-recurring expenditures), the
23 net effect of the \$176.3 million 1999 Second Series and Sixteenth Series
24 Bond issues, the long term component of projected settlements
25 associated with suits and claims and workers compensation. Also, starting
26 in the 1999-2000 fiscal year, payments will be made on the long term
27 debt portion of tax-exempt capital appreciation bonds (TECA's). These
28 payments account for a major portion of the \$5.0 million change
29 between the fiscal years.

1 The sum of net income and the previously mentioned adjustments is
2 reported on (Exhibit A-2, Line 6) as available from Operations and totals
3 \$113.5 million in the 2000-2001 fiscal period, \$59.0 million greater than
4 forecasted in the 1999-2000 fiscal year.

5 Funds Required for Capital (Line 7) represent one of the components of
6 PGW's cash management process. The funds withdrawn from the Capital
7 Improvement Fund are usually minimized to produce the largest possible
8 contribution from Operations for funding PGW's capital expenditures. In
9 1999-2000, as a result of the significantly warm winter, PGW's contribution
10 margin was reduced, lowering the level of available funds from
11 Operations. The 1999-2000 estimate anticipates \$68.2 million being
12 withdrawn from the Capital Improvement Fund to support capital
13 spending for the 1999-2000 period and to reimburse PGW for capital
14 spending that occurred in the prior 1998-99 fiscal year. No internally
15 generated funds are anticipated for the 1999-2000 fiscal period. The 2000-
16 2001 Budget year projects that \$34.8 million will be withdrawn from the
17 capital account to assist in financing capital spending, with \$21.5 million
18 anticipated to be utilized from internally generated funds, which was
19 provided, according to formula, by utilizing PGW's short-term commercial
20 paper program.

21 Capital Leasing (Line 8) - The \$2.8 million expected to be withdrawn from
22 this account in 1999-2000 will be utilized to finance Transportation and
23 Information Technology equipment purchases and combined with funds
24 from the Capital Improvement Fund and internally generated funds,
25 provide the support for PGW's \$51.0 million in capital expenditures. In the
26 2000-2001 Budget year, \$6.0 million is expected to be withdrawn from the
27 capital leasing account for Transportation and Information Technology
28 equipment purchases. When combined with funds from internally
29 generated sources and withdrawals from PGW's capital improvement

1 fund, PGW's \$62.3 million capital expenditure program is expected to be
2 financed by these three mechanisms.

3 Temporary Financing (Line 9) - In the current 1999-2000 fiscal period,
4 PGW's outstanding level in the tax-exempt commercial paper program is
5 anticipated to be \$97.0 million at August 31, 2000. This amount was paid
6 down on May 12, 2000. PGW then anticipates reissuing notes as needed
7 to assist in meeting year-end projected working capital requirements. The
8 change in the level of outstanding notes between August 1999 (\$75.0
9 million) and August 2000 (\$97.0 million) (Line 25) was the \$22.0 million
10 reported in temporary financing. The 2000-2001 Budget year anticipates
11 that \$97.0 million will be required to assist in meeting working capital
12 requirements and that the level of outstanding notes will be \$97.0 million
13 at August 2001. The overall impact of PGW's operations and the
14 outstanding level of commercial paper notes in the 2000-2001 Budget
15 year is projected to leave PGW with a cash balance of \$46.2 million,
16 compared to the \$5.5 million anticipated at the close of the 1999-2000
17 fiscal period. PGW has the ability to maximize the level of arbitrage
18 earnings during the 2000-2001 Budget year as there may be an
19 approximate 50 to 100 basis point differential between the interest
20 earnings rate and interest costs associated with the commercial paper
21 programs.

22 The Total Sources (Line 10) of \$154.4 million in the 2000-2001 fiscal year are
23 expected to be \$7.4 million greater than the level projected in fiscal year
24 1999-2000 mainly reflecting the additional net income and the level of
25 commercial paper outstanding as previously discussed.

26 Q. How are these Total Sources applied within PGW?

27 A. The Total Sources are utilized as detailed on the lower part of Exhibit A-2
28 under the category Uses. The primary areas of expenditures are as
29 follows:

1 Net Capital Expenditures (Line 11) represent expenses for approved
2 capital budget projects. These costs totaling \$62.3 million in the 2000-2001
3 Budget year are projected to increase by \$11.3 million from the 1999-2000
4 fiscal year level of \$51.0 million. These expenditures include: (1) direct
5 charges for labor, material, equipment, contractors and transportation
6 services; (2) allocated expenses for fringe benefits, and administrative and
7 general expenses; and (3) an allowance for funds used during
8 construction (AFUDC). The total costs are reported net of contributions
9 and salvage.

10 Funded Debt Reduction (lines 12, 13 and 14) - This expense is the payment
11 of the principal portion of PGW's long-term debt under pre-determined
12 debt amortization schedules. These payments include revenue bond,
13 subordinate revenue bond debt and capital lease principal repayments.
14 In the 2000-2001 Budget year, these payments will total \$42.2 million, an
15 increase of \$1.0 million from the 1999-2000 fiscal period.

16 Notes Payable - CNG Acquisition (Line 15) - This expense represents PGW's
17 purchase of two CNG refueling stations to support its Natural Gas vehicle
18 program.

19 Distribution of Earnings (Line 16) - This represents the annual \$18.0 million
20 paid to the City of Philadelphia under the Philadelphia Facilities
21 Management Corporation (PFMC) Agreement/Ordinance.

22 Additions to (Reductions of) Non-Cash Working Capital (line 17) - This
23 category represents PGW's continuing effort to shift from the accrual
24 method of accounting to a cash basis. The detail of Working Capital is
25 presented on Exhibit H-1, and the annual changes in working capital,
26 which specifically support Line 17 - Exhibit A-2 are detailed on Exhibit H-2.

27 Q. Would you please explain the major factors that resulted in the working
28 capital requirements for the 1999-2000 fiscal year and the continuing
29 impact on the proposed 2000-2001 Budget year.

1 A. The \$47.2 million increase in working capital requirements during the 1999-
2 2000 period (Exhibit H-2, Line 13) reflects a significant rise in accounts
3 receivable (Exhibit H-2, Line 1) of \$39.7 million and a commensurate
4 increase in the reserve for bad debts (Exhibit H-2, Line 3) of \$8.8 million
5 resulting in a net accounts receivable increase (Line 4) of \$30.7 million. The
6 substantial rise in accounts receivable was mainly the result of the
7 problems encountered with the new billing system which at times
8 produced inaccurate or no customer bills for certain portions of PGW's
9 overall customer base during the 1999-2000 fiscal year. In addition, as a
10 result of the flawed implementation of the new billing system, collection
11 activities were severely impacted as a result of not being able to generate
12 the proper information on delinquencies and notifications for delinquent
13 accounts. The combination of the above mentioned problems impacted
14 PGW's ability to successfully collect the monies owed by customers. PGW
15 is continuing to improve its ability to collect past-due amounts with a wide
16 range of collection activities targeting the substantial level of outstanding
17 accounts receivable. PGW is in the process of identifying those customers
18 who have not been billed for past consumption for all or part of the last
19 eleven months and will be resolving collections for the amounts that will
20 be billed during the next two months. PGW will be working with its outside
21 auditors to ascertain the required reserve for uncollectible accounts and
22 will present separate testimony, which details the interaction of the
23 accounts receivable, reserve for uncollectible accounts, bad debt
24 expense and the impact of low income programs. Materials and supplies
25 (Line 5) increased by \$14.3 million principally due to a slightly higher
26 volume of natural gas storage inventories at substantially higher prices of
27 nearly 74.0 cents per MCF or 30% , while other current assets (Line 6)
28 decreased by \$9.0 million primarily due to reduced deferred non-
29 recurring expenditures, FERC Order 636 costs and lower outstanding

1 capital reimbursable work orders. Liabilities, namely accounts payable
2 (Exhibit H-2, Line 10), rose by \$7.4 million mainly due to higher natural gas
3 and vendor accounts payable. Other current liabilities (Line 11)
4 decreased by \$18.6 million mainly as a result of the GCR overbilling of
5 \$16.1 million associated with the 1998-99 fiscal period. The net impact of
6 these working capital requirements results in an increase in the 1999-2000
7 fiscal year of \$47.2 million.

8 The 2000-2001 Budget year projects working capital requirements will
9 decline by \$8.8 million (Exhibit H-2, Line 13) primarily due to a \$5.7 million
10 net decrease in accounts receivable reflecting a decrease in the level of
11 delinquent customer accounts and a rise in the required reserve for bad
12 debt. Materials and supplies (Exhibit H-2, Line 5) are forecasted to decline
13 by \$3.1 million reflecting a decrease in the value of natural gas in storage
14 due to lower prices of nearly 16.0 cents per MCF. Also, Other current
15 assets (Exhibit H-2, Line 6) are expected to drop by \$3.0 million reflecting
16 the continuing decline in the amortization of non-recurring expenses.
17 Accounts Payable (Exhibit H-2, line 10) are expected to decrease by \$2.9
18 million reflecting lower natural gas accounts payable. These asset and
19 liability changes result in the reduced net working capital requirement of
20 \$8.8 million (Exhibit H-2, Line 13).

21 PGW's ending Cash Balance (Exhibit A-2, Line 23) at August 2000 is
22 expected to total \$5.5 million, \$91.5 million less than the outstanding level
23 of \$97.0 million of commercial paper notes. This year end cash balance
24 represents a continuing erosion from the \$16.1 million 1998-99 actual cash
25 balance which was \$58.9 million below the outstanding level of \$75.0
26 million in commercial paper. The major reason for the lower cash on
27 hand reflects the continued warm weather experienced which eroded
28 revenues, contribution margins and net income. In addition, 1999-2000
29 saw continued high capital expenditures associated with PGW's plans to

1 revamp its aging Information Technology infrastructure and equipment.
2 However, the major issue that impacted PGW's cash balance was the
3 tremendous increase in customer accounts receivable. The 2000-2001
4 Budget year projects a cash balance of \$46.2 million, \$50.8 million less
5 than the outstanding commercial paper level of \$97.0 million. The cash
6 balance forecasted shows substantial improvement from the prior year,
7 mainly reflecting the base rate increase. The 2000-2001 capital
8 expenditures of \$62.3 million show an upturn as a result of the significant
9 cost associated with the Phase 1 plan to refurbish PGW's LNG facility. The
10 proposed rate increase combined with reducing the level of outstanding
11 accounts receivable will provide some much needed relief in reducing
12 the outstanding utilized level of PGW's commercial paper program. In
13 the future PGW expects to partially support the financing of its forecasted
14 capital programs with internally generated funds.

15 Q. Could you explain the income and expense components that are utilized
16 when computing the Revenue Bond Debt Service Coverage Ratio for the
17 2000-2001 Budget year on Exhibit A-3?

18 A. The coverage ratio is now calculated based on the 1975 Ordinance and
19 the 1998 Ordinance which sets the priority of payments of outstanding
20 long-term debt. In deriving data for the coverage calculation, several
21 non-cash adjustments are made to both revenue and expense items:

22 Total Funds Provided (Exhibit A-3, Line 6) - The funds provided in the
23 proposed 2000-2001 Operating Budget total \$655.6 million and are
24 comprised of: (1) total gas and other operating revenues, (2) other
25 income adjusted to include actual cash withdrawals from both the
26 Capital improvement and Revenue Bond Sinking funds (rather than only
27 the interest earned in the fiscal period), and (3) AFUDC on borrowed funds
28 for capital expenditures.

29 Total Funds Applied (Line 12) - The funds applied reflect operating

1 expenses from Exhibit A-1, Line 23, totaling \$529.6 million, less certain non-
2 cash and subordinate expenses (Exhibit A-3, Line 11) totaling \$37.6 million.
3 The components of the non-cash expenses include: (1) depreciation
4 expense included in operating expenses, (2) payments to the City of
5 Philadelphia for miscellaneous services rendered, including Philadelphia
6 Gas Commission expenses.

7 Funds Available to Cover Revenue Bond Debt (Line 15) are projected to
8 be \$163.6 million in the 2000-2001 Fiscal year.

9 Revenue Bond Debt Service (Line 16) - The total funds applied to 1975
10 revenue bond debt service are \$51.6 million, representing the scheduled
11 cash payments of principal which are due annually with interest paid
12 semi-annually.

13 Debt Service Coverage Ratio 1975 Revenue Bond (Line 17) - The debt
14 service coverage ratio for 1975 Ordinance revenue bonds is obtained by
15 dividing Funds Available to cover 1975 Debt Service (\$163.6 million) by
16 Funds Applied to 1975 Debt Service Revenue Bonds (\$51.6 million). The
17 result produces a coverage ratio of 3.17 times. The mandatory coverage
18 ratio for 1975 debt service is 1.5 times. The remaining coverage ratios as
19 set forth in the 1998 Ordinance are now calculated. Net available after
20 1975 Debt Service (Line 18) totaling \$112.0 million is utilized to cover Other
21 Capital Leases (Line 19) of \$8.0 million at 1.0 times, with the balance
22 remaining of \$104.0 million (Line 20) used to calculate the coverage ratio
23 on 1998 Ordinance Revenue Bond Debt Service (Line 21) of \$29.4 million
24 at a mandatory 1.5 times. The projected calculation for this ratio is shown
25 at 3.53 times (Line 22). The final component of the coverage calculation
26 under the 1998 Ordinance is shown on (Lines 23 through 25). Net
27 available after the 1998 Debt Service (Line 23) of \$74.6 million is used to
28 calculate coverage on 1998 Subordinate Debt Service (Line 24) of \$2.0
29 million, the result is shown on (Line 25) as Debt Service Coverage

1 Subordinate Bonds of 37.46 times. The mandatory requirement is 1.0 times
2 on subordinate debt service. The projected coverage ratios for the
3 current 1999-2000 fiscal period are expected to be 1.72 times on 1975
4 Ordinance debt service and 1.61 times on 1998 Ordinance debt service.

5 Q. Returning to the Statement of Income (Exhibit A-1), could you explain in
6 detail the items that are included under the category Labor and Fringe
7 Benefits on Exhibit A-1, Line 19.

8 A. This category includes payroll costs (excluding that portion chargeable to
9 capital activities), payments made to beneficiaries of PGW's employee
10 pension plan and corresponding withdrawals from the pension fund. This
11 category also includes the cost of premiums paid for employees (both
12 active and retired) health and group life insurance coverage, payroll
13 taxes associated with FICA and Medicare, state and federal
14 unemployment taxes (exclusive of those taxes chargeable to capital
15 activities) and a provision for employee attendance incentives as
16 detailed on Exhibit C-3.

17 Q. Are contractual labor escalations included in the periods covered on
18 Exhibit A-1?

19 A. Yes, the current contractual agreement with the Gas Works Employee's
20 Union of Philadelphia, Local 686, is a three year contract expiring in May,
21 2001. The agreement provides for a 1.5% increase in November 1998 and
22 a 2% increase in May 1999. The remaining portion of the contract
23 provides for a 1% increase in November 1999 with a 3% increase effective
24 in May 2000. The 2000-2001 Budget also contains the impact of a 3%
25 increase for non-union employees which was scheduled to be effective
26 May 1, 2000. The budgetary assumption utilized for all employees was that
27 no new wage increase would be effective during the 2000-2001 Fiscal
28 period.

1 Q. Could you explain the difference in labor and fringe benefit expenses
2 between the 1999-2000 and 2000-2001 fiscal periods?

3 A. The 2000-2001 Budget reflects payroll costs of \$100.5 million, a decrease of
4 \$0.6 million from the 1999-2000 fiscal year level of \$101.1 million (Exhibit C-
5 3, Line 1). The effect of the May 2000 wage increases combined with
6 merit and progression increases accounts for nearly \$2.5 million of added
7 costs, while the decrease in the level of labor being capitalized further
8 increased operating labor costs by \$0.1 million. The above increases are
9 expected to be reduced by \$1.4 million due to lower payroll costs
10 reflecting an anticipated net staffing reduction of approximately 33
11 employees on average during the 2000-2001 Budget year. PGW
12 anticipates that approximately 100 employees (50 average) will retire
13 through either of PGW's retirement plans during the 2000-2001 Fiscal
14 period.

15 In addition, overtime costs which are projected at \$6.5 million for the
16 2000-2001 Budget year are expected to be lower by \$1.8 million
17 compared to the prior year's expected level of \$8.3 million. The
18 negotiated unionized workforce flexibility assignment clause is anticipated
19 to permit PGW to staff for operational requirements in the most efficient
20 and effective way.

21 The 2000-2001 Budget year projects pension beneficiary payments (Line 4)
22 to total \$28.9 million, with a \$27.5 million (Line 5) withdrawal from the
23 pension fund to meet the anticipated payments. This will result in an
24 actuarial pension expense of \$1.4 million for PGW. The 1999-2000
25 estimate for pension beneficiary payments is expected to be \$27.4
26 million, with a \$26.3 million withdrawal from the pension fund to meet the
27 scheduled payments. The actuarial pension expense for PGW in the 1999-
28 2000 fiscal year is forecasted to total \$1.1 million. The actuarially
29 computed pension expense for the 1999-2000 and 2000-2001 fiscal

1 periods was based on the updated information contained in PGW's most
 2 recently completed pension study prepared by its actuarial consultant.

3 Health insurance costs (Exhibit C-3, Line 8) are anticipated to be \$24.4
 4 million in the 1999-2000 fiscal period, while the 2000-2001 Budget year
 5 expects a \$0.9 million increase to \$25.3 million. The projected costs for
 6 the 2000-2001 Budget Year were \$29.3 million, however, a proposal to
 7 acheive nearly \$4.0 million in cost savings as a result of plan changes for
 8 both active and retired employees is underway. This effort to reduce
 9 PGW's overall health insurance is currently being evaluated with PGW's
 10 primary health care providers. PGW received a retrospective refund from
 11 one of its primary carriers in April, 2000 totaling approximately \$1,027,000,
 12 which lowered the total health costs for the 1999-2000 fiscal year.

13 Payroll taxes (Exhibit C-3, Line 15) are anticipated to be \$6.5 million in the
 14 2000-2001 Budget year, a reduction of \$0.1 million from the 1999-2000
 15 estimate. This \$0.1 million decline in payroll taxes mainly reflects the
 16 slightly lower overall payroll costs. The following schedule details the
 17 major components of the Labor and Fringe Benefits expense:

18 Labor and Fringe Benefits

19 (Dollars in Thousands)

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>1998-99</u>	<u>1999-2000</u>	<u>2000-2001</u>
22 Operating Labor	\$75,533	\$78,613	\$78,051
23 Pension Payments	27,303	27,438	28,900
24 Pension Fund Witharawals	(26,516)	(26,319)	(27,524)
25 Insurance	24,416	26,135	27,045
26 Payroll Taxes	6,091	6,674	6,548
27 Attendance Incentive	<u>411</u>	<u>393</u>	<u>387</u>
28 TOTAL	<u>\$107,238</u>	<u>\$112,934</u>	<u>\$113,407</u>

29 Q. Could you explain the personnel levels included on Exhibit C-3-1, Line 11

1 and why PGW feels that the 2000-2001 Budget year level is appropriate?

2 A. PGW, in the 2000-2001 Budget Year, expects to attain an average level of
3 1,822 employees, 33 employees on average less than the 1999-2000
4 estimate. The staffing reductions result in a 118 employee decrease at
5 August 31, 2001 compared to the prior year. PGW recognizes that certain
6 areas of the company associated with customer contact need additional
7 staffing and continued training and the 2000-2001 Budget provides the
8 necessary funding. Also, there is a need to staff the Information
9 Technology area which is currently being backfilled through the use of
10 outside contractors, while the Regulatory Affairs area will need added
11 resources with the advent of a change in regulatory authority to the
12 Pennsylvania Public Utility Commission. The continuing city-wide
13 implementation of the Automatic Meter Reading program along with
14 technological advances associated with on-going systems process
15 improvements is expected to allow PGW to perform its operations in the
16 most cost-effective, efficient and safe manner.

17 PGW expects to identify all areas of its operation that can be improved
18 through a more productive workforce with up to date standards, while
19 adhering to the highest level of safety in the work place and reducing
20 overall workers' compensation claims.

21 Q. Please detail the items included in Other Expenses and Depreciation on
22 Exhibit A-1, Line 21.

23 A. The expenses shown on Exhibit A-1, Line 19 captioned "Other Expenses
24 and Depreciation" include an appropriation for reserves and other losses
25 (excluding the appropriation for uncollectible gas accounts), advertising,
26 general material, property, liability and weatherization (revenue
27 protection) insurance, contracted maintenance, utilities, rentals,
28 purchased services, postage, promotion, depreciation and miscellaneous
29 expenses.

1 Also included in this category are credits to operating expenses for labor-
2 related fringe benefits such as insurance, taxes and pension expenses and
3 administrative and general costs chargeable to capital projects. In
4 addition, non-utility revenues are also contained in this category (repair
5 and other service revenues are now included as part of other operating
6 revenues). The detail of these expenses can be found on Exhibit C-4.

6 Exhibit C-4, Detail of Other Operating Expenses

9 Q. Have any adjustments been made to the expense categories detailed on
10 Exhibit C-4, to reflect past Gas Commission orders?

11 A. Yes, PGW has complied with the Gas Commission's past orders which
12 amortized certain non-recurring costs and normalized other expense items
13 for rate making and budgeting purposes. The categories of contracted
14 maintenance, rentals and leasing and purchased services reflect some of
15 these adjustments. Schedules (SD4.A-B-C) provide documentation of the
16 accounting for non-recurring expenses, and have been included as part
17 of PGW's Operating Budget filing.

18 Q. Please explain what is included in the Appropriation for Reserves and
19 Other Losses on Exhibit C-4, Line 1?

20 A. This expense category includes appropriations to the Injuries and
21 Damages Reserve for PGW's estimate of outstanding suits and claims and
22 workers' compensation settlements, corporate loss settlements and a
23 provision for employee's compensated absences. As stated previously,
24 this item excludes the appropriation for uncollectible accounts.

25 Q. What factors contributed to the decrease in settlements during the 1999-
26 2000 estimate compared to the 1998-99 actual, and the continued
27 projected decline in the level of settlements anticipated for the 2000-2001
28 Budget year?

29 A. PGW's settlements for suits and claims and workers' compensation were

1 \$4.2 million during the 1998-99 actual period principally due to one major
2 outstanding case being settled. PGW's current projection of total
3 reserves for outstanding suits and claims and workers' compensation
4 settlements is expected to total nearly \$4.4 million, a continued reduction
5 compared to the \$4.6 million projected at August 1999. This reduction, in
6 projected liabilities, accounts for a major portion of the reduced
7 settlements in the current and Budget fiscal years. Also, during the 1998-
8 99 fiscal year \$645,000 of general corporate related claims were settled,
9 in both the 1999-2000 and 2000-2001 fiscal periods it is anticipated that this
10 expense will be reduced to \$200,000.

11 The appropriation to the Reserve for injuries and damages is expected to
12 total \$2.3 million during the 1999-2000 fiscal period resulting in an ending
13 reserve balance of \$1.2 million. Settlements for the 1999-2000 fiscal period
14 are anticipated to total \$3.3 million. The reserve balance at August 2000 is
15 expected to provide coverage for suits and claims and workers'
16 compensation settlements during the 2000-2001 Budget year.

17 The 2000-2001 fiscal period projects settlements totaling \$1.5 million, while
18 the appropriation of \$1.9 million represents the required level necessary to
19 provide a year-end reserve balance of \$1.6 million. This forecasted
20 reserve balance at August 2001 is expected to provide coverage for
21 outstanding suits and claims and workers' compensation settlements
22 anticipated during the 2001-02 fiscal year.

23 PGW, through the Human Resources, Risk Management and Legal
24 departments, is currently assessing its workers' compensation program to
25 identify all potential savings that can be achieved.

26 The following schedule details the Injuries and Damages Reserve:
27
28
29

Injuries and Damages Reserve

(Dollars in Thousands)

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>1998-99</u>	<u>1999-2000</u>	<u>2000-2001</u>
Beginning Balance	\$3,503	\$2,216	\$1,181
Settlements	(4,152)	(3,307)	(1,463)
Appropriation	<u>2,865</u>	<u>2,272</u>	<u>1,908</u>
Ending Balance	<u>\$2,216*</u>	<u>\$1,181*</u>	<u>\$1,626*</u>

*The required reserve balance represents the current portion of the total outstanding liability at the end of the fiscal period.

Q. Would you explain the items included in the Advertising expenses shown on Exhibit C-4, Line 2 and the nearly 75% rise comparing the 2000-2001 Budget year to the 1999-2000 estimate?

A. The major components of the nearly \$600,000 increase in advertising expenditures in the 2000-2001 Budget year are related to corporate campaigns and the promoting of residential, commercial and major accounts market development. The Marketing department accounts for nearly \$0.3 million or 23% of the total as a result of plans to expand and further develop all market segments, while corporate related advertising to provide customer informational and safety related and educational advertising totaling \$0.6 million comprises 41% of the total advertising budget for the 2000-2001 fiscal year.

In addition, other advertising is associated with promoting customer safety awareness, including the proper handling of gas appliances and the appropriate customer response to the smell of gas, and for Parts and Labor plans and house-heater start-up campaigns. Other advertising costs are associated with employee hiring, and costs for Gas Commission activities related to meeting notices. Advertising costs in the 1999-2000 fiscal period were cut substantially in the Marketing and Public Policy

1 Departments as part of PGW's overall cost-cutting efforts on all but
2 essential services, because of the severe cash flow problems and
3 reduced margins on gas sales reflecting the warm 1999-2000 heating
4 season and its dramatic impact on revenues and subsequently debt
5 service coverage.

6 Q. What are the main factors that contribute to the higher material costs of
7 \$0.6 million or 12% on Exhibit C-4, Line 3 during the 2000-2001 Budget year
8 when compared to the 1999-2000 fiscal period?

9 A. The additional material costs projected for the 2000-2001 Budget year
10 mainly reflect higher gasoline costs in the Transportation department for
11 fueling PGW's vehicle fleet as a result of the substantially higher price for
12 all petroleum products. Also, higher expenses are expected in the
13 Customer Affairs area during the upcoming 2000-2001 fiscal period
14 associated with the mailing of customer bills and notices, which were
15 curtailed due to the billing problems that were experienced in the
16 current fiscal period. The Information Technology department expects
17 a \$0.2 million rise in material expenses in the computer operations area
18 due to the on-going replacement and improvements to corporate wide
19 systems and processes. PGW is committed to an overall cost containment
20 initiative by management for the 2000-2001 Budget Year, which is
21 expected to result in substantially lower material costs in PGW's street and
22 production plant operations. In the 1999-2000 estimate the three major
23 operating departments are anticipated to utilize nearly \$5.7 million in
24 materials, the 2000-2001 Budget Year projects that the same departments
25 will reduce their costs by \$0.3 million or 5% to a level of \$5.4 million.

26 Q. What type of insurance premium charges are included in the insurance
27 costs reported on Exhibit C-4, Line 4 and what is the reason for the \$0.9
28 million decline projected in the 2000-2001 Budget year?

A. Insurance expense includes premiums for property, public liability, workers' compensation and weather (revenue protection) coverage. Public liability coverage for the 1999-2000 and 2000-2001 fiscal years is expected to be maintained at the current \$200.0 million level with a self-retention level of \$500,000 per occurrence.

The 1999-2000 fiscal period provided \$1.0 million in insurance premiums in the Gas Planning Department for the purchase of a weather related revenue protection policy. This insurance policy was purchased to reduce PGW's risk of warmer than normal weather and its resultant impact on revenues, margins and debt service coverage. During the recently completed 1999-2000 winter heating season PGW received \$758,000 in proceeds from its weather insurance policy reflecting the warmer weather experienced. The cost of the policy was \$950,000 and after deducting the proceeds, PGW did not recover the full cost of purchasing the policy. PGW does not plan to renew the weather insurance policy for the upcoming 2000-2001 fiscal period. PGW expects that with the proposed increase in the customer charge as part of its overall base rate increase design, the need for weather related insurance will be mitigated. In the 1998-99 through 2000-2001 fiscal years, the cost of providing insurance coverage is reflected as follows:

Insurance Expense

(Dollars in Thousands)

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>1998-99</u>	<u>1999-2000</u>	<u>2000-2001</u>
Property Insurance	\$355	\$325	\$362
Public Liability & Workers' Comp.	1,252	926	954
Weather (Revenue Protection)	-	950	-
Miscellaneous	<u>55</u>	<u>55</u>	<u>63</u>
TOTAL	<u>\$1,662</u>	<u>\$2,256</u>	<u>\$1,379</u>

1 Other labor related insurance expenditures for employee health and
2 group life insurance were previously referenced as a component of the
3 labor and fringe benefit expenses.

4 Q. What expenses are included in contracted maintenance on Exhibit C-4,
5 Line 5?

6 A. Contracted maintenance represents the cost of work performed by
7 outside personnel, which are retained for their specialized experience in
8 particular tasks, while software maintenance fees and/or licensing are
9 also included in this category. This contracted work includes paving,
10 painting, inspections and charges for maintenance of such items as gas
11 engines, piping insulation, instrument repairs, tools, automobiles, elevators,
12 air conditioning equipment, alarms, fire protection equipment, office and
13 computer equipment and computer software maintenance, etc.

14 Q. Costs associated with contracted maintenance are projected to increase
15 by \$0.4 million or 9% in the 2000-2001 Budget year. Please explain the
16 reason for the additional expense.

17 A. The primary reason for the higher contracted maintenance centers on
18 additional contracted costs in the Gas Processing and Building Service
19 department. The 2000-2001 fiscal period projects a \$0.1 million rise in the
20 use of contractors at the Richmond production plant and at the many
21 PGW facility locations. The Information Technology department expects
22 to implement and/or replace and design new corporate-wide systems
23 and processes resulting in higher maintenance on this new equipment
24 and related software costs totaling nearly \$0.2 million. PGW expects to
25 spend approximately \$4.2 and \$4.6 million, in the the 1999-2000 and 2000-
26 2001 fiscal periods, respectively.

27
28 Q. What services are included within the category of Utilities on Exhibit C-4,
29 Line 6?

1 A. Utilities include the cost of electric, telephone and water service. In the
2 1998-99 through 2000-2001 fiscal years, the actual or projected costs for
3 these services are:

4 Utility Expense
5 (Dollars in Thousands)

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>1998-99</u>	<u>1999-2000</u>	<u>2000-2001</u>
6 Electric	\$1,822	\$1,774	\$1,763
7 Telephone	1,951	1,566	1,567
8 Water	<u>265</u>	<u>172</u>	<u>173</u>
9 TOTAL	<u>\$4,038</u>	<u>\$3,512</u>	<u>\$3,503</u>

10 The minor decrease in utility expenditures projected for the 2000-2001
11 Budget year mainly reflects lower costs for purchased electric. The
12 significantly lower telecommunication costs in the 1999-2000 period
13 reflect a renegotiated cost structure associated with cellular phone
14 usage during 1999. The utility expenses included above exclude the cost
15 of gas used by the company. This gas expense, in accordance with the
16 prescribed FERC accounting methodology, is included in Natural Gas
17 expense on Exhibit A-1, Line 14.

18
19
20
21 Q. What costs are included in rental expenses, as presented on Exhibit C-4,
22 line 7 and what are the reasons for the \$0.7 million rise in this expenditure
23 for the 2000-2001 fiscal year?

24 A. Rental expenses include the rental and leasing of such items as computer
25 related and telephone equipment, hand held microprocessors utilized by
26 meter readers, specialized bill processing and mail receipts, transportation
27 and construction equipment and PGW's district office service centers.
28 The main factors that result in the \$0.7 million increase in rental and
29 leasing costs in the 2000-2001 Budget are associated with the Information

1 Technology and Transportation departments. The leasing of computer
2 related equipment and software associated with PGW's overall corporate
3 policy to improve systems and processes accounts for nearly \$0.3 million
4 of the additional costs. PGW in the 2000-2001 Budget year is proposing an
5 operating lease for the acquisition of computer related and transportation
6 equipment. The cost of these leases for the upcoming 2000-2001 fiscal
7 period is \$0.7 million. The Customer Affairs area of PGW which includes
8 the operation of PGW's customer service centers expects to relocate the
9 Northeast customer center to PGW's Castor facility at a savings of \$0.1
10 million in rental costs annually.

11 **Q. Please detail the type of expenses included within the category**
12 **Purchased Services on Exhibit C-4, Line 8.**

13 **A.** This expense category primarily includes professional and technical
14 services such as: legal, engineering, auditing, consulting and computer
15 related services, as well as, certain specialized services, e.g., advertising
16 production, collection agencies, armored car services, weather
17 forecasting, banking and financial services and weatherization and
18 conservation services, etc., which are not normally available within the
19 company's internal organization. The 2000-2001 Budget year anticipates
20 purchased service costs to total \$21.4 million an increase of \$1.1 million or
21 5% above the 1999-2000 estimate of \$20.3 million. Legal fees for general
22 corporate legal services are projected to total \$2.2 million or \$0.3 million
23 less than the 1999-2000 estimate. PGW expects to spend nearly \$4.0
24 million during the 1999-2000 period in consulting costs to remediate the
25 problems that have been experienced with the implementation of the
26 billing system. In the 2000-2001 Budget Year \$0.75 million has been
27 earmarked for further enhancements to the billing system. PGW has also
28 provided \$2.0 million for training PGW employees who have contact with
29 customers whether by phone or in person. This training has been

1 determined to be absolutely critical to alleviate the poor customer
2 service that has been provided to our customers since the flawed
3 implementation of the billing and related systems. Also, higher
4 expenditures in the 2000-2001 Budget Year are anticipated for regulatory
5 matters, collection agencies fees, programming resources, advertising
6 and related costs and in the Marketing department as part of the
7 expanded Marketing initiative to promote the use of natural gas in the
8 marketplace. The 2000-2001 Budget expects that weatherization and
9 conservation expenditures will total \$2.2 million, unchanged from the
10 1999-2000 estimate. These costs are part of the non-fuel charges that are
11 currently recoverable through the Gas Cost Rate.

12 Q. Does the Postage Expense on Exhibit C-4, Line 9, include the cost of
13 mailing all of the gas bills and notices being sent to customers?

14 A. Yes. PGW mails all of the monthly customer gas bills. In addition, this
15 expense includes the cost for the mailing of collection notices, parts and
16 labor plan contracts and general business correspondence. The 2000-
17 2001 Budget year also reflects the partial year impact of the proposed
18 postal rate increase expected in 2001. As a result of the problems
19 experienced with the new billing system, customer bills and delinquent
20 notices were not sent for various periods of the current year. The 2000-
21 2001 Budget Year expects a return to a more normal mailing pattern of
22 customer bills and notices. Also, the Marketing department projects an
23 increase in customer correspondence regarding the promotion and
24 development of PGW's core gas business.

25 Q. Please describe the items included in the category Promotion, on Exhibit
26 C-4, Line 10.

27 A. The principal promotional expenses are associated with the Marketing
28 Department's initiatives to expand the use of natural gas in all market
29 segments. The \$1.0 million rise projected for the 2000-2001 Budget year

1 resulted from a concerted effort to hold down all non-safety related
2 expenditures during the 1999-2000 fiscal period to achieve corporate
3 cost-cutting goals. The Marketing department anticipates an aggressive
4 campaign to provide incentives to attract new customer load or convert
5 existing customers to expand their use of natural gas in the 2000-
6 2001 Budget period.

7 Q. What are the components of Non-Utility Revenues presented on Exhibit C-
8 4, Line 11?

9 A. This category formerly included repair and other service revenues, which
10 are now reported as part of other operating revenues. The remaining
11 components of these revenues are related to commissions paid by the
12 State of Pennsylvania for sales tax collection.

13 Q. On Exhibit C-4, Line 12, what expenses are charged to capital and what is
14 the basis for the allocated charges to capital and corresponding credits
15 to Operations?

16 A. Certain labor-related fringe benefit expenses, such as employee group
17 life and health insurance, pensions and payroll taxes are charged initially
18 to PGW's operating accounts on the Statement of Income, Exhibit A-1. In
19 order to assign a proportional share of these costs to capital projects that
20 utilize PGW personnel, a percentage of the total cost of the labor and
21 fringe benefit expenses to the total direct payroll is computed. On the
22 basis of the percentage, these expenses are charged to capital projects
23 and operating expenses are reduced on the basis of the direct labor
24 charges to capital. Also, administrative costs are allocated to capital
25 based on the percentage of administrative and general expenses to total
26 expenditures, excluding fuel costs. Capital projects are charged and
27 operating expenses lowered on the basis of the total charges on a
28 monthly basis to capital projects. The 2000-2001 Budget year anticipates
29 an allocation of \$12.1 million in labor related fringe benefits and

1 administrative and general costs to capital projects, an increase of \$1.0
2 million from the 1999-2000 fiscal period reflecting greater capitalized labor
3 costs and overall capital spending in the upcoming 2000-2001 Budget
4 Year.

5 Q. How are Depreciation rates determined and how do they relate to the
6 expense listed in Exhibit C-4, Line 13?

7 A. PGW currently depreciates plant-in-service based on a depreciation study
8 originally prepared by the firm of Coopers and Lybrand. PGW updated
9 this study and utilized the results to develop the 1998-99 depreciation
10 expense. The composite depreciation rate anticipated to be utilized is
11 2.5% in the 1999-2000 fiscal period. The 2000-2001 Budget year projects
12 the utilization of the 2.5% composite depreciation rate and when applied
13 to the projected plant-in-service balances, accounts for the \$1.2 million
14 rise in depreciation expense in the 2000-2001 Budget year. PGW will
15 present separate testimony which will provide more detail on the
16 depreciation expense and rates utilized during the 1999-2000 and 2000-
17 2001 fiscal years.

18 Q. Miscellaneous expenses included on Exhibit C-4, Line 15 are forecasted to
19 decline by \$7.7 million in the 2000-2001 Budget year. Please explain the
20 reasons for the decrease and the main components of this category?

21 A. Miscellaneous expenses are forecasted to decrease by \$7.7 million
22 primarily due to \$10.0 million of non-departmental defined cost savings
23 and productivity improvements as a result of the upcoming management
24 audit and on-going restructuring plans and cost-containment initiatives.
25 The amortization of non-recurring costs in the 2000-2001 fiscal period is
26 expected to decline by \$0.3 million. Higher amortization charges for
27 equipment acquired through PGW's existing capital lease is expected to
28 add \$1.2 million in costs for the Information Technology department in the
29 2000-2001 Budget Year. In addition, higher employee training costs

throughout various PGW departments, particularly the Customer Affairs area and costs associated with vacant PFMC positions account for the major portion of the increase in miscellaneous expenditures. A detail of the components of the miscellaneous expense category is listed below:

Miscellaneous Expenses

(Dollars in Thousands)

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>1998-99</u>	<u>1999-2000</u>	<u>2000-2001</u>
Expense of Employees	\$518	\$634	\$1,463
Dues & Subscriptions	795	714	954
Contributions & Sponsorships	100	-	-
Taxes (PGC & Other)	57	34	35
PFMC Management Fee	398	355	612
Regulatory Asset Amortization	3,156	3,750	3,750
Restructuring Costs Amortization	965	965	965
Y2K & Deregulation Amortization	882	888	888
Amortization Non-Recurring Expense	2,869	3,697	3,412
Deferred Compensation	345	376	385
Capital Lease Amortization	1,618	2,307	3,477
Cost Savings/Productivity Improve.	-	-	(10,000)
(Additions to)/Reductions of LNG Inv	<u>65</u>	<u>(23)</u>	<u>74</u>
TOTAL	<u>\$11,768</u>	<u>\$13,697</u>	<u>\$6,015</u>

Q. Does this conclude your testimony in this proceeding?

A. Yes, it does. Thank you.

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PREPARED DIRECT TESTIMONY
OF
THOMAS M. SMYTH
ON BEHALF OF
PHILADELPHIA GAS WORKS

7 **Q. Please state your name and business address.**

8 A. My name is Thomas M. Smyth. My business address is 800 West Montgomery
9 Avenue, Philadelphia, PA 19122.

11 **Q. By whom are you employed and in what capacity?**

12 A. I am employed by the Philadelphia Gas Works in the capacity of Vice President,
13 Controller and Chief Accounting Officer.

15 **Q. What are your principal responsibilities?**

16 A. My principal responsibilities are the monthly and annual financial reporting
17 including necessary disclosures; accounting for property records including
18 capital spending and depreciation; accounts payable; bank reconciliations;
19 financial statement analyses; and system administration for our Oracle financial
20 systems.

22 **Q. Have you previously presented testimony before the Philadelphia Gas
23 Commission?**

24 A. Yes.

26 **Q. What are your responsibilities in connection with PGW's Consolidated
27 filing that is the subject of these hearings?**

28 A. I am responsible for the development and preparation of the financial details
29 regarding Bad Debt Expense included in the June 19, 2000 filing of PGW's

1 proposed 2000-2001 Operating Budget.

2
3 **Q. What is the purpose of your testimony in this proceeding?**

4 A. The purpose of my direct testimony is to explain the documentation and
5 methodology that supports the schedules presented and, where necessary,
6 explain the reasons for variations between the fiscal periods.

7
8 **BAD DEBT EXPENSE**

9
10 **Q. Please summarize what amount of Bad Debt Expense is projected for FY**
11 **2001 and how this amount affects the revenue and net income of PGW?**

12 A. The FY 2001 Operating Budget projects Bad Debt Expense to be \$46 million or
13 7.11% of budgeted Operating Revenues. Bad Debt Expense has no effect on
14 revenue once rates are set. Net income is reduced dollar-for-dollar by Bad Debt
15 Expense.

16
17 **Q. How does this compare to the prior year in terms of amount and**
18 **percentage of revenue?**

19 A. The FY 2001 Bad Debt Expense is expected to increase by \$2.0 million over FY
20 2000. As a percentage of total gas revenues, however, Bad Debt expense is
21 projected to decline from 8.54% in FY 2000 to approximately 7% in FY 2001 due
22 to anticipated improvements in the billing and collection system and adequate
23 reserve balances for FY 2000.

1 **DEPRECIATION EXPENSE**

2
3 **Q. Please summarize the amount of depreciation expense that is projected for**
4 **FY 2001?**

5 A. The FY 2001 Operating Budget projects gross depreciation of \$35.8 million and
6 net depreciation of \$32.5 million.

7
8 **Q. What do you mean by gross and net depreciation?**

9 A. Depreciation is the periodic allocation of the cost of all utility plant in service
10 over the estimated periods benefited by those assets. Gross depreciation is the
11 expense recorded prior to any allocations. Net depreciation is the expense
12 recognized in the current period after allocation of depreciation expense to
13 designated operating departments.

14
15 **Q. How do gross and net depreciation effect the financial statements for**
16 **PGW?**

17 A. For PGW, there are three (3) major financial statements: the Statement of
18 income, the Balance Sheet, and the Statement of Cash Flows. **Statement of**
19 **Income** - Gross depreciation expense is charged to the income statement. The
20 adjustment to net, by allocating the expense to various operating departments,
21 does not reduce the overall expense. **Balance Sheet** - Gross depreciation
22 reduces the value of assets (Utility Plant in Service) on the Balance Sheet. The
23 adjustment to net depreciation does not impact this reduction. All depreciation
24 taken as of the Balance Sheet date is recorded in Accumulated Depreciation.
25 **Statement of Cash Flows** - Gross depreciation is added back to Operating
26 Income as part of the cash flow calculation.

1 **Q. How does this amount compare to the prior year?**

2 A. The gross and net depreciation expenses are expected to rise \$1.2 million and
3 \$1.4 million, respectively. The increase in the gross amount is attributed to the
4 forecasted capital spending of \$62 million in FY 2001. The increase in the net
5 amount is the result of a change in gross depreciation and an increase in the
6 amortization of IT and Transportation leased assets charged to operating
7 departments.

8
9 **Q. When was the most recent depreciation study conducted?**

10 A. A depreciation study was performed at August, 1999 utilizing the Cooper &
11 Lybrand's Depreciation Valuation System (DVS) software for Utility Plant in
12 Service data as of August, 1998. The composite rate which resulted is 2.5%.

13
14 **Q. Does this conclude your prepared direct testimony in this proceeding?**

15 A. Yes, it does.
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PGW
A/R and Reserve
FY1999 - 2001

Schedule 1 - Receivable Balances

	<u>FY1999</u>	<u>FY2000</u>	<u>FY2001</u>
Opening Balance	\$ 88,290	\$ 97,038	\$ 139,206
Plus:			
Revenue	482,700	499,606	574,282
Non-CRP/ Taxes / Other	22,094	15,745	20,770
Base Increase			52,000
Total	\$ 504,794	\$ 515,351	\$ 647,052
Less:			
Collections	459,412	438,183	608,229
Writeoffs	36,634	35,000	40,000
Total	\$ 496,046	\$ 473,183	\$ 648,229
Ending Balance	\$ 97,038	\$ 139,206	\$ 138,029

Schedule 2 - Reserve Balances

Opening Balance	\$ 64,704	\$ 67,070	\$ 75,820
Appropriation	39,000	44,000	46,000
Writeoffs	(36,634)	(35,000)	(40,000)
Writeoff - (OAR/M&J)		(250)	(250)
Ending Balance	\$ 67,070	\$ 75,820	\$ 81,820

**PREPARED DIRECT
TESTIMONY OF CRAIG WHITE
ON BEHALF OF
PHILADELPHIA GAS WORKS**

1 **Q. Please state your name and position with company.**

2 A. My name is Craig White. My position is Sr. Vice President - Marketing and
3 Supply Services.

4
5 **Q. How long have you held this position?**

6 A. I assumed the position of Vice President Marketing in November 1, 1998
7 and was promoted to Sr. Vice President - Marketing & Supply Services in
8 November 1999.

9
10 **Q. Have you ever provided testimony to this Commission before, and in
11 what capacity?**

12 A. Yes. I have previously provided written and oral testimony pertaining to
13 PGW's GCR filings, operating budgets and forecasts, and various tariff
14 changes. In addition, I have provided testimony regarding the PGW/Grays
15 Ferry/Trigen/Sun contracts.

16
17 **Q. How is your testimony structured?**

18 A. My testimony has been prepared in two sections. First, I will discuss those
19 operations under my control that deal with gas management issues.
20 Second, I will discuss Sales and Marketing issues.

21

1 **Section I - Gas Management**

2
3 **Q. What is the purpose of this section of your testimony?**

4 A. *The purpose of my testimony in this area is twofold: 1) to explain the*
5 *assumptions and methodology used in arriving at a six month actual and six*
6 *month estimated sales, sendout, gas cost and revenue forecast for the*
7 *remainder of Fiscal Year 2000, in light of the problems with the new billing*
8 *system and, 2) to discuss and support PGW's Fiscal Year 2000-2001*
9 *Operating Budget Filing and the accompanying documentation which you*
10 *will find contained in Volumes I and II, provided as exhibits in this*
11 *proceeding. My testimony will include a discussion on the underlying*
12 *assumptions contained in the FY 2001 Operating Budget including: a)*
13 *natural gas supply and cost assumptions, b) natural gas demand and load*
14 *projection assumptions and, c) the procedures used to develop factors for*
15 *the planning model such as the development of a domestic load factor (DOM*
16 *Factor), a space heating factor (CFDD Factor), load growth and load loss*
17 *assumptions and customer counts. Finally, I will explain how the budget*
18 *satisfies the company's requirements.*

19
20 **Q. Given the problems with the new billing system during the past year,**
21 **how were you able to arrive at actual sales and revenues for the six**
22 **month period September 1999 through February 2000?**

23 A. *First, it is important to recognize that the new customer information system*
24 *(BCCS) was placed into production in early July 1999. During the final two*
25 *months of the 1998-99 fiscal year, significant over billing occurred. The*
26 *Accounting & Reporting Department in turn adjusted the 1998-99 fiscal year*
27 *over billing by decreasing the General Ledger for the best approximation of*
28 *the over billing in the amount of \$22,416,022.*

1 At this same time the new version of the former legacy report referred to as
2 the, "Gas Sales and Revenue Report" was not yet available. This report
3 historically provided a detailed breakdown of company information, including
4 sales and revenues by homogeneous class, which then reconciled with, and
5 supported, the sales volumes and revenue amounts included in the General
6 Ledger.

7
8 Following the second quarter of the 1999-2000 fiscal year the "new" Gas
9 Sales and Revenue Report was validated and run for the months of
10 September through February. However, included in the output of the new
11 Gas Sales and Revenue Report were the adjusting entries for the July and
12 August 1999 over billing. Therefore, \$22,416,022 in revenue and associated
13 sales needed to be "added back" to the sales and revenue reported in the
14 "new" Gas Sales and Revenue Report to reflect the true sales and revenue
15 billed in fiscal year 1999-2000.

16
17 In order to accomplish this task, sales associated with the \$22,416,022 of
18 revenue needed to be determined. General Accounting provided a "Gas
19 Sales Report" which identified an interruptible adjustment volume of
20 1,228,016 Mcf associated with the July and August 1999 adjustment.

21
22 Armed with this information and the "new" Gas Sales and Revenue Report,
23 actual gas sales and revenue was determined for the first six months of
24 fiscal year 1999-2000 utilizing the following methodology. First, in order to
25 match unspecified interruptible revenue intrinsic to the \$22,416,022
26 adjustment to the known interruptible sales adjustment (1,228,016 Mcf), an
27 average weighted unit of revenue was calculated for the interruptible class
28 based on the new Gas Sales and Revenue Report year to date detail
29 through February 2000 (February A2 Report). This Mcf unit value was
30 assigned to the 1,228,016 Mcf of interruptible sales. Result: Unit revenue of

1 \$4.78/Mcf x 1,228,016 = \$6,156,718 revenue adjustment for the interruptible
2 class.

3
4 Second, a calculated weighted average unit of revenue for the firm customer
5 classes from the February A2 Detail was determined, result: \$8.3085/Mcf. to
6 arrive at the revenue and sales adjustment for the firm classes:

	<u>Revenue</u>	<u>Sales</u>
9 Overall Adjustment	\$22,416,022	
10 Less Interruptible Adjustment	<u>6,156,718</u>	
11 Firm Class Adjustments	<u>\$16,259,304</u> / \$8.3085 =	<u>1,956,948</u> Mcf

12
13
14 Third, the total sales adjustment (3,244,963 Mcf) and the associated
15 revenue adjustment (\$22,416,022) was segregated into the four customer
16 categories of BPS, LBS, firm non-heating and firm heating based on the
17 percentage relationships of these classes included in the February A2
18 Report. These volumes and amounts were subsequently distributed over
19 the months of September through November (where adjustments reversing
20 the July and August over billing were estimated to have occurred) based on
21 monthly percentages of usage in September through November, per
22 calculations based upon the "new" Gas Sales and Revenue Report. Below
23 are the adjustments which were added or "spread" proportionally in the
24 months of September through November 1999.

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<u>Adjustment Summary</u>	<u>Revenue</u>	<u>Sales</u>
Firm Non-Heat	\$1,749,505	210,569 Mcf
Firm Heat	<u>\$14,509,799</u>	<u>1,746,379</u> Mcf
Sub-total Firm	<u>\$16,259,304</u>	<u>1,956,948</u> Mcf
Interruptible BPS	\$2,793,170	584,345 Mcf
Interruptible LBS	<u>\$3,363,549</u>	<u>703,671</u> Mcf
Sub-total Interruptible	<u>\$6,156,718</u>	<u>1,288,016</u> Mcf
Grand Totals	<u>\$22,416,022</u>	<u>3,244,963</u> Mcf

Q. Please describe any other adjustments necessary to develop the Actual/Estimated 1999-2000 fiscal year data?

A. In addition to the above described calculations, unbilled sales and revenues for the first six months of fiscal year 2000 were also addressed. In order to address this issue a "Special Demand Run", based on the 1999 Actual/Estimated (10&2), with actual temperatures for the period September 1999 through March 2000, was prepared and used as a proxy for true sales and revenue as if the billing system had been working perfectly during this period.

The results of the data included in the monthly new Gas Sales and Revenue Report adjusted for the July and August 1999 over billing was subtracted from the Special Demand Run to arrive at unbilled sales for the first six months of FY2000. Result: 3.267 Bcf in unbilled sales.

These calculated unbilled sales were ratably spread (added) to the monthly demand run sales volumes in the months of May through August 2000

1 (816.675 Mcf/month), to arrive at the new monthly firm demand volume.
2 Customer Responsibility Program (CRP) sales for the period May through
3 August were held to the previous adjustment for CRP as presented in the 2nd
4 Quarter GCR filing. Therefore, firm sales were adjusted by the net of
5 816.675 Mcf/month less the allocation for CRP.

6
7 **Q. Were any other modifications made to further refine the**
8 **Actual/Estimated 1999-2000 fiscal year?**

9 A. Yes, the March 2000 demand run sendout was adjusted by rate class to
10 match the actual March 2000 reported sendout.

11
12 Additionally, at the completion of all of the above, a final calculation was
13 included for unaccounted-for gas (e.g., line loss, line pack, theft). In this
14 case, sales were increased in the April through August period and
15 proportionally spread to all firm rate classes to maintain the historical
16 unaccounted-for percentage of 3.6%.

17
18 **Q. You have included two exhibits: Supporting Documentation – Gas**
19 **Costs and Purchasing Plans, Volumes I & II (Exhibits A-1 and A-2**
20 **respectively). Please describe what is contained in Volumes I and II.**

21 A. With respect to the Company's gas supply/demand strategy, supporting data
22 is presented in Section A of Volume I (Exhibit A-1). With respect to natural
23 gas cost and cost recovery, supporting data is presented in Section B
24 including the recommended GCR factor for the budget year with CRP
25 discounted revenues recovered through the GCR. With respect to sales and
26 revenue, supporting data is presented in Section C of Volume I. A complete
27 modeling system computer printout, underlying the Operating Budget
28 projections of sales and revenue, GCR and raw material expenses is
29 contained in Volume II (Exhibit A-2).

30

1 **Q. What are your underlying assumptions surrounding gas purchases and**
2 **utilization?**

3 A. First, I would like to direct your attention to Schedule SDS-1, contained in
4 Volume I, Exhibit A-1. Schedule SDS-1 is the framework or standard by
5 which we govern our demand/supply strategy. The 2000-2001 Operating
6 Budget, as filed, reflects sales, revenues and natural gas expenses resulting
7 from this applied standard particularly in the areas of inventory valuation,
8 priorities of gas selection and interruptible supply availability.

9
10 *Other assumptions include:*

- 11 1. Projections of gas usage are based on a normal 4600 Degree Day
12 temperature pattern.
- 13 2. For the Budget Year 2000-2001, unbundling is not assumed.
- 14 3. Maximum LNG drawdown of 3.9 Bcf is assumed for the Winter Period
15 2000-2001.
- 16 4. Natural gas supplies assume no curtailment for the Budget Year 2000-
17 2001.
- 18 5. Natural gas prices are based on projections provided by the Standard
19 and Poors' March 2000 price forecast; with the exception of increased
20 near term cash market and NYMEX closing price intelligence utilized in
21 the April through August 1999 period.
- 22 6. As for supply, except for WESCO's Firm Service (FS Service) of up to
23 55,212 Dts/d and Amerada Hess on both pipelines (Transco up to
24 20,000 Dts/d plus fuel November 1 through March 31 and up to 10,000
25 Dts/d plus fuel April 1 through October 31 -- TETCO up to 20,000 Dts/d
26 plus fuel November 1 through March 31 and up to 12,000 dts/d plus fuel
27 April 1 through October 31), no other gas for Budget Year 2000-2001
28 has been contracted for. All required supply is assumed purchased at
29 index.

- 1 7. All pipeline transportation and storage contracts are in full force and
2 effect for the 2000-2001 Budget Year. All storage inventories are
3 assumed full at the start of the Winter operating season, November 1,
4 2000.
- 5 8. All storage inventories are assumed reduced to the pipeline minimum
6 balances regardless of economics as of March 31, 2001.
- 7 9. Sales are presumed to remain fully open throughout the period.
- 8 10. LBS/BPS tariff sales are assumed to continue year-round where
9 operationally feasible and economically justified, drawn from seasonal
10 supply and storage supplies. BPS is assumed to be interrupted at
11 temperatures below 20 degrees Fahrenheit in design winter conditions.
- 12 11. For the purpose of interruption, sales service under the BPS sales rate is
13 assumed to have a higher level of priority than those under the LBS and
14 co-generation rate.
- 15 12. Customer demand will incorporate the Marketing Department's most
16 current sales projections.
- 17 13. Unaccounted-for gas will be at a level of 3.6% calculated on firm gas
18 only.
- 19 14. CRP anticipated customer counts are assumed to decline from 52,000 to
20 49,000 through budget year 2000-01.

21
22 **Q. You mentioned that you calculate a factor for estimating gas usage for**
23 **domestic load, e.g., water heating, clothes drying, etc. How is the**
24 **domestic load factor (DOM Factor) developed?**

25 **A.** A trial domestic factor is developed by class of customer from sales reported
26 for the previous year's summer months. This average factor is then utilized
27 in the sendout formula with customer counts for the months of July, August
28 and September. A comparison between what the formula calculates and the
29 actual sendout experienced for those two months is ascertained and the trial
30 domestic (DOM) factors are finalized to replicate the total sendout

1 experienced. For the 2000-2001 Budget, due to well documented problems
2 with the new billing system and the inability to get reliable overall sales
3 information from that system, we continued to use the domestic factors last
4 developed during the period of July, August and September 1998. As the
5 billing system stabilizes, we will use newer data.

6
7 **Q. You also mentioned that you calculate a factor for heating load. How is**
8 **the heating load factor (CFDD Factor) developed?**

9 A. The finalized domestic factors are then utilized in conjunction with actual
10 sales and customer counts for the months of December, January and
11 February to determine the average Mcf per degree day for each of the
12 individual months for the remaining temperature sensitive load. The results
13 are weighted by degree days to give an average value which, in turn, is
14 utilized as a trial value for the heating factor. The finalized domestic factor
15 and the trial heating factor developed above are then applied in the sendout
16 calculations, in conjunction with customer counts for the three months of
17 December, January and February (the peak winter period), in order to
18 project an estimated sendout for this period. The projected sendout is then
19 compared with the actual sendout experienced. Any variation between the
20 projected and actual is adjusted to force the replication of the actual sendout
21 experience, thus resulting in determination of a finalized heating factor. As
22 was the case with the development of the domestic factor, the factor for
23 forecasting space heating load was developed during the period February
24 1998, December 1998 and January 1999.

25
26 **Q. How is load growth and load loss incorporated into the planning**
27 **process?**

28 A. Once the volumetric load growth or load loss amount is determined by the
29 Marketing Department for all rate classes and forwarded to the Gas Planning
30 Department (Gas Planning). Gas Planning then converts the volumetric

1 number into an approximate number of customers by rate class. This is
2 done by dividing the volumetric increase/decrease in load by the historical
3 average usage per customer. The result is an annual projected
4 increase/decrease to the number of customers by rate class. The annual
5 projection is then converted to a monthly number by dividing by 12 for use in
6 the planning model for the appropriate year.

8 **Q. How do you determine the number of customers by each rate class?**

9 A. To project the number of customers for each individual rate class, the
10 following categories of customers are reviewed and accumulated
11 individually: current customers are ascertained from the number of billings
12 data obtained from the Sales and Revenue database actually experienced
13 immediately prior to the commencement of the budget. Load reductions are
14 projected for anticipated losses to alternative energy sources, demolition of
15 buildings and transfers to other rates. Direct transfers from a non-heating to
16 a heating account, as a result of a current customer's conversion to gas
17 heat, transfers the domestic load to the new category. Projected customer
18 additions are developed within the Marketing Department. Staff dealing with
19 individual classes of customers and having the most direct knowledge of
20 conditions within their sphere, project the annual load additions which are
21 translated into customer counts based upon typical historical customer
22 usage for that individual customer class. The approximate month of turn-on
23 is also developed to permit reflection of the effective portion of the load
24 addition within the fiscal period under study. Interruptible class customers,
25 as well as other large special accounts, are developed, incorporating
26 expected gains and/or losses as the direct survey has indicated.

1 **Q. Please explain the details of your gas supply, gas demand and**
2 **optimization strategy.**

3 A. With regard to the details of our gas supply strategy, please refer to Exhibit
4 A-1, "Gas Costs and Purchasing Plans – Volume I". This document
5 contains a thorough rendering of our optimization strategy in narrative and
6 *supporting schedule format beginning with Section A. Gas Supply/Demand*
7 *Strategy.*

8
9 **Q. Does this conclude the Gas Supply Services portion of your**
10 **testimony?**

11 A. Yes.
12

13 **Section II - Sales & Marketing**

14

15 **Q. What is the purpose of this section of your testimony?**

16 A. In this section of my testimony, I will discuss: a) the role of the Sales and
17 Marketing Department (Marketing), b) the department's current structure, c)
18 *the load projections submitted to Gas Management for modeling purposes,*
19 *d) the Parts and Labor Program, e) the details of the fiscal year 2001*
20 *operating budget and how the budget satisfies the company's needs, and f)*
21 *the goals that need to be accomplished in both the long and short term.*
22

23 **Marketing's Role In The Organization**

24

25 **Q. Please discuss the role of the Sales and Marketing Department.**

26 A. Since March 1999, the strategic direction of the company has shifted from
27 the sale of new products and services, both inside and outside Philadelphia,
28 to simply narrowing our focus to that of providing service to the residents
29 and businesses of Philadelphia in the most efficient and cost effective
30 manner possible.

1 Additionally, I would like to reiterate a point that I have stressed in prior
2 testimony, that Marketing does much more than just sales. Sales is a
3 relatively small portion of the activity of the department.

4
5 Under normal operating circumstances, I would estimate that approximately
6 75% of the total hours are spent performing financial and technical analyses
7 pertaining to sales, managing and expediting the actual jobs, developing
8 pricing for the various interruptible rates, major accounts billing inquiries and
9 operational problems, researching new opportunities, collecting and
10 managing customer information, and the normal day to day activities
11 associated with managing any department.

12
13 Marketing's role is to not only increase both new and incremental gas load,
14 but to maintain existing load and provide a high degree of customer
15 satisfaction.

16
17 **Departmental Structure**

18
19 **Q. Please discuss the current departmental structure.**

20 A. Upon my appointment to the Sales & Marketing department in November
21 1998, staffing was at 62 employees, however, the department was budgeted
22 to be staffed at 92 employees during fiscal year 1999 to address the
23 strategic initiatives underway at the time. With the refocus of our efforts on
24 the core business, the current manpower requirements are not as great,
25 however, manpower levels in the Sales & Marketing section, focused on the
26 core business, were traditionally at approximately 50 employees.

1 **Q. Was the Sales & Marketing Department fully staffed during fiscal year**
2 **2000?**

3 A. No. As a matter of fact there was a series of organizational matters
4 throughout the year that significantly impacted the manpower available to
5 meet Marketing's goals for the year. At one point Marketing was operating
6 with only 27 employees, two of which were not available due to personal
7 emergencies.

8
9 **Q. How many employees are in your operating budget for fiscal year**
10 **2001?**

11 A. Excluding the two personnel for Federal Regulatory Affairs, there are 37
12 employees dedicated to the Sales & Marketing department.

13
14 **Q. Why are the Federal Regulatory personnel budgeted in the Sales &**
15 **Marketing department?**

16 A. As a practical matter, PGW has attempted to limit the number of outside
17 hires. Additionally, there is a scarcity of available people with a background
18 in the Federal Regulatory arena. The Marketing Director has a background
19 in this area and has been assigned all Federal Regulatory work while
20 training the new personnel.

21
22 **Q. What are the primary functional areas under your control?**

23 A. The five primary functional areas directly under my control include: 1)
24 Residential/Commercial Sales, 2) Major Accounts (Sales) 3) Marketing &
25 Services, 4) Transportation & Supply, and 5) Tariffs, Regulatory and
26 Reporting. For purposes of this portion of my testimony, I will limit my
27 comments to areas 1,2 and 3.

28
29 The Residential/Commercial section deals with a much greater volume of
30 calls than the Major Accounts section, however, these jobs are generally

1 much less sophisticated to accomplish. Further, unlike the Major Accounts
2 customers, these customers can address their issues through PGW's
3 Customer Service Department. The responsibility of the
4 Residential/Commercial section is to handle the customer from initial contact
5 through ensuring that the customer is activated in PGW's billing system
6 (BCCS).

7
8 With regard to Major Accounts, obtaining new business is much more
9 complicated than the Residential/Commercial customer base, specifically,
10 this function requires the analysis of customer information such as load
11 profiles, financial and technical analysis, and promotional incentives.
12 Additionally, it was recognized that Major Accounts customers need a
13 tremendous amount of attention (i.e. customer service) after the sale due to,
14 but not limited to, such issues as billing errors and incorrect meter reads.

15
16 The Marketing & Services section provides a variety of functions including
17 monthly interruptible pricing, budgeting, managing the sales aspects of the
18 Parts & Labor Plan, providing market research, developing marketing
19 communications, seeking out and developing new areas of business,
20 providing technical support for both the Residential/Commercial and Major
21 Accounts sections of the department, providing data management, contract
22 management, and coordination of training. The Technical Services section
23 assists Major Accounts in developing energy audits and alternatives that
24 help the customer make the appropriate choices. Additionally, as stated
25 earlier in my testimony, the Federal Regulatory Affairs section also resides in
26 the Marketing & Services section.

1 **Load Projections**

2
3 **Q. Please discuss how you arrived at your projected load volumes.**

4 A. Sales & Marketing develops the anticipated load growth/loss expectations
5 and provides them to the Gas Planning section under the Director -
6 Transportation & Supply. This forecast information is then input into the
7 Planmetrics modeling system as a component of the calculations to
8 determine costs and revenues to be incurred by the company for future
9 periods.

10
11 In my former role as Manager - Energy Planning, it was my contention that
12 the forecasts generated by the Marketing department were over zealous and
13 did not reflect market realities. I have attempted to incorporate these Market
14 realities into the forecasted volumes.

15
16 One of the chief housekeeping tasks that had to be accomplished upon my
17 arrival in the Sales & Marketing was the collection of accurate sales data.
18 Previously, there was a disparate collection of information among the
19 Residential, Commercial and Major Accounts groups. None of the
20 information could be considered reliable since there were no guidelines or
21 controls. Over the past 18 months we have enforced the use of the
22 GoldMine contact manager software to track all customer contacts and
23 associated sales activity. I believe that the data has developed a high
24 degree of accuracy.

25
26 For the remainder of fiscal year 2000, load growth was determined based
27 upon the information available in GoldMine. Actual data was totaled for gas
28 turned on for the months from September 1, 1999 through February 28,
29 2000. This data was incorporated directly into the analysis for the fiscal year
30 2000 to date. The remaining portion of FY 2000 was estimated by utilizing

1 information that was consistent with what was experienced in a prior period.
2 In preparing this information, it was assumed that the difficulties experienced
3 would not be resolved prior to April 1, 2000. Therefore, the overall estimate
4 for the period March 1 through 31, 2000 was modified by an amount
5 commensurate with an increase/reduction in each rate class for a prior
6 historic period. Beginning April 1, 2000, we resumed with the originally
7 budgeted load increase levels.

8
9 **Q. In retrospect, do you believe that this was a reasonable methodology
10 to generate your revised load forecast for fiscal year 2000?**

11 A. The information collected to date leads me to believe that this was a
12 reasonably accurate assessment of the load increases, particularly in the
13 residential sector.

14
15 Determining new load is predicated upon many factors including, but not
16 limited to, impacts of alternate fuel prices in relation to natural gas,
17 competing incentive programs, general economic health of the city, region
18 and nation, demographic trends, political impacts, financial markets, etc. In
19 addition to these external factors impacting PGW's ability to increase load,
20 we were also confronted by diminishing resources and additional ancillary
21 workload necessitated by BCCS.

22
23
24 **Q. How did you arrive at the load forecast for fiscal year 2001?**

25 A. It was assumed that the approach in the original fiscal year 2000 forecast
26 was appropriate, however, actual activity was negatively impacted by a
27 preponderance of customer service and manpower issues. Therefore, we
28 elected to use the fiscal year 2000 forecast in 2001, anticipating no
29 significant changes in the growth of the city, weather, or the demand for
30 commodity. Additionally, it is our belief that although the data for actual

1 experience for fiscal year 2000 is accurate, it is artificially low due to the
2 aforementioned manpower constraints and computer problems.

3
4 When this load level was originally forecasted for the fiscal year 2000, actual
5 information was utilized for the first half of fiscal year 2000 and it was
6 assumed that the same level of growth would be achieved in the second half
7 of the year. This resulted in a total load of approximately 1,011 MMcf. The
8 apportionment to the various rate classes reflects a doubling of what was
9 actually experienced in the first half of the period. The total for each rate
10 class was spread evenly across all months with the exception of specific
11 jobs that were expected to be turned on by a particular date.

12
13 With regard to demographic losses for fiscal year 2001, it was assumed that
14 one half of one percent of the total existing load for each of the rate classes
15 conservatively reflected the census information which stated that
16 Philadelphia's population is shrinking by approximately 1% per year. In the
17 short term, we have not identified any large customers that will be leaving
18 our system, therefore, it seems prudent to expect that the one half of 1% is a
19 reasonable level of demographic loss.

20
21 With the exception of the School District of Philadelphia, no other customers
22 with a high potential to move from firm to interruptible were identified.
23 Therefore, this category (i.e. Transfers) was set to 0 for all rate classes
24 except BPS. It is anticipated that 50 MMcf will migrate from the GS to BPS
25 rate schedule.

26
27 The calculation for the "Sales to GTS Loss" amount was based upon our
28 understanding of the state deregulation legislation coupled with
29 conversations with representatives from other LDC's. The migration for GTS
30 losses were set at 5% of the total customer load for those customers in rate

1 classes BPS and LBS-L. I have no concrete information to date that would
2 lead me to believe that these customers would move to GTS, however, I
3 believe that assuming that 5% would move is reasonable in recognition of
4 the current level of only ten (10) GTS customers on the PGW system.

5
6 **Parts & Labor Program**

7
8 **Q. Please describe the current Parts and Labor Program (PLP).**

9 A. PGW's current Parts and Labor Program is essentially an insurance based
10 program designed to protect customers from high repair bills. The company
11 *provides its best effort to give these customers priority service.*

12
13 **Q. What is Marketing's role with regard to this program?**

14 A. There is a bright line distinction between selling this program and servicing
15 the customer's needs. Marketing is solely responsible for selling this
16 program to PGW's customers while Customer Service fields the calls for
17 service and the Field Services Department provides the actual service to the
18 customer.

19
20 **Q. What functions does Marketing perform in "selling" the program?**

21 A. Essentially, selling the PLP program represents a massive coordination
22 effort between all departments within the company. Additionally, the
23 company must review and coordinate with outside advertising agencies and
24 production houses to create and produce the advertising materials. This
25 effort is performed to ensure that the maximum number of PGW customers
26 respond and purchase the service.

1 **Q. Please describe the current allocation of costs for this program.**
2 A. Currently, the funding for the marketing of this program resides in the Field
3 Services Department. Any question with regard to the level of costs should
4 be addressed by the Field Services Department.

5
6 **Q. Why does the budgetary responsibility lie in the Field Services
7 Department?**

8 A. The reason for budgeting the "selling" portion of the PLP to Field Services is
9 so that both the costs and the revenues are contained in one place.

10
11 It is my understanding that various departments have addressed the selling
12 function of the Parts & Labor Program over the years. This is because
13 various department's either exhibited a degree of expertise, or lack thereof,
14 in their ability to effectively market this program. This is not an indictment of
15 the people who marketed the program in the past. Their capability was
16 primarily based on available manpower and experience. There has been a
17 degree of inconsistency over the past several years in terms of
18 management, early retirements and reorganization of processes and
19 personnel.

20
21 **Q. Do you believe the allocation of costs to Field Services should
22 continue?**

23 A. Yes. As stated above, having the costs and revenues for this program in
24 one department allows for accuracy and consistency in the assignment of
25 costs and revenues to the accounting process.

26
27 **Q. What Appliances does the current PLP program service?**

28 A. The program currently includes heating, central air conditioning (in tandem
29 with a heater plan), water heaters, gas ranges and gas dryers.

30

1 **Q. Please describe any proposed enhancements to the PLP in fiscal year**
2 **2001.**

3 A. PGW is not recommending any significant changes to the services provided
4 under the Parts & Labor Program offered to PGW's residential customers
5 from last year's program.
6

7 **Q. Do you anticipate any significant changes to your pricing structure for**
8 **the program?**

9 A. Marketing is currently in the process of reviewing the costs and revenues
10 required to generate an adequate level of margin while maintaining a
11 competitive pricing structure. Research, is being conducted to ascertain
12 program offerings by other service providers as well as internal costs.
13

14 **Q. What are your sales goals for the fiscal year fiscal year 2001 Parts &**
15 **Labor Program?**

16 A. Marketing's goal is to sell 125,000 plans.
17

18 **Q. How do you intend to achieve this goal?**

19 A. We will utilize a strategy similar to last year in which we utilized direct mail,
20 newspaper and transit advertising.
21

22 **Q. Last year you discussed the possibility of monthly billing. Will this**
23 **strategy be employed this year?**

24 A. No. Our information systems are not currently in place to allow for monthly
25 billing. Additionally, there are a plethora of business issues surrounding
26 monthly billing that have not yet been resolved.
27

1 **Details of the FY 2001 Operating Budget**

2
3 **Q. Please discuss the details of the Operating Budget by category for**
4 **fiscal year 1999-2000.**

5
6 **Labor**

7 A. Currently, Marketing is budgeted for 34 management and 5 union covered
8 employees. Two of the 34 management personnel are dedicated to Federal
9 Regulatory Affairs activities.

10
11 We are continuing to evaluate developing an incentive based salary
12 structure to aid in stimulating sales growth, however, we cannot find another
13 natural gas provider that can adequately identify recognizable benefits.
14 Although incentive based pay appears to be a plausible approach on the
15 surface there are a myriad of pitfalls that must be reviewed before such a
16 plan could be implemented. No money has been budgeted for incentive pay
17 for any of the forecast years.

18
19 **Expense Of Employees**

20 The Marketing department has undergone a tremendous reorganization over
21 the past eighteen months. Many people have left the organization both
22 voluntarily and involuntarily Employee morale and loyalties have been
23 twisted in every conceivable manner due to management instability and
24 employment uncertainties. I believe, however, that the employees
25 understand and accept this change in direction and focus on the core
26 business.

27
28 Marketing is committed to having a trained and knowledgeable workforce
29 and has devoted funds for job related training ranging from computer

1 efficiencies, project management, marketing research, gas cooling and
2 engineering certification.

3 This category also contains funding for parking, travel, attending and
4 sponsoring customer seminars, customer lunches, etc. Total funds
5 budgeted for training and related customer expenses totals \$272,000.

6
7 **General Materials**

8 The total budgeted amount for this category is \$78,100. This category
9 includes office supplies purchased outside of PGW or ordered internally from
10 Materials Management, manuals, the purchase of existing research
11 documents or files, tools, general reference materials, assorted office
12 supplies including paper for copiers, faxes and printers.

13
14 **Postage**

15 The total budgeted amount for postage is \$398,000. A total of \$200,000 is
16 dedicated to the mailing of direct mail pieces for a proposed appliance
17 saturation study. The remaining \$198,000 is dedicated to a gas application
18 informational publication, conversion campaigns, FSD piping specifications,
19 heater cards, Federal Regulatory expenses, etc..

20
21 **Advertising**

22 A total of \$304,000 has been budgeted for departmental advertising. This
23 category covers the costs associated with the creation and placement costs
24 for brochures, literature, and other advertising. The sum of \$20,000 has
25 been budgeted for the Philadelphia Yellow Pages. The sum of \$10,000 has
26 been budgeted for the Commercial Realty Review.

27
28 The Residential/Commercial section has budgeted \$62,000 for various
29 commercial advertisements and the development of a brochure to explain
30 the application process to the customer.

1 The remaining dollars have been budgeted for various advertising initiatives
2 and promotional items that may be developed throughout the year for
3 special events.

4 5 **Promotion**

6 This category refers specifically to incentives for the purchase and
7 installation of natural gas equipment. A total of \$1,645,000 has been
8 budgeted for this category. Of this total amount, the Major Accounts section
9 has budgeted \$1,210,000 which is below the amount budgeted last year.

10
11 The Residential/Commercial section has budgeted \$435,000 for various
12 incentive programs for developers for rehabilitation projects that utilize
13 natural gas and customer based conversion incentives.

14 15 **Dues & Subscriptions**

16 The category includes dues for national and local organizations of which
17 PGW is a member. It also includes subscriptions for trade and research
18 publications, magazines, newspapers, that are germane to our core
19 function. The sum of \$142,309 has been budgeted for this category for all
20 sections of the department. Subscriptions represent approximately \$10,000
21 of the total. The remainder is for organizational memberships.

22 23 **Purchased Services**

24 This category includes consultants, vendors, contracted services that do not
25 require a service contract, training of PGW employees by an outside agency,
26 License & Inspection fees, repair services not under a maintenance
27 agreement and software purchases. Airborne Express delivery costs fall into
28 this category. Additionally, Market research conducted by outside firms on
29 PGW's behalf. Such activities would include market satisfaction surveys.

1 segmentation studies, and competitive analyses. A total of \$781,000 has
2 been budgeted for this category.

3
4 The Residential/Commercial Sales section has budgeted \$14,000 for various
5 in-house training and creative work associated with advertisements and
6 brochures.

7 Marketing Services has budgeted \$153,354 for the development of PGW's
8 WEB site. This amount will cover the costs of vendors and consultants
9 necessary to establish the base configuration for all phases of development
10 excluding online customer nominations.

11
12 The Technical Support section has budgeted \$146,090 primarily for services
13 provided by an outside Engineering firm. The services provided involve
14 detailed technical energy audits and analyses to assist customers in their
15 determination to purchase gas fired equipment, which support load growth
16 on our system.

17
18 **Short & Long Term Goals**

19
20 **Q. Please provide a brief overview of your goals.**

21 A. Marketing's goals have not changed since last year. First, the overall
22 function of the Marketing Department is to satisfy the customer and provide
23 additional new and incremental load, revenues and margins to the company
24 and to mitigate any losses. Marketing needs to function in a manner that is
25 both *fiscally responsible and consistent with the operating realities of the*
26 *company.* To accomplish this task, we need appropriate staffing levels and
27 resources. Employees must be properly trained in both the sales and
28 technical aspects of the job, the available technologies that utilize gas, and
29 the processes that the company uses to provide service to the customer.

1 Second, we have developed tighter controls on the rates of return
2 generated. I have implemented more stringent requirements for the
3 minimum rates of return to insure an increased level of margin for our efforts
4 while providing the customer with the economics and information that they
5 need to make a reasoned decision to use natural gas.

6
7 Third, we are actively collecting data and staffing the department to assist us
8 in the development of appropriate departmental marketing plans and related
9 strategies.

10
11 Fourth, we need to continue to develop the tools and systems necessary to
12 manage our contracts and tariff so that we can more effectively determine if
13 a customer is honoring their contract with regard to their commitment to use
14 gas as a sole fuel source in the event that the company expends capital or
15 incentive programs. Additionally, if a customer sells the property or goes out
16 of business, we must be prepared to recover that expenditure from that
17 customer.

18
19 Fifth, we need to continue to develop our knowledge base regarding the
20 potential impacts of deregulation on our markets, develop strategies on how
21 to best address these challenges, and educate our employees and
22 customers.

23
24 Sixth, Marketing will continue to evaluate tariff modifications which enhance
25 our ability to grow markets and respond to competitive pressures.

26
27 Seventh, Marketing will continue to explore PUC requirements pertaining to
28 restructuring and the development of the required filing. Additionally, we will
29 continue to communicate with other LDC's to discuss pertinent business
30 strategies related to natural gas unbundling.

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7

Eighth, in concert with the Field Services Department, we will explore opportunities to expand the PLP offerings to include maintenance and repair services as well as commercial programs.

Q. Does this conclude your prepared direct testimony?

A. Yes it does.

**A RESOLUTION FOR AUTHORIZATION TO REQUEST THE
PHILADELPHIA GAS COMMISSION TO EXPAND THE PGW FISCAL YEAR
2001 CONSOLIDATED OPERATING AND CAPITAL BUDGET AND GAS
COST RATE PROCEEDING INTO A REGULATION ONE PROCEEDING**

I, ABBY L. POZEFSKY, Assistant Secretary of **PHILADELPHIA FACILITIES MANAGEMENT CORPORATION**, do hereby certify that the following is a true and correct copy of action taken by the Board of Directors of said corporation by unanimous consent to the adoption of this resolution dated June 16, 2000 pursuant to provisions of Section 5727(b) of the Non-Profit Corporation Law of the Commonwealth of Pennsylvania.

WHEREAS, according to the Agreement between the City of Philadelphia and the Philadelphia Facilities Management Corporation ("PFMC") for the management and operation of the Philadelphia Gas Works ("PGW") dated December 29, 1972, as amended (the "Management Agreement"), §IV.2(b), PGW's capital budget and forecast are subject to review and recommendations by the Philadelphia Gas Commission ("Commission") for approval of the Philadelphia City Council ("City Council") and;

WHEREAS, according to the Management Agreement §IV.2(a), PGW's operating budget and forecast are subject to review and approval of the Commission, and;

WHEREAS, the Commission, at its meeting of June 6, 2000, decided to inform City Council that there will be a delay in the Commission's submission of the PGW Capital Budget Fiscal Year 2001 and Forecast to the City Council pursuant to the Management Agreement §IV.2(b), in order to accommodate the Commission's combined review of PGW's Fiscal Year 2001 Operating and Capital Budgets and Forecasts commencing in June 2000, and;

WHEREAS, PGW is preparing its Fiscal Year 2001 Operating and Capital Budgets and Forecasts for Fiscal Years 2002 through 2006 and this Board has by resolution of this same date approved these as prudent and authorized their submission to the Commission;

WHEREAS, these budgets indicate a need for an increase in base rates of Fifty-two Million Dollars;

WHEREAS, PGW is preparing its Fiscal Year 2001 Gas Cost Rate ("GCR") filing and supporting schedules indicating changes in the GCR factor;

WHEREAS, PGW desires that this proceeding be expanded by the Commission to include a Regulation One proceeding which requests an increase in base rates of Fifty-two Million Dollars with associated tariff changes;

WHEREAS, counsel has advised PGW that there may be circumstances under which a rate order, including a GCR filing approval, entered by the Gas Commission in a proceeding filed before July 1, will be given full recognition by the PUC or in the alternative, that a Gas Commission decision approving a budget and GCR will be given credence by the PUC; and

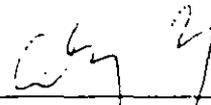
WHEREAS, given PGW's need to have new rates in effect before the beginning of the heating season, PGW believes it prudent to pursue all reasonable options.

NOW, THEREFORE, BE IT

RESOLVED, that PFMC authorizes PGW to ask the Commission to expand these budget proceedings to include a Regulation One proceeding in which PGW requests an increase in base rates of Fifty-two Million Dollars with associated tariff changes.

IN WITNESS THEREOF, I have hereunto set my hand and have caused the corporate seal of said Corporation to be hereunto affixed this 16th day of June 2000.

PHILADELPHIA FACILITIES
MANAGEMENT CORPORATION

By: 
Abby L. Pozefsky

**A RESOLUTION FOR AUTHORIZATION TO SUBMIT THE
PGW FISCAL YEAR 2001 OPERATING AND CAPITAL BUDGETS AND
FORECASTS TO THE DIRECTOR OF FINANCE AND TO THE
PHILADELPHIA GAS COMMISSION FOR REVIEW AND APPROVAL**

I, ABBY L. POZEFSKY, Assistant Secretary of **PHILADELPHIA FACILITIES MANAGEMENT CORPORATION**, do hereby certify that the following is a true and correct copy of action taken by the Board of Directors of said corporation by unanimous consent to the adoption of this resolution dated June 16, 2000 pursuant to provisions of Section 5727(b) of the Non-Profit Corporation Law of the Commonwealth of Pennsylvania.

WHEREAS, according to the Agreement between the City of Philadelphia and the Philadelphia Facilities Management Corporation ("PFMC") for the management and operation of the Philadelphia Gas Works ("PGW") dated December 29, 1972, as amended (the "Management Agreement"), §IV.2(b), PGW's capital budget and forecast are subject to review and recommendations by the Philadelphia Gas Commission ("Commission") for approval of the Philadelphia City Council ("City Council") and;

WHEREAS, according to the Management Agreement §IV.2(a), PGW's operating budget and forecast are subject to review and approval of the Commission, and;

WHEREAS, the Commission, at its meeting of June 6, 2000, decided to inform City Council that there will be a delay in the Commission's submission of the PGW Capital Budget Fiscal Year 2001 and Forecast to the City Council pursuant to the Management Agreement §IV.2(b), in order to accommodate the Commission's consolidated review of PGW's Fiscal Year 2001 Operating and Capital Budgets and Forecasts commencing in June 2000, and;

WHEREAS, PGW is preparing its Fiscal Year 2001 Operating and Capital Budgets in accordance with the exhibits attached hereto and incorporated herein, and Forecasts for Fiscal Years 2002 through 2006 through the careful evaluation of the current operating and capital and future operating and capital needs of the municipally owned utility, and;

WHEREAS, PGW is preparing its Fiscal Year 2001 Gas Cost Rate ("GCR") filing and supporting schedules indicating changes in the GCR factor;

WHEREAS, PFMC has accepted management's recommendations for PGW's 2001 Operating and Capital Budgets in accordance with the exhibits

attached hereto and incorporated herein, and Forecasts for Fiscal Years 2002 through 2006 and the Gas Cost Rate filing to find them in satisfactory form and content, representing a prudent assessment of the current operating and capital and future operating and capital needs of the municipally owned utility.

NOW, THEREFORE, BE IT

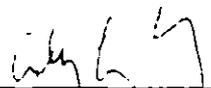
RESOLVED, that PFMC accepted management's recommendations for the PGW Budgets in accordance with the exhibits attached hereto and incorporated herein, and Forecasts for Fiscal Years 2002 through 2006, subject to further refinement by a budget subcommittee appointed by PFMC, should that become necessary or desirable, and;

BE IT FURTHER RESOLVED, that PGW is authorized to file the PGW Fiscal Year 2001 Operating and Capital Budgets in accordance with the exhibits attached hereto and incorporated herein, and Forecasts for Fiscal Years 2002 through 2006 with the approval of the Director of Finance, as to form, and to file these with the Philadelphia Gas Commission for approval of the Fiscal Year 2001 Operating Budget and Forecast in accordance with the Management Agreement §IV.2(a) and recommendations and submission to City Council for approval of the Fiscal Year 2001 Capital Budget and Forecast for Fiscal Years 2002 through 2006, in accordance with the Management Agreement §IV.2(b).

BE IT FURTHER RESOLVED, that PGW is authorized to submit the PGW Fiscal Year 2001 Gas Cost Rate filing with the Philadelphia Gas Commission for its approval.

IN WITNESS THEREOF, I have hereunto set my hand and have caused the corporate seal of said Corporation to be hereunto affixed this 16th day of June 2000.

PHILADELPHIA FACILITIES
MANAGEMENT CORPORATION

By: 
Abby L. Pczefsky

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PA. P. SECRETARY'S BUREAU
BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

DIRECT TESTIMONY OF

BARBARA BISGAIER **DOCKETED**
OCT 10 2000

DOCUMENT
FOLDER ON BEHALF OF
PHILADELPHIA GAS WORKS

DOCKET NOS. P-00001831
R-00005654

RE: PETITION OF PHILADELPHIA GAS WORKS
FOR ESTABLISHMENT OF INTERIM RATE
PROCEDURES AND FOR A DECLARATORY ORDER

AUGUST 2000

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

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

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

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

7 Q. SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS.

8 A. I have been employed by Public Financial Management, Inc. for more than 18 years. For
9 approximately 16 of those years, I have had the title of managing director and have
10 managed the firm's municipal utility practice. During my career at Public Financial
11 Management, Inc., I have served as a Financial Advisor to a broad range of state and local
12 governments and authorities. In particular, my experience has been concentrated in the
13 area of publicly-owned utility systems. In addition to the Philadelphia Gas Works, my
14 utility clients have included the Water Department of the City of Philadelphia, the
15 Pittsburgh Water and Sewer Authority, the Harrisburg Water and Sewer Authority, the
16 New Jersey Water Supply Authority, the North Jersey District Water Commissioners, the
17 Passaic Valley Sewerage Commissioners, the Middlesex County (NJ) Utilities Authority,
18 the Ocean County (NJ) Utilities Authority, the Atlantic County (NJ) Utilities Authority,
19 the Southeast Morris County Water Authority and the Atlantic City Sewerage Authority.
20 In addition, I have served, since 1992, as the Financial Advisor to the City of
21 Philadelphia. In that capacity, I have served as the City's advisor for all debt issued by
22 the City and by its authorities and enterprises (the Water Department, the Division of
23 Aviation, the Philadelphia Municipal Authority and PGW). This has included serving as

1 the advisor for two bond issues that were each in excess of one billion dollars. Most
2 recently, I served as the Financial Advisor for the largest issue of municipal bonds to
3 come to market in 2000: \$1.8 billion of Turnpike Revenue Bonds for the New Jersey
4 Turnpike Authority. Over the course of my career, I have served as the advisor for the
5 issuance of long-term debt having a par value in excess of \$15 billion.

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

16 **Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

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

19 **Q. WHAT IS YOUR EMPLOYMENT EXPERIENCE?**

20 A. Prior to my employment by Public Financial Management, Inc., I was employed by
21 Strouse, Greenberg & Co. from 1980-1982 as a financial analyst. From 1974-1980, I was
22 employed by the City of Philadelphia, concluding my employment with the title of
23 Deputy Director of the Office of Housing and Community Development.

1 Q. **EXPLAIN THE BASIS OF YOUR EXPERIENCE WITH AND KNOWLEDGE OF**
2 **PGW.**

3 A. Public Financial Management, Inc. was engaged in 1992 by the City of Philadelphia to
4 serve as its Financial Advisor. That engagement included, broadly, responsibility for the
5 preparation of the Five-Year Financial Plans mandated by the Pennsylvania
6 Intergovernmental Cooperation Authority, general financial planning for the City and
7 traditional financial advisory work for the City and its enterprises in connection with the
8 issuance of long-term and short-term debt. At the commencement of this engagement,
9 the City's below-investment-grade bond rating and general fiscal distress essentially
10 barred it and its enterprises from the public debt markets. In 1993, with the beginning of
11 a return to fiscal stability, the City began its return to the capital markets. I began serving
12 specifically as the Financial Advisor to PGW with the issuance of its 14th Series Bonds. I
13 have subsequently worked on each of PGW's bond transactions. I have assisted PGW in
14 the implementation of certain asset management transactions, most notably the
15 competitive acquisition of a Forward Rate Agreement for its debt service reserve fund
16 and the implementation of a "knock-in" swap with Morgan Guaranty Trust Company. I
17 have also assisted PGW with the issuance of its commercial paper; that assistance has
18 included the annual preparation of the offering/disclosure document, procurement of the
19 various letters of credit that have provided program liquidity and management of the
20 process of obtaining and maintaining a credit rating for PGW's commercial paper
21 program. I also managed the competitive implementation of PGW's equipment leasing
22 program. In the course of each of these specific engagements, I have made various
23 presentations on PGW's behalf to the Philadelphia City Council, the Philadelphia Gas

1 Commission and the Philadelphia Facilities Management Corporation. I have had
2 extensive contact with each of the three municipal bond rating agencies on behalf of
3 PGW, both with regard to specific bond transactions and to the general credit of PGW. I
4 have had similar contacts with the four principal municipal bond insurers on PGW's
5 behalf and have been responsible for the procurement of letters of credit for the
6 commercial paper program. This work has permitted me to become familiar with the
7 financial structure, condition and issues of PGW, and to have obtained a substantial
8 institutional knowledge of PGW.

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

10 A. Yes, I have testified before the Philadelphia Gas Commission.

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

12 A. The purpose of my testimony is to provide my expert opinion regarding the impact on
13 PGW of a failure by the Public Utility Commission to grant the establishment of the
14 interim rates requested by PGW in its petition dated August 8, 2000 as it relates to access
15 to the capital markets generally, the cost of funds and the commercial paper program and
16 the impact on PGW of a failure by the Public Utility Commission to grant an increase in
17 the Gas Cost Recovery charge requested by PGW in its petition dated August 2, 2000.

18 **SUMMARY OF FINDINGS**

19 **Q. COULD YOU SUMMARIZE YOUR FINDINGS.**

20 A. I would like to divide my findings into several separate related sections in order to
21 address the impact of certain outcomes for PGW.

22 a. **Failure to meet its bond covenants** – If PGW is not granted increases in both its
23 GCR and base rates, there is a substantial probability that PGW will be in default

1 of one or more of its bond covenants. In its various bond resolutions, PGW has
2 essentially committed to its bondholders to set rates that are sufficient to pay for
3 the cost of operating and maintaining PGW and to pay principal and interest on its
4 outstanding debt (as well as provide for a minimum of 1.5x debt service coverage
5 on all long-term debt). Failure of PGW to generate revenues to pay all of its
6 expenses or to meet the 1.5x debt service coverage test, even if debt service
7 payments are timely made, will result in a technical default under those bond
8 resolutions. In my opinion, and in the present circumstances, this technical
9 default (and the implications of such an eventuality) will immediately result in the
10 down-grading to below investment-grade of PGW's long-term credit rating by
11 each of the three municipal credit rating agencies. It has long been understood
12 that PGW has maintained its investment grade rating substantially as a result of its
13 unusually high debt service coverage requirement (most municipal utilities have
14 required coverage between 1.1x and 1.25x annual debt service). **Absent**
15 **achievement of the debt service coverage requirement, the rating agencies**
16 **will have no alternative but to reduce PGW's rating to junk bond status.**
17 **That status will prevent PGW from accessing the public credit markets.**
18 Further, PGW will be unable to obtain insurance on its bonds. Furthermore, PGW
19 will be unable to obtain capital to maintain and/or upgrade its capital facilities.
20 This was precisely the situation that the City of Philadelphia found itself in 1991.
21 In fact, the final financial crisis that led to the Commonwealth's passage of the
22 Pennsylvania Intergovernmental Cooperation Act was the attempt by and failure
23 of the City to sell its temporary loan notes in 1991, after the City's general credit

1 was reduced to junk bond status. In fact, extreme fiscal distress is often heralded
2 by a cash flow crisis.

3 The implications of PGW's loss of investment-grade status are dire in that
4 PGW will be denied access to the capital markets.¹ This inability to replenish
5 PGW's capital account through the sale of bonds will initially and immediately
6 contribute to the stress on PGW's cash position in that it is currently PGW's
7 intention to reimburse itself for previous capital expenditures in the amount of
8 \$21.5 million from the proceeds of bonds to be issued in the spring of 2001. It is
9 my understanding that PGW believes that the availability of this \$21.5 million of
10 capital is essential to the maintenance of its program of upgrading crucial capital
11 facilities, such as mains. This reimbursement has been anticipated in the cash
12 flow projections prepared by PGW and will not be available in the event that
13 bonds cannot be sold.

14 **b. Collapse of the commercial paper program** – In my opinion, the most
15 *immediate and devastating impact of a failure of PGW to meet its rate covenant*
16 *would be the absolute collapse of the commercial paper program. PGW has, for*
17 *many years, depended upon its commercial paper program to provide a stable*
18 *source of monthly operating cash in the face of the peaks and valleys of cash*
19 *receipts over the course of each year. For the past several years, PGW has*
20 *maintained an outstanding balance of commercial paper at the \$100,000,000 level*
21 *for much of every year. The commercial paper has become, in effect, a permanent*

¹ PGW is currently two rating steps above junk bond status. There is no requirement that a downgrade occur one step at a time.

1 part of PGW's capital structure rather than a mechanism used to smooth over cash
2 flow irregularities. **In either of these two modes, the ability of PGW to issue**
3 **its commercial paper is an absolute necessity for the maintenance of the basic**
4 **operation and financial integrity of PGW. It is almost impossible to imagine**
5 **PGW as a going concern without access to its commercial paper program.**

6 Tax-exempt commercial paper (except in the instance of very highly rated
7 governments) is always secured by a letter of credit provided by a highly rated
8 commercial bank. The PGW commercial paper is currently secured by a letter of
9 credit provided by the Morgan Guaranty Trust Company. That letter of credit
10 matures in June 2001. Pursuant to the terms of that letter of credit, PGW, in June
11 2000, requested a one-year extension of the Morgan letter of credit (to June 2002).
12 Assuming that Morgan grants that extension (by no means a sure thing), the
13 commercial paper program will survive until June 2002. If Morgan does not grant
14 the extension, PGW will be faced with the immediate need to find a letter of credit
15 bank to replace Morgan in 2001. In my opinion, that will be difficult to do. It
16 will be difficult, in part, because the letter of credit market is currently contracting
17 and there is a substantially reduced number of banks that remain active in the
18 municipal market. In particular, the troubled financial condition of PGW, absent
19 the requested interim rate increase, will virtually eliminate the possibility of
20 getting a replacement letter of credit. Even assuming that Morgan grants the
21 requested one year extension (and does so because PGW will have met its rate
22 covenant as of August 31, 2000), it is a virtual certainty that neither Morgan nor
23 any other bank would issue a letter of credit in June 2001 if no rate relief has been

1 granted and PGW has been down-graded to below investment-grade. Given the
2 reserve requirements that the Controller of the Currency places on a commercial
3 bank, providing a letter of credit to a below investment-grade entity, no bank
4 would be willing to provide such a facility. While there may be a year of grace
5 until June 2002 if Morgan does grant the extension, a failure to meet the rate or
6 coverage covenant on August 31, 2001 will guarantee that no extension or
7 replacement would be available in June 2002. In my opinion, this would be
8 catastrophic for PGW.

9 The cash flow projections for fiscal year 2000-2001 prepared by PGW rely
10 upon the fact that \$97 million of commercial paper will be outstanding for
11 virtually the entire year. Other analyses, for example, the Public Advocate's cash
12 flow projection presented to the Philadelphia Gas Commission (which assumes
13 no increase to the base rate but rather a commitment by the City to forego the \$18
14 million annual payment and a loan to PGW of \$20 million) assumes that the full
15 amount of \$97 million of commercial paper is already fully outstanding at the
16 start of the year. This is an unrealistic projection because there will be no
17 commercial paper available after June 2001 if PGW loses its investment grade
18 rating and, as a direct result of that loss, the letter of credit that supports the
19 commercial paper program.

20 The potential loss of the Morgan Guaranty letter of credit is a very real
21 threat. The current letter of credit agreement permits PGW to request a one-year
22 extension of the letter of credit one year prior to the final maturity date of that
23 letter of credit. Therefore, in May 2000, PGW requested that Morgan Guaranty

1 extend the term of the letter of credit for one year past the scheduled maturity date
2 of June 2001. In response to my recent (the second week of August, 2000)
3 request to Morgan Guaranty as to the status of that extension application, I was
4 advised by a senior official at Morgan that the banks that participate in the letter
5 of credit with them were unwilling to continue to do so after the current expiration
6 date in June 2001.² Morgan Guaranty must, therefore, seek other bank
7 participants as they are unwilling to underwrite the full \$100 million of the letter
8 of credit themselves. They further advised me that, in their opinion, the search for
9 new participants should be delayed until November or December 2000 in
10 anticipation that the GCR and base rate increases will have been granted and thus
11 make it possible to find new participants. **Absent the unlikely commitment of**
12 **new participants, Morgan Guaranty, on its own, may or may not elect to**
13 **extend the letter of credit but in no event will that extension be for an amount**
14 **in excess of \$50 million.** This will be the first result of a failure to receive GCR
15 and base rate relief.

- 16 c. **Substantially increased cost of funds** - Even if and when PGW were to return to
17 investment-grade status at a point in time in the future, the credit markets would
18 continue for some time to extract an interest rate premium on PGW bonds. In my
19 opinion (which is substantially based upon the experience of the City of
20 Philadelphia when it finally returned to investment-grade status and had access to

² PNC Bank had previously informed me that, based upon the unanimous vote of its credit committee, it was withdrawing its participation in the Morgan Guaranty letter of credit.

1 the public credit markets), the markets will demand interest rates higher than
2 those paid on comparable bonds for at least five years following the return to
3 investment-grade status. This premium may begin in the range of 50 basis points
4 and decline over time. That additional cost would be borne by PGW's rate payers
5 for years to come. Additionally, PGW would be forced to pay a premium when it
6 attempted to obtain municipal bond insurance to improve the marketability of its
7 bonds. That additional premium could be as much as 100 basis points. For
8 example, on a \$75 million bond issue, this would translate into an added cost of
9 \$300,000 in increased insurance premiums alone. This conclusion is again based
10 upon the experience of the City of Philadelphia that was required to pay a bond
11 insurance premium of 125 basis points when it first returned to investment-grade
12 status and now routinely pays insurance premiums of 25 basis points.

13 The investment-grade bond rating would be lost because the rating
14 agencies would view the City's contributions as a one-time fix rather than a
15 systemic improvement to PGW's financial condition. The rating agencies are
16 well aware of the fact that the City is not in a position to maintain this level of
17 financial commitment to PGW without severely stressing its own financial well-
18 being and, in fact, will be prevented from doing so by the Pennsylvania
19 Intergovernmental Cooperation Authority, the body that oversees the City's
20 financial affairs. In addition, the rating agencies would view such a City bailout
21 as PGW using up of the only "life preserver" available to PGW in the event that
22 its financial projections understate its case or income results (e.g., PGW
23 experiences a considerably warmer than normal winter).

1 In my opinion, the rating agency analysis and conclusion in this instance
2 will not only focus upon the fact that the bond covenants had been met, but also
3 upon whether the Public Utility Commission clearly demonstrates a willingness to
4 meet its legal obligation to grant rates sufficient to permit PGW to meet its bond
5 covenants. It is important to PGW and its customers that the correct signal be
6 sent to PGW's creditors.

7 **II. SPECIFIC ANALYSES OF PGW BOND COVENANTS**

8 **Q. ARE YOU FAMILIAR WITH THE RATE COVENANT THAT IS CONTAINED**
9 **IN PGW'S BOND ORDINANCES?**

10 A. Yes.

11 **Q. HOW HAVE YOU BECOME FAMILIAR WITH THEM?**

12 A. In the course of my work with PGW during the past eight years, I have read and worked
13 with their bond documents on many occasions.

14 **Q. EXPLAIN THESE COVENANTS AS YOU UNDERSTAND THEM.**

15 A. The major elements of the rate covenants require PGW to set rates and charges at a level
16 that generates revenue that is sufficient to:

- 17 1) pay the costs of operating and maintaining PGW (the "rate covenant");
- 18 2) pay the interest and principal, when due, of outstanding PGW revenue bonds;
- 19 3) after operating expenses have been met, provide at least 1.5x coverage of the debt
20 service on outstanding PGW revenue bonds (its "coverage" covenant); and
- 21 4) pay principal and interest on subordinated bonds, including interest on the
22 commercial paper (Nos. 2 and 4 are its debt service covenants).

23 **Q. EXPLAIN WHAT PGW MUST DO TO AVOID A DEFAULT.**

1 A. To avoid a technical default of its "rate covenant," it needs to have collected sufficient
2 revenue in that year to cover all of its operating expenses including all of its debt service
3 obligations, but not including its payment obligation to the City. In addition, PGW must
4 satisfy its covenants associated with its "debt service" and "coverage." A monetary
5 default would occur if PGW failed to pay timely principal and/or interest on its revenue
6 bonds. A technical default would occur if PGW paid principal and interest timely, but
7 did not produce sufficient revenue from rates to cover all of its net operating expenses
8 (which does not include its City payment) and provide the mandated 1.5x debt service
9 coverage from revenues available after the payment of operating and maintenance
10 expenses.

11 **Q. HAVE YOU REVIEWED MR. KNUDSEN'S TESTIMONY?**

12 A. Yes.

13 **Q. BASED UPON MR. KNUDSEN'S FINANCIAL PRESENTATION AND**
14 **ASSUMING IT TO BE ACCURATE, WHAT WOULD BE THE EFFECT ON**
15 **PGW'S ABILITY TO MEET ITS BOND COVENANTS IF PGW DOES NOT**
16 **RECEIVE ADDITIONAL RATE RELIEF?**

17 A. Without interim rate relief, PGW would be in technical default of its "rate" covenant at
18 the end of August, 2001 because it would end the year with a negative income level of
19 over \$100 million, over and above the full use of its commercial paper capacity. (PGW
20 St. 1.0, App. B). Even if PGW obtained a GCR increase but no base rate relief, it would,
21 at the end of the year, still be over almost \$17 million short of covering its expenses in
22 2000-01, even with its ability to borrow from its commercial paper line of credit.

23 **Q. WITHOUT RATE RELIEF WILL PGW BE ABLE TO MEET ITS COVERAGE**
24 **COVENANTS?**

25 A. Mr. Knudsen's financial presentation indicates that PGW will barely make its coverage

1 covenant at the end of fiscal year 1999-2000. Without interim rate relief, PGW clearly
2 would not be able to meet its coverage covenants at the end of August 2001. It would
3 still fail the coverage test for its 1998 revenue bonds even if it obtained an immediate
4 GCR increase. Even with interim rate relief, PGW's ability to make coverages will not
5 be without risk. This is because Mr. Knudsen's presentation makes several crucial
6 assumptions. Most importantly, he assumes that weather will be normal (i.e., 4,600
7 degree days³). Any deviation from that — whether warmer or colder — will result in, at
8 a minimum, cash flow difficulties **and, if warmer, a huge loss of income as well.**

9 **Q. WHAT WOULD BE THE EFFECT IF PGW RECEIVED RATE RELIEF IN**
10 **LATE 2001 RATHER THAN IN NOVEMBER 2000?**

11 A. If PGW obtained permanent rate relief in the late 3rd or 4th Quarter 2001, a technical
12 default would have occurred or have been projected. This would result in the bond rating
13 degradation and other negative consequences I have described. In any event, it would
14 delay PGW's ability to sell the long-term debt it is counting on in June, 2001, with very
15 negative consequences to its cash flow.

16 **Q. WHAT WOULD BE THE OVERALL CONSEQUENCES TO PGW AND ITS**
17 **CUSTOMERS IF PGW FOUND ITSELF IN TECHNICAL DEFAULT OF ITS**
18 **COVENANTS?**

19 A. As noted above, PGW's bonds would be down-graded to junk bond status. Access to the
20 capital markets would be eliminated. Even upon an ultimate return to investment-grade
21 status, interest rate premiums would be significant and would add to the cost to carry
22 PGW's debt for years to come. Most immediately, there would, in my opinion, be a

³ PGW's proposed budget forecasts a marginal reduction in revenues of \$4 million to reflect a warmer heating season.

1 staggering cash crisis that would threaten the ongoing operation of PGW as a result of an
2 inability to retain the cash life line of the commercial paper program.

3 **Q. ARE YOU FAMILIAR WITH THE INVESTMENT COMMUNITY AND THE**
4 **RATING AGENCIES THAT FOLLOW ISSUERS LIKE PGW?**

5 A. Yes. Working with the investment community and the rating agencies is an essential
6 element of my job as a financial advisor. I work with these institutions on virtually a
7 daily basis.

8 **Q. IN YOUR OPINION, HOW WOULD INVESTORS AND THE RATING**
9 **AGENCIES RESPOND IF PGW WERE UNABLE TO SECURE SUFFICIENT**
10 **RATE RELIEF IN A TIMELY FASHION?**

11 A. In the secondary market, investors will either experience a loss in the value of the PGW
12 bonds they already own (whether or not that loss is immediately realized) and potential
13 investors will only buy PGW bonds if their yield is sufficiently high to overcome the risk
14 of non-payment and lack of liquidity (i.e., the ability to resell the bonds to someone else
15 in the future). As I have noted above, I believe that PGW will not itself pay an immediate
16 interest rate penalty since I have concluded PGW will not be in a position to issue new
17 bonds after the decline to junk bond status that I believe will follow a failure to secure
18 sufficient and timely rate relief. Standard & Poor's Corporation, for example, has
19 recently placed PGW's credit on their Credit Watch with Negative implications. Their
20 report on PGW, dated July 21, 2000, explicitly states that "rate relief is needed by this
21 fall" and "to preserve its ratings, PGW will need to obtain rate relief" A copy of
22 that report is attached hereto (Appendix A). Both Moody's and Fitch IBCA are closely
23 monitoring the rate increase situation and there is no doubt that each would reduce
24 PGW's rating absent the requested rate relief.

1 Q. **WOULD THERE BE AN EFFECT ON THE BOND RATING OR INVESTMENT**
2 **VIEW REGARDING OTHER TAX-EXEMPT INVESTMENTS IN THE**
3 **COMMONWEALTH AS THE RESULT OF A TECHNICAL DEFAULT BY**
4 **PGW?**

5 A. The secondary impact of a PGW technical default would be felt first by the City of
6 Philadelphia. The City has spent the past nine years re-establishing its financial
7 condition. A technical default by one of its related entities would not reflect well upon
8 the City. For example, the City believes that it is a candidate for a rating increase from
9 BBB to BBB+ at Standard & Poor's. This rating increase would result in a reduced cost
10 of capital to the City. A technical default of PGW might well imperil that increase. From
11 the point of view of the Commonwealth, I do not believe there would be a direct or
12 immediate cost, but I do believe, just as the technical default of the Pennsylvania Housing
13 Finance Authority in the mid-1970's raised questions for the Commonwealth, the failure
14 of the PUC to act to grant necessary rate relief might well raise questions for other state
15 financing entities.

16 Q. **HOW WOULD THE INVESTMENT COMMUNITY/RATING AGENCIES**
17 **RESPOND IF PGW HAD TO GET A SHORT-TERM LOAN FROM THE CITY**
18 **TO AVOID A TECHNICAL DEFAULT?**

19 A. A loan from the City to PGW would certainly help PGW's cash flow situation but a loan
20 (as opposed to an outright, unconditional grant) would not be "Project Revenues" under
21 the terms of the rate covenant and, therefore, could not be counted toward meeting the
22 rating covenant requirements. A loan from the City would not help PGW avoid a
23 technical default.

24 Q. **DESCRIBE YOUR UNDERSTANDING OF PGW'S FINANCIAL OBLIGATIONS**
25 **TO THE CITY.**

26 A. I understand that PGW has a contractual obligation to make an annual payment of \$18

1 million to the City and that that payment is permitted (but not required) under PGW's
2 bond ordinance.

3 **Q. IF PGW WERE ABLE TO AVOID ITS OBLIGATION TO MAKE THE**
4 **PAYMENT TO THE CITY, HOW WOULD THIS AFFECT ITS ABILITY TO**
5 **MAINTAIN ITS BOND COVENANTS?**

6 A. I do not believe that a failure to pay the City would result in a violation of PGW's rate
7 covenant because it is a contractual obligation rather than part of the rate covenant. By
8 the same token, however, relief from making the City payment does not translate directly
9 into the availability of additional revenues for the purpose of calculating compliance with
10 the rate covenant. PGW would have to pay the \$18 million to the City and have the City
11 grant it back to PGW as "Project Revenues" for the \$18 million to accrue to PGW's
12 benefit.

13 **Q. WHAT WOULD THE IMPACT ON PGW BE IF IT WERE ABLE TO MEET ITS**
14 **BOND COVENANTS DURING FISCAL YEAR 2000-2001 AS A RESULT OF**
15 **SOME COMBINATION OF THE CITY'S FORGIVENESS OF THE \$18**
16 **MILLION ANNUAL PAYMENT AND A CITY LOAN IN THE AMOUNT OF**
17 **APPROXIMATELY \$20 MILLION?**

18 A. In my opinion, PGW's ability to satisfy technically its bond covenants (e.g., the payment
19 of operating and maintenance expenses and the satisfaction of the debt service coverage
20 test) as a result of one time payments from the City necessitated by the unwillingness or
21 inability for some reason of the Public Utility Commission to grant rate relief would
22 result in virtually the same set of outcomes described above. Specifically, PGW would
23 be viewed very negatively by the rating agencies. One of their greatest concerns in rating
24 utility bonds is the potential responsiveness of a regulatory body to provide rate relief to
25 enable bond covenants to be satisfied. The failure of the Public Utility Commission to
26 grant such requested relief would be a substantial negative in their assessment of PGW's

1 creditworthiness.

2 **Q. ARE THERE OTHER CONSEQUENCES IF PGW DOES NOT MEET ITS**
3 **FINANCIAL OBLIGATION TO THE CITY?**

4 A. The financial consequences of PGW's failure to pay the City would, in the first instance,
5 be felt by the City. In its Ninth Five-Year Plan (Fiscal Years 2001-2005), the City has
6 anticipated a total of \$90 million of revenues from PGW. The loss of some or all of this
7 revenue would be a significant financial hardship for the City. PGW would also suffer
8 certain negative consequences of a failure to make the required payments. While this
9 would not precipitate a technical bond default, it would eliminate the comfort that the
10 rating agencies, bond holders and credit enhancers have always felt in knowing that the
11 need to make the City payment (after debt service had been fully paid) was a "cushion"
12 against a monetary default. Failure to make the payment even once would signal the
13 City's willingness to forgive the payment and hence remove the assurance of the cushion
14 that had been provided.

15 **Q. IN YOUR OPINION, FROM THE STANDPOINT OF PGW'S STATUS WITH**
16 **MUNICIPAL BOND INVESTORS, THE CAPITAL MARKETS GENERALLY**
17 **AND THE RATING AGENCIES SPECIFICALLY, WHAT WOULD BE THE**
18 **BEST COURSE TO FOLLOW?**

19 A. Without a doubt or hesitation, the best course for PGW is to obtain both the full amount
20 of interim rate relief and the increase to the GCR that are the subject of the pending
21 petition. This rate relief will permit stabilized operations to be sustained while a longer
22 term rate strategy and permanent rate structure for PGW is developed and approved.

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

24 A. Yes it does.

APPENDIX "A"

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

Curtis Moulton
Managing Director
Infrastructure Finance Ratings

Standard & Poor's

A Division of The McGraw-Hill Companies



July 20, 2000

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

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

Dear Mr. Kishinchand:

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

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

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

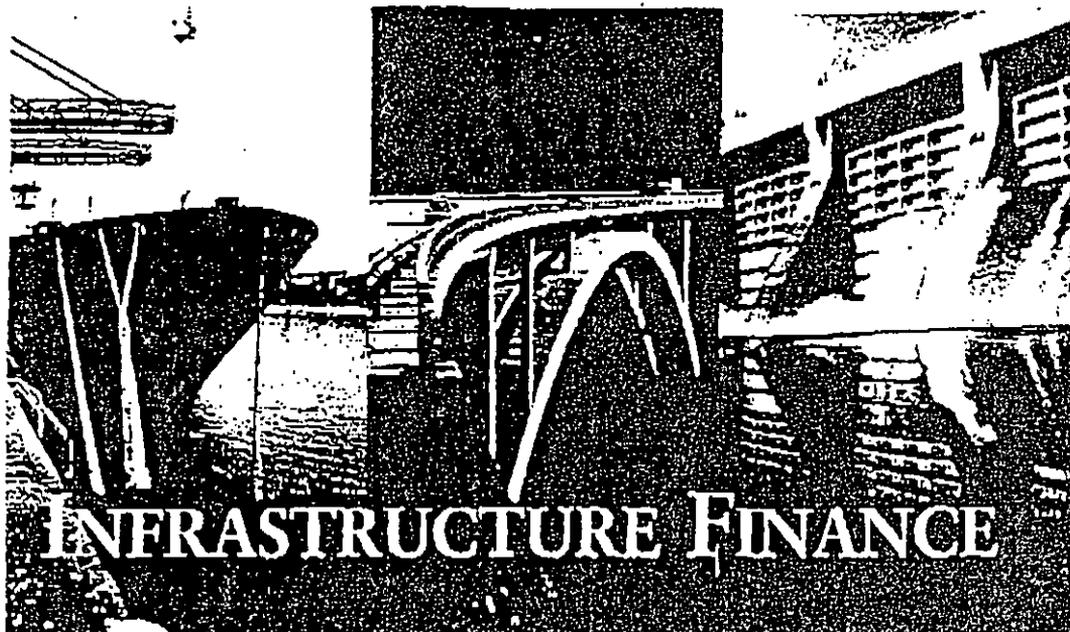
If you have any questions please feel free to contact Jodi Hecht at (212) 438-2019.

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

Very truly yours,

cc: Barbara C. Bisgaier, Public Financial Management

**STANDARD
& POOR'S**



INFRASTRUCTURE FINANCE

Credit Profile

Outstanding Ratings

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

Revised: CreditWatch

Negative

Analysts:

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

PHILADELPHIA GAS WORKS, PENNSYLVANIA

Rationale

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

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

Other credit weaknesses include the following:

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

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

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

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

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

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

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

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

PHILADELPHIA GAS WORKS, PENNSYLVANIA

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

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

Over the past three years, including estimates for fiscal 2000, operating expenses have exceeded operating revenues, reducing reserves and cash balances. In fiscal 2000, no excess revenues were generated to contribute to ongoing and long-term capital needs. The revised five-year fiscal 2002-2006 capital program totals \$266.4 million—a \$91 million decline from the previous program. While current management believes this program is better targeted to address immediate needs, it is unclear that the ongoing investment has been adequately made in the system. Funding

for this program includes a \$75 million bond issue next fiscal year (28% of the program) with the balance (72%) funded from internally generated funds. Funding for the capital program is largely dependent on PGW's ability to implement the five-year operating plan, as projected.

Outlook

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

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PGW-IR St. 3.0

9/27/00

Phls. Ph

MS

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

DIRECT TESTIMONY OF

DOCKETED
OCT 10 2000

CRAIG WHITE

DOCUMENT

FOLDER

ON BEHALF OF

PHILADELPHIA GAS WORKS

DOCKET NOS. P-00001831

R-00005654

RE: PETITION OF PHILADELPHIA GAS WORKS
FOR ESTABLISHMENT OF INTERIM RATE
PROCEDURES AND FOR A DECLARATORY ORDER

AUGUST, 2000

1 Q. PLEASE STATE YOUR NAME AND POSITION WITH THE COMPANY.

2 A. My name is Craig White. My position is Sr. Vice President - Marketing and Supply
3 Services.

4 Q. HOW LONG HAVE YOU HELD THIS POSITION?

5 A. I assumed the position of Vice President Marketing/Economic and New Business
6 Development in November 1, 1998 and was promoted to Senior Vice President,
7 Marketing & Supply Services in November 1999.

8 Q. WHAT ARE YOUR JOB RESPONSIBILITIES?

9 A. My formal responsibilities include the oversight of the following functions: Sales,
10 Marketing, Business Development, Rates, Federal Regulatory Affairs, Gas Acquisition,
11 Gas Accounting, Gas Control and Energy Planning & Forecasting.

12 Q. PLEASE SUMMARIZE YOUR WORK EXPERIENCE.

13 A. I have held the following positions at PGW: Accounting Specialist, Office of VP,
14 Finance; Demand Analyst, Energy Planning & Forecasting; Planning Analyst, Corporate
15 Planning & Analysis; Federal Regulatory Specialist and Administrator, Federal
16 Regulatory Affairs, Gas Acquisitions & Federal Regulatory Affairs; Manager-Energy
17 Planning & Federal Regulatory Affairs and Vice President, Marketing/Economic and
18 New Business Development.

19 Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.

20 A. I received a Bachelor's Degree in Business from Kutztown University and a Master's
21 Degree in Finance/Management from Drexel University.

22 Q. HAVE YOU EVER PROVIDED TESTIMONY TO A REGULATORY
23 COMMISSION BEFORE, AND IN WHAT CAPACITY?

1 A. Yes. I have previously provided written and oral testimony to the Philadelphia Gas
2 Commission pertaining to PGW's GCR filings, operating budgets and forecasts, and
3 various tariff changes. In addition, I have provided testimony regarding the PGW/Grays
4 Ferry/Trigen/Sun contracts. I am also submitting testimony in PGW's GCR proceeding
5 (R-00005619).

6 **Q. WHAT IS THE SUBJECT OF YOUR TESTIMONY?**

7 A. My testimony explains the Company's proposal to increase rates on an interim basis to
8 produce the \$52 million determined to be necessary in the short term to avoid serious
9 financial problems. I will also explain how this interim rate structure proposal differs
10 from PGW's proposal that it filed with the PGC.

11 **Q. HOW DO YOU PROPOSE TO CHANGE RATES TO PRODUCE PGW'S**
12 **REQUESTED \$52 MILLION INTERIM RATE INCREASE?**

13 A. PGW is proposing that it produce the interim rate increase by increasing the volumetric
14 rates for each customer class on an across-the-board, equal percentage basis. I have
15 included a summary and proposed tariff revisions that are designed to produce the
16 necessary additional revenues as PGW-IR Exh. 3.1.

17 **Q. HOW DOES THIS PROPOSAL DIFFER FROM THE INITIAL FILING FROM**
18 **WITH THE PGC?**

19 A. PGW's original filing proposed to produce the requested additional revenue by a
20 combination of increases to the customer charge for each class as well as an increase to
21 the commodity charge, with approximately 86% coming from the customer charge
22 increase. This was designed to bring these portions of the rates in line with our

1 calculation of their costs, as well as to reduce the sensitivity of the Company and its
2 customers to the effects of weather.

3 **Q. WHY DID YOU ALTER YOUR RATE STRUCTURE PROPOSAL?**

4 A. Increasing the customer charge, particularly for residential and small commercial
5 customers, was likely to produce questions and concerns from representatives of these
6 customer classes. Because of the "fast track," interim nature of this proceeding it was
7 determined by PGW management that it would be prudent to eliminate this as an issue in
8 this proceeding. Accordingly, we are requesting that the interim rate increase be made on
9 a volumetric basis.

10 **Q. DO YOU INTEND TO RENEW YOUR REQUEST FOR INCREASES IN THE**
11 **CUSTOMER CHARGE?**

12 A. Yes. We will be filing a request for permanent rates on or before January 1, 2001. In that
13 filing, we will resubmit our request that the customer charges for each rate class be
14 increased and the volumetric charges be correspondingly decreased. We believe that a
15 better alignment of the customer charges with their costs is important step in making our
16 rates more reflective of how costs are incurred on PGW's system as well as to reduce the
17 volatility that PGW has experienced in the last several years due to swings in weather.

18 **Q. DOES THAT COMPLETE YOUR DIRECT TESTIMONY?**

19 A. Yes it does.

DOCUMENT
 FOLDER

DOCKETED
 OCT 10 2000

Philadelphia Gas Works						
Interim Rate Increase Request Docket No. R-00005654						
Proposed Interim Rate Increases						
	Current	Current		Revised		
Customer	Customer	Commodity	Proposed	Commodity	Percent	Regulation/
Category	Charge	Charge	Increase	Charge	Increase	Rate
	\$	¢/Ccf	¢/Ccf	¢/Ccf		
Residential	8.00	66.13	8.942	75.072	13.52%	Rate GS
Commercial	10.00	71.20	9.628	80.828	13.52%	Rate GS
Industrial	20.00	71.20	9.628	80.828	13.52%	Rate GS
Municipal/MS	N/A	64.13	8.672	72.802	13.52%	Rate MS
PHA	N/A	71.26	9.636	80.896	13.52%	Rate PHA
Legend:						
Rate GS, General Service; Rate MS, Municipal Service; and Rate PHA, Philadelphia Housing Authority Service						

PHILADELPHIA GAS WORKS

GENERAL SERVICE - RATE GS

Rate: Applicable to all gas consumed on or after September 1, 1991
for Commercial and Industrial Customers, and to all gas consumed
on or after June 1, 1999 for Residential Customers
Air Conditioning Provision: Effective July 14, 2000
Compressed Natural Gas Provision: Effective July 14, 2000

AVAILABILITY

Available for any purpose where the Company's distribution mains adjacent to the proposed gas service location are, or can economically be made, suitable to supply the quantities of gas required. Gas service is also available under this rate for comfort cooling and/or pilot usage for buildings served under seasonal rates, during those periods of the year when gas service is not ordinarily available under such seasonal rates.

RATES

CUSTOMER CHARGE: Per Meter (except parallel meters)
\$ 8.00 per month for Residential Customers.
\$ 10.00 per month for Commercial Customers.
\$ 20.00 per month for Industrial Customers.

Plus

COMMODITY CHARGE: ~~66.1375,072¢~~ per 100 cubic feet for Residential Customers
~~71.2080,828¢~~ per 100 cubic feet for Commercial, Industrial Customers

SPECIAL PROVISION – AIR CONDITIONING – For the billing months May through September, the Commodity Charge shall become 40.00 cents per 100 cubic feet for all gas used for cooling purposes. Provided, however, if one hundred and ten percent (110%) of the incremental gas costs for gas sold under this rate schedule plus an adjustment for all applicable taxes as determined by the Company exceeds 40.00 cents per 100 cubic feet, then the rate under this provision shall be the lesser of one hundred and ten percent (110%) of the incremental gas costs for gas sold under this rate schedule plus an adjustment for all applicable taxes as determined by the Company, or the applicable Commodity Charge set forth above. This rate is applicable for directly and indirectly fired gas cooling equipment of minimum cooling capacity of 3 tons, installed on or after September 1, 1990. Where practicable, such equipment must be separately metered and the cost for any additional metering, related equipment and installation shall be subject to Regulation 10 of the Rules and Regulations of this tariff. Where separate metering is impracticable for directly or indirectly fired gas cooling and heating equipment, one meter shall be installed for the heating/cooling equipment and such gas rendered to the Customer through such meter will be charged the full Rate GS for the billing months October through April. Under no circumstances will Customers be permitted to use gas rendered through such meter for any purpose other than cooling or heating.

PHILADELPHIA GAS WORKS

MUNICIPAL SERVICE - RATE MS

Rate: Applicable to all gas consumed on or after September 1, 1991.

Air Conditioning Provision - Effective March 10, 1991

Compressed Natural Gas Provision: Effective July 14, 2000

AVAILABILITY

Available to properties owned or occupied by the City of Philadelphia or the Board of Education, or any of their respective agencies or instrumentalities, for any type of gas service, unless purchased for resale to others, and where the Company's distribution mains adjacent to the proposed gas service locations are, or can economically be made, suitable to supply the quantities of gas required; provided, however, that the rate shall not be available to commercial tenants of any such property.

This rate is also available for service at such locations, served under seasonal rates for comfort cooling and/or pilot usage, during periods of the year when gas is not ordinarily available under such seasonal rates.

RATE

The rate per hundred cubic feet ~~64.1372~~.802¢

SPECIAL PROVISION - AIR CONDITIONING - For the billing months of May through September, the rate shall become 40.00 cents per 100 cubic feet for all gas used for cooling purposes. This rate is applicable for directly and indirectly fired gas cooling equipment (gas engine, absorption, adsorption) of minimum cooling capacity of 15 tons, installed on or after September 1, 1990. Such equipment must be separately metered and the cost for any additional metering, related equipment and installation, remain the responsibility of the customer.

SPECIAL PROVISION - COMPRESSED NATURAL GAS (CNG) - Natural gas provided under this rate schedule for purposes of fueling CNG vehicles shall be dispensed on a liquid gallon basis but billed on an Mcf basis. The conversion between liquid gallons and Mcf shall use a ratio in which the numerator is the Department of Energy BTU energy content of one gallon of gasoline and the denominator is the Lower Heating Value (LHV) in BTUs of the Company's average annual natural gas sendout.

GAS COST RATE CLAUSE

The Gas Cost Rate Clause as set forth in Regulation 11 of the Rules and Regulations of this Tariff shall apply to the above rate.

PHILADELPHIA HOUSING AUTHORITY SERVICE - RATE PHA

Rate: Applicable to all gas consumed on or after September 1, 1991.

Air Conditioning Provision: Effective July 14, 2000

AVAILABILITY

Available for all gas usage in multiple dwelling residential buildings containing ten or more dwelling units, owned and operated by the Philadelphia Housing Authority, where cooking shall be performed exclusively with gas and where gas service shall be supplied through one or more single point metering arrangements at locations where the Company's distribution mains adjacent to the proposed gas service locations are, or can economically be made, suitable to supply the quantities of gas required.

This rate is also available for all gas usage in single and multiple dwelling residential buildings, containing less than ten dwelling units, provided, and only so long as, gas is used exclusively for cooking, water heating and space heating for all such residential buildings owned and operated by the Philadelphia Housing Authority, except (1) buildings operated by the Philadelphia Housing Authority, prior to the original effective date of this rate (January 1, 1969), and (2) buildings for which, in the judgment of the Company, such gas service cannot be provided economically.

This rate is also available in buildings, meeting the above specifications, served under seasonal rates for comfort cooling and/or pilot usage, during periods of the year when gas service is not ordinarily available under such seasonal rates.

RATE

The rate per hundred cubic feet ~~71.2680.896¢~~

SPECIAL PROVISION – AIR CONDITIONING – For the billing months May through September, the Commodity Charge shall become 40.00 cents per 100 cubic feet for all gas used for cooling purposes. Provided, however, if one hundred and ten percent (110%) of the incremental gas costs for gas sold under this rate schedule plus an adjustment for all applicable taxes as determined by the Company exceeds 40.00 cents per 100 cubic feet, then the rate under this provision shall be the lesser of one hundred and ten percent (110%) of the incremental gas costs for gas sold under this rate schedule plus an adjustment for all applicable taxes as determined by the Company, or the PHA rate set forth above. This rate is applicable for directly and indirectly fired gas cooling equipment of minimum cooling capacity of 3 tons, installed on or after September 1, 1990. Where practicable, such equipment must be separately metered and the cost for any additional metering, related equipment and installation shall be subject to Regulation 10 of the Rules and Regulations of this tariff. Where separate metering is impracticable for directly or indirectly fired gas cooling and heating equipment, one meter shall be installed for the heating/cooling equipment and such gas rendered to the Customer through such meter will be charged the full Rate PHA for the billing months October through April. Under no circumstances will Customers be permitted to use gas rendered through such meter for any purpose other than cooling or heating.

Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

Docket No. R-00005654

CROSS-EX
OCA Hearing Exhibit No.

Date Entered: 9/27/00

PLMs PD

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DOCUMENT
FOLDER

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00 OCT -6 PM 12:57
P.A. P.U.C.
SECRETARY'S BUREAU

DOCKETED
OCT 10 2000

**RESPONSE TO INFORMAL DISCOVERY DATA REQUESTS
REGARDING FY 2001 CONSOLIDATED BUDGET PROCEEDING**

Question ID-9: Provide listing re: BCCS fixes to be completed (e.g. budget billing, PLP) with targeted completion date and number of accounts affected.

Response:

Team Assignment	Issue Number	Priority	Current Status	Date Needed	Functional Description/Statement of Problem	Accounts/Dollars Impacted
Field	21	Critical	Testing	21-Aug-00	Selection of Solicitation file for PLP	471,198 accounts
Financial	5	Critical	Analysis	31-Aug-00	Review and verify mapping to the GL	All Accounts
Billing	23	Critical	Testing	30-Aug-00	Reinstatement of Budget Billing Customers with incorrectly converted expiry dates.	20,000 Accounts
Financial	10	Critical	Testing	31-Aug-00	Uncollectable money has been on the books without a plan in place to write off the bad debt.	\$18 - \$35 Million
Billing	30	High	Testing	30-Aug-00	Creation of Budget Plan Payment Dates	New Budget Customers
Field	8	Critical	SPL	05-Sep-00	Need to correct cash posting of PLP payment.	471,198 accounts
Billing	11	Regulatory	Pending Approval	25-Sep-00	Determine CRP payback strategy.	20,000 Accounts
Field	20	Critical	SPL	15-Sep-00	Interface to Mobile for PLP Orders	471,198 accounts
Field	19	Critical	Analysis	01-Oct-00	Bill print message - acknowledging PLP customers	110,000 accounts

Financial	3	Regulatory	Identified		CRP Collection Path - validate and test path before turning it on in production	20,000 Accounts
Billing	38	Critical	Analysis	30-Aug-00	CRP loans (NSA) have credits or were not billed due to the rebill process	5,000 Accounts
Billing	6	Critical	Analysis	31-Aug-00	Determine remainder of accounts not billing and financial implications	14,000 Accounts
Financial	68	High	Analysis	30-Sep-00	Correct program to allow accounts written off to be sent to collection agencies.	Varies By Month
Billing	2	Medium	SPL	11-Sep-00	LIHEAP makeup charges - Need to identify customer base, send letter and create loans	
Field	55	Critical	Testing		Need to develop a Batch program to retry Mobile upload records nightly	Varies by Night
Financial	67	Critical	Identified		Payments received for customer accounts previously written off and not converted.	About 600 payments
Financial	34	Critical	Identified	15-Sep-00	There is a duplicate journal entry being passed to the general ledger from BCCS for Cust.Refunds	
Billing	63		Identified		Reversal discount transaction is not created when a CRP customer comes off of CRP.	20,000 Accounts
Billing	79	Critical	Analysis	23-Aug-00	Implement software in the District Offices that will check for valid account numbers.	
Field	46	Critical	Identified		Preventing changes to a SIO that has been downloaded to MDT - MobileUP status of Dispatched	
Billing	80	High	Testing	30-Aug-00	Reset LPC on Closed SA's - (Pre Conversion Errors)	
Financial	14	Critical	Analysis	31-Aug-00	System Balancing	
Billing	81	High	Testing	30-Aug-00	Fix LPC and LPCWVE - Post Conversion Errors	
Billing	82	High	Testing	31-Aug-00	Converted Write Off Fix	
Field	73	Critical	Analysis		Timeout problems for multi premise accounts prevent SIO Initiation.	

Billing	83	High	Testing	31-Aug-00	CRP loans without FT's
Billing	84	High	Testing	31-Aug-00	Fix Arrears on PLP Accounts
Field	42	High	Testing		No Tracking mechanism for user changes to SIO's.
Billing	85	High	Testing	31-Aug-00	PLP SAs WITH CAMTD and no TAMTD
Billing	86	High	Testing	31-Aug-00	Add CONVBL Adjustment to correct CONVRC Adjustment
Billing	89	Critical	SPL	25-Aug-00	Create a program that will reapply grant payments in error.
Field	22	High	Pending Approval	01-Oct-00	Creation of PLP revenue reports. Also need Cost of PLP service reports.

FINANCIAL CONSIDERATIONS

REVENUE BOND FINANCING

Rate Covenants

All outstanding revenue bonds issued prior to 1998 were issued under the 1975 General Ordinance. The rate covenant in the 1975 General Ordinance requires that the City, at a minimum, impose, charge and collect in each Fiscal Year, such gas rates and charges as shall, together with all other Project Revenues (as defined in the Act) to be received in such Fiscal Year, equal not less than the greater of:

A. The sum of:

- (i) All Net Operating Expenses payable during such Fiscal Year.
- (ii) 150% of the amount needed to satisfy sinking fund requirements of principal and interest which will become due and payable during such Fiscal Year for all bonds issued and outstanding under the 1975 General Ordinance; and
- (iii) The amount, if any, required to be paid into the sinking fund reserve under the 1975 General Ordinance during such Fiscal Year, or

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B. The sum of:

- (i) All Net Operating Expenses payable during such Fiscal Year; and
- (ii) All Sinking Fund deposits required during such Fiscal Year with respect to all outstanding bonds issued under the 1975 General Ordinance and general obligation bonds issued for improvements to the Gas Works and all amounts, if any, required during such Fiscal Year to be paid into the Sinking Fund Reserve under the 1975 General Ordinance.

The rate covenant in the 1998 General Ordinance requires the City, at a minimum, to impose, charge and collect in each Fiscal Year such gas rates and charges as shall, together with all other Gas Works Revenues to be received in such Fiscal Year, equal not less than the greater of:

1. The sum of:

- (i) all Net Operating Expenses payable during such Fiscal Year,
- (ii) all principal of and interest on bonds issued and outstanding under the 1975 General Ordinance payable during such Fiscal Year and amounts required to be paid into the sinking fund reserve under the 1975 General Ordinance during such Fiscal Year,
- (iii) 150% of the amount required to pay sinking fund deposits required during such Fiscal Year in respect of all Outstanding Senior Bonds (as defined in the 1998 General Ordinance) and 100% of the amounts payable in respect of the Prior Obligations (as defined in the 1998 General Ordinance) during such Fiscal Year,

- (iv) the amount required to pay sinking fund deposits required during such Fiscal Year in respect of all Outstanding Subordinate Bonds (as defined in the 1998 General Ordinance) and other obligations of the Gas Works on a parity with Subordinate Bonds payable during such Fiscal Year,
- (v) the amount, if any, required to be paid into the Sinking Fund Reserve under the 1998 General Ordinance during such Fiscal Year,
- (vi) the Rebate Amount required to be paid to the United States during such Fiscal Year, and
- (vii) the amounts required to be paid to the issuers of Credit Facilities and the providers of Qualified Swaps and Exchange Agreements (as such terms are defined in the 1998 General Ordinance) during such Fiscal Year, or

2. The sum of:

- (i) all Net Operating Expenses payable during such Fiscal Year,
- (ii) all principal of and interest on bonds issued and outstanding under the 1975 General Ordinance payable during such Fiscal Year and amounts required to be paid into the sinking fund reserve under the 1975 General Ordinance during such Fiscal Year,
- (iii) all sinking fund deposits required during such Fiscal Year in respect of all Outstanding Bonds and all amounts payable in respect of obligations of the Gas Works which are on a parity with any of the bonds issued under the 1998 General Ordinance and in respect of general obligation bonds issued for improvements to the Gas Works and all amounts, if any, required during such Fiscal Year to be paid into the sinking fund reserve under the 1998 General Ordinance,
- (iv) the Rebate Amount required to be paid to the United States during such Fiscal Year, and
- (v) the amounts required to be paid to the issuers of Credit Facilities and the providers of Qualified Swaps and Exchange Agreements during such Fiscal Year.

The Gas Commission is authorized and directed by the 1975 and 1998 General Ordinances to impose, charge and collect, or cause to be collected, all rents, rates and charges which shall be sufficient in each Fiscal Year to comply with the foregoing Rate Covenants.

Bond Ratings

In February 1999, Moody's Investors Service announced the downgrade of the underlying long-term ratings of the Revenue Bonds of the Philadelphia Gas Works ("PGW"). A copy of the Moody's rating change was forwarded to the Municipal Securities Rulemaking Board on March 17, 1999, pursuant to Securities and Exchange Commission rules.

Bond Proceeds

We have been informed by PGW that the proceeds from the sale of the Bonds will be used to:

- Finance PGW's current and future capital programs as approved by City Council.
- Refund all or a portion of the City's outstanding Gas Works Revenue Bonds, Eleventh C Series and Fourteenth Series which were issued under the 1975 General Ordinance.
- Pay any other Project Costs (as defined in the Act.)

It is understood that the bonds will be secured solely by the revenues of PGW received from all Gas System users.

The \$100.0 million of the Second Series Bonds (net after sinking fund reserve and issuance expenses) to be issued in 1999, and the projected \$75.0 million of the Third Series Bonds to be issued in 2003, will be used as shown on Table 16. The application of proceeds from these issues can be summarized as follows:

	<u>Amount</u> (000's)
Capital Improvement Fund Balance (08/31/98)	\$65,213
Total Revenue Bonds Issued for Capital Improvements	
- Second Series Bonds (up to)	100,000
- Third Series Bonds issued in 2003	75,000
Less Deposits for Sinking Fund Reserve and Issue Expenses (associated with Third Series Bonds to be issued in 2003)	<u>8,440</u>
Balance Available to PGW as Applied (08/31/05)	<u>\$231,773</u>
Capital Improvement Fund Drawdown	\$231,773
Capital Improvement Fund Balance (08/31/05)	<u>0</u>
Balance Accounted for (08/31/05)	<u>\$231,773</u>

CURRENT ESTIMATE OF 1999 RESULTS

Weather Results to Date

Fiscal year 1999 is turning out to be warmer than most years. This will have a major effect on planned 1999 income. PGW's current estimate of financial results is based on fiscal year 1999 containing 3,925 degree days, which is 675 degree days (14.7%) fewer degree days than the average weather which was assumed for budget purposes. The current estimate for fiscal year 1999 is based on six months of actual results (September, 1998 through February, 1999), and projections based upon other currently available information for the remaining six months.

We consider the weather results for the winter of 1998-1999 to be significantly atypical. We believe that average weather is the correct basis for PGW to use for budget and forecast plans.

Impact on PGW

The 14.7% decrease in degree days in the current estimate for fiscal 1999 has affected PGW's sales and consequently affected its estimated financial results (Exhibit II). PGW projects a drop in firm sales, compared to original 1999 budgeted amounts, of 6,790 MMcf, amounting to a decrease of 11.2%. Firm sales, which primarily consist of heating load, tend to be most directly affected by changes in weather. Residential and Commercial categories of firm sales are estimated to fall 9.2% and 14.7% respectively.

Sales to interruptible customers are estimated to drop by (9.1%) to 8,740 MMcf. The reduction in interruptible sales is primarily due to the warmer than normal weather which had a significant effect on the Boiler & Power Service and LBS direct sales categories. Transportation service volumes are down slightly (4.2%) from budget also primarily due to the effects of warmer than normal weather.

Total Billed Revenues, due to the effects cited above, are estimated to decline from the budgeted level of \$546.2 million to about \$485 million, a drop of \$61 million (11%), as shown on Exhibit II.

In order to offset that decline and ultimately meet the rate covenant under the 1975 and 1998 General Ordinances, PGW initiated a series of expense reductions, as budgeted, and other initiatives. Total reductions and savings from initiatives are projected to be approximately \$18.5 million. At April 1, 1999, nearly \$15.0 million of such reductions had been realized. The remaining \$3.5 million of reductions and initiatives are anticipated to be realized by August 31, 1999. The reductions and expense initiatives consist of (1) a decrease in the reserve for bad debt (savings of \$3.5 million); (2) a decrease in labor costs for overtime associated with normal winter and routine operations, personnel reductions achieved through a hiring freeze and the capitalization of applicable labor costs to capital projects (savings of \$5.0 million); (3) restricted operating and maintenance spending (savings of \$4.3 million); (4) reduction in pension actuarial expense as a result of the overfunded status (\$5.1 million); (5) other income primarily interest earnings on restricted funds are expected to produce \$6 million in interest income. In addition, the refunding of certain outstanding Gas Works revenue bonds will result in \$2.1 million in debt service savings.

We believe the responses of PGW's management are appropriate.

STATEMENT OF INCOME

We have reviewed Philadelphia Gas Works' budget and forecast of revenues, operating expenses, and annual amounts of internally generated funds needed to satisfy its capital improvement program, its debt service, payments to the City of Philadelphia, and working capital requirements. (Reference Tables 15 through 18 and Exhibits I through VI at the back of this report.) Recognizing current regulatory and economic conditions under which PGW operates, we believe that PGW has developed a reasonable financial plan for the budgeted fiscal year 2000 and the forecasted fiscal years 2001-2005 assuming normal weather conditions for the forecasted years. The 1999 Current Estimate is also shown in these Tables and Exhibits and we consider this estimate to be atypical due to a warmer than normal winter.

Financial Plan

PGW's projections for gas revenues and expenses are based upon historical data and assumptions which we consider reasonable. Other components of PGW's projected revenues and expenses have less of a historical basis, but are also based on assumptions which we consider reasonable.

The budget and forecast contemplate increased revenues in the amount of \$20.0 million in 2002.

Debt Service Coverage

As detailed previously, PGW's rate covenant in the 1975 General Ordinance requires the debt service coverage ratio to be at least 1.50. PGW's applicable rate covenant in the 1998 General Ordinance requires a debt service coverage ratio of (i) 1.00 for debt service on all outstanding Bonds issued under the 1975 General Ordinance, (ii) 1.50 for debt service on all outstanding Senior Bonds issued under the 1998 General Ordinance, and 1.00 for debt service on outstanding obligations to the Philadelphia Municipal Authority existing on the date of adoption of the 1998 Ordinance, and (iii) 1.00 for debt service on (a) all outstanding Subordinate Bonds issued under the 1998 General Ordinance and (b) all other obligations on a

parity with such Subordinate Bonds. In PGW's rate proceeding before the Commission in 1988 all parties agreed that there should be some cushion above the 1.50 level to allow PGW to retain its bond rating. PGW's current projection (6 months actual plus 6 months estimated) results in sufficient coverage ratios under the 1975 General Ordinance and sufficient funds above requirements under the 1998 General Ordinance.

Bond coverage under both the 1975 General Ordinance and the 1998 General Ordinance has been calculated as shown in Table 15A, assuming both the Sixteenth Series Bonds and the Second Series Bonds are issued during fiscal 1999. Coverages of debt service from operations in this case are as follows:

	<u>Fiscal Year Ended August 31,</u>						
	Current Estimate <u>1999</u>	Budget <u>2000</u>	Forecast				
			<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Bonds							
1975 Ordinance	1.64	1.95	2.30	2.48	3.01	2.88	3.33
Senior Bonds							
1998 Ordinance	1.92	2.23	2.02	3.19	3.07	3.07	2.93
Subordinate Bonds							
1998 Ordinance	6.75	13.46	14.94	26.24	31.02	30.58	33.37

This table indicates that sufficient funds are estimated to exist in each year of the forecast to provide the required coverage for each type of debt service as specified under the terms of both the 1975 General Ordinance and the 1998 General Ordinance. All of our tests made under the 1975 General Ordinance and the 1998 General Ordinance show that sufficient funds to provide the required coverage can reasonably be expected to be available during the forecast period.

Table 15B represents an alternate scenario in which only the Second Series Bonds are issued in fiscal 1999. No Sixteenth Series Refunding is included.

A third scenario is presented in Table 15C in which only the Sixteenth Series Bonds are issued in fiscal 1999. This table assumes that revenue bonds to finance revenue projects are issued in fiscal 2000.

Tables 15B and 15C indicate that sufficient funds are estimated to exist in each year of the forecast to provide the required coverage under terms of both the 1975 General Ordinance and the 1998 General Ordinance under either of these alternate scenarios.

To the extent that the City of Philadelphia refunds a portion of the Fourteenth Series Bonds (as well as Eleventh Series C Bonds), we believe this would not adversely affect the debt service coverages shown in Table 15A, Table 15B, or Table 15C.

TABLE 15 A

PHILADELPHIA GAS WORKS
COVERAGE OF DEBT SERVICE FROM OPERATIONS

Sixteenth Series Bonds and Second Series Bonds Issued

	<u>Fiscal Years Ended August 31,</u>						
	<u>Current (a)</u>	<u>Budget</u>	<u>Forecast</u>	<u>Forecast</u>	<u>Forecast</u>	<u>Forecast</u>	<u>Forecast</u>
	<u>Estimate</u> <u>1998-99</u>	<u>1999-2000</u>	<u>2000-01</u>	<u>2001-02</u>	<u>2002-03 (b)</u>	<u>2003-04</u>	<u>2004-05</u>
Funds Available For Debt Service Calculation (Exhibit V)	\$94,573	\$115,742	\$118,351	\$137,182	\$142,907	\$144,248	\$146,779
<u>1975 Ordinance Bonds</u>							
Debt Service Bonds	\$57,741	\$59,330	\$51,402	\$55,312	\$47,442	\$50,056	\$44,052
Debt Service Coverage	1.64	1.95	2.30	2.48	3.01	2.88	3.33
Net Available After Prior Debt Service	\$36,832	\$56,412	\$66,949	\$81,870	\$95,465	\$94,192	\$102,727
Capital Lease for Building							
Other Capital Leases	7,882	7,991	7,977	5,953	3,997	3,998	1,999
Total	\$7,882	\$7,991	\$7,977	\$5,953	\$3,997	\$3,998	\$1,999
Net Available After Capital Leases	\$28,950	\$48,421	\$58,972	\$75,917	\$91,468	\$90,194	\$100,728
<u>1998 Ordinance Senior Bonds</u>							
Debt Service Existing	\$15,097	14,128	\$22,047	\$16,711	\$22,646	\$17,371	\$21,495
Debt Service Proposed	0	7,565	7,181	7,123	7,121	11,998	12,934
Total	\$15,097	\$21,693	\$29,228	\$23,834	\$29,767	\$29,369	\$34,429
Debt Service Coverage	1.92	2.23	2.02	3.19	3.07	3.07	2.93
Net Available after Debt Service on Sr. Bonds	\$13,853	\$26,728	\$29,744	\$52,083	\$61,701	\$60,825	\$66,299
<u>1998 Ordinance Subordinate Bonds</u>							
Debt Service	\$2,053	\$1,986	\$1,991	\$1,985	\$1,989	\$1,989	\$1,987
Debt Service Coverage	6.75	13.46	14.94	26.24	31.02	30.58	33.37

(a) Current Estimate is based on six months actual data and six months projections based upon currently available information.

(b) Assumes tax-exempt interest rate of 6.5% for Senior new money issue under the 1998 Gen'l. Ordinance in 2003 (\$75.0 million).

TABLE 15 B

PHILADELPHIA GAS WORKS
COVERAGE OF DEBT SERVICE FROM OPERATIONS

Only Second Series Bonds Issued

	<u>Fiscal Years Ended August 31,</u>						
	<u>Current (a)</u>						
	<u>Estimate</u> <u>1998-99</u>	<u>Budget</u> <u>1999-2000</u>	<u>Forecast</u> <u>2000-01</u>	<u>Forecast</u> <u>2001-02</u>	<u>Forecast</u> <u>2002-03 (b)</u>	<u>Forecast</u> <u>2003-04</u>	<u>Forecast</u> <u>2004-05</u>
Funds Available For Debt Service Calculation (Exhibit V)	\$94,573	\$115,742	\$118,351	\$137,182	\$142,907	\$144,248	\$146,779
<u>1975 Ordinance Bonds</u>							
Debt Service Bonds	\$59,847	\$59,849	\$51,918	\$55,830	\$47,961	\$50,570	\$44,569
Debt Service Coverage	1.58	1.93	2.28	2.46	2.98	2.85	3.29
Net Available After Prior Debt Service	\$34,726	\$55,893	\$66,433	\$81,352	\$94,946	\$93,678	\$102,210
Capital Lease for Building	-	-	-	-	-	-	-
Other Capital Leases	7,882	7,991	7,977	5,953	3,997	3,998	1,999
Total	\$7,882	\$7,991	\$7,977	\$5,953	\$3,997	\$3,998	\$1,999
Net Available After Capital Leases	\$26,844	\$47,902	\$58,456	\$75,399	\$90,949	\$89,680	\$100,211
<u>1998 Ordinance Senior Bonds</u>							
Debt Service Existing	\$15,097	14,128	\$22,047	\$16,711	\$22,646	\$17,371	\$21,495
Debt Service Proposed	0	7,565	7,181	7,123	7,121	11,998	12,934
Total	\$15,097	\$21,693	\$29,228	\$23,834	\$29,767	\$29,369	\$34,429
Debt Service Coverage	1.78	2.21	2.00	3.16	3.06	3.05	2.91
Net Available after Debt Service on Sr. Bonds	\$11,747	\$26,209	\$29,228	\$51,565	\$61,182	\$60,311	\$65,782
<u>1998 Ordinance Subordinate Bonds</u>							
Debt Service	\$2,053	\$1,986	\$1,991	\$1,985	\$1,989	\$1,989	\$1,987
Debt Service Coverage	5.72	13.20	14.68	25.98	30.76	30.32	33.11

(a) Current Estimate is based on six months actual data and six months projections based upon currently available information.

(b) Assumes tax-exempt interest rate of 6.5% for Senior new money issue under the 1998 Gen'l. Ordinance in 2003 (\$75.0 million).

TABLE 15 C

PHILADELPHIA GAS WORKS
COVERAGE OF DEBT SERVICE FROM OPERATIONS

Only Sixteenth Series Bonds Issued
 (Assumed issuance of bonds to finance capital
 projects in FY 2000)

	<u>Fiscal Years Ended August 31,</u>						
	<u>Current (a)</u>						
	<u>Estimate</u> <u>1998-99</u>	<u>Budget</u> <u>1999-2000</u>	<u>Forecast</u> <u>2000-01</u>	<u>Forecast</u> <u>2001-02</u>	<u>Forecast</u> <u>2002-03 (b)</u>	<u>Forecast</u> <u>2003-04</u>	<u>Forecast</u> <u>2004-05</u>
Funds Available For Debt Service Calculation (Exhibit V)	\$93,643	\$111,391	\$118,357	\$137,187	\$142,907	\$144,248	\$146,779
<u>1975 Ordinance Bonds</u>							
Debt Service Bonds	\$57,741	\$59,330	\$51,402	\$55,312	\$47,442	\$50,056	\$44,052
Debt Service Coverage	1.62	1.88	2.30	2.48	3.01	2.88	3.33
Net Available After Prior Debt Service	\$35,902	\$52,061	\$66,955	\$81,875	\$95,465	\$94,192	\$102,727
Capital Lease for Building Other Capital Leases							
Other Capital Leases	7,882	7,991	7,977	5,953	3,997	3,998	1,999
Total	\$7,882	\$7,991	\$7,977	\$5,953	\$3,997	\$3,998	\$1,999
Net Available After Capital Leases	\$28,020	\$44,070	\$58,978	\$75,922	\$91,468	\$90,194	\$100,728
<u>1998 Ordinance Senior Bonds</u>							
Debt Service Existing	\$15,097	14,128	\$29,612	\$23,832	\$29,769	\$24,492	\$28,618
Debt Service Proposed	0	0	0	0	0	4,875	5,815
Total	\$15,097	\$14,128	\$29,612	\$23,832	\$29,769	\$29,367	\$34,433
Debt Service Coverage	1.86	3.12	1.99	3.19	3.07	3.07	2.93
Net Available after Debt Service on Sr. Bonds	\$12,923	\$29,942	\$29,366	\$52,090	\$61,699	\$60,827	\$66,295
<u>1998 Ordinance Subordinate Bonds</u>							
Debt Service	\$2,053	\$1,986	\$1,991	\$1,985	\$1,989	\$1,989	\$1,987
Debt Service Coverage	6.29	15.08	14.75	26.24	31.02	30.58	33.36

(a) Current Estimate is based on six months actual data and six months projections based upon currently available information.

(b) Assumes tax-exempt interest rate of 6.5% for Senior new money issue under the 1998 Gen'l. Ordinance in 2003 (\$75.0 million).