

APPENDIX A

AGREEMENT

Between

THE CITY OF PHILADELPHIA

AND

THE PHILADELPHIA FACILITIES
MANAGEMENT CORPORATION

FOR THE MANAGEMENT AND OPERATION
OF THE PHILADELPHIA GAS WORKS

PRINTING DATE: January, 1996
Original Agreement Dated December 29, 1972
Includes Amendments Through December 31, 1995

Original Agreement between the City of Philadelphia and the Philadelphia Facilities Management Corporation was executed on December 29, 1972, for the management and operation of the Philadelphia Gas Works, pursuant to an Ordinance of City Council, approved December 29, 1972 (Bill #455), and to Resolutions of the Board of Directors of the Corporation adopted at a meeting held on December 13, 1972.

Agreement amended, pursuant to an Ordinance of City Council, approved December 14, 1973 (Bill #1021), relating to gas rate discount for Senior Citizens.

Agreement amended, pursuant to an Ordinance of City Council, approved May 30, 1975 (Bill #1870), relating to Gas Works Revenue Bonds.

Agreement amended, pursuant to an Ordinance of City Council, approved November 1, 1976 (Bill #396), relating to Company's management fee.

Agreement amended, pursuant to an Ordinance of City Council, approved June 22, 1978 (Bill #1410), relating to Temporary financing.

Agreement amended, pursuant to an Ordinance of City Council, approved April 10, 1979 (Bill #1374), relating to Company's management fee.

Agreement amended, pursuant to an Ordinance of City Council, approved June 11, 1979 (Bill #1948), relating to Management personnel provided by company; production purchase and delivery of gas; paving requirements; natural gas standards; heating value standards; attendance at meetings; classification of service; definitions and indemnifications.

Agreement amended, pursuant to an Ordinance of City Council, approved September 5, 1980 (Bill #319), relating to Company's management fee.

Agreement amended, pursuant to an Ordinance of City Council, approved September 5, 1980 (Bill #320), relating to Company's management fee.

Agreement amended, pursuant to an Ordinance of City Council, approved September 5, 1980 (Bill #321), relating to Gas Works Temporary Loan Notes.

Agreement amended, pursuant to an Ordinance of City Council, approved June 25, 1981 (Bill #750), relating to Temporary Financing.

Agreement amended, pursuant to an Ordinance of City Council, approved September 22, 1982 (Bill #1315), relating to change in fiscal year basis.

Agreement amended, pursuant to an Ordinance of City Council, approved December 3, 1982 (Bill #1314), relating to Temporary Financing.

Agreement amended, pursuant to an Ordinance of City Council approved April 11, 1990 (Bill #737), relating to compensation.

Agreement amended, pursuant to an Ordinance of City Council approved December 28, 1995 (Bill #1256), relating to Company's management fee.

Marginal notes are not part of the agreement, but are provided for convenience of use.

AGREEMENT made this 29th day of December, 1972, by and between the CITY OF PHILADELPHIA (hereinafter called "City"), and PHILADELPHIA FACILITIES MANAGEMENT CORPORATION, a corporation organized and existing under the laws of the State of Pennsylvania (hereinafter called "Company").

Parties and dates

WITNESSETH:

WHEREAS, the City is the owner of a group of real and personal assets known as the Philadelphia Gas Works ("Gas Works"); and

WHEREAS, the City desires to provide quality gas services to its citizens at reasonable rates; and

WHEREAS, the Company is a non-profit corporation organized for the specific purpose of operating the Philadelphia Gas Works.

NOW, THEREFORE, the parties to this Agreement, intending to be legally bound, agree as follows:

SECTION I

General

1. The City hereby authorizes Company on the terms and conditions herein set forth to manage and operate all the property, real and personal, collectively known as the Gas Works, for the sole and exclusive benefit of City; provided, however, City may retrieve from the Gas Works any property or equipment which City determines to be unnecessary to the efficient and economic operation of the Gas Works.

Authority to manage and operate PGW property

City may retrieve surplus property or equipment

2. City, to the extent that it has or shall have the authority or power so to do, authorizes and empowers Company to maintain, change, alter, replace, repair and operate the Gas Works and appurtenances along and beneath the surfaces of the highways, streets, avenues, lanes, alleys, ways and public places in City, for the supply and distribution of gas, subject to provisions hereinafter set forth. For these purposes Company may enter upon, occupy and open all said highways, streets, avenues, lanes, alleys, ways and public places, and supply and distribute gas through pipes laid therein.

Right to enter highways

3. During the term of this Agreement, Company will maintain the Gas Works for the sole and exclusive benefit of the City, including all additions, extensions, betterments, and improvements made thereto, in good order and efficient operating condition. Upon termination of this Agreement by expiration of the term or by any other means, City, its agents, servants, or employees shall be entitled without further payment to Company to use all processes established at the Gas Works for the manufacture or distribution of gas of any type or kind. To the extent that use of any such process is authorized by a contract with a third party, City may at its option either continue the use of such process in accordance with the terms of such contract or may discontinue use of such process.

Company to maintain Gas Works

City's use of processes upon termination

4. Company shall not assign or subcontract this Agreement or any rights hereunder to any person or corporation, nor delegate any duties hereunder.

Agreement not assignable

5. Company's primary obligation shall be to apply the highest standards of management practice and diligence to the operation of the Gas Works.

Highest management standards -

"Recommendations" in the Ordinance.

6. Company shall provide the following personnel for the operation of the Gas Works:

*Management
personnel provided
by Company*

- (a) a chief executive officer;
- (b) a chief operating officer;
- (c) a chief financial officer; and
- (d) such other personnel as deemed appropriate by Company.

All such personnel shall be subject to the approval of the Gas Commission, which approval shall not be unreasonably withheld. In the event the Gas Commission fails to approve any such personnel they shall be replaced by approved personnel forthwith.

*Personnel subject to
Gas Commission
approval*

7. Company shall file semi-annual reports with the Gas Commission setting forth all salaries, fringe benefits, expenses and costs incurred by Company in carrying out its duties and responsibilities under the terms and conditions of this Agreement.

*Company to file
semi-annual reports*

SECTION II

Production, Purchase and Delivery of Gas

1. The Company shall take all reasonable steps to insure that the capacity of the Gas Works to manufacture, provide and distribute gas is at all times sufficient for the estimated maximum requirements of gas users in the City of Philadelphia.

*Capacity shall
meet requirements*

2. Company may purchase natural gas or other gas from other parties pursuant to contracts and agreements for such purchases which are first submitted to the Gas Commission for its recommendations and approved by City Council; except that in temporary or emergency situations, Company may purchase natural or other gas from other parties and then seek the approval for such purchase or purchases from the Gas Commission and City Council within 30 days after the initiation of such purchase. In the event such temporary purchase shall be disapproved such supply if continuing shall immediately terminate.

Approval of purchase of gas

Company shall have the right to contract with others for the distribution and/or transmission of such gas to the Gas Works or its facilities which are ancillary, attendant or related in any manner to purchase of gas after such contracts are first submitted to the Gas Commission for its recommendations and approved by City council.

Approval of natural gas delivery facilities

3. Company, to the extent permitted by the lawfully constituted authorities, may enlarge or extend the facilities for the distribution of gas to an agreed-upon customer meter location as may be necessary to meet the demand for gas. In any situation where such enlargement or extension of the Gas Works' facilities will place an unreasonable financial burden upon the then existing customers, in view of the anticipated revenues to be expected from such enlargement or extension Company shall make reasonable charges for the same as defined from time to time in Company regulations which are approved by the Gas Commission.

Charges to customers for extensions

4. The intention of this Agreement is that all changes, additions, extensions, betterments, improvements, alterations and replacements in the Gas Works and in the mains, pipes and appurtenances thereof, and in the property needed to meet the demands for gas as herein provided, shall be made in such a way and manner as shall maintain the Gas Works in good order and condition with the best and most economical processes in use that are customary in the best regulated gas works, to the extent permitted by funds available for said purposes.

Company shall maintain Gas Works in good order

5. All openings, excavations and repaving shall be made subject to such general rules, regulations, specifications, ordinances and such Acts of Assembly as may apply, as from time to time shall be in force concerning the opening, excavation and repaving of streets and the protection of travel along the same, and the trenches shall be refilled and repaved with the same material and character of paving as before they were opened, unless otherwise ordered by the Streets Commissioner. Refilling and making opening safe for traffic shall be completed by Company within five (5) days after the pipe, services, or mains have been laid, and said repaving shall be completed, weather permitting, within sixty (60) days thereafter.

Paving requirements

6. All ordinances, rules and regulations of City regulating the safety of the piping and fixtures of houses or buildings shall be binding upon Company.

Safety regulations

SECTION III

Standards of Gas

1. *General*

Company may supply straight natural gas in accordance with the standards provided for in the General Terms and Conditions of the supplier Company's Tariffs on file with the Federal Energy Regulatory Commission and incorporated by reference in the Agreements for the purchase of natural gas, to which the Company, City and Supplier companies are parties. Also for supplemental purposes, the Company may, as necessary, supply other gases interchangeable and compatible with natural gas.

Natural gas standards

Interchangeable supplemental gases

2. *Testing--Facilities and Inspection*

Adequate facilities for testing the heating value and purity of the gas shall be provided at the Gas Works' expense and equipped with calorimeters for continuously determining the heating value of the gas, apparatus for determining presence of sulphureted hydrogen in the gas, apparatus for determining total sulphur content, apparatus for determining total ammonia content, apparatus for determining specific gravity of the gas and such other apparatus customary and necessary for such purposes, or which will be found to improve the rapidity and accuracy of such testing.

Plant testing facilities

The location of testing facilities shall be selected by Company, and approved by Gas Commission.

Location of testing facilities

The design and accuracy of all testing apparatus when desired by City, Gas Commission or Company shall be certified by the United States Bureau of Standards.

Certification of test equipment

Standards and tests specified herein may be changed and altered from time to time as recommended by Company and approved by Gas Commission.

Change in standards and tests

City and Gas Commission shall have the right at all times by its proper officers, during the term of this Agreement, to test the quality and pressure of gas. Full facilities for these purposes shall be afforded by Company. All such tests shall be made in the presence of a representative of Company. Accurate written records of such test shall be maintained by Company.

City and Gas Commission have right to inspect

3. *Heating Value--Requirements And Determination*

The monthly average total heating value of the gas, when determined as provided below, shall not be less than 950 British Thermal Units per cubic foot, measured at a temperature of 60° Fahrenheit and a pressure of 30 inches of mercury.

Heating value standards

The daily average total heating value shall not differ from the monthly average total heating value to such extent as to interfere with the satisfactory functioning of consumer appliances.

The total heating value of the gas shall be continuously recorded daily unless prevented by circumstances beyond the Company's control.

Daily recording

The monthly average total heating value of the gas shall be the average of the daily averages of the total heating value for that month.

Average monthly value

The daily average total heating value shall be the average of 24-hourly readings.

Average daily value

4. *Purity--Requirements and Determination*

Sulphureted Hydrogen--The gas shall contain not more than a trace of sulphureted hydrogen. The gas shall be considered to contain not more than a trace of sulphurated hydrogen if a strip of white filter paper moistened with a solution containing five per cent by weight of lead acetate is not distinctly darker than a second paper freshly moistened in the same solution after the first paper has been exposed to the gas for one and one-half minutes in an apparatus of approved form through which the gas is flowing at the rate of approximately 5 cubic feet per hour, the gas not impinging directly from a jet upon the test paper.

Sulphureted hydrogen

Total sulphur--The gas shall contain in each 100 cubic feet not more than 30 grains of total sulphur.

Sulphur

Ammonia--The gas shall contain in each 100 cubic feet not more than 5 grains of ammonia.

Ammonia -

5. *Pressure Regulations*

Company shall maintain pressures throughout the City within limits compatible with the satisfactory utilization of gas and as more fully defined in the Rules and Regulations* of the Company's Tariff and as approved from time to time by the Gas Commission.

Gas pressure requirements

Company shall take pressure readings continuously in representative locations throughout the City, which readings shall be available to representatives of City and the Gas Commission upon request for a period of one year prior to the date of such request, or in compliance with the rules issued from time to time by the Gas Commission.

Pressure readings

Gas Commission may order Company by written notice to adjust pressures to acceptable limits for satisfactory utilization of gas, and due diligence shall be employed by Company to adjust pressures at such points to within such acceptable limits. If compliance with the order of the Gas Commission shall require the installation of new apparatus or mains, Company shall be allowed six (6) months, after the necessary financing has been secured to obtain permits for opening of streets and for the laying of the mains and the installation of the necessary apparatus.

Adjustments of pressures

Delay in compliance

SECTION IV

Accounting Methods; Operating Budget and Forecast; Capital Budget and Forecast; Temporary Financing and Financial Statements

1. *Accounting Methods*

(a) *In General*

The accounts and reporting shall be on the accrual methods in which the accounting for depreciation shall be as described in subsection 1(b) herein.

Accounting to be on accrual method

The Gas Works revenues and expenses shall be operated and accounted for an extended period basis from July 1, 1981 to August 31, 1981, and on a fiscal year basis commencing September 1, 1982 and terminating August 31, 1983 and from September 1 to August 31 from year to year thereafter. Accounting shall be employed to show separately the operating accounts and the capital accounts. Operating and capital accounts shall follow generally the classifications specified by the Public Utility Commission of Pennsylvania, expanded or altered, as required by the Director of Finance to portray the special charges and special accounting prescribed in this agreement.

*Fiscal year
September 1 to
August 31*

*Accounting to follow
PUC*

(b) Depreciation

There shall be established and maintained a reserve for depreciation reasonably estimated to be adequate to care for the retirement (due to exhaustion, wear and tear and obsolescence) of property at original cost. The amount necessary to be credited to the reserve each year for such purposes shall be charged to operations.

*Depreciation on
original cost*

(c) Employee Retirement Costs

There shall be provided for and charged to operations annually retirement cost for retired employees and employees still in service on the following basis:

For retired employees, the amount necessary to meet current payments to them under their retirement schedules.

Retired employees

An additional amount, as determined by the Director of Finance, shall be placed in a retirement fund to be held and invested by the Sinking Fund Commission. Such additional amount shall be determined by the Director of Finance after taking into consideration the current payrolls, the retirement schedules then in effect applicable to various classes of employees and the extent to which it appears desirable and reasonable to build up such fund in current and future years.

Pension fund

To this end, the Director of Finance at appropriate times shall obtain competent actuarial advice and shall have available at all times a report made within the immediately preceding five (5) years by a competent actuary based upon an actuarial investigation of the pertinent factors with the costs to be paid by the Gas Works. Payment out of such funds shall be subject to the approval of the Director of Finance as to amounts and when and how payable.

Any proposed change in the retirement plan, schedule or system recommended by Company first shall be transmitted to the Director of Finance for his approval and then transmitted to City Council for its approval, for which purpose there shall be made available to the City Council an appropriate actuarial report prepared under the direction of the Director of Finance.

Retirement plan changes

No employee of Company shall be entitled to be paid a retirement or separation allowance unless and until he can establish his direct and immediate and exclusive connection as such employee with the Gas Works whether under the present operator or former operator.

Employee eligibility for pensions

All such retirement and separation allowances which are paid during the continuance of this agreement and the terms of which, as so approved, require their continued payment after its termination, shall be thereafter paid by City, or City shall cause the same to be paid by any person succeeding to the operation of the Gas Works.

Obligation of City to continue to pay pensions

2. Budgets

(a) Operating Budget and Forecast

There shall be prepared annually an operating budget for the ensuing year and an operating forecast for four (4) years comprising the ensuing year and the three (3) years next following.

Operating budget

Such budget and forecast shall be prepared by Company with the aid of the Director of Finance; shall be consistent with the accounting methods prescribed in Section IV (1); and in general shall be in form and extent satisfactory to the Director of Finance and Gas Commission. The operating budget and forecast shall be subject to the approval of the Gas Commission.

*Approval of
operating budget by
Gas Commission*

(b) Capital Budget and Forecast

There shall be prepared annually a proposed capital budget for the ensuing year and a forecast for six (6) years comprising the ensuing year and the five (5) years next following. Such budget and forecast shall be prepared by Company; shall be consistent with the accounting methods prescribed in Section IV (1); and in general be in form and extent satisfactory to the Director of Finance and the Gas Commission.

Capital budget

The proposed budget and forecast first shall be transmitted to the Director of Finance and the Gas Commission for their recommendations thereon. The Director of Finance and Gas Commission shall transmit such budget and forecast together with their recommendations thereon to City Council for its approval. The submission of the proposed budget and forecast to the Director of Finance and Gas Commission by Company shall be made in sufficient time for their review and for the Director of Finance and Gas Commission in turn to submit the said budget and forecast together with their recommendations thereon to City Council no later than the middle of the fourth month preceding the beginning of the Gas Works' fiscal year, so that City Council may act on it at least thirty (30) days prior to the next ensuing fiscal year.

*Approval of capital
budget by City
Council*

The capital budget and forecast shall include a showing of the nature of the proposed capital additions and replacements, the amounts needed therefor and how the funds required are to be supplied as between--

*Nature of capital
items*

(i) funds generated within the business through charges to customers or otherwise; and

(ii) funds to be obtained through capital loans.

Capital loans

At any time during the fiscal year, or before the budget accounts are closed for the year, the division between (i) and (ii) above may, if conditions so warrant, be changed or the total thereof increased upon recommendation of the Director of Finance and the Gas Commission and upon approval by City Council.

Approval of changes

In the event that capital loans are required in any year under (ii) above, plans therefor shall be submitted to the Director of Finance for approval of the amount of loan and the method of effecting it, and then transmitted to City Council for its approval.

Approval of capital loans

(c) Expenditures Pursuant to Budgets

All expenditure and commitments therefor shall be made pursuant to such approved budgets and subject to rules and regulations, if any, promulgated by the Gas Commission in connection therewith.

Gas Commission rules regulate expenditures

3. Temporary Financing

Short-term loans not exceeding twenty million dollars in amount or twelve months in duration may be negotiated in anticipation of revenues, except that short-term loans exceeding twenty million dollars but not exceeding forty-five million dollars in amount may be negotiated in anticipation of revenues for Fiscal Year 1982 of the Gas Works and may be outstanding during the period July 1, 1981 through June 30, 1982. If such loans are required, plans therefor shall be submitted to the Gas Commission and the Director of Finance for approval of amount of loan. The amount of any such loan shall also be subject to the approval by resolution or by ordinance of City Council.

Approval of short term loans

The Gas Works may also receive temporary advances from the City in anticipation of revenues which are anticipated to be received by the Gas Works provided that such advances do not exceed twenty million dollars in amount or twenty-four months in duration; provided further, however, that during the period June 30, 1981 through June 30, 1983, such advances may exceed twenty million dollars but shall not exceed forty-five million dollars in amount. The amount of each such advance shall be subject to the prior approval of the Director of Finance and the Gas Commission and to the approval by resolution or by ordinance of City Council.

In addition to the foregoing authorized borrowings, loans not exceeding one hundred million dollars in aggregate principal amount at any time outstanding may be incurred for financing accounts receivable and the purchase of inventory for the Gas Works, as authorized by applicable law. If such loans are required, plans therefor shall be submitted to the Gas Commission and the Director of Finance for approval of the aggregate principal amount of such loans which may be outstanding at any single time. Such aggregate principal amount shall also be subject to approval by resolution or by ordinance of City Council.

4. Financial Statements

Company shall within a reasonable time after the close of the Gas Works' fiscal year furnish to the Mayor, the Gas Commission, the City Controller, the City Solicitor, the Director of Finance and City Council a financial statement of such year in form and extent satisfactory to the Director of Finance and Gas Commission. Such financial statement shall be audited by a certified public accountant in accordance with generally accepted accounting principles.

*Furnishing of
financial
statements by
Company*

*CPA to audit
financial statement*

All books, records and accounts of the Gas Works shall be kept separate and apart from all other books, records and accounts of Company. The City Controller and the Director of Finance and Gas Commission may examine or cause to be examined the books, records and accounts of Gas Works for the purpose of auditing and reporting upon

*Books, records and
accounts of PGW to
be kept separate*

such financial statement to the Mayor, the Gas Commission, the City Council, the City Solicitor and the Director of Finance; and the Director of Finance, Gas Commission and the City Controller shall at all times hereafter, for such purpose or for the purpose of ascertaining any facts in relation to the operation of the Gas Works and the performance of the obligations of Company, have full and free access at all reasonable hours to the related books, records and accounts of Gas Works.

*City controller,
Director of Finance
and Gas Commission
may audit books*

Company shall furnish the Mayor, the Gas Commission, the City Controller, the City Solicitor, the Director of Finance and City Council with copies of regular interim financial or operating reports, prepared for periods within the fiscal year, which any such parties may reasonably request.

*Furnishings of
regular interim
reports by company*

SECTION V

Insurance: Eminent Domain

1. Insurance

Company shall insure against loss the buildings, machinery, and equipment and other property of the Gas Works and other risks to the Gas Works, all of which shall be insured to the extent that such property and risks of gas companies are usually insured except that the Gas Commission may provide otherwise in its discretion.

*Adequate insurance
to be provided*

2. Eminent Domain

In the event that Company shall be lawfully required to remove or reconstruct any portion of the Gas Works, or to acquire additional land or property therefor, in consequence of the taking of any of the land or property of the said Gas Works by the United States, the State of Pennsylvania or the City of Philadelphia, in the exercise of the right of eminent domain, or for any other reason whatsoever, the cost and expense thereof shall be accorded appropriate accounting treatment.

*Exercise of right of
eminent domain*

SECTION VI

Gas Commission

1. The Gas Commission as it is presently constituted shall be retained.

Retained

2. The Gas Commission shall consist of the City Controller, two members appointed by City Council and two members appointed by the Mayor.

Membership

3. The members of the Gas Commission appointed by the Mayor shall be designated for four year terms to hold office until their successors are appointed and qualified. The City Controller shall hold office during his incumbency and until his successor has been elected and qualified. The members of the Gas Commission appointed by City Council shall be designated for four year terms, to hold office until their successors are appointed and qualified. The terms of all members of the Gas Commission shall terminate if this agreement is terminated by either party prior to the expiration of their respective terms.

Terms of office

4. Members of the Gas Commission shall receive compensation as fixed by City Council from time to time.

Compensation

5. The Gas Commission shall have the power and authority to obtain such professional services and to employ experts, consultants and such other personnel as in its judgment shall be deemed necessary, their compensation and expenses to be considered an operating expense of the Gas Works.

Power to hire experts

6. A statement of the expenses of the Gas Commission shall be filed annually by the Gas Commission with the City Controller and copies thereof transmitted to the Mayor, the City Solicitor, the Director of Finance and City Council.

Statement of expenses to be filed annually

7. Company shall keep the Gas Commission fully informed of its plans for operation, improvement, extension and betterment of the Gas Works.

Company to keep Gas Commission fully informed

8. The Gas Commission shall hold regular meetings and shall conduct all Commission business thereat. The City Solicitor and the Director of Finance or their designates or deputies shall and the Chief Executive Officer of the Gas Works or his designates may attend all such meetings of the Gas Commission.

Regular meetings

9. The Gas Commission shall have the responsibility for the overseeing of the operation of the Gas Works by the Company. All power not specifically granted to the Company shall reside in the Gas Commission.

Responsibility, powers, and duties

SECTION VII

Gas Rates

1. The Gas Commission shall fix and regulate rates and charges for supplying gas to customers, other than the City and the Board of Education, without further authorization of City Council, which (together with revenues for gas supplied to the City and to the Board of Education and other revenues of the Gas Works qualifying as "project revenues" as such term is defined in Section 2 of The First Class City Revenue Bond Act) will, in each fiscal year produce revenues, at a minimum:

Gas commission shall fix rates

"Project Revenues"

First Class City Revenue Bond Act

(a) Sufficient to pay all of the operation and maintenance costs and expenses of conducting the Gas Works enterprise and to pay the interest and amortization becoming due in such fiscal year on debt incurred for the Gas Works, including, but not limited to:

*Rates to include
Operating and
maintenance costs
Interest and
amortization on
debt*

(i) Charges for depreciation as prescribed in Section IV 1. (b);

Depreciation

(ii) Charges for employees' retirement costs as prescribed in Section IV 1. (c);

Retirement costs

(iii) A management fee to Company equal to the actual cost to Company of managing the Gas Works but not to exceed the sum of:

Management Fee

(A) The amount needed to pay or provide for the payment of base salaries for the Chief Executive Officer, chief Operating Officer and Chief financial Officer and to pay the other expenses of the Company, not to exceed the following amounts for the specified fiscal years:

Salaries

FY1996	\$700,000
FY1997	\$725,000
FY1998	\$750,000
FY1999	\$775,000
FY2000	\$800,000

FY2001 and thereafter The prior fiscal year's maximum amount adjusted to reflect the percentage change in the Consumer Price Index for All Urban Consumer (CPI-U) All Items Index, Philadelphia, Pennsylvania, United States Department of Labor, Bureau of Labor Statistics, as most recently published and available to the Director of Finance on March 1 of each such fiscal year; and

(B) Incentive compensation, if any, awarded to Company management at the discretion of Company's Board of Directors, in total amount not to exceed \$150,000 per annum and in an amount per employee not to exceed \$75,000 per annum. Incentive compensation shall be payable only pursuant to performance standards established, and performance measured against such standards, by the Board of Directors of the Company. The performance standards shall include standards which the Board of Directors determines, from time to time, to be important for the improved operations of the Gas Works such as the achievement of the Gas Works' financial plan, customer service, billing and collection efficiencies and development of new revenues (other than from general rate increases).

*Incentive
compensation*

The Gas Works shall reimburse Company against vouchers on the first day of each calendar month for monies expended for the operation of the Gas Works in the previous calendar month.

(iv) Expenses of the Gas Commission; and

*Gas Commission
expenses*

(v) All sinking fund charges payable in respect of principal and interest on all obligations of the City issued for or with respect to the Gas Works and, with respect to Gas Works Revenue Bonds issued pursuant to The First Class City Revenue Bond Act, such additional amount as may be required to comply with any rate covenant and sinking fund reserve requirement approved by ordinance of City Council in connection with the authorization or issuance of Gas Works Revenue Bonds.

*Sinking fund
charges in
connection with Gas
Works Revenue
Bonds*

(b) Sufficient also (together with the excess on a cumulative basis of internally generated funds available for the purposes set forth below in this subparagraph (b) of prior years beginning after June 30, 1974, to the extent that such excess shall not have been applied to such purposes and shall be available for the payment of general expenses of such fiscal year and, subject and subordinate to the payment or provision for payment of all operation and maintenance costs and all sinking fund and sinking fund reserve

General expenses

requirements as set forth in subparagraph (a) of this subsection 1., together with the excess funds provided by revenues of such fiscal year not required for such purposes):

(i) To make base payments to the City in the aggregate annual principal amount of \$18,000,000 payable in the amount of \$4,500,000 on each February 1, March 1, April 1 and May 1, provided that the Gas Works may defer this payment to any time between said due date and June 30 of each year in which event it shall be assessed interest on the principal amount of prevailing rates, to be determined by the Director of Finance and the Gas Works, from the said due date of the date of payment or such different amounts at such different times, not greater in annual aggregate principal amount, as City Council shall prescribe;

Payments to City

(ii) To provide appropriations, to the extent not otherwise provided, for prepayment of debt and for capital additions which have been determined by the Gas Commission to be reasonable and which have been approved by City Council; and

Debt reduction and capital additions

(iii) To provide cash, or equivalent, for working capital in such reasonable amounts as may be determined by Company to be necessary and as shall be approved by the Gas Commission.

Working capital

(c) Anything to the contrary herein contained notwithstanding, Company may continue to budget and report revenues and expenses in the form and by the methods heretofore used and the Gas Works shall continue to pay out of its revenues all of the expenses set forth in this subsection 1, and all other expenses necessary and proper to the operation of the Gas Works, excepting only the Company's own personnel and administrative costs which are payable out of the management fee.

Non-cash expenses included in estimates of revenue requirements

For the purposes of clauses (a) and (b) of this subsection 1., to the extent that operating expenses do not represent an actual outflow of funds (e.g., depreciation) such amount may be included in ascertaining whether revenues are sufficient to meet other costs, expenses and requirements of said clauses (a) and (b). Company shall at all times to the extent of its authority observe and comply with all terms, covenants and provisions of all ordinances enacted by City Council relating to the Gas Works including without limitation, ordinances enacted pursuant to The First Class City Revenue Bond Act authorizing Gas Works Revenue Bonds.

Company to comply with terms of City Council ordinances

2. Upon any change in the rates for gas, the Gas Commission, at least thirty (30) days prior to the effective date thereof, shall notify City Council and give public notice by advertisement once in one or more daily newspapers having a circulation of at least 10,000 published in the City of Philadelphia, of the rates for gas to be charged.

Public notice of rate change

3. Company shall furnish to the City and the Board of Education, delivered in their various public buildings along the lines of its mains, such amounts of gas as may be required by the City or the said Board. Rates for gas for such public purposes shall be established from time to time by the Gas Commission upon the recommendations of Company and subject to approval by City Council.

Gas Rates for municipal purposes

4. In connection with any gas rate study or matter related thereto, Company shall furnish the Gas Commission such data as may reasonably be required therefor.

Company to furnish rate data to Gas Commission

5. In the determination of rate schedules for gas, the Gas Commission shall establish and apply non-discriminatory rates based on suitable and reasonable classification of the services provided, taking into consideration the preparation of such schedules, the nature and purpose of the use, the quantity used, the time of year when used, the available supply of gas and other competing fuels, the maximum demand, and such other factors, including state, and federal laws, regulations or guide lines,

Non-discriminatory rates

Classification of service

* "quality" in the Ordinance

as may be appropriate to the economics of the purchase, manufacture, distribution and sale of gas and consistent with the intent and purpose of this ordinance and/or Agreement. Such rates may provide for sufficient revenue to stabilize them over a reasonable number of years.

6. If conditions warrant, the Company shall pay to the City, but only from any excess described in clause (b) of subsection 1. of this Section VII, such amounts, in addition to those set forth in clause (b) (i) of subsection 1. of this Section VII, as may be determined and agreed upon by the Gas Commission and City Council.

Additional city payments

7. The Gas Commission is authorized to establish rates for gas users authorizing a reduction in gas rates, in the amount of 20% of charges for non-heating and heating purposes to his residence, for any individual 65 years of age or older, residing in the City of Philadelphia, who directly makes payment to the operator of the Gas Works for gas services at his residence. In order to qualify for any rate reduction a person must first apply to the Philadelphia Gas Works for a rate reduction at least thirty days before the next scheduled meter reading. The reduction shall then take effect at the start of the succeeding billing period.

Senior Citizen rate

8. Notwithstanding any provisions to the contrary contained herein, no payments will be made to the City under subparagraph (b) of Paragraph 1 or under Paragraph 6 of this Section VII until the \$20,000,000 Gas Works Temporary Loan Note, Series of 1980, of the City has been paid in full with interest.

Temporary Loan Notes

SECTION VIII

Purchases and Sales of Non-Gas Items

1. Except in the purchase of unique articles or articles which for any other reason cannot be obtained in the open market, competitive bids shall be secured, pursuant to

procurement standards adopted and promulgated by the Gas Commission, before any purchase, by contract or otherwise, is made or before any contract is awarded for material and supplies, construction, alterations, repairs or maintenance or for rendering any services to Company other than professional services or for the purchase of any other item, thing or service, and the purchase shall be made from or the contract shall be awarded to the lowest responsible bidder.

Purchases to be made by competitive bids

2. All residuals and by-products from operations, unserviceable property or equipment shall be sold to the highest responsible bidder pursuant to standards adopted and promulgated by the Gas Commission in a manner similar to that required for awards of contracts for the purchase of goods and services.

Gas Commission to set purchasing standards

Residuals to be sold to highest responsible bidder

3. All acquisitions, sales and leases of real estate proposed by or for the Gas Works by Company shall be submitted to the Gas Commission for its action and approval, and shall be submitted to City Council for its approval by ordinance.

Real estate transactions to be approved by Gas Commission and City Council

SECTION IX

Legal Services

The Law Department of the City of Philadelphia shall be the legal advisor for the Gas Commission and the Gas Works. It shall supervise, direct, and control all of the law work of the Gas Commission and the Gas Works including, but not limited to, litigation or other legal representation, investigation, and drafting of documents including contracts, bonds and all other legal instruments for the Gas Commission and the Gas Works.

Law Department legal advisor for Gas Commission and PGW

Duties of Law Department:

The City Solicitor shall determine whether legal services for the Gas Works shall be performed by other counsel, and in such event he shall designate such counsel and the compensation therefor in his sole discretion.

City Solicitor shall designate other counsel

All legal services rendered, by the Law Department and by other special legal counsel, to the Gas Commission and to the Gas Works shall be billed to the Gas Works and shall be payable out of gas revenues.

PGW shall pay for legal services

SECTION X

Company's Obligations During Disputes

No disputes between City and Company concerning any of the terms or provisions of this Agreement shall release Company from its obligations to manufacture, provide and supply gas in accordance with the terms and provisions hereof during the existence of this Agreement.

Disputes between City and Company

SECTION XI

Definitions

The following terms are defined for purposes of this Agreement as set forth below:

1. *Director of Finance* - The Director of Finance of the City of Philadelphia.
2. *City Solicitor* - The City Solicitor of the City of Philadelphia.
3. *City Controller* - The City Controller of the City of Philadelphia.
4. *Mayor* - The Mayor of the City of Philadelphia.

5. *City Council* - The City Council of the City of Philadelphia.

6. *Streets Commissioner* - The Commissioner of the Department of Streets of the City of Philadelphia.

7. *Gas Works* - All of the property, both personal and real, including mains and pipes, which together constitute the plant and equipment of the Philadelphia Gas Works.

8. *Non-Gas Items* - Non-gas items include but are not limited to every tangible or intangible article, item or thing except natural gas and substitute natural gas.

SECTION XII

Term

The term of this Agreement shall be for a period of two (2) years commencing January 1, 1973. Said term shall be subject to cancellation by City at any time, or upon the expiration of said two (2) years, upon ninety (90) days notice. No such cancellation shall be effective unless and until such cancellation shall have been approved by resolution or ordinance of City Council. In the absence of such notice, the term shall be extended for further two (2) year periods upon the terms and conditions herein.

Two year term

Termination by City

SECTION XIII

Other Agreements

1. Unless approved by the Gas Commission, no contract or agreement with a third party, including without limitation any union contract covering Gas Works personnel, entered into by Company or at its direction on behalf of the Gas Works during the term of this Agreement shall provide by its terms that it shall terminate or expire in the event that this Agreement between City and Company shall terminate or expire.

Contracts shall not terminate with this

2. The City agrees and hereby does, indemnify and hold harmless the Directors, the officers and the employees of Company, individually and collectively, while acting within the scope of their employment, against and from any and all personal liability, actions, causes of action, and any and all claims made against them whatever in their capacities as Directors, Officers or employees of Company with regard to this Agreement.

*Indemnification of
Board by City*

SECTION XIV

Counterparts

This Agreement may be executed in counterparts, all of which taken together shall constitute one document.

SECTION XV

Effectiveness

This Agreement shall not be effective or binding upon the parties unless it has been approved by an effective ordinance of City Council and has been ratified by the Board of Directors of Company.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement, the corporate seal of the City of Philadelphia has been duly affixed by the Mayor of said City, and the corporate seal of the Philadelphia Facilities Management Corporation has been duly affixed by an authorized officer thereof, the day and year first above written.

CITY OF PHILADELPHIA

Attest:(s) Pace Reich
Deputy to the City Solicitor

By: (s) Frank L. Rizzo
Mayor

By: (s) William A. Costello
Commissioner of Public Property

PHILADELPHIA FACILITIES MANAGEMENT CORPORATION

Attest: (s) Stephen S. Gardner
Secretary

By: (s) F. Eugene Dixon, Jr.
President

Approved for the City of Philadelphia
as to correctness and form:

(s) Martin Weinberg
City Solicitor

APPENDIX B

PROPOSED FINDINGS OF FACT

1. The Pennsylvania Public Utility Commission (“Commission”) assumed jurisdiction of the Philadelphia Gas Works (“PGW”) on July 1, 2000.
2. On January 5, 2001, PGW filed Supplement No. 7 to Tariff Gas-Pa. P.U.C. No. 1 to become effective March 6, 2001, containing proposed changes in rules, regulations and rates calculated to produce \$65,000,000 in additional annual revenues.
3. By Order entered February 8, 2001, Commission instituted an investigation into the lawfulness, justness and reasonableness of the proposed rate increase.
4. Pursuant to section 1308(d) of the Public Utility Code, 66 Pa. C. S. §1308(d), Supplement No. 7 to Tariff Gas-Pa. P.U.C. No. 1 was suspended by operation of law until October 6, 2001 unless otherwise directed by Order of the Commission.
5. PGW’s request for waiver of 52 Pa. Code §53.42(a) which requires that a utility file with the Commission written notice 30 days prior to the filing of a rate case was granted.
6. PGW’s request to provide notice to customers under the alternative method set forth in 52 Pa. Code §53.45(b)(4) was granted.
7. PGW’s request for waiver from providing the information required at 52 Pa. Code §§53.52 and 53.53 was denied.

8. PGW's rate increase claims in this proceeding is based on the Company's Revised Budget 2000-01(August 31, 2001).¹

9. PGW's did not provide operating revenues and expenses for the future test year ending August 31, 2001 using present rates.²

10. PGW is projecting total sales volumes of 58,498,387 Mcf and 512,891 total customers.³

11. PGW utilized the historic sales period of September 1, 1999 through August 31, 2000, together with adjustments for projections and customer counts for the test year ending August 31, 2001.⁴

12. PGW's average usage projections and adjustments made to historic data reflect the use of 4,555 normalized heating degree-days to projected total sales.⁵

13. Weather normalization is a methodology used to restate historic test year actual sales on a per customer basis to reflect the level of sales that the utility would have achieved had actual heating or cooling degree days been considered what is normal.⁶

14. PGW utilized a two step process in developing normalized usage for the residential and commercial heating class.⁷

¹ PGW Exhibit Volume II, Part Two, Revised Exhibits A-1, A-2, A-3, PGW Exhibit HSG-5, Schedule 7, at page 1, PGW St. 5.0, at page 3 and PGW St. 1.0, at page 3.

² PGW Exhibit Volume II, Exhibit A-1-1.

³ PGW Exhibit HSG-1, Schedule 4-A.

⁴ OTS St. No. 2 at page 7.

⁵ PGW St. No. 4 at page 4.

⁶ OTS St. No. 2 at pages 4-5.

⁷ OTS St. No. 2 at page 8.

15. The first step utilized by PGW in developing normalized usage for residential and commercial heating class was the base load usage, which is a non-heating load, determined by averaging sales during July, August and September 1998.⁸

16. The second step utilized by PGW in developing normal heating usage was the adjusting of actual historic sales using a computer model and a normal year of 4,555 heating days to determine the normal heating usage.⁹

10. The mathematical calculation for PGW's two-step process is the base load usage plus the normal heating usage equals the total usage for residential and/or commercial class.¹⁰

11. PGW is claiming an average usage of 100.94 Mcf per residential heating customer and 445.21 Mcf per commercial heating customer.¹¹

12. PGW had a history of billing discrepancies that were corrected during the year 2000.¹²

13. The Commission should not rely on projections, base load, and heat load calculations made before PGW's billings corrections were made.¹³

14. The proper basis for determining PGW's average usage per residential heating customer and commercial heating customer is the weather normalized

⁸ OTS St. No. 2 at page 8.

⁹ PGW St. No. 4 at page 4.

¹⁰ OTS Exhibit No. 2, Schedule 1.

¹¹ PGW Exhibit HSG-1, Schedule 4A, at page 1.

¹² PGW St. No. 1 at pages 25-27.

¹³ OTS St. No. 2 at page 10.

heating load for the year 2000 and using the actual sales for July, August and September 2000 to determine base load.¹⁴

15. Using the weather normalized heating load for the year 2000 and PGW's actual sales for July, August and September 2000 to determined base load, PGW's average usage per residential heating customer should be increased to 103.91 Mcf, and the average usage per commercial heating customer should be increased to 477.11 Mcf per year.¹⁵

16. By increasing PGW's projected use per residential heating customer to 103.91 Mcf per year when determining proposed rates, the Company will receive \$12,892,000 in additional revenue at proposed rates.¹⁶

17. By increasing PGW's projected use per commercial heating customer to 477.11 Mcf per year when determining proposed rates, the Company will receive \$6,859,000 in additional revenue at proposed rates.¹⁷

18. After re-running its computer analysis that predicts sales, by replacing the number of average heating days with the actual number of heating degree days, using the most recent five month period from November 2000 through March of 2001, PGW's forecasting model is only off by 2%.¹⁸

¹⁴ OTS St. No. 2 at page 9.

¹⁵ OTS St. No. 2 at page 9.

¹⁶ OTS Exhibit No. 2, Schedule 3, page 2, column C, Line 14.

¹⁷ OTS Exhibit No. 2, Schedule 4, page 2, column C, Line 14.

¹⁸ PGW St. No. 4.1, at page 3.

19. PGW's utilization of the most recent five-month period from November 2000 through March 2001 is not valid, when compared to OTS' twelve-month period.¹⁹

20. Record high natural gas prices this past winter could have caused some customers to use less gas.²⁰

21. PGW's five-month analysis is invalid, since the Company kept all the inputs the same when comparing firm sendouts to calculated sales, as it is possible that some of these other inputs could have changed and should have also been updated.²¹

22. PGW witness White's table on page 2 of PGW St. No. 3.1, shows that the Company sent out less gas in February 2001 than the computer model predicted that customer should have used.²²

23. The average annualized normalized sales for each residential heating class customer was determined by dividing the total normalized usage of 44,069,567 Mcf by the average of 424,099 customers for determining the total annual normalized usage for January 2000 through December was 103.91 Mcf.²³

24. In this proceeding, PGW projected 412,910 residential heating customers and 19,061 commercial heating customers.²⁴

¹⁹ OTS St. No. 2SR, at page 2 and OTS St. No. 2, at page 9.

²⁰ OTS St. No. 2SR, at page 3.

²¹ OTS St. No. 2SR, at pages 2-3.

²² PGW St. No. 3.1, at page 2 and OTS St. No. 2SR, at page 3.

²³ OTS Exhibit No. 2, Schedule 3, page 1, column E, Line 24.

²⁴ PGW Exhibit HSG-1, Schedule 4-1, page 1.

25. The projected number of customers in the residential heating and commercial heating classes for the last four months of 2000 do not match the actual number of customers in these classes for the last four months of 2000.²⁵
26. By adding the number of actual residential heating customers for each month in the year 2000, and dividing the total by 12 months, indicates that the average number of residential customers in the year 2000 was 424,099.²⁶
27. By adding the actual residential heating customers for each month in the year 2000, and dividing the total by 12 months, results in there being 11,189 more than the 412,190 residential heating customers claimed by the Company in its proof of revenue schedules.²⁷
28. By recognizing the 11,189 additional residential heating customers, the proposed increase in revenues is \$27,114,000.²⁸
29. By adding the actual commercial heating customers for each month in the year 2000, and dividing the total by 12 months, results in their being 51 more than the 19,061 commercial heating customers claimed by the Company in its proof of revenues schedules.²⁹
30. By recognizing the 51 additional commercial heating customers, the proposed increase in revenues is \$7,149,000.³⁰

²⁵ OTS St. No. 2, at page 16.

²⁶ OTS Exhibit No. 2, Schedule 3, page 1, column B.

²⁷ PGW Volume III, Exhibit HSG-1, page 1 and OTS Exhibit No. 2, Schedule 3, page 3, line 3.

²⁸ OTS Exhibit No. 2, Schedule 3, page 4, column C, Line 21.

²⁹ PGW Exhibit HSG-1, Schedule 4A, page 1 and OTS Exhibit No. 2, Schedule 4, page 3, column C, line 3.

³⁰ OTS Exhibit No. 2, Schedule 4, page 4, column C, line 21.

31. In the rebuttal phase of the proceeding, after comparing the actual records for February 2001 and the projected numbers for March 2001, PGW concluded that residential customers should be increase by 9,709 customers and the number of commercial customers should be increase by 700 customers.³¹

32. In the rebuttal phase of the proceeding, PGW conceded that revenues should be increased slightly less than \$2 million to reflect the additional residential and commercial customers paying the proposed monthly customer charges.³²

33. The actual number of customers in March 2000 was 5,035 less than the average for the year, indicating that using one month total is not indicative of a normal year.³³

34. After conceding that 10,409 customers needed to be added, PGW is refusing to add gas usage for these additional customers.³⁴

35. If the both the average use per customer and number of customer adjustments proposed by OTS are accepted by the Commission, the total cost of gas adjustment would be \$16,195,000 for the residential heating class and \$4,284,000 for the commercial heating class.³⁵

36. The Company is requesting a \$45 million increase in its customer charge plus a \$20 million increase in its volumetric rates.³⁶

³¹ PGW St. No. 4.1, at pages 6-7.

³² PGW St. No. 4.1, at page 8.

³³ OTS Exhibit No. 2, Schedule 3, page 1, column B.

³⁴ PGW St. No. 4.1, at page 7.

³⁵ OTS Exhibit No. 2, Schedule 3, at page 4, column C, Line 24 and OTS Exhibit No. 2, Schedule 4, at page 4, column c, Line 24.

³⁶ OTS St. No. 1, at page 2.

37. On February 21, 2001, the Commission adopted a Settlement Agreement, which granted PGW a base rate increase of \$11 million that was included in the customer charge, and the increase effectively reduced the Company's customer charge requested increase from \$45 million to \$34 million and reduces its overall request to \$54 million.³⁷

38. PGW engaged the Lukens Energy Group, Inc. for \$100,000 to review the cost-of-service study and develop a revenue requirement that PGW would require if the Company were an investor owned utility.³⁸

39. Based upon the fact that rate case expense is an ongoing, although recurring at irregular intervals, the rate case expense is subject to normalization for ratemaking purposes, not amortization.³⁹

40. While the uncollectible account expense is a prospective claim, the proper calculation begins with an historic analysis of actual net write-offs to gross revenues to develop an historic write-off ratio.⁴⁰

41. When the write-off percentage of 7.6160% is applied to the projected total future test year sales revenues of \$802.6 million, the result is an allowance of \$61.1 million.⁴¹

³⁷ OTS St. No. 1, at page 3.

³⁸ OTS St. No. 1, at page 10.

³⁹ OTS St. No. 1, at page 9.

⁴⁰ OTS St. No. 1, at page 6.

⁴¹ OTS St. No. 1, at pages 7-8.

42. A five-year historic analysis is current enough to reflect present customer payment tendencies and sufficiently long enough to levelize any fluctuation in write-off activity by the Company.⁴²

43. The bad debt percentage of 7.6160 is known and measurable, and the recommendation is based on a five-year average of actual net write-offs to gross revenues.⁴³

44. PGW does not have the ability to compete against alternate fuel sources by flexing their rates.⁴⁴

45. In recognition of the Company's inability to flex its rates, OTS modified its recommendation to allow \$385,000 for Promotional Activities to be recovered from PGW's ratepayers.⁴⁵

46. OTS recommended increase of \$44 million in revenues is well in excess of the minimum requirements set forth in the Bond Ordinances.⁴⁶

47. OTS recommended increase of \$44 million in revenue show a cash flow analysis for the fiscal year ended August 31, 2001 of an ending cash balance of \$9.2 million.⁴⁷

48. The ending cash balance using OTS' recommendation of \$44 million in revenue plus the Interim rate relief is approximately \$21.7 million.⁴⁸

⁴² OTS St. No. 1, at page 8.

⁴³ OTS Exhibit No. 1, Schedule 4.

⁴⁴ Tr. 567.

⁴⁵ Tr. 743.

⁴⁶ OTS St. No. 5, at pages 4-5.

⁴⁷ OTS Exhibit No. 5, Schedule 3.

⁴⁸ OTS St. No. 1SR, at pages 1-2.

49. The Company's rebuttal schedules designed to reflect the impact of OTS' recommended \$44million increase did not reflect OTS' corresponding adjustments to the Company's Filing.⁴⁹

50. PGW witness Sullivan's testimony and study extends outside the future test year, by using PGW fiscal years ending August 31, 2002 through August 31, 2006.⁵⁰

51. PGW includes Purchase Electric Expenses in its GCR mechanism for approximately \$965,000 for purchased electric.⁵¹

52. The purchased electric costs represent the electrical usage by the plants and buildings of the Company.⁵²

53. Purchased Electric Expenses are non-natural gas costs.⁵³

54. PGW's Customer Responsibility Program is a low-income customer assistance program.⁵⁴

55. The costs for the Customer Responsibility Program are recovered through PGW's GCR mechanism.⁵⁵

56. The costs for the Customer Responsibility Program are non-natural gas costs.⁵⁶

⁴⁹ Tr. 602-603

⁵⁰ PGW St. No. 8, Table 10.

⁵¹ OTS St. No. 3, at page 32.

⁵² OTS St. No. 3, at page 33.

⁵³ OTS St. No. 3, at page 33.

⁵⁴ OTS St. No. 4, at page 2.

⁵⁵ OTS St. No. 4, at page 3.

⁵⁶ OTS St. No. 4, at page 3.

57. The Conservation Works Program is a customer program designed to provide cost-effective energy savings to PGW's low-income customers, who participate in the Customer Responsibility Program.⁵⁷

58. The costs for the Conservation Works Program are recovered through PGW's GCR mechanism.⁵⁸

59. The costs for the Conservation Works Program are non-natural gas costs.⁵⁹

60. PGW's Senior Citizens Discount Program is a customer assistance program which provides for reduced monthly charges to those customers who are City residents, 65 years of age or older, and pay for gas service at their residence.⁶⁰

61. Customers meeting the age and residential requirements pay only 80 percent of their total monthly bill for gas service and receive a discount of 20 percent.⁶¹

62. The costs for the Senior Citizens Discount Program are being recovered through PGW's GCR mechanism.⁶²

63. The costs for the Senior Citizens Discount Program are non-natural gas costs.⁶³

64. The costs of the non-natural gas programs in the GCR mechanism are as follows: (1) \$36,852,448 for the Customer Responsibility Program; (2) \$2,200,000

⁵⁷ OTS St. No. 4, at page 5.

⁵⁸ OTS St. No. 4, at page 5.

⁵⁹ OTS St. No. 4, at page 5.

⁶⁰ OTS St. No. 4, at page 5.

⁶¹ OTS St. No. 4, at page 5.

⁶² OTS Exhibit No. 4, at page 8 and OTS St. No. 4, at page 12.

⁶³ OTS St. No. 4, at page 12.

for the Conservation Works Program; (3) \$21,884,717 for the Senior Citizens Discount Program and (4) \$965,000 for Purchased Electric Expenses.⁶⁴

65. PGW's customers who receive the senior citizens discount are not means-tested for income eligibility.⁶⁵

66. The majority of the PGW customers receiving the senior citizens discount are above the 150 percent of the Federal poverty level, which is the threshold for eligibility to participate in PGW's Customer Responsibility Program.⁶⁶

67. Since 1998, PGW has not monitored the participants in the Senior Citizens Discount Program to ensure that all those receiving discounts are in fact eligible to receive the senior citizen discount.⁶⁷

68. PGW has agreed to meet with the Office of Trial Staff in a workshop environment, to address the unresolved Tariff issues.⁶⁸

69. The costs assigned in PGW's Cost of Service Study to each customer class have been compared to the revenue produced by the rates in the Company's proposed Gas Rate Tariff, as presented in its Base Rate Case filing of January 2001.⁶⁹

⁶⁴ OTS St. No. 3, at page 32 and OTS St. No. 4, at page 13.

⁶⁵ OTS St. No. 4, at page 8.

⁶⁶ OTS St. No. 4, at page 8.

⁶⁷ OTS Exhibit No. 4, Schedule 3.

⁶⁸ PGW St. No. 4.1, at page 14.

⁶⁹ PGW St. No. 5, at page 2.

70. The Company compares the revenue requirements by customer class, which are needed to achieve the surplus, to the costs required to serve each customer class.⁷⁰

71. The Company predetermines the revenue requirement by relying on their cash flow analysis.⁷¹

72. The Company's Cost of Service Study is not needed in a cash flow filing except for (1) a comparison between proposed revenues and class cost responsibility and (2) a guide to set customer charges.⁷²

73. The Company should perform a fully allocated class Cost of Service Study at present and proposed rates for the its next base rate filing.⁷³

74. There are several customer classes in which the revenues do not equal the costs allocated to that customer class.⁷⁴

75. The increase in the customer charge will generate approximately \$44.5 million of the requested total increase of \$65 million.⁷⁵

76. The average Residential customer charge is \$10.35 per month, the average Commercial customer charge is \$16.79 per month, and the average Industrial customer charge is \$59.50 per month for the seven largest natural gas utilities in Pennsylvania.⁷⁶

⁷⁰ OTS St. No. 3, at page 4.

⁷¹ OTS St. No. 3, at page 7.

⁷² OTS St. No. 3, at page 8.

⁷³ OTS St. No. 3, at page 9.

⁷⁴ OTS St. No. 3, at page 11.

⁷⁵ PGW St. No. 4, at page 6.

⁷⁶ OTS Exhibit No. 2, Schedule 5.

77. PGW witness White testified that Equitable Gas Company should be used in determining an appropriate customer charge for PGW.⁷⁷

78. PGW witness White acknowledges that OTS' recommended residential customer charge for PGW was based on Equitable's Gas Company residential customer charge.⁷⁸

⁷⁷ PGW St. No. 4.1, at page 5.

⁷⁸ Tr. 684 and OTS Exhibit No. 3, Schedule 5.

APPENDIX C

PROPOSED CONCLUSION OF LAW

1. The Philadelphia Gas Works did not satisfy its Burden of Proof pursuant to 66 Pa. C.S.A. §315(a) that its proposed increase in rates of \$65 million was just and reasonable.
2. That Philadelphia Gas Works' claims for a rate increase is based on its Revised Budget for 2000-01, which creates a future test year ending August 31, 2001.

APPENDIX D

PROPOSED ORDERING PARAGRAPHS

IT IS ORDERED:

1. That Philadelphia Gas Works' Supplement No. 7 to Tariff Gas-Pa. P.U.C. No. 1 filed January 4, 2001 and docketed at R-00006042 is hereby granted, consistent with this Recommended Decision.
2. That Philadelphia Gas Works is hereby authorized to file Tariff Supplement designed to change rules, regulations and rates calculated to produce \$33,000,000 in additional revenues.
3. That all complaints filed in opposition to the Philadelphia Gas Works' base rate increase are hereby granted in part and dismissed in part, consistent with this Recommended Decision.
4. That Philadelphia Gas Works shall make a Compliance Filing with Pennsylvania Public Utility Commission implementing this Recommended Decision.
5. That Philadelphia Gas Works shall meet in a collaborative with the Office of Trial Staff for the purpose of resolving Tariff issues.
6. That Philadelphia Gas Works' shall submit a plan to the Commission outlining its Recertification of Participants in the Senior Citizens Discount Program.

7. That Philadelphia Gas Works' shall submit a plan to the City Council of Philadelphia outlining the phase-out of the Senior Citizens Discount Program over a five (5) year period.
8. That Philadelphia Gas Works' shall move all eligible participants in the Senior Citizens Discount Program into Customer Responsibility Program.
9. That Philadelphia Gas Works' shall mean-test all participants in the Senior Citizens Discount Program at 150% of the Federal poverty level or below.
10. That Philadelphia Gas Works shall remove all non-natural gas expenses from its GCR mechanism, move the expenses into Base Rates.

APPENDIX E

**PHILADELPHIA GAS WORKS
INCOME STATEMENT
FISCAL YEAR ENDING AUGUST 31,2001**

	<u>8/8/00 Volume 11/10</u> <u>Revised Budget 2000-01</u> (Dollars in Thousands)	<u>OTS Ajustments</u> (Dollars in Thousands)	<u>OTS Ajusted</u> <u>Revised Budget 2000-01</u> (Dollars in Thousands)
<u>OPERATING REVENUES</u>			
Non-Heating	\$121,544		\$121,544
Gas Transport Service	3,656		3,656
Heating	535,415	\$34,263	\$569,678
Proposed Base Rate Increase	65,000		<u>\$33,000</u>
CRP/CWP/Senior Discount		\$60,937	\$60,937
Interim Increase	0	\$11,000	\$11,000
Electric Cost from GCR		\$965	\$965
<i>Unbilled Adjustment</i>	<u>1,844</u>		<u>\$1,844</u>
Total Gas Revenues	\$727,459		\$802,624
Appliance Repair & Bill Paid Turn-Ons	13,233		13,233
<i>Other Operating Revenues</i>	<u>14,793</u>		14,793
Total Other Operating Revenues	<u>28,026</u>		<u>28,026</u>
Total Operating Revenues	\$755,485		\$830,650
<u>OPERATING EXPENSES</u>			
Natural Gas	\$394,576	\$20,479	\$415,055
Other Raw Material	<u>10</u>		<u>\$10</u>
Sub-Total Fuel	\$394,586		\$415,065
Contribution Margins	\$360,899		\$415,585
Gas Processing	13,968		13,968
Field Services	33,061		33,061
Distribution	13,601		13,601
Customer Affairs	31,208		31,208
Electric Costs		965	965
Social Programs		60,937	60,937
Bad Debt Expense	65,297	(4,169)	61,128
Marketing & Point of Sale Expenses	6,713	(\$1,260)	5,453
Administrative & General	45,407	(\$362)	45,045
Health Insurance	26,290		26,290
Capitalized Fringe Benefits	(5,333)		(5,333)
Capitalized Administrative Charges	(6,815)		(6,815)
Regulatory Asset Amortization	3,750		3,750
Amortization of Restructuring Costs	965		965
Year 2000 & Deregulation Amortization	888		888
Pensions	1,376		1,376
Taxes	6,548		6,548
Amortization of Non-Recurring IT Costs	0		0
Personnel Reductions/Retirements	(2,500)		(2,500)
Cost Savings/Productivity Improvements	<u>(10,000)</u>		<u>(10,000)</u>
Sub-Total Other Oper. & Maintenance	\$224,424		\$280,535

**PHILADELPHIA GAS WORKS
INCOME STATEMENT
FISCAL YEAR ENDING AUGUST 31,2001**

	<u>8/8/00 Volume 11/10</u> <u>Revised Budget 2000-01</u> (Dollars in Thousands)	<u>OTS Ajustments</u> (Dollars in Thousands)	<u>OTS Ajustments</u> <u>Revised Budget 2000-01</u> (Dollars in Thousands)
Depreciation	\$33,381		\$33,381
Cost of Removal	2,500		2,500
To Clearing Accounts	<u>(3,344)</u>		<u>(\$3,344)</u>
	\$32,537		\$32,537
TOTAL OPERATING EXPENSES	\$651,547		\$727,752
OPERATING INCOME	\$103,938		\$102,898
Other Income	<u>6,106</u>		6,106
Income Before Interest	\$110,044		\$109,004
Interest			
Long-Term Debt	47,871		47,871
Other	6,102		6,102
AFUDC	(346)		(346)
Loss From Extinguishment of Debt	<u>4,162</u>		4,162
Total Interest	\$57,789		57,789
NET INCOME	\$52,255		\$51,215
City Payment	<u>18,000</u>		<u>\$18,000</u>
Net Earnings	<u>\$34,255</u>		<u>\$33,215</u>

APPENDIX F

**PHILADELPHIA GAS WORKS
CASH FLOW STATEMENT
FISCAL YEAR ENDING AUGUST 31, 2001**

**8/8/00 Volume 11/10
Revised Budget 2000-01
(Dollars in Thousands)**

SOURCES

Net Income	\$51,215
Depreciation and Amortization	42,827
Earnings on Restricted Funds	451
Impact of Refunded Debt Service	
Increased/(Decreased) Other Liabilities	<u>3,682</u>
Available From Operations	\$98,175
Funds Required for Capital	34,000
Capital Leasing	6,000
Temporary Financing	<u>0</u>
TOTAL SOURCES	\$138,175

USES

Net Construction Expenditures	\$62,293
Funded Debt Reduction:	
Revenue Bonds	34,192
PMA Leases/Subordinate Debt	1,065
Capital Leases	6,901
Temporary Financing	0
Notes Payable- CNG Acquisition	59
Temporary Financing Repayment	
Distribution of Earnings	18,000
Additions To (Reductions of) Non-Cash Working Capital	14,891
Cash Needs	137,401
Cash Surplus (Shortfall)	<u>774</u>
TOTAL USES	\$138,175
Cash- Beginning of Period	\$8,425
Cash- Surplus (Shortfall)	<u>774</u>
ENDING CASH	<u>\$9,199</u>

Internally Generated Funds	22,293
Outstanding Commercial Paper	97,000

APPENDIX G

**PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
FISCAL YEAR ENDING AUGUST 31,2001**

DEBT SERVICE COVERAGE

**8/8/00 Volume 11/10
Revised Budget 2000-01
(Dollars in Thousands)**

FUNDS PROVIDED

Total Gas Revenues	\$802,624
Other Operating Revenues	<u>28,026</u>
Total Operating Revenues	830,650
Other Income Less Restricted Funds	6,557
AFUDC (Interest)	<u>346</u>
TOTAL FUNDS PROVIDED	\$837,553

FUNDS APPLIED

Fuel Costs	\$415,065
Other Operating Costs	<u>312,687</u>
Total Operating Expenses	727,752
PMA Lease Cost	0
\$20.1M Capital Lease Cost	3,980
\$23M Capital Lease Cost	3,997
Less: Non-Cash Expense	<u>37,272</u>
TOTAL FUNDS APPLIED	\$698,457

Funds Available to Cover Debt Service	139,096
Add-back Lease Costs	7,977
Funds Available Excluding Lease Costs	147,073

1975 Ordinance Bonds Debt Service	51,611
Debt Service Coverage 1975 Bonds	2.85

Net Available after Prior Debt Service	95,462
PMA & Other Capital Leases	<u>7,977</u>
Net Available after Prior Capital Leases	87,485

1998 Ordinance Bonds Debt Service	29,449
Debt Service Coverage New Bonds	2.97

Net Available after New Debt Service	58,036
--------------------------------------	--------

1998 Ordinance Subordinate Bond Debt Service	1,990
Debt Service Coverage Subordinate Bond	29.16

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :

v.

:

Docket No. R-00006042

Philadelphia Gas Works

:

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Main Brief** of the Office of Trial Staff, dated June 21, 2001, either personally, by first class mail, electronic mail, or by fax upon the persons listed below:

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Pa Public Utility Commission
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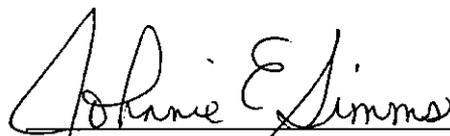
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Johnnie E. Simms
Senior Prosecutor
Office of Trial Staff

Dated: June 20, 2001
Docket No. R-00006042

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MARK S. STEWART
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June 20, 2001

VIA HAND DELIVERY

James McNulty
Secretary
PA Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

RE: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00006042

Dear Secretary McNulty:

Enclosed for filing please find the original and three copies of Philadelphia Gas Work's Motion to Reopen the Record in the above-referenced matter. As evidenced by the attached Certificate of Service, all parties of record have been served in the manner indicated.

If you have any questions regarding this filing, please contact me at your convenience.

DOCUMENT
FOLDER

Very truly yours,



Mark S. Stewart

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

MSS/md
Enclosures
cc: Hon. Cynthia W. Fordham (w/enc.)
Parties of Record (w/enc)

DSH:27733.1

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CERTIFICATE OF SERVICE

ORIGINAL

I hereby certify that I have this day served a true copy of the foregoing document

upon the participants listed below in accordance with the requirements of § 1.54 (relating to service by a participant).

VIA HAND DELIVERY

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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PA.P.U.C.
SECRETARY'S BUREAU

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

DOCKET NO. R-00006042

PHILADELPHIA GAS WORKS

DOCKETED
JUN 25 2001

PHILADELPHIA GAS WORKS' MOTION TO
REOPEN THE RECORD

Philadelphia Gas Works ("PGW") submits this Motion, pursuant to 52 Pa. Code §§ 5.103 and 5.571, requesting that the Commission reopen the record to include in the record the executed Credit Agreement reflecting PGW's successful renewal of its commercial paper program. The status of the commercial paper program was a subject of discussion during the proceeding, but the renewal occurred after the record closed. The Credit Agreement provides relevant facts that should be available to the PUC in considering PGW's permanent rate request including:

DOCUMENT
FOLDER

- The commercial paper program was successfully renewed for a period of 1 year at the full \$100 million level.
- PGW is required to reduce its outstanding commercial paper to \$80 million by the end of FY 2002.

In support of this Motion, PGW states as follows:

1. Through the above captioned docket, the Commission is reviewing a request by PGW for base rate relief. The matter was assigned to ALJ Cynthia Williams Fordham for the

development of a record. Testimony has been filed, hearings have been conducted and the evidentiary record was closed on May 31, 2001.

2. The level of base rate relief PGW requires to fulfill its bond covenants, satisfy its financial obligations when they come due and maintain access to the capital markets was a critical issue in this proceeding. One of its financial obligations is its commercial paper program.

3. On June 12, 2001, Morgan Guaranty Trust Company renewed the Letter of Credit that is necessary for the maintenance of PGW's commercial paper program at the \$100 million level, although it required PGW to reduce the amount of outstanding commercial paper by \$20 million by the end of FY 2002.

4. The Amended and Restated Credit Agreement is attached to this Motion and identified as PGW Exhibit BB-3. A verified statement by Ms. Bisgaier authenticating the Agreement is also attached (marked for identification as PGW St. 2.2).

5. Inclusion of the Amended and Restated Credit Agreement in the record of these proceedings will provide relevant information concerning the status of one of PGW's key financial obligations and sources of external financing.

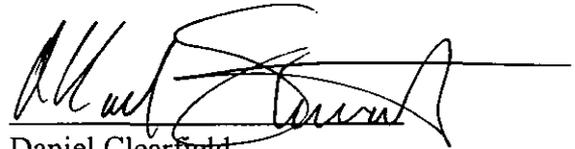
6. Accordingly, PGW requests the ALJ to reopen the record to accept PGW exhibit BB-3, attached to this Motion, as a late filed exhibit pursuant to 52 Pa. Code § 5.571.

7. PGW has discussed this Motion with the following parties who have indicated that they do not oppose reopening the record for the inclusion of the Restated Credit Agreement or the Bisgaier Statement: the Office of Consumer Advocate; the Office of Trial Staff; the Office of Small Business Advocate; the Philadelphia Industrial and Commercial Gas Users Group; and

CEPA. The other active parties were notified of PGW's proposed Motion, but PGW was not able to discuss it with them prior to filing.

WHEREFORE, for all of the foregoing reasons, PGW requests the ALJ to reopen the record to accept exhibit BB-3 and PGW statement the Morgan Guaranty Trust Company Amended and Restated Credit Agreement, and PGW St. 2.2 as a late filed submission into this record.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Daniel Clearfield", is written over a horizontal line.

Daniel Clearfield
Mark Stewart
Wolf, Block, Schorr and Solis-Cohen LLP
212 Locust Street, Suite 300
Harrisburg, PA 17101
(717) 237-7160

Dated: June 20, 2001

PGW St. 2.2

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

In Re: Petition of Philadelphia Gas Works for :
Waiver of Certain Notification and Filing :
Requirements and Establishment of : **Docket No. R-00006042**
Expedited Hearing Schedule for Base :
Rate Proceeding :

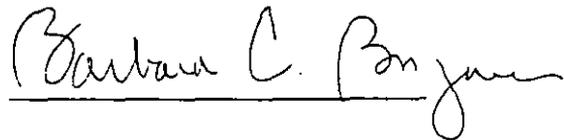
VERIFIED STATEMENT OF BARBARA C. BISGAIER

1. I am the same Barbara Bisgaier who has presented testimony in the above captioned proceeding.

2. Attached to this Statement is a copy of the amended and restated Credit Agreement between the Philadelphia Gas Works and the Morgan Guaranty Trust Company. The amended and restated Credit Agreement was executed on June 12, 2001 and amends the original Credit Agreement dated May 28, 1999.

VERIFICATION

I, Barbara C. Bisgaier, hereby state that the facts above set forth in the foregoing statement are true and correct (or are true and correct to the best of my knowledge, information and belief). I understand that the statements herein are made subject to penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).



Barbara C. Bisgaier

Dated: 6/15/01

EXHIBIT BB-3

CREDIT AGREEMENT

Dated as of May 28, 1999

As amended and restated
as of June 12, 2001

between

CITY OF PHILADELPHIA, PENNSYLVANIA

and

FIRST UNION NATIONAL BANK,

PNC BANK, NATIONAL ASSOCIATION,

THE BANK OF NOVA SCOTIA,

MELLON BANK, N.A.

and

MORGAN GUARANTY TRUST COMPANY OF NEW YORK,
as Agent

Relating to

\$100,000,000

Gas Works Revenue Notes, CP Series C

of

City of Philadelphia, Pennsylvania

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- Exhibit A – Form of Letter of Credit
- Exhibit B – Form of Note
- Exhibit C – Form of Opinion of New York Bank Counsel
- Exhibit D – Form of Assignment and Acceptance

CREDIT AGREEMENT

This amended and restated Credit Agreement (as so amended and restated, the "Agreement") is dated as of May 28, 1999 as amended and restated as of June 12, 2001 between the City of Philadelphia, Pennsylvania (the "Borrower") and Morgan Guaranty Trust Company of New York (the "Agent") and First Union National Bank, PNC Bank, National Association, The Bank of Nova Scotia and Mellon Bank, N.A. (collectively, the "Non-Agent Banks" and together with the Agent, the "Banks").

SECTION 1.

DEFINITIONS AND ACCOUNTING TERMS

Section 1.1 Definitions.

"Act" means The City of Philadelphia Municipal Utility Inventory and Receivables Financing Act (Act No. 231, approved December 7, 1982).

"Amendment" means the Amendment and Restatement of the Original Credit Agreement and the Original Letter of Credit.

"Amendment Date" means the date on which this Agreement and the Letter of Credit have been executed by the Borrower and the Agent and the Non-Agent Banks and all the conditions precedent set forth in Section 5.4 hereof shall have been satisfied.

"Available Credit" means at the time any determination thereof is made, the Commitment less Credits Outstanding.

"Base Rate" means the rate of interest established by the Agent from time to time in New York, New York, as its U.S. Dollar base rate.

"Borrowing" means the incurrence of a Loan on a given date (or resulting from conversions or continuations on a given date).

"Business Days" means a day on which banks are open for business in New York, New York and Philadelphia, Pennsylvania.

"Commercial Paper" means short term Gas Works Revenue Notes, CP Series C issued and outstanding pursuant to the General Ordinance and the Committee Resolution and which are entitled to the benefit of the Letter of Credit; provided, however, that if the events described in Section 2.1(b) hereof occur, the term "Commercial Paper" shall no longer mean the Gas Works Revenue Notes, CP

Series C, but shall mean the commercial paper supported by the Letter of Credit amended as provided in Section 2. 1(b).

"Commercial Paper Dealer" means Goldman, Sachs & Co. or such other firm designated by the Borrower by notice to and with the prior written consent of the Agent.

"Commercial Paper Dealer Agreement" means the agreement between the Borrower and the Commercial Paper Dealer with respect to the purchase and sale of Commercial Paper, as supplemented or amended from time to time with the prior written consent of the Agent.

"Commercial Paper Memorandum" means any information statement, commercial paper memorandum or offering material used in connection with the sale of the Commercial Paper.

"Committee Resolution" means the Resolution or Resolutions of the Committee of the City of Philadelphia authorizing the transactions contemplated herein in form and substance satisfactory to the Agent, as supplemented or amended from time to time with the prior written consent of the Agent and any further reenactment thereof.

"Commitment" or "Commitment Amount" means the commitment of the Agent under this Agreement, the Letter of Credit and the Note to advance funds on the terms and conditions hereof and thereof in an amount equal to \$100,000,000 or such lesser or greater amount to which the Commitment may be reduced or increased pursuant to the terms of Section 4.4 of this Agreement.

"Credit Event" means any combination of the following, as the context may indicate: (a) the issuance of Commercial Paper, (b) the issuance of the Letter of Credit or (c) the making of a Loan.

"Credits Outstanding" means, at any date of determination thereof, the sum of (a) the aggregate amount of Letter of Credit Disbursements to the extent theretofore not reimbursed by the Borrower or converted into a Loan pursuant to Section 3.1 hereof and (b) the aggregate amount of unpaid principal of Loans outstanding.

"Documents" means the Commercial Paper, this Agreement, the Note, the Fiscal Agent Agreement, the Commercial Paper Dealer Agreement, the Senior Bond Ordinance the General Inventory and Receivables Gas Works Revenue Note Ordinance of 1998, the General Gas Works Revenue Bond Ordinance of 1998, the First Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1998, the Second Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1998, the Third Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1998, the Fourth Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1998, the Act and all agreements, certificates or other instruments executed by the Borrower in connection with the issuance of the Commercial Paper and the Letter of Credit.

"Dollars" or "\$" means lawful currency of the United States of America.

"Effective Date" means the date on which the Original Credit Agreement was executed by the Borrower and the Agent and the Original Banks and all the conditions precedent set forth in Section 5.1 thereof were satisfied and the Original Letter of Credit was issued.

"Eligible Assignee" means (i) a commercial bank organized under the laws of the United States, or any State thereof; (ii) a commercial bank organized under the laws of any other country that is a member of the Organization for Economic Cooperation and Development ("OECD") or has concluded special lending arrangements with the International Monetary Fund associated with its General Arrangements to Borrow, or a political subdivision of any such country, provided that such bank is acting through a branch or agency located in the United States; (iii) a finance company, insurance company or other financial institution or fund (whether a corporation, partnership or other entity) engaged generally in making, purchasing or otherwise investing in commercial loans in the ordinary course of its business; (iv) the central bank of any country that is a member of the OECD; or (v) any Bank; provided, however, that (A) any such Person described in clause (i), (ii), (iii) or (iv) is also subject to approval by the Agent.

"Event of Default" means any of those Events of Default specified in Section 9.

"Expiration Date" means August 15, 2002 or such later date to which the Agent may extend such date of expiration of the Letter of Credit pursuant to the terms of Section 2.2 hereof.

"Face Amount", at the time any determination thereof is made, means the principal amount of Commercial Paper, together with the amount of interest on such Commercial Paper, to the stated maturity thereof.

"Federal Reserve Board" means the Board of Governors of the Federal Reserve System as constituted from time to time.

"Fiscal Agent" means U.S. Bank Trust National Association or any successor to or substitute therefor acting as depositary and issuing agent for the holders of Commercial Paper designated by the Borrower with the prior written consent of the Agent.

"Fiscal Agent Agreement" means the agreement between the Borrower and the Fiscal Agent with respect to Commercial Paper, in form and substance satisfactory to the Agent, as supplemented or amended from time to time with the prior written consent of the Agent.

"Fitch" means Fitch, Inc., New York, New York, or any successor rating agency thereto.

"General Ordinance" means the General Inventory and Receivables Gas Works Revenue Note Ordinance of 1998, or any subsequent reenactment thereof, as supplemented or amended from time to time with the prior written consent of the Agent, and in accordance with Section 11.1(e) hereof.

"Governmental Authority" means any national, federal, state or local government (whether foreign or domestic), any political subdivision thereof or any governmental, quasi-governmental, judicial, public or statutory instrumentality, authority, body or entity, or any other regulatory bureau, authority, body or entity.

"Interest Payment Date" means (a) the last Business Day of each March, June, September and December and (b) the date of the last principal repayment of the Loan.

"Interest Period" shall have the meaning provided in Section 3.3 hereof

"Letter of Credit" means the amended and restated letter of credit issued by the Agent on the Amendment Date pursuant to Section 2.1 hereof, substantially in the form of Exhibit A hereto, as the same may be amended pursuant to this Agreement.

"Letter of Credit Disbursements" means any payment or disbursements made by or on behalf of the Agent pursuant to a drawing under the Letter of Credit.

"Letter of Credit Fees" means, collectively, the fees enumerated in Section 4.1.

"Letter of Credit Termination Date" means the earlier of (a) the Expiration Date or (b) the date on which the Letter of Credit otherwise terminates in accordance with its terms.

"Lien" means, with respect to any asset, any mortgage, lien, pledge, charge, security interest or encumbrance of any kind in respect of such asset.

"Loan" means any Loan pursuant to Section 3 hereof.

"Loans" means Loans made and/or being maintained at a rate of interest based upon the Base Rate.

"Moody's" means Moody's Investors Service Inc., New York, New York, or any successor rating agency thereto.

"Non-Agent Banks" means First Union National Bank, PNC Bank, National Association, The Bank of Nova Scotia, and Mellon Bank, N.A. (each a Non-Agent Bank).

"Note" means the promissory note of the Borrower delivered pursuant to the Section 3.2 hereof in the form attached hereto as Exhibit B.

"Note Redemption Account" means the note redemption account described in Section 2.5(a) hereof.

"Operating Account" means the operating account described in Section 2.5(c) hereof.

"Original Banks" means the Agent, First Union National Bank, and PNC Bank, National Association, each the banks under the Original Credit Agreement.

"Original Credit Agreement" means the Credit Agreement, dated May 28, 1999, among the Borrower, the Agent, First Union National Bank, and PNC Bank, National Association.

"Original Letter of Credit" means the Letter of Credit issued by the Agent, dated May 28, 1999.

"Outstanding Commercial Paper" or "Commercial Paper Outstanding" means all Commercial Paper issued, authenticated and delivered pursuant to the Fiscal Agent Agreement which has not been paid and for which immediately available funds for the payment of Commercial Paper are not held in the Note Redemption Account.

"Participants" shall have the meaning set forth in Section 12.5 hereof.

"Payment Obligations" means all obligations of the Borrower to pay or reimburse the Agent for the account of the Non-Agent Banks contained in or evidenced by any Document, including the Note, including, without limitation, the Reimbursement Obligations contained in Section 2.7 of this Agreement and accrued interest thereon and the obligations of the Borrower contained in Section 3.1 (the loan), the obligations contained in Section 4.1 (fees), the obligations contained in Section 12.3 (indemnity) and the obligations contained in Section 12.6 (costs and expenses) of this Agreement.

"Person" means an individual or a corporation, partnership, trust, incorporated or unincorporated association, joint venture, joint stock company, government (or an agency or political subdivision thereof) or other entity of any kind.

"Philadelphia Gas Works" and "PGW" means all the real and personal property owned by the Borrower and used in the acquisition, manufacture, storage, and distribution of natural, liquified, synthetic or manufactured gas or in the maintenance, management and administration thereof and also, as the context may require, the business entity operating such property.

"Principal Letter of Credit Disbursement" means a Letter of Credit Disbursement which is used to pay the principal of Commercial Paper.

"Pro-Rata Share" shall have the meaning ascribed thereto in Section 11.1 hereof.

"Rating Agencies" means Moody's, S&P and Fitch IBCA.

"Reduction Date" means the date in each calendar year falling between May 1st and August 15th (i) which will be designated by a certificate filed by PGW with the Agent on or prior to 11 a.m. New York City time on the date so determined and (ii) on which (a) there are no outstanding Commercial Paper, or Credits Outstanding pursuant to Section 7.13 hereof or (b) there are available

cash or investments as set forth in Section 7.13; provided, however, if such Reduction Date is not achieved due to the failure of either (i) or (ii), August 15th will be determined to be the Reduction Date for such calendar year and for purposes of Sections 2.9(a) and 3.1.

"Reimbursement Account" means the reimbursement account described in Section 2.5(b) hereof.

"Revenues" means the Gas Works Revenues as defined in the General Ordinance.

"Senior Bond Ordinance" means the General Gas Works Revenue Bond Ordinance of 1975, approved May 30, 1975, Bill No. 1871, as heretofore amended.

"S&P" means Standard and Poor's Ratings Services, a Division of The McGraw Hill Companies, or any successor rating agency thereto.

"Stated Amount" shall have the meaning ascribed to it in the Letter of Credit.

"Swaps" means Qualified Swaps and Exchange Agreements as defined in the General Ordinance, which relate to Senior Bonds or Subordinate Bonds, as each is defined in the General Ordinance.

Section 1.2 Accounting Terms. All accounting terms not specifically defined herein shall be construed in accordance with generally accepted accounting principles as in effect from time to time, including, without limitation, applicable statements and interpretations issued by the Financial Accounting Standards Board and the Governmental Accounting Standards Board and bulletins, opinions, interpretations and statements issued by the American Institute of Certified Public Accountants or its Committees. When used herein the term "financial statements" shall include the notes and schedules thereto, but need not include such notes or schedules when used with reference to such statements of any Person (other than the Borrower or PGW) and any date other than the end of a fiscal year of such Person.

SECTION 2. TERMS OF THE CREDIT

Section 2.1 Letter of Credit.

(a) Subject to the terms and conditions of this Agreement, the Borrower hereby requests that the Agent issue a Letter of Credit and the Agent hereby agrees that on the Amendment Date it shall issue its Letter of Credit to the Fiscal Agent in trust for the holders of the Commercial Paper for the account of the Borrower. The Letter of Credit shall be issued in an amount equal to the

Commitment then in effect and shall be issued to support the obligations of the Borrower under the Commercial Paper up to a maximum Face Amount not exceeding (except as provided in Section 2.4(b) hereof) at the close of business on any day the amount of the Commitment.

(b) In the event that (x) the Commercial Paper is retired and not reissued prior to the expiration date of the Letter of Credit and the Agent receives an opinion of Bond Counsel satisfactory in form, scope and substance to the Agent that the Commercial Paper may not be reissued, and (y) new commercial paper is issued by the Borrower in a Face Amount which, when added to the Credits Outstanding is not greater than the Commitment of the Agent at the time, giving effect to any reduction or increase which may have been made pursuant to Section 4.4 hereof, which commercial paper is (i) in form and substance identical to the retired Commercial Paper, except for series designation and date, (ii) subject to each of the Documents or new documents identical in form and substance to the Documents, except for series designation and date, and (iii) entitled to security in form and substance identical to the security for the Commercial Paper, except, in the case of (i), (ii) and (iii), for any changes that the Agent, in its sole discretion may approve, then in such case the Agent shall make such amendments to the Letter of Credit to reflect that the Letter of Credit supports such new series of commercial paper and no longer supports the series of Commercial Paper so retired.

Section 2.2 Issuance and Expiry Date.

(a) The Letter of Credit shall be dated the date of issuance thereof and shall expire on the Expiration Date. The request for issuance of the Letter of Credit shall constitute a representation and warranty by the Borrower that as of the date of such request the representations and warranties set forth in Section 6 hereof are true and correct and that no Event of Default or event which, with the giving of notice or lapse of time or both, would become an Event of Default, has occurred and is continuing.

(b) Not earlier than 120 days prior to the Letter of Credit Termination Date then in effect the Borrower may request in writing that the Agent renew the Letter of Credit in the stated amount of up to \$100,000,000 for an additional term of one year. If the Borrower makes such a written request, not later than 60 days after receipt of such request, the Agent will use its best efforts to give written notice to the Borrower and the Fiscal Agent as to whether the Agent will renew the Letter of Credit and, if the Agent indicates that it will renew the Letter of Credit, which shall be in the Agent's sole and absolute discretion, the proposed renewal terms thereof. Any failure by the Agent to respond to a request for an extension or renewal of the Letter of Credit shall be deemed to be a denial of such request.

Section 2.3 Amendment to Letter of Credit and the Note.

(a) If the Commitment is reduced pursuant to Section 4.4 hereof, then on the effective date of such reduction, the Agent shall have the right to amend the Letter of Credit then held by the Fiscal Agent so that the maximum amount payable by the Agent thereunder shall be equal to the amount of the reduced Commitment.

(b) Nothing contained herein shall affect the obligations of the Agent hereunder or under the Letter of Credit with respect to Commercial Paper outstanding prior to the amendment of the Letter of Credit.

Section 2.4 Issuance of Commercial Paper.

(a) Fiscal Agent. The Borrower has authorized and directed the Fiscal Agent to act as its agent for the issuance, authentication and delivery and payment of the Commercial Paper, all in accordance with the terms of the Fiscal Agent Agreement. All Commercial Paper shall bear a maturity date not later than two hundred seventy (270) days from the issuance date thereof which shall be a Business Day and which in no event shall be later than fifteen (15) days prior to the Expiration Date. Except as provided in paragraph (b) below, the Borrower shall not issue Commercial Paper if the Face Amount of such Commercial Paper exceeds the Available Credit.

(b) Issuance of Commercial Paper in Excess of Available Commitment. Notwithstanding the preceding paragraph, the Borrower may issue new Commercial Paper in an amount exceeding the Available Credit, provided that (i) such excess is not greater than the aggregate principal amount of Commercial Paper maturing on the date of such issuance, (ii) after the closing time for third party transfers via Federal Reserve wire in New York (presently 4:30 p.m., New York time) on the day of such issuance after giving effect to the receipt of proceeds of Commercial Paper issued on that day the Face Amount of all Outstanding Commercial Paper would not exceed the Available Credit, and (iii) prior to issuance of such Commercial Paper, there shall be available with the Fiscal Agent funds sufficient to pay the Agent an amount equal to the Face Amount of Commercial Paper maturing on such date.

(c) Consent of the Agent, Cessation of Issuance of Commercial Paper. The Borrower shall not issue any Commercial Paper unless the Agent shall have consented to such issuance and the conditions precedent for such issuance set forth in Section 5 shall have been met. The Agent shall be deemed to have consented to the issuance of any Commercial Paper by the Borrower unless the Agent shall have instructed the Borrower, the Fiscal Agent and the Commercial Paper Dealer, not later than 4:00 p.m., New York time, on any Business Day, by telephonic notice or other telecommunication, which instructions shall be effective on the next succeeding Business Day and shall be promptly confirmed in writing, to cease issuing, delivering and selling Commercial Paper as provided in Sections 2.9(a), 4.4(b) and 10 hereof, and such instructions shall not have been rescinded by the Agent as herein provided.

If as further provided in the Fiscal Agent Agreement the Agent shall instruct the Borrower, the Fiscal Agent and the Commercial Paper Dealer, in the manner specified above, to cease issuing, delivering and selling Commercial Paper. the Borrower shall not, after the receipt of such instructions, issue any Commercial Paper until the Agent shall have rescinded such instructions in writing and concurrently with or subsequent to such rescission shall have consented in writing to the issuance of Commercial Paper.

Section 2.5 Note Redemption Account; Reimbursement Account; Operating Account; Sinking Fund Account; Letter of Credit Reimbursement Account.

(a) Contemporaneously with the execution and delivery by the Borrower of the Original Credit Agreement, the Fiscal Agent established a special purpose trust account (the "Note Redemption Account") for the sole and exclusive benefit of the holders of the Commercial Paper, over which the Fiscal Agent has exclusive control and sole right of withdrawal. Each payment or disbursement received by the Fiscal Agent from the Agent honoring a demand by the Fiscal Agent for payment under the Letter of Credit shall be deposited in the Note Redemption Account and used solely to pay the matured and concurrently maturing Commercial Paper with respect to which such demand for payment was made.

(b) Contemporaneously with the execution and delivery by the Borrower of the Original Credit Agreement, the Fiscal Agent established a second special purpose trust account for the sole and exclusive benefit of the Agent as issuer of the Letter of Credit to the extent necessary to reimburse it for amounts drawn under the Letter of Credit or to repay a Loan (the "Reimbursement Account"). Proceeds of the sale of the Commercial Paper shall be deposited by the Fiscal Agent in the Reimbursement Account to the extent necessary to reimburse the Agent for each payment or disbursement made by the Agent under the Letter of Credit and are withdrawn from the Reimbursement Account and transferred to the Agent on each day any funds are deposited therein in accordance with the provisions of Section 3.1 of the Fiscal Agent Agreement; provided, however, that in no event shall any funds be deposited in the Reimbursement Account before the funds received by the Fiscal Agent from the Agent pursuant to a drawing under the Letter of Credit made on the same day to pay maturing Commercial Paper shall have been deposited with general funds of the Agent into the Note Redemption Account in accordance with paragraph (a) above.

(c) Contemporaneously with the execution and delivery by the Borrower of the Original Credit Agreement, the Fiscal Agent established a third special account (the "Operating Account") for the Borrower into which shall be transferred the remaining proceeds of the sale of Commercial Paper from the Reimbursement Account after payment to the Agent under paragraph (b) above. The Borrower shall have the sole right to direct the disposition of funds in the Operating Account.

(d) Contemporaneously with the execution and delivery by the Borrower of the Original Credit Agreement, the Fiscal Agent established a fourth special account known as the City of Philadelphia Gas Works Revenue Notes, Sinking Fund Account (the "Sinking Fund Account"). Funds shall be deposited into the Sinking Fund Account in accordance with the provisions of Section 3.1(e) of the Fiscal Agent Agreement.

Section 2.6 Payment of Commercial Paper.

(a) No later than 3:00 p.m. (New York time) on the Business Day before Commercial Paper matures the Fiscal Agent shall, to the extent permitted by the Fiscal Agent Agreement and the Letter of Credit, without request by the Borrower or authorization of the Agent, make a demand for payment under the Letter of Credit with respect to Commercial Paper maturing on the next Business Day in an amount which is equal to the Face Amount of all such Commercial

Paper; and the Agent shall under the Letter of Credit pay to the Fiscal Agent the amount so demanded no later than 2:15 p.m. (New York time) on the maturity date of such Commercial Paper. If demand for payment is received by the Agent on or before 11:00 a.m. (New York time) on the same day Commercial Paper matures, payment will be made on such day no later than 4:30 p.m. (New York time). If demand for payment is received by the Agent after 11:00 a.m. (New York time) on the same day Commercial Paper matures, payment will be made as promptly thereafter as possible but in no event later than 2:15 p.m. (New York time) on the next succeeding Business Day after such demand. All payments under the Letter of Credit will be made with general funds of the Agent.

(b) In addition, upon the occurrence and during the continuance of an Event of Default, the Fiscal Agent shall, if so requested by the Agent, make a demand for payment under the Letter of Credit in the amount required to pay in full all outstanding Commercial Paper upon maturity.

(c) The proceeds of a drawing made pursuant to paragraphs (a) or (b) above shall be deposited by the Fiscal Agent in the Note Redemption Account.

(d) All amounts at any time on deposit in or otherwise to the credit of the Note Redemption Account shall be held by the Fiscal Agent in trust for the benefit of the holders of Commercial Paper and shall be applied as provided in the Fiscal Agent Agreements.

Section 2.7 Agreement to Reimburse Letter of Credit Disbursements.

(a) The Borrower hereby agrees to reimburse the Agent for any Letter of Credit Disbursements no later than closing time for third party transfers via Federal Reserve wire in New York (presently 4:30 p.m., New York time) on the date of any Letter of Credit Disbursement; provided, however, that any Principal Letter of Credit Disbursement which is not reimbursed in full on the date when made, shall be automatically converted to a Loan on the date of such Principal Letter of Credit Disbursement in accordance with Section 3 hereof. If any Letter of Credit Disbursement is reimbursed to the Agent on the date such Letter of Credit Disbursement is made, notwithstanding the provisions of Section 3.3(c) hereof, such Letter of Credit Disbursement shall not bear interest. If a Letter of Credit Disbursement, other than a Principal Letter of Credit Disbursement, is not reimbursed on the date such Letter of Credit Disbursement is made, such Letter of Credit Disbursement shall bear interest at a rate per annum (based on a year of 365 days and actual days elapsed) for each day such Letter of Credit Disbursement is not reimbursed or converted to a Loan equal to the Base Rate plus 3%.

(b) The Borrower's obligation to reimburse the Agent under this Section 2.7 for the amount of all Letter of Credit Disbursements directly or from the proceeds of the sale of new Commercial Paper, on the same day or by borrowing in accordance with Section 3 hereof, and the Borrower's obligation to pay principal and interest on any and all Loans, shall be absolute and unconditional under any and all circumstances and irrespective of any setoff, counterclaim or defense to payment which the Borrower may have or have had against the Agent, including, without

limitation, any defense based on the failure of any drawing to conform to the terms of the Letter of Credit, any failure of the Borrower to receive all or any part of the proceeds of the sale of Commercial Paper with respect of which such Letter of Credit Disbursement was made or any nonapplication or misapplication of the proceeds of such sale or the legality, validity, regularity or enforceability of the Letter of Credit; provided, however, that the Borrower shall not be obligated to reimburse the Agent for any wrongful payment or disbursement made under the Letter of Credit as a result of the acts or omissions constituting willful misconduct or gross negligence on the part of the Agent or any of its officers, employees or agents. Nothing herein shall prevent the assertion by the Borrower of any claim or defense by separate suit or compulsory counterclaim.

Section 2.8 Reinstatement of the Available Credit.

(a) The Letter of Credit is a revolving credit, and the Agent agrees that the Commitment Amount of the Letter of Credit shall at all times remain equal to the amount of the Commitment and shall not be reduced by the amount of any Letter of Credit Disbursement for the payment of Commercial Paper; provided, however, that the Available Credit shall be reduced by the amount of any such Letter of Credit Disbursement, subject to reinstatement as provided in the immediately succeeding clause (b).

(b) Upon (i) the reimbursement to the Agent by the Borrower, or by the Fiscal Agent for the account of the Borrower, of any unpaid Letter of Credit Disbursement (by means other than conversion into a Loan in accordance with Section 3 hereof on or after the date of such Letter of Credit Disbursement) or (ii) the repayment to the Agent, by the Borrower, or by the Fiscal Agent for the account of the Borrower, of a Loan, the Available Credit shall be increased by the amount of such reimbursement or repayment.

Section 2.9 Modification or Termination of Letter of Credit Facility in Certain Events.

(a) In the event any restriction or limitation is imposed upon or determined or held to be applicable to the Agent or the Borrower by, under or pursuant to any law or regulation now or hereafter in effect (including, without limitation, any legal lending limits imposed by state or Federal law or regulation) or by reason of any interpretation thereof by any court or governmental or supervisory agency which, in the sole and reasonable judgment of the Agent, after consultation with the Borrower, would prevent the Agent from consenting to the issuance or sale of Commercial Paper entitled to the benefit of the Letter of Credit or from honoring demands for payment, or from otherwise legally incurring liability under the Letter of Credit with respect to subsequently issued Commercial Paper, the Agent shall give prompt written notice thereof to the Borrower, the Fiscal Agent and Commercial Paper Dealer instructing them to cease issuing, delivering and selling Commercial Paper, and thereupon the Commitment shall terminate (except with respect to the amount of Commercial Paper Outstanding at the time such notice is received by the Borrower). So long as the extension of such Loan does not violate any applicable law or regulation, any Loan outstanding at the time the Commitment is terminated pursuant to this Section 2.9 shall be due and payable not later than the then next succeeding Reduction Date.

(b) If any law, regulation or change in any law or regulation adopted after the date hereof or in the interpretation thereof or any ruling, decree, judgment, guideline, directive or recommendation (whether or not having the force of law) by any regulatory body, court, central bank or any administrative or governmental authority charged or claiming to be charged with the administration hereof (including, without limitation, a request or requirement that affects the manner in which the Agent or any affiliates, subsidiaries or Participants allocate capital resources to its commitments, including its obligations hereunder or under the Letter of Credit or in connection therewith) shall either:

(i) impose upon, modify, require, make or deem applicable to the Agent, any Non-Agent Bank or any of their affiliates, subsidiaries or Participants any reserve requirement, special deposit requirement, insurance assessment or similar requirement against or affecting the Letter of Credit, or

(ii) subject the Agent, any Non-Agent Bank or any of their affiliates, subsidiaries or Participants to any tax, charge, fee, deduction or withholding of any kind whatsoever in connection with the Letter of Credit or change the basis of taxation of the Agent, any Non-Agent Bank or any of their affiliates, subsidiaries or Participants (other than a change in the rate of tax based on the overall net income of the Agent, such Non-Agent Banks or such affiliate, subsidiary or Participant), or

(iii) impose any condition upon or cause in any manner the addition of any supplement to or increase of any kind to the Agent's, any Non-Agent Bank or any affiliates's, subsidiary's or Participant's capital or cost base for issuing, maintaining or participating in the Letter of Credit that results in an increase in the capital requirement supporting the Letter of Credit, or

(iv) impose upon, modify, require, make or deem applicable to the Agent, any Non-Agent Bank or any of their affiliates, subsidiaries or Participants any capital requirement, increased capital requirement or similar requirement, such as the deeming of the Letter of Credit to be an asset held by the Agent, any Non-Agent Bank or any of their affiliates, subsidiaries or Participants for capital adequacy calculation or other purposes (including, without limitation, a request or requirement that affects the manner in which the Agent, such Non-Agent Bank or such affiliate, subsidiary or Participant allocates capital resources to its commitments, including its obligations hereunder or under the Letter of Credit),

and the result of any events referred to in (i) (ii), (iii) or (iv) above shall be to materially increase the costs in any way to the Agent, any Non-Agent Bank or any affiliate, subsidiary or Participant of issuing, maintaining, or participating in the Letter of Credit or to materially reduce the amounts payable by the Borrower hereunder or materially reduce the rate of return on capital, as a consequence of the issuing or maintaining or participating in the Letter of Credit, to a level below

that which the Agent, such Non-Agent Banks, their affiliates, subsidiaries or Participants could have achieved but for such events; then and in such event, the Borrower shall, within fifteen (15) days after receipt of written notice to the Borrower of such increased costs and/or decreased benefits (accompanied by an explanation in reasonable detail of such increased costs and/or decreased benefits), pay to the Agent all such additional amounts as, in the Agent's, Non-Agent Banks or any affiliate's, subsidiary's or Participant's sole good faith calculation as allocated to the Letter of Credit, shall be sufficient to compensate it for all such increased costs and/or decreased benefits, all as certified by the Agent in said written notice to the Borrower. Such certification shall be conclusive and binding on the parties hereto, absent manifest error. Notwithstanding anything in this Section to the contrary, if such costs are to be incurred on a continuing basis and the Agent shall so, notify the Borrower in writing as to the amount thereof, such costs shall be paid by the Borrower to the Agent quarterly in arrears on each Interest Payment Date. If it shall later be determined that any amount so paid by the Borrower pursuant to this paragraph (b) is in excess of the amount required to be paid by the Borrower under the provisions hereof, the Agent shall promptly refund such excess to the Borrower.

In determining such amount, if the Agent, any Non-Agent Bank, any affiliate, subsidiary or any Participant making a claim for compensation under this Section shall fail to notify the Borrower of the amount of such claim for compensation within one year of the date of the adoption of the law or regulation, the change in law or regulation or in the interpretation thereof, or the ruling, decree, judgment, guideline, directive or recommendation giving rise to such claim for compensation, the Agent, such affiliate, such subsidiary, or such Participant shall be deemed to have waived its right to compensation under this Section.

Section 2.10 Obligation to Pay Outstanding Commercial Paper Notwithstanding Reduction, Termination or Suspension of Letter of Credit Commitment. Anything to the contrary herein notwithstanding, no reduction, termination or suspension of the Commitment in accordance with the terms of this Agreement shall affect the obligations of the Agent hereunder and under the Letter of Credit with respect to Commercial Paper Outstanding prior to the date of such reduction, termination or suspension and otherwise entitled to the benefits of the Letter of Credit then outstanding.

Section 2.11 Liability of the Agent. The Borrower assumes all risks of the acts or omissions of the Fiscal Agent and any transferee of the Letter of Credit with respect to its use of the Letter of Credit. Neither the Agent nor any of its officers or directors shall be liable or responsible for (a) the use which may be made of the Letter of Credit or for any acts, omissions, errors, interruptions, delays in transmission, dispatch or delivery of any message or advice, however transmitted, of the Fiscal Agent in connection with the Letter of Credit; (b) any action, inaction or omission which may be taken by the Agent in good faith without gross negligence in connection with the Letter of Credit, (c) the validity, sufficiency or genuineness of documents, or of any endorsements thereon, even if such documents should in fact prove to be in any or all respects invalid, insufficient, fraudulent or forged; (d) payment by the Agent against presentation of documents which do not comply with the terms of the Letter of Credit, including failure of any documents to bear any reference or adequate reference to the Letter of Credit; or (e) any other

circumstances whatsoever in making or failing to make payment under the Letter of Credit, except only that the Borrower shall have a claim against the Agent for acts or events described in the immediately preceding clauses (a) through (e), and the Agent shall be liable to the Borrower, to the extent, but only to the extent, of any direct, as opposed to consequential, damages suffered by it which the Borrower proves were caused by (i) the Agent's willful misconduct or gross negligence in determining whether documents presented under the Letter of Credit comply with the terms of the Letter of Credit or (ii) the Agent's willful failure or gross negligence in failing to pay under the Letter of Credit after the presentation to it by the Fiscal Agent of a certificate strictly complying with the terms and conditions of the Letter of Credit. The Borrower further agrees that any action taken or omitted by the Agent under or in connection with the Letter of Credit or the related draft or documents, if done in good faith without gross negligence, shall be effective against the Borrower as to the rights, duties and obligations of the Agent and shall not place the Agent under any liability to the Borrower. In furtherance and not in limitation of the foregoing, the Agent may accept documents that appear on their face to be in order, without responsibility for further investigation, regardless of any notice or information to the contrary, provided, that if the Agent shall receive written notification from the Fiscal Agent that sufficiently conforming (in the opinion of the Agent) documents presented to the Agent are not to be honored, the Agent agrees that it will not honor such documents.

Section 2.12 Security of the Payment Obligations. Pursuant to Section 4.08 of the General Ordinance, the Borrower, under the Original Credit Agreement pledged to the Agent, for the benefit of the Original Banks, for the security and payment of the Payment Obligations to the Original Banks thereunder, including the Loan obligation evidenced by the Note, and thereby granted a security interest to the Agent, for the benefit of the Original Banks, in:

- (i) the Gas Works Revenues (as defined in the General Ordinance) and all accounts and general intangibles representing the Gas Works Revenues (as defined in the General Ordinance);
- (ii) the proceeds from the sale of the Commercial Paper; and
- (iii) in each case, the proceeds of the foregoing.

The Borrower hereby ratifies and confirms its pledge made under the Original Credit Agreement to the Agent, for the benefit of the Banks hereunder, and confirms that the Security Interest in (i), (ii) and (iii) of this Section 2.12 remains valid.

The Payment Obligations of the Borrower hereunder are secured on a parity basis with the Commercial Paper as set forth in the General Ordinance.

SECTION 3.

THE LOANS

Section 3.1 Loans. The Agent agrees, upon the terms, subject to the conditions and relying upon the representations and warranties hereinafter set forth, to make Loans to the Borrower by converting the amount of each unreimbursed Principal Letter of Credit Disbursement into a Loan pursuant to this Section 3. The obligation of the Borrower to repay such Loan under this Section 3 shall be substituted in full for the obligation of the Borrower to reimburse such Principal Letter of Credit Disbursement under Section 2.7 hereof. Each Loan shall be in an aggregate principal amount of not less than \$100,000. Until the Letter of Credit Termination Date, the Borrower may borrow, pay, prepay and reborrow hereunder in accordance with this Section 3. Except as further restricted in Sections 2.9(a) and 4.4 hereof, all Loans shall be due and payable not later than the earlier of the Expiration Date and the next succeeding Reduction Date.

Section 3.2 Note. The Loans of the Agent shall be evidenced by the Note, substantially in the form attached hereto as Exhibit B, appropriately completed, duly executed and delivered on behalf of the Borrower and payable to the Agent or its registered assigns. The date and amount of each Loan, and the date and amount of each payment or prepayment of principal of any Loan, shall be recorded on the grid schedule annexed to the Note and the Borrower authorizes the Agent to make such recordation; provided, however, that failure of the Agent to make such recordation shall in no way derogate from the Borrower's obligations thereunder or hereunder.

Section 3.3 Interest (a) The Borrower agrees to pay interest in respect of the unpaid principal amount of each Loan from the date of the making of such Loan until such Loan shall be paid in full at a rate per annum which shall be equal to the Base Rate in effect from time to time, such rate to change as and when the Base Rate changes; provided, however, that in the event the Borrower's debt secured by the Revenues shall be rated less than BBB-, BBB- or Baa3 or its equivalent by two of the three Rating Agencies, the rate per annum shall be equal to the Base Rate plus .5 %, such increase effective from the date either rating agency publishes such rating; (if the rating of a Rating Agency is withdrawn or suspended, such rating shall be deemed to be less than the requirements of this Section 3.3(a)); provided, further that if after any such downgrading referred to above the Borrower's debt secured by the Revenues shall no longer be rated less than BBB-, BBB- or Baa3 or its equivalent by two of the three Rating Agencies, the rate per annum shall again be equal to the Base Rate, such decrease effective from the date such rating agency publishes such rating.

(b) In the event that, and for so long as, any Event of Default shall have occurred and be continuing, the outstanding principal amount of all Loans and, to the extent permitted by law, overdue interest in respect of all Loans, shall bear interest at a rate per annum (the "Default Rate") equal to the sum of three percent (3%) plus the interest rate otherwise applicable hereunder to such principal amount in effect from time to time.

(c) Interest on each Loan shall accrue from and including the date of the Borrowing thereof to but excluding the date of any repayment thereof (provided that, subject to the provisions of Section 2.7(a) hereof, any Loan borrowed and repaid on the same day shall accrue one

day's interest) and shall be payable quarterly in arrears on each Interest Payment Date and on any prepayment or conversion (on the amount prepaid or converted), at maturity (whether by acceleration or otherwise) and, after such maturity, on demand.

Section 3.4 Voluntary Prepayments. The Borrower shall have the right to prepay the Loans in whole or in part from time to time on the following terms and conditions: (i) the Borrower shall give the Agent written notice (or telephonic notice promptly confirmed in writing), which notice shall be irrevocable, of its intent to prepay the Loans at least one Business Day prior to a prepayment of Loans, which notice shall specify the amount of such prepayment and (ii) each prepayment shall be in a minimum principal amount of \$100,000.

SECTION 4.

OTHER CREDIT TERMS

Section 4.1 Letter of Credit Fees.

(a) Annual Fee. The Borrower shall pay to the Agent for the benefit of the Banks (including the Agent Bank), an annual fee equal to 150 basis points per annum; provided, however that in the event any of the Borrower's debt secured by the Revenues shall be rated less than BBB-, BBB- or Baa3 or its equivalent by two out of the three Rating Agencies, the annual fee shall be equal to 225 basis points per annum, such increase effective from the date the second Rating Agency publishes such rating (if the rating of a Rating Agency is withdrawn or suspended, such rating shall be deemed to be less than the requirements of this Section 4.1(a)); provided, further that if after any such downgrading referred to above the Borrower's debt secured by the Revenues shall no longer be rated less than BBB-, BBB- or Baa3 or its equivalent by two out of the three Rating Agencies, the annual fee shall again be equal to 150 basis points per annum, such decrease effective from the date such second Rating Agency publishes such rating.

(b) Fronting Fee. The Borrower shall pay to the Agent for the account of the Agent a Fronting Fee equal to 15 basis points per annum; provided, however that in the event any of the Borrower's debt secured by the Revenues shall be rated less than BBB-, BBB- or Baa3 or its equivalent by two out of the three Rating Agencies, the Fronting Fee shall be equal to 20 basis points per annum, such increase effective from the date the second Rating Agency publishes such rating (if the rating of a Rating Agency is withdrawn or suspended, such rating shall be deemed to be less than the requirements of this Section 4.1(b)); provided, further that if after any such downgrading referred to above the Borrower's debt secured by the Revenues shall no longer be rated less than BBB-, BBB- or Baa3 or its equivalent by two out of the three Rating Agencies, the Fronting Fee shall again be equal to 15 basis points per annum, such decrease effective from the date such second Rating Agency publishes such rating.

(c) Drawing Fee. The Borrower shall pay to the Agent a drawing fee of \$150 each time a drawing is made on the Letter of Credit; provided, however, that the drawing fee

for any one year shall not exceed \$7,500. The drawing fee payable for any quarter shall be paid quarterly in arrears on the last Business Day of each March, June, September and December and on the Letter of Credit Termination Date, such amount payable determined as of the fifth Business Day prior to each such payment date and any adjustments to such drawing fee necessitated by drawings after such Day to such payment date shall be allocated to the next succeeding drawing fee installment.

(d) Administrative Agency Fee. The Borrower shall pay to the Agent an administrative agency fee equal to \$1,500 per Bank, payable on the Amendment Date and on each anniversary date thereof; provided, however, that no payment on any anniversary with respect to the administrative agency fee shall exceed \$6,000.

(e) Transfer Fee. The Borrower shall pay to the Agent a transfer fee of \$1,500 upon each transfer of the Letter of Credit.

(f) Payment of Letter of Credit Fees. The Letter of Credit Fees described in (a) and (b) above shall be payable quarterly in arrears on each Interest Payment Date, commencing on the last Business Day of June, and on the later of the date on which the last maturing Commercial Paper is paid or the Letter of Credit Termination Date and shall be multiplied by the average Commitment outstanding during each such quarter. Any Letter of Credit Fees not paid when due shall accrue interest at a rate per annum (computed on the basis of a year of 365 days and actual days elapsed) equal to the Base Rate plus three percent (3 %) until paid. The Agent shall mail a written invoice to the Borrower at least five (5) Business Days prior to each date on which the Letter of Credit Fees are due and payable setting forth the amount of such Fees; provided, however, that failure of the Agent to deliver such invoice shall not affect the obligations of the Borrower hereunder, except that (i) interest on any such obligation shall accrue at the Base Rate until five Business Days after such invoice is received, and (ii) failure to pay any such amount shall not constitute an Event of Default under Section 9.1 (c) hereof until 10 Business Days after such invoice is received.

(g) Up-front Fees. The Borrower shall pay to the Agent on the Amendment Date an up-front fee of \$150,000 for the account of the Banks and an up-front agency fee of \$75,000.

Section 4.2 Payments. All payments to be made by the Borrower hereunder shall be made to the Agent at the account designated in Section 12.2 hereof, or to such other account as the Agent shall from time to time designate by notice in writing to the Borrower, and shall be made in immediately available funds without deduction, setoff, defense or counterclaim no later than 4:00 p.m. (New York time) on the day when due; any funds received after such time shall be deemed to have been received by the Agent on the next succeeding Business Day.

Section 4.3 Computation of Interest and Fees. All interest payable under this Agreement and the Note and the Letter of Credit Fees payable under this Agreement shall be calculated on the basis of a three hundred sixty (360) day year for the actual days elapsed.

Section 4.4 Reduction or Termination of Commitment Amount.

(a) The Borrower shall have the right to reduce or terminate the Commitment at any time from time to time upon not less than one (1) month's prior written notice to the Agent and the Fiscal Agent, designating the date (which shall be a Business Day) of the termination or change and the amount of any change, all without penalty or premium; provided, however, that the Commitment may not be reduced to an amount less than the Credits Outstanding and Commercial Paper Outstanding. Such termination or partial reduction of the Commitment shall be effective on the date specified in the aforesaid notice of the Borrower. Any such partial reduction of the Commitment shall be in the aggregate amount of \$1,000,000 or an integral multiple thereof. The Letter of Credit Fees shall, in case of a termination of the Commitment, cease to accrue from and after the date of such termination and, in case of a partial reduction of the Commitment Amount, cease to accrue from and after the date of such reduction on the amount by which the Commitment shall have been so reduced.

(b) If at any time during the term of this Agreement the Borrower has debt secured by the Revenues outstanding with a rating from two of the three Rating Agencies of less than "BBB-" from Fitch, "BBB-" from S&P or "Baa3" from Moody's and such ratings have continued for a six-month period, the Agent may, upon written notice to the Borrower, cancel this Agreement and terminate the Commitment (except with respect to the amount of Commercial Paper Outstanding at the time such notice is received by the Borrower) and instruct the Fiscal Agent immediately to cease issuing, delivering and selling Commercial Paper, and on the date thereof, all Loans shall be paid in full.

Section 4.5 Setoff. Upon the occurrence and during the continuance of any Event of Default or any event which, with the giving of notice or lapse of time or both, would become an Event of Default, the Banks are hereby authorized at any time and from time to time without notice to the Borrower (any such notice being expressly waived by the Borrower), and, to the fullest extent permitted by law, to setoff, to exercise any banker's lien or any right of attachment or garnishment and apply any and all balances, credits, deposits (general or special, time or demand, provisional or final), accounts or monies at any time held and other indebtedness at any time owing by the Banks to or for the account of PGW against any and all of the obligations of the Borrower now or hereafter existing under or in connection with this Agreement, the Letter of Credit, or Note, whether or not the Agent shall have made any demand hereunder or thereunder. The rights of the Banks under this Section are in addition to, in augmentation of, and do not derogate from or impair other rights and remedies (including, without limitation, other rights of setoff) which the Banks may have. Anything herein to the contrary notwithstanding, any amounts realized by the Banks pursuant to this Section 4.5 shall be consistent with the priorities for payment established herein and in the General Ordinance.

SECTION 5.

CONDITIONS OF CREDIT

Section 5.1 Conditions Precedent to Initial Credit Event. At or prior to the occurrence of the initial Credit Event, and as conditions precedent thereto, each of the following conditions shall have been satisfied:

(a) the Borrower and the Fiscal Agent shall have executed and delivered the Fiscal Agent Agreement, which shall be in full force and effect on the date of the initial Credit Event;

(b) the Agent shall have received each of the following documents with sufficient copies for each of the Non-Agent Banks:

(i) the signed opinions of the City Solicitor and of Wolf, Block, Schorr and Solis-Cohen LLP, Bond Counsel to the Borrower, each in form and substance satisfactory to the Agent;

(ii) the signed opinion of Hawkins, Delafield & Wood, New York, New York, counsel to the Agent, in the form of Exhibit C hereto, dated the Effective Date;

(iii) a certified copy or executed original, as the Agent may request, of (x) the General Ordinance, certified by the Clerk of the Council as being in full force and effect on the Effective Date, (y) the Committee Resolution authorizing the transactions provided for herein and the execution, delivery and performance of this Agreement, and (z) each of the Documents and any other documents to be executed by the Borrower related to this transaction;

(iv) a certificate, dated the Effective Date, as to the incumbency, and containing the specimen signature or signatures, of the authorized officer or officers executing and delivering this Agreement and any instrument or agreement required hereunder on behalf of the Borrower;

(v) the Note executed by the Borrower;

(vi) copies of all financing statements and continuation statements executed by the Borrower in favor of the Fiscal Agent for the benefit of the holders of Commercial Paper and the Agent;

(vii) a certificate, dated the Effective Date, executed by the Borrower covering such matters as the Agent may reasonably request, including but without limitation to the following: (i) certification as to all Documents under which PGW is obligated as of the Effective Date to pay or secure obligations in a priority equal or prior to the obligations to the Banks hereunder, and (ii) a

statement setting forth the outstanding amount of all obligations issued or entered into pursuant to any of the documents set forth in (i) above; and

(viii) a certificate, dated the Effective Date, executed by the Fiscal Agent covering such matters as the Agent may reasonably request;

(c) the Agent shall have received a copy of any consent or approval of any Person required in connection with the consummation of this Agreement;

(d) The Agent shall be satisfied that neither the Borrower nor PGW is subject to any present or contingent environmental liability which in the aggregate is in excess of \$100,000, except as disclosed in writing to the Agent; and

(e) All other legal matters pertaining to the execution and delivery of this Agreement and the Documents, the issuance of the Commercial Paper and the Letter of Credit shall be reasonably satisfactory to the Agent and its counsel.

Section 5.2 Conditions Precedent to all Credit Events. As a condition to the issuance of any Commercial Paper or any other Credit Event, the following conditions precedent shall be satisfied at the time of issuance:

(a) the representations and warranties on the part of the Borrower contained in Section 6 of this Agreement shall be true and correct in all material respects at and as of the date of such issuance as though made on and as of such date (except to the extent that such representations and warranties expressly relate solely to an earlier date);

(b) no Event of Default shall have occurred and be continuing on the date of such issuance or would result from such issuance;

(c) in connection with Commercial Paper only, all conditions precedent to the issuance of the Commercial Paper hereunder and under the Documents shall have been satisfied;

(d) there shall have been no amendments to the General Ordinance or Committee Resolution since the date of the certificates or certifications furnished by the Borrower pursuant to Section 5.1(b) hereof except as approved in writing by the Agent;

(e) the funds in the Reimbursement Account shall not be subject to any writ, order, judgment, warrant of attachment, execution or similar process, except as is being contested in good faith;

(f) the funds in the Operating Account shall not be subject to any writ, order, judgment, warrant of attachment, execution or similar process, except as is being contested in good faith;

(g) all necessary action shall have been taken as required to assign and pledge under the General Ordinance and the Committee Resolution the Revenues for the benefit of the Agent and to ensure the priority thereof against any actual or potential creditors of the Borrower;

(h) in connection with the initial issuance of Commercial Paper only, no Commercial Paper is currently outstanding and the Letter of Credit No. SYN-10005 issued by CIBC dated May 1, 1994 has been terminated prior to the issuance of the Commercial Paper, and

(i) in connection with the initial issuance of Commercial Paper only, (i) the Commercial Paper shall have been rated "A-1+" by S&P and "P-1" by Moody's (or the then comparable S&P or Moody's rating), (ii) the Agent shall have received a copy of the rating letters or other documents evidencing any such ratings, and (iii) such ratings shall continue in effect on the Effective Date; and

(j) no loans are outstanding under the credit agreement between CIBC and PGW dated May 1, 1994 relating to Letter of Credit No. SYN-10005.

Section 5.3 Representations and Warranties with Respect to all Issuance of Commercial Paper. Each issuance of Commercial Paper shall be deemed a representation and warranty by the Borrower that the conditions precedent to such issuance of Commercial Paper, unless otherwise waived in accordance herewith, shall have been satisfied.

Section 5.4 Conditions Precedent to the Amendment. In addition to the conditions set forth above, at or prior to the Amendment Date, the Agent shall have received:

(a) each of the Documents and any other documents to be executed by the Borrower in connection with the Amendment;

(b) bring-down certificates of the Borrower related to the Committee Resolutions, and as to the continued effectiveness of each of the Commercial Paper Dealer Agreement and the Fiscal Agent Agreement;

(c) a certified copy of each of (i) the General Ordinance, (ii) the Senior Bond Ordinance and (iii) the General Gas Works Revenue Bond Ordinance of 1998, each together with copies of any supplemental ordinances amending such ordinances, and each certified by the Chief Clerk of the City Council as being in full force and effect on the Amendment Date;

(d) a copy of the Preliminary Official Statement, dated June 5, 2001 (the "Preliminary Official Statement"), relating to the City of Philadelphia, Pennsylvania Gas Works Revenue Bonds, Third Series, together with a deemed-final certificate executed by the Borrower in connection therewith;

(e) a certificate, dated the Amendment Date, as to the incumbency, and containing the specimen signature or signatures, of the authorized officer or officers executing and delivering the Agreement and any instrument or agreement required hereunder on behalf of the Borrower;

(f) a certificate, dated as of the Amendment Date, executed by the Borrower related to the following: (i) that, except as disclosed in the Preliminary Official Statement or in such certificate, there is no pending litigation in which a final adverse determination would result in any material adverse change in the business, financial position or results of operations of PGW, (ii) that no Event of Default by the Borrower under the Original Credit Agreement has occurred and is continuing, (iii) that the Fiscal Agent Agreement has not been amended and remains in full force and effect on the Amendment Date, (iv) that the representations and warranties on the part of the Borrower contained in Section 6 of this Agreement are true and correct in all material respects at and as of the Amendment Date (except to the extent that such representations and warranties expressly relate solely to an earlier date), (v) that no Event of Default has occurred and is continuing on the Amendment Date or would result from the Amendment, (vi) that the Certificate shall be deemed a representation and warranty by the Borrower that the conditions precedent to the Amendment, unless otherwise waived in accordance herewith, shall have been satisfied.

(g) a certificate, dated as of the Amendment Date, executed by the Borrower covering such matters as the Agent may reasonably request, including but without limitation to the following: (i) certification as to all Documents under which PGW is obligated as of the Amendment Date to pay or secure obligations in a priority equal or prior to the obligations to the Banks hereunder, and (ii) a statement setting forth the outstanding amount of all obligations issued or entered into pursuant to any of the documents set forth in (i) above;

(h) an opinion of the City Solicitor of the Borrower as to the due authorization, execution and delivery of the Agreement and that the Agreement is a valid, binding and enforceable obligation of the Borrower;

(i) a Bond Committee Determination authorizing the execution and delivery of the Agreement;

(j) the comfort letters, each dated May 29, 2001, each executed by the Director of Finance of the Borrower, and each individually addressed to the respective Banks; and

(k) an opinion of Blank Rome Comisky & McCauley LLP as to priority of payments under the General Ordinance.

SECTION 6.

REPRESENTATIONS AND WARRANTIES

In order to induce the Agent to enter this Agreement, the Borrower agrees and warrants to the Agent:

Section 6.1 Organization Power. The Borrower is a first class city and political subdivision duly organized and validly existing under the laws of the Commonwealth of Pennsylvania and the Borrower has all required power and authority (a) to own and operate the Philadelphia Gas Works, (b) to execute, deliver and perform its obligations under the Documents, and (c) to execute, deliver and perform its obligations under all other agreements and instruments executed and delivered by the Borrower pursuant to or in connection with this Agreement.

Section 6.2 Authorization. The execution, delivery and performance by the Borrower of the Documents have been duly authorized and do not and will not (a) violate any provision of any law, rule, regulation, order, writ, judgment, injunction, decree, determination or award presently in effect having applicability to the Borrower, (b) result in a breach of or constitute a default under any resolution of the Borrower with respect to PGW or any indenture or loan or credit agreement or any other agreement, lease or instrument with respect to PGW to which the Borrower is a party or by which the Borrower or any of its properties within PGW may be bound or affected, or (c) result in, or require, the creation or imposition of any Lien other than those imposed in the General Ordinance or Committee Resolution, upon or with respect to any of the assets now owned or hereafter acquired by the Borrower for PGW; and the Borrower is not in any material respect in violation of or in default under any such law, rule, regulation, order, writ, judgment, injunction, decree, determination or award or any such indenture, agreement, lease or instrument material to its operations of PGW.

Section 6.3 Enforceable Obligation. This Agreement and each of the other Documents to which the Borrower is or is to be a party constitute legal, valid and binding obligations of the Borrower enforceable against the Borrower in accordance with their respective terms, except as they may be limited by applicable bankruptcy, insolvency, reorganization or similar laws affecting the enforcement of creditors' rights generally.

Section 6.4 Financial Condition. PGW's financial statements for the period ending August 31, 2000 which have been furnished to the Agent, and all financial statements when prepared and delivered have been or will be prepared in conformity with generally accepted accounting principles and fairly present the financial condition of PGW as at the dates, and the results of its operations for the periods, covered thereby. Except as set forth in the Preliminary Official Statement, since August 31, 2000 there has been no material adverse change in the business, financial position, results of operations or projections or prospects of PGW. PGW has no material contingent liabilities or other material contracts or commitments which are not reflected in such financial statements or in the notes thereto or the Preliminary Official Statement.

Section 6.5 Information. All information supplied and statements and representations made to the Agent by an authorized Person on behalf of Borrower in any financial, credit or accounting statement, application for credit or other statement or document furnished to the Agent in connection with this Agreement, whether prior to, contemporaneously with or subsequent to the

execution hereof, and any certificate, document, schedule or other writing furnished to the Agent pursuant to this Agreement or in response to a request made by the Agent pursuant to this Agreement, are and will be, when furnished in all material respects true, complete, correct, valid, genuine and what they purport or are represented to be.

Section 6.6 Regulatory Approvals with Respect to this Agreement. Each authorization, consent, approval, license or formal exemption from, or filing, declaration or registration with, any court, governmental agency or regulatory authority (Federal, state or local), required in connection with the execution and delivery by the Borrower of the Documents and the performance by the Borrower of its obligations under the Documents has been obtained or made and is in full force and effect (except for such authorizations, consents, approvals, licenses, exemptions, filings, declarations or registrations, if any, which may be required to be obtained or made subsequent to the Effective Date, all of which, if then required, will have been duly obtained or made on or before each date on which the foregoing representation and warranty shall be made or effective or reaffirmed, as the case may be, will be sufficient for all purposes thereof and will be in full force and effect on each such date).

Section 6.7 Use of Commitment and Loan Proceeds. The Borrower will use the Commitment and the proceeds of the Loans solely for the purposes set forth herein and in the Fiscal Agent Agreement.

Section 6.8 Modifications and Waivers. Neither the Act, the General Ordinance nor the Committee Resolution has been amended, modified or waived, except as provided herein.

Section 6.9 Security. The, General Ordinance and the Committee Resolution create the security interest in the Revenues which they purport to create to secure the Agent on a parity with all Commercial Paper holders.

Section 6.10 Investment Company Act. The Borrower is not an "investment company" within the meaning of the Investment Company Act of 1940, as amended.

Section 6.11 Commercial Paper Memorandum. No information statement, commercial paper memorandum or offering material, other than updating information based on publicly available information, describing or pertaining to the Agent, this Agreement, the Letter of Credit or the transactions contemplated hereby or thereby, will be used in connection with the sale of the Commercial Paper unless approved by the Agent in writing. No such commercial paper memorandum, given the purpose and scope of the memorandum as it relates to a commercial paper program, will contain any untrue statement of a material fact or will omit a material fact necessary to make information contained therein not misleading; provided, however, that the Borrower makes no representation with respect to information contained in any such commercial paper memorandum relating to the Agent which is provided by the Agent in writing for inclusion therein.

Section 6.12 Compliance; No Default. The Borrower is in compliance with the terms and conditions of this Agreement and each of the other Documents applicable to it, except for any such terms and conditions which are to be satisfied after the date hereof, and no Event of Default has occurred and is continuing, and no event, act or omission has occurred and is continuing which, with the lapse of time, the giving of notice, or both, would constitute an Event of Default.

Section 6.13 Litigation. Except as provided in the certificate dated as of the Amendment Date as required by Section 5.4(f)(i), there is no action, suit, investigation or proceeding pending, or to the best knowledge of the Borrower, threatened, against or affecting the Borrower before any court, arbitrator or administrative or other Governmental Authority (i) which could result in any material adverse change in the business, financial position or results of operations of PGW, (ii) which in any manner draws into question the validity or enforceability of this Agreement or any Document or any Lien created hereby or thereby, or (iii) which could materially adversely affect the ability of the Borrower to comply with its obligations under or in respect of this Agreement and each of the other Documents or in connection with the transactions contemplated hereby or thereby.

Section 6.14 Disclosure. Neither this Agreement, none of the other Documents nor any other document, certificate or statement furnished to the Agent by or on behalf of the Borrower in connection with the transactions contemplated hereby or thereby contains any untrue statement of any material fact or omits to state any material fact necessary so as to make the statements contained herein or therein, in light of the circumstances under which they were made, not misleading.

Section 6.15 Immunity. There is no governmental immunity which would protect the Borrower from the service of process, from a judgment resulting from such service of process or the enforcement of any judgment, pursuant to applicable law, rendered against it in connection with proceedings commenced by the Agent to enforce any of its rights under the Documents. Nothing contained herein shall be construed as pledging the credit or the taxing power of the Borrower or creating any debt or charge against the tax or general revenues of the Borrower to the payment of the obligations under this Agreement.

Section 6.16 Title to Properties. The Borrower has good title to the properties and assets of PGW except for any defects or Liens that, in the aggregate, do not materially adversely affect the ability of the Borrower to perform its obligations under this Agreement.

Section 6.17 Incorporation of Representations and Warranties by Reference. Borrower hereby makes to the Agent the same representations and warranties made by the Borrower in each Document, which representations and warranties, as well as the related defined terms contained therein, are hereby incorporated by reference for the benefit of the Agent with the same effect as if each and every such representation and warranty and defined term were set forth herein in its entirety. No amendment to such representations and warranties or defined terms made pursuant to any Document shall be effective to amend such representations and warranties and defined terms as incorporated by reference herein without the prior written consent of the Agent.

Section 6.18 Regulation U. The Borrower is not entering into this Agreement and the transactions contemplated hereby for the purpose of purchasing or carrying margin stock as defined in Regulation U of the Board of Governors of the Federal Reserve System.

SECTION 7.

AFFIRMATIVE COVENANTS OF THE BORROWER

The Borrower hereby covenants and agrees that, so long as this Agreement or the Commitment remains in effect, the Note or any of the Commercial Paper remain outstanding and unpaid or any amount is owing to the Agent under this Agreement, unless the Agent shall otherwise consent in writing:

Section 7.1 Financial and Other Information. The Borrower will furnish to each of the Banks:

(a) Notice of Default. (i) Forthwith after the Borrower shall have obtained knowledge of the occurrence of an Event of Default, or an event which with the lapse of time or the giving of notice may become an Event of Default, the statement of an authorized officer of the Borrower setting forth the details of each such Event of Default or an event which with the lapse of time or the giving of notice may become an Event of Default which has occurred (for purposes of this Section 7.1(a), such notice shall include notice of events specified in Section 9.2, without taking into account the minimum principal amounts specified therein); and (ii) within thirty (30) days after the delivery of the statement described in clause (i) above, provide to the Agent the statement of an authorized officer of the Borrower setting forth the action which the Borrower proposes to take with respect thereof;

(b) Interim Reports. Within ninety (90) days after the end of each of the first three quarters of each fiscal year of PGW, (i) financial statements consisting of a balance sheet of PGW as at the end of such quarter and a statement of income and equity of PGW and for the fiscal year through such quarter, setting forth in comparative form the corresponding figures for the corresponding periods of the preceding fiscal year, all in reasonable detail and certified (subject to year-end audit adjustments), by an authorized financial officer of PGW, as being fairly presented, accompanied by (ii) a letter from such officer addressed to the Agent stating that no Event of Default, and no event which with the lapse of time or the giving of notice would become an Event of Default, has come to his attention which was continuing at the end of such quarter or on the date of his letter, or, if such an Event of Default or event which with the lapse of time or the giving of notice would become an Event of Default has come to his attention and was continuing at the end of such quarter or on the date of his letter, indicating the nature of such Event of Default or event which with the lapse of time or the giving of notice would become an Event of Default and the action which Borrower proposes to take with respect thereto;

(c) Annual Reports

(i) Within one hundred twenty (120) days after the end of each fiscal year of the PGW, (A) financial statements consisting of a balance sheet of PGW as at the end of such fiscal year and a statement of income and equity of PGW for such fiscal year, setting forth in comparative form (beginning with the fiscal year ending August 31, 2001) the corresponding figures for the preceding fiscal year, all in reasonable detail and accompanied by an unqualified audit report of the independent public accountants of PGW stating that they have been prepared in accordance with generally accepted accounting principles consistently applied, accompanied by (B) a letter from an authorized financial officer of PGW addressed to the Agent stating that no Event of Default, and no event which with the lapse of time or the giving of notice would become an Event of Default, has come to his attention which was continuing at the end of such fiscal year or on the date of his letter, or, if such an Event of Default or event which with the lapse of time or the giving of notice would become an Event of Default has come to his attention and was continuing at the end of such fiscal year or on the date of his letter, indicating the nature of such Event of Default or event which with the lapse of time or the giving of notice would become an Event of Default and the action which the Borrower proposes to take with respect thereto; and

(ii) Within one hundred and eighty (180) days after the end of each fiscal year of the Borrower or as soon thereafter as they are available, the annual financial statements of the Borrower for such fiscal year:

(d) Other Filings. Promptly upon their becoming available, a copy of any other non-routine, periodic or special reports of its activities or condition submitted to any Governmental Authority and any other audit report prepared with respect to its activities or condition for delivery to a third party, in each case to the extent such reports are deemed relevant by the Borrower to the Borrower's ability to perform its obligations under this Agreement, and copies of any material adverse notice or other material adverse communication from any Governmental Authority, if such report, notice or communication is of a scope which would be required to be disclosed in an audit report of the Borrower. The Banks agree to maintain the confidentiality of all non-public information provided pursuant to this paragraph; provided, however, that the Banks shall not be precluded from disclosing such information or the contents of such information to its Participants or, to the extent required by statute, rule, regulation or judicial process or upon the lawful demand of any court, agency or other governmental authority having jurisdiction over the Banks;

(e) Litigation. As promptly as practicable, written notice of all litigation filed against the; Borrower or PGW and all proceedings before any court or Governmental Authority which (i) relate to this Agreement or (ii) relate to any of the other Documents and, in either case, if determined adversely to the Borrower or PGW, would have a material adverse effect upon the ability of the Borrower to perform its obligations hereunder;

(f) Additional Debt. Notice of the issuance of any additional debt of the Borrower secured by the Revenues, promptly after the issuance thereof, and

(g) Other Information. Copies of all official statements issued by Borrower with respect to PGW, prompt notice of any amendment to any Document, and such other information respecting the business affairs, financial condition and/or operations of PGW, as the Agent may from time to time reasonably request.

Section 7.2 Maintenance of Books and Records. The Borrower shall keep proper books of record and account in which full, true and correct entries will be made of all dealings or transactions in relation to its business and activities.

Section 7.3 Inspections; Discussion. The Borrower shall permit the Agent or its respective representatives, at any reasonable time and upon reasonable notice, during normal business hours and from time to time, at the request of the Agent to visit and inspect the properties of PGW, to examine and make copies of and take abstracts from the records and books of account, and to discuss the affairs, finances and accounts with the appropriate officers of PGW. The Agent agrees to maintain the confidentiality of all such books, records and information; provided, however, that the Agent shall not be precluded from disclosing such information or the contents of such books and records to its Participants or, to the extent required by statute rule, regulation or judicial process or upon the lawful demand of any court, agency or other governmental authority having jurisdiction over the Agent,

Section 7.4 Use of Proceeds. In the case of the Borrower, the Borrower shall not use the proceeds of the sale of any Commercial Paper or the proceeds of any investments made with such proceeds for any purposes other than the following: (a) the payment to the Reimbursement Account for each Letter of Credit Disbursement, (b) the payment of the principal of and interest, if any, on the Note, (c) the payment of any other indebtedness (including the Letter of Credit Fees specified in Section 4. 1) owing to the Agent hereunder. (d) the payment of any fees or other amount which it is obligated to pay to the Commercial Paper Dealer pursuant to the agreement in effect on the date hereof and fees to the Fiscal Agent for its services under the Fiscal Agent Agreement and billed to it, and (e) Project Costs (as defined in the General Ordinance).

Section 7.5 Security. The Borrower shall take any and all actions necessary or reasonably requested by the Agent to continue the security interest described in Section 6.9 hereof.

Section 7.6 Securities Act. The Borrower will sell or offer to sell Commercial Paper only in compliance with the registration provisions of the Securities Act of 1933, as amended, or pursuant to an exemption under Section 3(a)(2) thereof, for a political subdivision of the Commonwealth of Pennsylvania, and in compliance with the registration or qualification provisions of the Blue Sky or similar securities laws of any state having jurisdiction and, if applicable, any regulatory authority thereof. Prior to the initial sale or offer to sell Commercial Paper under an exemption under Section 3(a)(2) or at such subsequent time, as the Agent may reasonably request, the Borrower will provide the Agent with a favorable opinion of counsel in respect of such sale and offer to sell.

Section 7.7 Licenses, Permits, Etc. The Borrower will at all times and in all material respects maintain and comply with all necessary permits and licenses with respect to the operation of PGW issued by governmental authorities having jurisdiction over PGW, if any.

Section 7.8 Payment of Obligation. The Borrower shall pay and discharge all of its obligations and liabilities, including, without limitation, all taxes, assessments and governmental charges on or against the income and properties of PGW, when due, except to the extent only that such obligations, liabilities, taxes, assessments and governmental charges shall be contested in good faith and by appropriate proceedings and then only to the extent that a bond is filed in cases where the filing of a bond will avoid the creation of a Lien against any of its properties, or if no such bond can be filed, then only to the extent that such contest does not involve, in the reasonable judgment of the Agent, a substantial risk of sale, foreclosure, forfeiture or loss of a material item of property of PGW which would, in the opinion of the Agent, materially adversely affect the ability of the Borrower to perform its obligations under this Agreement.

Section 7.9 Compliance with Documents. The Borrower shall perform and comply with each and every covenant and agreement required to be performed or observed by it in the Documents, which provisions, as well as related defined terms contained therein, are hereby incorporated by reference herein with the same effect as if each and every such provision were set forth herein in its entirety all of which shall be deemed to be made for the benefit of the Agent and shall be enforceable against the Borrower. To the extent that any such incorporated provision permits the Borrower, the fiscal Agent or the holders of Commercial Paper to waive compliance with such provision or requires that a document, opinion or other instrument or any event or condition be acceptable or satisfactory to the Borrower, the Fiscal Agent or the Commercial Paper Holders, for purposes of this Agreement, such provision shall not be complied with only if it is specifically waived by the Agent in writing and such document, opinion or other instrument and such event or condition shall be acceptable or satisfactory only if it is acceptable or satisfactory to the Agent which shall only be evidenced by the Agent's written approval of the same. No termination or amendment to such covenants and agreements or defined terms or release of the Borrower with respect thereto made pursuant to the Documents shall be effective to terminate or amend such covenants and agreements or defined terms or release of the Borrower with respect thereto as incorporated by reference herein without the prior written consent of the Agent. Notwithstanding any termination or expiration of any such Document, the Borrower shall continue to observe the covenants therein contained for the benefit of the Agent until the termination of this Agreement. All such incorporated covenants shall be in addition to the express covenants contained herein and shall not be limited by the express covenants contained herein nor shall such incorporated covenants be a limitation on the express covenants contained herein.

Section 7.10 Insurance. The Borrower shall keep, or cause to be kept, the works, plants and facilities comprising the PGW and the operations thereof insured to the extent available at reasonable cost with responsible insurers with policies payable to the Borrower for the benefit of PGW against risks of direct physical loss, damage or destruction of such works, plants and facilities, and against accidents, casualties, or negligence, including liability insurance and employer's liability,

at least to the extent that similar insurance is usually carried by natural gas utilities operating like properties, if failure to maintain such insurance could materially adversely affect the ability of the Borrower to perform its obligations under this Agreement.

Section 7.11 Further Assurances. From time to time hereafter, the Borrower will execute and deliver such additional instruments, certificates or documents, and will take all such actions as the Agent may reasonably request for the purposes of implementing or effectuating the provisions of this Agreement and each of the other Documents or for the purpose of more fully perfecting or renewing the Agent's rights with respect to the rights, properties or assets subject to such documents pursuant hereto or thereto. Upon the exercise by the Agent of any power, right, privilege or remedy pursuant to this Agreement and each of the other Documents which requires any consent, approval, registration, qualification or authorization of any Governmental Authority or instrumentality, the Borrower will, to the extent permitted by law, execute and deliver all necessary applications, certifications, instruments and other documents and papers that the Agent may be required to obtain for such governmental consent, approval, registration, qualification or authorization.

Section 7.12 Use of Commitment. The Borrower will use the Commitment provided for herein for purposes of supporting the Commercial Paper.

Section 7.13 Reduction of Outstanding Commercial Paper. (a) The Borrower will either (i) reduce its Outstanding Commercial Paper, its Credits Outstanding and outstanding Loan under the Credit Agreement to zero at least once each year on the Reduction Date, or (ii) demonstrate that its (a) available cash and (b) investments in obligations of the United States of America or obligations guaranteed as to all payments of principal and interest by the United States of America, which obligations have a maturity of one year or less, exceed the amount of Commercial Paper outstanding for a period of five consecutive business days ending on the Reduction Date at least once each year.

(b) The Borrower will reduce its Outstanding Commercial Paper for the Agent and each Non-Agent Bank on a Pro-Rata Shares basis, so that the Commitment reduces to not more than the following amounts on the following dates:

May 20, 2002	\$95,000,000
June 20, 2002	\$90,000,000
July 20, 2002	\$85,000,000
August 10, 2002	\$80,000,000

SECTION 8.

NEGATIVE COVENANTS

The Borrower covenants, undertakes and agrees with the Agent that from the date hereof and throughout the term of this Agreement and so long as this Agreement or the Commitment remains in effect, the Note or any of the Commercial Paper remains outstanding and unpaid or any amount is owing to the Agent under this Agreement, it will not

Section 8.1 Compliance with Laws, etc. Violate any laws, rules, regulations, or governmental orders to which it is subject, which violation involves a reasonable possibility of materially and adversely affecting the financial condition, business or results of operations of PGW.

Section 8.2 Rate Covenant. Fail to impose, charge and collect gas charges, as shall be sufficient to comply with the rate covenant applicable to all outstanding Gas Works Revenue Bonds as defined in the General Ordinance.

Section 8.3 Amendment. Amend or modify or agree to amend or modify in any way the General Ordinance, the Committee Resolution or any Document except with the prior written consent of the Agent, and in accordance with Section 11.1(e) hereof.

Section 8.4 Removal of Fiscal Agent or Commercial Paper Dealer. Cause or permit the removal of the Fiscal Agent or the Commercial Paper Dealer or the appointment of successors thereto unless (i) in the case of a removal, such removal does not take effect until the appointment of a successor and (ii) in the case of any appointment, the successor is satisfactory to the Agent.

Section 8.5 Sale of Assets. Sell, transfer, convey or lease (whether in a single transaction or a series of transactions) all or any substantial part of the properties or assets of PGW.

Section 8.6 Liens. Create, assume or permit to exist any Lien with respect to any assets now owned or hereafter acquired and used in connection with PGW, other than (i) mechanic's or materialman's Liens which are being contested in good faith by the Borrower or on the Borrower's behalf, and (ii) Liens authorized by the Documents, if any such Lien would materially adversely affect the ability of the Borrower to perform its obligations under this Agreement. Nothing herein shall be construed as prohibiting the Borrower from incurring indebtedness secured by the Revenues permitted pursuant to the provisions of the Act and the General Ordinance or pursuant to The First Class City Revenue Bond Act of the Commonwealth of Pennsylvania, Act 234, approved October 18, 1972, P.L. 955 or the Senior Bond Ordinance, as amended from time to time subject to 8.7.

Section 8.7 Additional Bonds. Issue any additional bonds or incur any additional loans payable from the revenues of PGW except for any such debt that is subject to the rate covenant requiring net revenues at least equal to 1.5 times annual debt service without the prior written consent of the Agent.

Section 8.8 Swap Termination Payments. Enter into any Swaps under which the termination payments are payable from the revenues of PGW, unless such payments are paid on a basis subordinate in lien and payment priority to the payments under this Agreement.

SECTION 9.
EVENTS OF DEFAULT

Each of the following events, acts or occurrences shall constitute an "Event of Default" under this Agreement.

Section 9.1 Failure to Pay Principal or Interest. The Borrower shall fail to pay (a) the principal amount of any Loan when due, (b) any interest on any Loan within five (5) Business Days after the same shall be due and payable, or (c) any fees or other amounts owing under this Agreement within five (5) Business Days after the same shall be due and payable.

Section 9.2 Default by Borrower under Other Obligations.

(a) The Borrower shall default in the payment when due (subject to any applicable notice or grace period), whether at stated maturity or otherwise, of any principal of or interest on (howsoever designated) any indebtedness for borrowed money payable from Revenues in excess of \$500,000, whether such indebtedness now exists or shall hereafter be created, provided, however, this Section 9.2(a) shall not apply to PGW debt to the Borrower,

(b) an event of default as defined in any mortgage, indenture, instrument or resolution under which there may be issued, or by which there may be secured or evidenced, any indebtedness for money borrowed of, or guaranteed by, the Borrower and payable from Revenues in excess of \$500,000, whether such indebtedness now exists or shall hereafter be created, shall occur and shall result in the indebtedness becoming due and payable prior to the stated maturity or due date thereof; or

(c) any event shall occur which shall permit such indebtedness in excess of \$500,000 to be so declared due and payable prior to its stated maturity or due date and such event shall continue unremedied past any period of grace provided for in any mortgage, indenture, instrument or resolution under which such indebtedness is issued.

Section 9.3 Representations or Warranties Untrue. Any representation or warranty made by the Borrower herein or in any other Document or in any certificate, letter or other writing or instrument furnished or delivered by the Borrower to the Agent pursuant hereto or thereto or in connection with this Agreement or therewith, shall prove to have been untrue or incorrect in any material respect when made or when reaffirmed, as the case may be.

Section 9.4 Bankruptcy, Etc. (i) The Borrower or PGW shall commence any case, proceeding or other action (A) under any existing or future law of any jurisdiction relating to bankruptcy, insolvency, reorganization or relief of debtors, seeking to have an order for relief entered with respect to it or seeking to adjudicate it insolvent or a bankrupt or seeking reorganization, arrangement, adjustment, winding-up, liquidation, dissolution, composition or other relief with

respect to it or its debts, or (B) seeking appointment of a receiver, trustee, custodian or other similar official for itself or for any substantial part of its property, or the Borrower shall make a general assignment for the benefit of its creditors, or (ii) there shall be commenced against the Borrower or PGW any case, proceeding or other action of a nature referred to in clause (i) and the same shall remain undismissed for a period of 30 days, or (iii) there shall be commenced against the Borrower or PGW any case, proceeding or other action seeking issuance of a warrant of attachment, execution, distraint or similar process against all or any substantial part of its property which results in the entry of an order for any such relief which shall not have been vacated, discharged, or stayed or bonded pending appeal, within 30 days from the entry thereof, or (iv) the Borrower shall take action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the acts set forth in clause (i), (ii) or (iii) above, or (v) the Borrower shall generally not, or shall be unable to, or shall admit in writing its inability to, pay its debts as they become due.

Section 9.5 Document or General Ordinance Default. The Borrower shall default in the due observance of any covenant, condition or agreement contained in the General Ordinance or any Document and the expiration of any applicable grace period shall have occurred.

Section 9.6 Default in Covenants Hereunder. The Borrower shall (a) default in the observance of its covenants set forth in Section 7.1(a) or 8, or (b) default in the observance of its other covenants hereunder not specifically referred to in this Section 9, and such default shall continue unremedied for thirty (30) days (or, if the Borrower is diligently pursuing a cure of such default, and such default is capable of cure within such time period, sixty (60) days) after written notice of such default shall have been given to the Borrower by the Agent.

Section 9.7 Accounts. The Note Redemption Account, the Reimbursement Account, the Sinking Fund Account or the Operating Account or any funds on deposit in, or otherwise to the credit of such account shall become subject to any writ, order, judgment, warrant of attachment, execution or similar process and such writ, order, judgment, warrant of attachment, execution or similar process prevents payment into or out of such Accounts for the purposes and at the times contemplated by the Documents, unless such writ, order, judgment, warrant of attachment, execution or similar process shall be fully bonded.

Section 9.8 Certain Judgments. Any judgment arising out of the operation of Borrower or PGW in an aggregate amount in excess of \$5,000,000 shall be entered against Borrower or PGW as the case may be and which is not (a) appealed or (b) paid within ninety (90) days of becoming final.

Section 9.9 Invalidity of Documents. Any provision of this Agreement or any of the other Documents or the General Ordinance shall at any time for any reason cease to be valid and binding on the related obligor thereunder or shall be declared to be null and void by any court or Governmental Authority or agency having jurisdiction over the Borrower, or the validity or the enforceability thereof shall be contested by the Borrower or PGW in a judicial or administrative proceeding.

Section 9.10 Changes in Act. Any change shall be made in any provision of the Act if such change would, in the reasonable judgment of the Agent, materially and adversely affect the ability of the Borrower to pay any amount coming due hereunder.

SECTION 10.

REMEDIES UPON DEFAULT

If any Event of Default shall occur and be continuing then, and in any such event, the Agent may immediately in its sole discretion take any or all of the following actions:

Section 10.1 Cease Issuing Commercial Paper. Instruct the Borrower and the Fiscal Agent with a copy to the Commercial Paper Dealer to immediately cease issuing and delivering Commercial Paper (if such instructions have not theretofore been given and are not then in effect).

Section 10.2 Terminate Commitment. Declare the Commitment to be terminated, whereupon the Commitment shall forthwith terminate except with respect to the amount of Commercial Paper Outstanding prior to the date of such termination; provided, however, that when the Commercial Paper Outstanding is paid the remaining Commitment shall be terminated..

Section 10.3 Draw Under the Letter of Credit. Direct the Fiscal Agent to make a drawing under the Letter of Credit in the amount required to pay in full all Outstanding Commercial Paper entitled to the benefit of the Letter of Credit upon maturity.

Section 10.4 Revenue Deposit. Direct the Fiscal Agent and the Borrower to deposit an amount into the Reimbursement Account equal to the Credits Outstanding.

Section 10.5 Acceleration. Upon not less than thirty (30) days prior notice to the Borrower, declare all the unpaid principal amount of the Note, interest accrued thereon and all other amounts owing by the Borrower hereunder or under the Note to be due and payable without presentment, demand, protest or notice of any kind, all of which are hereby expressly waived, and an action therefor shall immediately accrue; provided, however, that with respect to an Event of Default under Section 9.4 hereof, all the unpaid principal amount of the Note, interest accrued thereon and all other amounts owing by the Borrower hereunder or under the Note shall be immediately due and payable without presentment, demand, protest or notice of any kind, all of which are hereby expressly waived, and an action therefor shall immediately accrue. Anything herein to the contrary notwithstanding, no declaration or termination of the Commitment of the Agent pursuant to the foregoing provisions of this Section 10 shall affect the obligations of the Agent to make payments under the Letter of Credit with respect to Commercial Paper Outstanding.

SECTION 11.

THE BANKS

The provisions of this Section 11 are for the sole and exclusive benefit of the Agent and the Non-Agent Banks, and the Borrower shall have no rights or obligations under this Section 11.

Section 11.1 Obligations of Non-Agent Banks. On the following terms and conditions, the Agent hereby agrees to sell and the Non-Agent Banks hereby agree to purchase an undivided interest (the "Subcommitment") in the Agent's obligations in respect of this Agreement. The maximum amount of the Subcommitment of each Non-Agent Bank is set forth on the signature page hereto and the relationship which such amount bears to the maximum amount of the Agent's obligations under the Letter of Credit (determined at any given time after giving effect to any assignment by the Agent of any of its right, title and interest under the Agreement but without giving effect to the sale of any Subcommitment) is hereinafter called the "Pro Rata Share".

(a) At any time that a drawing in respect of principal and/or interest is not reimbursed by the Borrower under the terms of this Agreement, then the Agent will give notice to the Non-Agent Banks of a drawing under the Letter of Credit not later than noon on the succeeding Business Day. Such notice will state the date, the amount of the drawing and the amount of each Non-Agent Bank's Pro Rata Share in the drawing. The Non-Agent Banks will, before 3:00 p.m. (New York City time) on the date of such notice, make available to the Agent (ABA # 021-000-238) c/o J.P. Morgan Services, Inc., 500 Stanton Christiana Road, P.O. Box 6071, Newark, Delaware 19713-2107, Attention, Letter of Credit Services (account # 001-39-968), in immediately available funds, an amount equal to each Non-Agent Banks' Pro Rata Share.

(b) The Agent will promptly credit the account of each Non-Agent Bank, with its Pro Rata Share of all amounts representing reimbursement of drawings, interest on drawings, and the Annual Fee in accordance with Section 4.1(a) hereof.

(c) If the Agent should for any reason make any payment to any of the Non-Agent Banks in anticipation of the receipts of funds from the Borrower and such funds are not received by the Agent from the Borrower on the date payment is due, then each Non-Agent Bank shall, on demand of the Agent, forthwith return to the Agent any such amounts transferred to such Non-Agent Bank by the Agent in respect of the Subcommitment plus interest thereon for the period from the day such amounts were transferred by the Agent to such Non-Agent Bank to but not including the day such amounts are returned by such Non-Agent Bank, at a rate per annum equal to the effective Federal Funds rate for such period. If the Agent is required at any time to return to the Borrower or to a trustee, receiver, liquidator, custodian or other similar official any portion of the payments made by the Borrower to the Agent, then the Non-Agent Bank shall, on demand of the Agent, forthwith return to the Agent any such payments transferred to the Non-Agent Bank by the Agent in respect of the Subcommitment, but without interest on such payments (unless the Agent is required to pay interest on such amounts to the person recovering such payments).

(d) The Agent will exercise the same care in making and in handling the credits under this Section 11.1 as the Agent exercises with respect to credits in which no Subcommitments are granted.

(e) The Agent reserves the sole right and responsibility to enforce the obligations of the Borrower and any other entity obligated in respect of this Section 11.1. and may, in its sole discretion (a) agree to any modification of any of the terms of this Agreement or any other agreement or instrument evidencing, securing or otherwise relating to this Agreement, (b) waive any of such terms or give or withhold consents or approvals to any action or failure to act by the Borrower or any such other entity and (c) exercise or refrain from exercising, or waive, any rights or powers the Agent may have in respect thereof; provided that no amendment, waiver, or consent shall increase the Subcommitment or subject any Non-Agent Bank to any additional obligation, extend, as to the Subcommitment, the expiry date of the Letter of Credit, reduce the Letter of Credit Fees or reduce the rate of interest on draws under the Letter of Credit, extend the due date of any principal or interest on the Loans in connection therewith, release items of security under Section 2.12 of this Agreement, or consent to the assignment of the Borrower's obligations under this Agreement pursuant to Section 12.17 of this Agreement without the prior written consent of 100% of the Banks; and provided, further, however, with respect to Acceleration under Section 10.5. the Agent may only accelerate the Note if Banks whose Pro-Rata Share (including the Pro-Rata Share of the Agent) is at least equal to 100% of the Commitment, give their prior written consent to such remedy and provided further that the Agent may only (i) consent to additional bonds under Section 8.7 of this Agreement or amendments to the General Ordinance, or the Committee Resolutions, (ii) waive any Event of Default under this Agreement (iii) elect not to pursue remedies under this Agreement if Banks whose Pro-Rata Share (including the Pro-Rata Share of the Agent) is at least equal to 75% of the Commitment give their prior written consent to such consent, waiver or election; and provided, further, however, that the Agent shall pursue remedies if so directed by the Banks whose Pro-Rata Share (including the Pro-Rata Share of the Agent) is at least 75% of the Commitment. If the Non-Agent Banks do not agree or consent to a request of the Agent in writing within 10 days, the Agent may, in its option, repurchase the Pro Rata Share of such Non-Agent Banks immediately at par or such purchase price as shall be agreed between the Agent and such Non-Agent Banks at such time. The Agent shall not, in the absence of gross negligence or willful misconduct, be under any liability to the Non-Agent Banks with respect to anything which it may do or refrain from doing which may seem to the Agent to be necessary or desirable. Without in any way limiting the foregoing, the Agent may rely upon the advice of counsel concerning legal matters and upon any written communication or telephone conversation which it believes to be genuine and correct or to have been signed, sent or made by the proper person and shall not be required to make an inquiry concerning the performance by the Borrower of its obligations under this Agreement. The Agent shall have no obligation to make any claim on, or assert any lien upon, or assert any setoff against, any property held by it, and if it elects to do so, the Agent may in its discretion apply the same against indebtedness of the Borrower other than its indebtedness in respect of the Agreement. The Agent and the Non-Agent Banks may accept deposits from, make loans or otherwise extend credit

to and generally engage in any kind of banking or trust business with, the Borrower or any other entity obligated in respect of this Agreement.

(f) Each Non-Agent Bank agrees to indemnify the Agent for each Non-Agent Bank's Pro Rata Share (to the extent not reimbursed by the Borrower) of any and all liabilities, obligations losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursements of any kind and nature whatsoever which may be imposed on, incurred by or asserted against it in any way relating to or arising out of (i) any legal proceedings relating to this Agreement or the transactions contemplated thereby or (ii) the enforcement of any of the terms thereof, provided that each Non-Agent Bank shall not be liable for any of the foregoing to the extent they arise from the Agent's gross negligence or willful misconduct. This indemnity shall survive termination of this Agreement.

(g) The Agent makes no representation or warranty in connection with, and shall have no responsibility with respect to, the solvency, financial condition, or statements of the Borrower, or the validity and enforceability of the obligations of the Borrower in respect of this Agreement. Each Non-Agent Bank acknowledges that it has, independently and without reliance on the Agent, and based on such documents and information as it has deemed appropriate, made its own credit analysis and decision to purchase the Subcommitment and will continue to be responsible for making its own independent appraisal of the business, affairs and financial condition of the Borrower.

(h) The Agent shall retain a Pro-Rata Share at least equal to ten percent (10%) of the Commitment.

(i) The Agent shall give notices of default hereunder to the Borrower if requested to do so by any Non-Agent Bank.

Section 11.2 Notices to the Banks. Upon receipt by the Agent of any notice under this Agreement or the Documents, the Agent shall promptly forward copies of any such notice to the Banks. Within 45 days following the date on which any Bank receives a copy of the Borrower's request for an extension of the Expiration Date as provided in Section 2.2 hereof, each Non-Agent Bank shall deliver to the Agent written notice indicating whether or not such Non-Agent Bank consents to the Borrower's extension request. The failure of any Non-Agent Bank to notify the Agent in writing of any decision within such 45-day period shall be deemed to be a rejection of such request.

Section 11.3 Authorization and Action. Each Bank hereby appoints and authorizes the Agent to take such action as agent on its behalf and to exercise such powers under this Agreement and under the Documents as are delegated to such the Agent by the terms hereof and thereof, together with such powers as are reasonably incidental thereto. As to any matters not expressly provided for by this agreement or the other Documents, the Agent shall not be required to exercise discretion or take any action, but shall be required to act or to refrain from acting (and shall be fully

protected in so acting or refraining from acting) upon the instructions of the Banks, and such instructions shall be binding upon all the Banks; provided, however, that the Agent shall not be required to take any action which exposes the Agent to personal liability or which is contrary to this Agreement or applicable law. The Agent agrees to give to each Bank prompt notice of each notice given to it by the Borrower or the Fiscal Agent pursuant to the terms of this Agreement or the other Documents. In addition, the Agent shall, within 30 days of its receipt thereof from the Borrower, deliver a complete set of the documents executed and delivered with respect to the Amendment on the Amendment Date, to each Non-Agent Bank. The Agent shall deliver to each Non-Agent Bank, within 30 days of its delivery by the Borrower to the Agent, any other information relating to PGW reasonably requested in writing by such Non-Agent Bank.

Section 11.4 Agent's Reliance, Etc. Neither the Banks nor any of their directors, officers, administrative agents or employees shall be liable to any Bank for any action taken or omitted to be taken by it or them under or in connection with this Agreement or the other Documents, except for its or their own gross negligence or willful misconduct. Without limitation of the generality of the foregoing, each Bank may consult with legal counsel (including counsel for the Borrower), independent public accountants and other experts selected by it and shall not be liable for any action taken or omitted to be taken in good faith by it in accordance with the advice of such counsel, accountants or experts. The Banks (i) make no warranty or representation to any Bank and shall not be responsible to any Bank for any statements, warranties or representations (whether written or oral) made in or in connection with this Agreement; (ii) shall not have any duty to ascertain or to inquire as to the performance or observance of any of the terms, covenants or conditions of this Agreement on the part of the Borrower or to inspect the property (including the books and records) of the Borrower; (iii) shall not be responsible to any Bank for the due execution, legality, validity, enforceability, genuineness, sufficiency or value of this Agreement, the Documents or any other instrument or document furnished pursuant hereto or thereto, and (iv) shall incur no liability under or in respect of this Agreement by acting upon any notice, consent, certificate or other instrument or writing (which may be by telecopier, telegram, cable or telex) believed by it to be genuine and signed or sent by the proper party or parties. The Banks and the Borrower acknowledge that only the Agent has duties or responsibilities hereunder.

Section 11.5 Agents and Affiliates. The Agent and each Bank and its affiliates may accept deposits from, lend money to, act as trustee under indentures of, and generally engage in any kind of business with, the Borrower, any of its subsidiaries and any Person who may do business with or own securities of the Borrower or any such subsidiary, all as if it were not a Bank and without any duty to account therefor to any other Bank.

Section 11.6 Bank Credit Decision. Each Bank acknowledges that it has, independently and without reliance upon any other Bank and based on the financial statements referred to in Sections 6.4 and 7.1 and such other documents and information as it has deemed appropriate, made its own credit analysis and decision to enter into this Agreement. Each Bank also acknowledges that it will, independently and without reliance upon any other Bank and based on such documents and

information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under this Agreement.

SECTION 12.

MISCELLANEOUS

Section 12.1 No Waiver: Modifications in Writing. No failure or delay on the part of the Agent in exercising any right, power or remedy hereunder or under any other document, instrument or agreement required, referred to or contemplated hereunder or with respect to any Loan, the Letter of Credit or any Letter of Credit Disbursement shall operate as a waiver thereof, nor shall any single or partial exercise of any such right, power or remedy preclude any other or further exercise thereof or the exercise of any other right, power or remedy. The rights and remedies of the Agent provided for herein are cumulative and are not exclusive of any remedies that may be available to the Agent at law or in equity. Any waiver of any provision of this Agreement, and any consent to any departure by the Borrower from the terms of any provision of this Agreement, shall be effective only in the specific instance and for the specific purpose for which given. No notice to or demand on the Borrower in any case shall entitle the Borrower to any other or further notice or demand in similar or other circumstances.

Section 12.2 Notices, etc. Except as otherwise specified herein, all notices, demands, instructions and other communications required or permitted to be given to or made upon any party hereto shall be in writing, and such writing may be satisfied by communication by telecopy or tested telex or shall be personally delivered or sent by registered or certified mail, postage prepaid, return receipt requested, and shall be deemed to be given for purposes of this Agreement on the day that such writing or telecopy or tested telex is received by the intended recipient thereof in accordance with the provisions of this Section 12.2. Unless otherwise specified in a notice sent or delivered in accordance with the foregoing provisions of this Section 12.2, notices, demands, instructions and other communications in writing, or by telecopy or tested telex shall be given to or made upon the parties hereto at their respective addresses, telecopier number, or telex number set forth below, and, in the case of telephonic instructions or notices, by calling the telephone number or numbers indicated for such party below:

- (a) In the case of communications and payments to the Agent:

Morgan Guaranty Trust Company of New York,
One Chase Plaza
New York, New York 10081,
Reference: ABA# 02100021 for the credit of Philadelphia Gas Works Clearing
Account 323224415

- (b) In the case of communications and payments to the Non-Agent Banks:

- (i) First Union National Bank
123 South Broad Street (PA 1220)
Philadelphia, Pennsylvania 19109-7558
Attention: Underwriting Department

- (ii) PNC Bank, National Association
1600 Market Street, 221 Floor
Philadelphia, Pennsylvania 19103
Attention: Michael Valerio

- (iii) Bank of Nova Scotia
New York Agency
1 Liberty Plaza, 26th Floor
New York, New York 10006
Attention: Sandra Edwards, Letters of Credit

- (iv) Mellon Bank, N.A.
1735 Market Street, Suite 465
Philadelphia, PA 19103
Attention: Maryann M. George

or to such other account as the Agent or such Non-Agent Bank may from time to time designate in writing to the Borrower

- (c) If to the Borrower:

City of Philadelphia
Municipal Services Building, Suite 1330
1401 John F. Kennedy Boulevard
Philadelphia, Pennsylvania 19102
Attention: Director of Finance
Telephone: 215-686-6140
Telecopier: 215-988-0865

Copy to:

PGW
800 W. Montgomery Avenue
Philadelphia, Pennsylvania 19122
Attention: Chief Financial Officer
Telephone: 215-684-6456
Telecopier: 215-684-6602

(d) If to Fiscal Agent:

U.S. Bank Trust National Association
100 Wall Street
20th Floor
New York, New York 10005
Attention: William Martinez
Telephone: 212-361-3841

(e) If to Commercial Paper Dealer:

Goldman Sachs & Co.
85 Broad Street
New York, New York 10004
Attention: Municipal Money Market Desk
Telephone: 212-902-6632

Section 12.3 Indemnity. The Borrower hereby indemnifies and holds harmless the Banks from and against any and all claims, damages, losses, liabilities, reasonable costs or expenses whatsoever which the Agent may incur (or which may be claimed against the Agent by any Person or entity whatsoever) by reason of or in connection with the offering and sale of the Commercial Paper (including, without limitation, by reason of any inaccuracy in any material respect, or any untrue statement or alleged untrue statement of any material fact, contained in any Commercial Paper Memorandum or any amendment or supplement thereto, or by reason of the omission or alleged omission to state therein a material fact necessary to make such statements, in the light of the circumstances under which they were made, not misleading), the execution and delivery of this Agreement or the Letter of Credit or the transfer of the Letter of Credit, or payment or failure to pay under the Letter of Credit; provided, however, that the Borrower shall not be required to indemnify the Agent for any claims, damages, losses, liabilities, costs or expenses to the extent, but only to the extent, caused by (a) the willful misconduct or gross negligence of the Agent in determining whether a certificate presented under the Letter of Credit complied with the terms of the Letter of Credit, (b) the Agent's willful failure or gross negligence in failing to pay under the Letter of Credit after the presentation to it by the Fiscal Agent of a certificate strictly complying with the terms and conditions of the Letter of Credit or (c) an inaccuracy in a material respect, or an untrue statement, with respect to information supplied in writing by the Agent for inclusion in any Commercial Paper Memorandum. Nothing in this Section 12.3 is intended to limit any other obligations of the Borrower contained in this Agreement. The provisions of this Section 12.3 shall survive the termination of this Agreement.

Section 12.4 Survival of Agreement. All covenants, agreements, representations and warranties made herein, in the Fiscal Agent Agreement and in the certificates delivered pursuant hereto shall survive the issuance of the Letter of Credit and the Note and shall continue in full force and effect as to the Agent so long as any obligations of the Borrower hereunder or under the Note

are outstanding and unpaid and so long as the Agent has any liability hereunder or under the Letter of Credit. Whenever in this Agreement any of the parties hereto is referred to, such reference shall be deemed to include the successors and assigns of such party, but no assignment or transfer (by operation of law or otherwise) of this Agreement by the Borrower or any of its rights or duties hereunder may be made without the prior written consent of the Agent; and all covenants, promises and agreements by or on behalf of the Borrower which are contained in this Agreement and the documents, instruments and agreements required hereunder shall inure to the benefit of the successors and assigns of the Agent.

Section 12.5 Participations. The Agent may at any time sell, assign, negotiate, grant participations in, or otherwise dispose of its rights under this Agreement or the Note, to certain participating entities (the "Participants") but, no such disposition shall affect or reduce any obligations of the Agent or the rights of the Borrower hereunder, and all obligations of the Agent hereunder shall continue in full force and effect to the same extent as though no such disposition was made. Non-Agent Banks are not deemed to be Participants as defined in this Section 12.5

Section 12.6 Costs and Expenses.

(a) Costs of Enforcement. The Borrower agrees to pay to the Agent upon receipt of an invoice therefor whether or not any extension of credit is made under this Agreement the reasonable costs and other reasonable expenses (including, without limitation, legal fees and disbursements) incurred (as a direct or indirect result of action taken or omitted to be taken by or on behalf of the Borrower) in enforcing or seeking to enforce any of the rights of the Agent under this Agreement.

(b) Taxes. The Borrower agrees to pay all stamp, transfer and other similar taxes payable or determined to be payable in connection with the execution and delivery of this Agreement and in connection with any payment made by the Agent under or with respect to the Letter of Credit. The Borrower shall pay all such taxes payable or determined to be payable in connection with issuance of the Note or the making of any Loan made to it, and the Borrower agrees to save and hold the Agent harmless from and against any and all liabilities with respect to or resulting from any delay in paying or omission to pay such taxes.

Section 12.7 Applicable Law. This Agreement and the Note shall be construed in accordance with and governed by the laws of the Commonwealth of Pennsylvania.

Section 12.8 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall constitute an original but all of which, when taken together, shall constitute but one instrument, and shall become effective when such counterparts shall have been duly executed and delivered as of the date hereof by all parties hereto.

Section 12.9 Severability. In case any one or more of the provisions contained in this Agreement, the Fiscal Agent Agreement, the Note or any document, instrument, or agreement

required hereunder should be declared invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained herein and therein shall not in any way be affected or impaired thereby.

Section 12.10 Oral Negotiations. This Agreement and the documents, instruments, and agreements required hereunder supersede all oral negotiations and prior writings in respect of the subject matter hereof and thereof.

Section 12.11 Disclaimer. The Borrower acknowledges that the Agent has made no representation that the transactions contemplated by this Agreement or any other agreement delivered in connection herewith will have particular tax or accounting treatment upon the Borrower or any other person.

Section 12.12 No Third Party Beneficiary Rights or Benefits. This Agreement shall not be construed so as to confer any right or benefit upon any person other than the parties to the Agreement and their respective successors and assigns (including the Participants).

Section 12.13 Responsibility. Except to the extent required by law, neither the Agent nor any Participants shall have any responsibility as to the application by the Borrower of the proceeds of any Loan.

Section 12.14 Descriptive Headings. The Section headings are for convenience and are not part of this Agreement. Accordingly, they shall not affect the interpretation of any of the provisions hereof.

Section 12.15 Limited Liability. The Note, the Loans, and any obligation under this Agreement are not general obligations of the Borrower and do not pledge the credit or taxing power or create any debt or charge against the tax or general revenues of the Borrower. Any liability of the Borrower arising out of this Agreement shall be a limited liability of the Borrower payable solely from the Revenues and from the proceeds of the Commercial Paper. This Agreement is the corporate obligation of the Agent only. No recourse may be had by the Borrower or the Agent against any of the other's incorporators, shareholders, controlling persons, directors, officers, employees or agents with respect to claims arising under this Agreement.

Section 12.16 Liability of each Bank. As to each Bank, including the Agent, the Borrower assumes all risks of the acts or omissions of the Fiscal Agent with respect to its use of the Letter of Credit and the proceeds thereof; provided, however, that this assumption is not intended to, and shall not, preclude the Borrower from pursuing such rights and remedies as it may have against the Fiscal Agent at law or under any other agreement. Neither the Banks nor any of their officers, directors, employees or agents shall be liable or responsible for:

(a) the use made of the Letter of Credit or any proceeds of the Letter of Credit or for any acts or omissions of the Fiscal Agent;

(b) the validity, sufficiency or genuineness of any documents or endorsements, except the Letter of Credit, even if such documents should in fact prove to be in any or all respects invalid, insufficient, fraudulent or forged;

(c) payment by the Agent on behalf of the related Non-Agent Banks against presentation of documents which do not comply with the terms of a Letter of Credit, including failure of any documents to bear adequate reference to such Letter of Credit; or

(d) any other circumstances in making or failing to make payment under a Letter of Credit;

provided, however, that the Borrower shall have a claim against the Agent, and the Agent shall be liable to the Borrower for direct, but not consequential, damages suffered by the Borrower which were caused solely by the willful misconduct or gross negligence of the Agent in connection with drawings under the Letter of Credit (it being understood that, without limitation, failure to honor a draft accompanied by documentation in proper form shall constitute gross negligence). By way of amplification, the Agent may accept documents that appear on their face to be in order without responsibility for further investigation, regardless of any notice or information to the contrary. Subject to the foregoing, the determination of whether a draft has been presented under the Letter of Credit prior to the Expiration Date or whether a draft drawn under the Letter of Credit or any accompanying document or instrument is in proper and sufficient form shall be made by the Agent in its sole discretion, which determination shall be conclusive and binding upon the Borrower absent evidence that such determination was manifestly in error. The Borrower hereby waives any right to object to any payment made under the Letter of Credit against a draft with accompanying documents in the forms provided for in such Letter of Credit but varying in punctuation, capitalization, spelling or similar matters of form.

The provisions of this Section 12.16 shall not affect any claim which the Borrower or the Holder of any Commercial Paper may have against the Agent regarding information provided by the Agent for inclusion in any offering document for the Commercial Paper.

Section 12.17 Successors and Assigns. This Agreement is a continuing obligation and shall be binding upon the Agent, the Non-Agents Banks, the Borrower, and their respective successors, transferees and assigns, and shall inure to the benefit of and be enforceable by the Agent, the Non-Agent Banks, the Borrower and their respective successors, transferees and assigns; provided, however, that the Borrower shall not assign all or any part of this Agreement without the prior written consent of the Agent.

Section 12.18 Sharing of Payments Etc. If any Bank shall obtain any payment (whether voluntary, involuntary, through the exercise of any right of set-off or otherwise) on account of the Payment Obligations (other than pursuant to Section 2.7 or 12.3) in excess of its ratable share of payments on account of the Payment Obligations payable to all the Banks, such Bank shall forthwith

purchase from the other Banks such participations in the Payment Obligations as shall be necessary to cause such purchasing Bank to share the excess payment ratably with each of them, provided, however, that if all or any portion of such excess payment is thereafter recovered from such purchasing Bank, such purchase from each Bank shall be rescinded and such Bank shall repay to the purchasing Bank the purchase price to the extent of such recovery together with an amount equal to such Bank's ratable share (according to the proportion of (i) the amount of such Bank's required repayment to (ii) the total amount so recovered from the purchasing Bank) of any interest or other amount paid or payable by the purchasing Bank in respect of the total amount so recovered. The Borrower agrees that any Bank so purchasing a participation from another Bank pursuant to this Section 12.18 may, to the fullest extent permitted by law, exercise all its rights of payment (including the right of set-off) with respect to such participation as fully as if such Bank were the direct creditor of the Borrower in the amount of such participation.

Section 12.19 Assignments and Participations.

(a) Each Non-Agent Bank may, with the prior written consent of the Agent (which consent shall not be unreasonably withheld or delayed), assign to one or more banks or other entities all or a portion of its rights and obligations under this Agreement; provided, however, that (i) each such assignment shall be of a constant, and not a varying, percentage of all such rights and obligations, (ii) each such assignment shall be to an Eligible Assignee, and (iii) the parties to each such assignment shall execute and deliver to the Agent, an Assignment and Acceptance a form of which is attached hereto as Exhibit D, together with a processing and recordation fee of \$2,500; provided further that the prior written consent of the Borrower shall be required for any assignment resulting in a change in Non-Agent Banks. Upon such execution, delivery, acceptance and recording, from and after the effective date specified in each Assignment and Acceptance, (x) the assignee thereunder shall be a party hereto and, to the extent that rights and obligations hereunder have been assigned to it pursuant to such Assignment and Acceptance, have the rights and obligations of a Bank hereunder and (y) the Bank assignor thereunder shall, to the extent that rights and obligations hereunder have been assigned by it pursuant to such Assignment and Acceptance, relinquish its rights and be released from its obligations under this Agreement (and, in the case of an Assignment and Acceptance covering all or the remaining portion of an assigning Bank's rights and obligations under this Agreement, such Bank shall cease to be a party hereto).

(b) By executing and delivering an Assignment and Acceptance, the Bank assignor thereunder and the assignee thereunder confirm to and agree with each other and the other parties hereto as follows: (i) other than as provided in such Assignment and Acceptance, such assigning Bank makes no representation or warranty and assumes no responsibility with respect to any statements, warranties or representations made in or in connection with this Agreement or the execution, legality, validity, enforceability, genuineness, sufficiency or value of this Agreement or any other instrument or document furnished pursuant hereto; (ii) such assigning Bank makes no representation or warranty and assumes no responsibility with respect to the financial condition of the Borrower or the performance or observance by the Borrower of any of its obligations under this Agreement or any other instrument or document furnished pursuant hereto; (iii) such assignee

acknowledges that it has received a copy of this Agreement, together with copies of the financial statements referred to in Sections 6.4 and 7.1 and such other documents and information as it has deemed appropriate to make its own credit analysis and decision to enter into such Assignment and Acceptance; (iv) such assignee will, independently and without reliance upon the Agents, upon such assigning Bank or upon any other Bank and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under this Agreement; (v) such assignee confirms that it is an Eligible Assignee, (vi) such assignee appoints and authorizes the Agent to take such action on its behalf and to exercise such powers under this Agreement as are delegated to the Agent by the terms hereof, together with such powers as are reasonably incidental thereto; and (vii) such assignee agrees that it will perform in accordance with their terms all of the obligations which by the terms of this Agreement are required to be performed by it as a Bank.

(c) The Agent shall maintain at its address referred to in Section 12.2 hereof a copy of each Assignment and Acceptance delivered to and accepted by it and a register for the recordation of the names and addresses of the Banks. The entries in the register shall be conclusive and binding for all purposes, absent manifest error, and the Borrower, the Agent and the Non-Agent Banks may treat each Person whose name is recorded in the register as a Bank hereunder for all purposes of this Agreement. The register shall be available for inspection by the Borrower or any Bank at any reasonable time and from time to time upon reasonable prior notice.

(d) Upon its receipt of an Assignment and Acceptance executed by an assigning Bank and an assignee representing that it is an Eligible Assignee, the Agent shall, if such Assignment and Acceptance has been completed and is in substantially the form of Exhibit D hereto, (i) accept such Assignment and Acceptance, (ii) record the information contained therein in the register and (iii) give prompt notice thereof to the Borrower.

(e) Each Bank may sell participations to one or more banks or other entities in or to all or a portion of its rights and obligations under this Agreement; provided, however, that (i) such Bank's obligations under this Agreement shall remain unchanged, (ii) such Bank shall remain solely responsible to the other parties hereto for the performance of such obligations, and (iii) the Borrower, the Agent and the other Banks shall continue to deal solely and directly with such Bank in connection with such Bank's rights and obligations under this Agreement.

(f) Any Bank may, in connection with any assignment or participation or proposed assignment or participation pursuant to this Section 12.19, disclose to the assignee or participant or proposed assignee or participant any information relating to the Borrower furnished to such Bank by or on behalf of the Borrower, provided that the Borrower shall have no liability for any Bank's failure to indicate the date when such information was provided by Borrower or to provide complete and up to date information provided by Borrower.

(g) Notwithstanding anything to the contrary set forth herein, any Bank may assign, as collateral or otherwise, any of its rights hereunder (including, without limitation, its rights

to receive payments of principal and interest hereunder) to any Federal Reserve Bank without notice to or consent of the Borrower or the Agent.

Section 12.20 Discretion of Bank as to Manner of Funding. Notwithstanding any other provision of this Agreement, each Bank shall be entitled to fund and maintain its funding of all or any part of its participation interests in any manner it sees fit.

Section 12.21 Consent. The Agent acknowledges and agrees that any consent requested by Borrower of the Agent hereunder shall not be unreasonably withheld.

IN WITNESS WHEREOF, the Borrower and the Agent have caused this Agreement to be duly executed by their duly authorized officers as of the day and year first above written.

CITY OF PHILADELPHIA

By: _____
Mayor

By: _____
City Solicitor

By: _____
City Controller

Approved: _____
Director of Finance

MORGAN GUARANTY TRUST
COMPANY OF NEW YORK
30% of Commitment

By: _____
Name:
Title:

FIRST UNION NATIONAL BANK
25% of Commitment

By: _____
Name:
Title:

Title: THE BANK OF NOVA SCOTIA
25% of Commitment

By: _____
Name:
Title:

IN WITNESS WHEREOF, the Borrower and the Agent have caused this Agreement to be duly executed by their duly authorized officers as of the day and year first above written.

CITY OF PHILADELPHIA

By: _____
Mayor

By: _____
City Solicitor

By: _____
City Controller

Approved: _____
Director of Finance

MORGAN GUARANTY TRUST
COMPANY OF NEW YORK
30% of Commitment

By: Sandra B...
Name:
Title:

FIRST UNION NATIONAL BANK
25% of Commitment

By: _____
Name:
Title:

Title: THE BANK OF NOVA SCOTIA
25% of Commitment

By: _____
Name:
Title:

IN WITNESS WHEREOF, the Borrower and the Agent have caused this Agreement to be duly executed by their duly authorized officers as of the day and year first above written.

CITY OF PHILADELPHIA

By: _____
Mayor

By: _____
City Solicitor

By: _____
City Controller

Approved: _____
Director of Finance

MORGAN GUARANTY TRUST
COMPANY OF NEW YORK
30% of Commitment

By: _____
Name:
Title:

FIRST UNION NATIONAL BANK
25% of Commitment

By: Thomas Essex
Name: Thomas Essex
Title: Senior Vice President

Title: THE BANK OF NOVA SCOTIA
25% of Commitment

By: _____
Name:
Title:

IN WITNESS WHEREOF, the Borrower and the Agent have caused this Agreement to be duly executed by their duly authorized officers as of the day and year first above written.

CITY OF PHILADELPHIA

By: _____
Mayor

By: _____
City Solicitor

By: _____
City Controller

Approved: _____
Director of Finance

MORGAN GUARANTY TRUST
COMPANY OF NEW YORK
30% of Commitment

By: _____
Name:
Title:

FIRST UNION NATIONAL BANK
25% of Commitment

By: _____
Name:
Title:

Title: THE BANK OF NOVA SCOTIA
25% of Commitment

By: 
Name:
Title: WILLIAM R. COLLINS
MANAGING DIRECTOR

PNC BANK, National Association
10% of Commitment

By: Michael A. Valerio, Jr. VP
Name: Michael A. Valerio, Jr.
Title: Vice President

MELLON BANK, N.A.
10% of Commitment

By: _____
Name:
Title:

PNC BANK
10% of Commitment

By: _____
Name:
Title:

MELLON BANK, N.A.
10% of Commitment

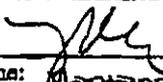
By: 
Name: Maryann W. George
Title: Vice President

EXHIBIT A

FORM OF AMENDED AND RESTATED
IRREVOCABLE LETTER OF CREDIT

Morgan Guaranty Trust Company of New York

May 28, 1999,
as amended and restated
June 12, 2001

LETTER OF CREDIT No. S-868812

U.S. Bank Trust National Association
100 Wall Street
Suite 1600
New York, New York 10005

Attention: Corporate Trust Services

Ladies and Gentlemen:

1. We hereby establish in favor of U.S. Bank Trust National Association or any successor fiscal agent (the "Fiscal Agent"), as Fiscal Agent under the Fiscal Agent Agreement dated as of May 1, 1994, as amended (the "Fiscal Agent Agreement"), with the City of Philadelphia, Pennsylvania (the "Issuer"), relating to the Issuer's Gas Works Revenue Notes, CP Series C (the "Notes"), an irrevocable credit whereby you are authorized to draw on Morgan Guaranty Trust Company of New York (the "Agent"), Irrevocable Letter of Credit No. S-868812 for the account of the Issuer pursuant to a Credit Agreement dated as of May 28, 1999 as amended and restated as of June 12, 2001 (as amended and restated, the "Credit Agreement"), by and between the Issuer and the Agent, First Union National Bank, PNC Bank, National Association, The Bank of Nova Scotia and Mellon Bank, N.A. available by drafts at sight, an aggregate amount not exceeding \$100,000,000 (the "Stated Amount"), which amount may be drawn upon by the Fiscal Agent with respect to payment of the aggregate face amount of Notes maturing on the date of any such drawing, subject to reinstatement pursuant to paragraph 5 hereof. This Letter of Credit is effective immediately and expires on August 15, 2002. As used in this Letter of Credit, with respect to any Notes, "face amount" shall mean the principal amount of such Notes, together with the amount of interest thereon, to the stated maturity thereof.

2. Funds under this Letter of Credit are available to you against your sight drafts drawn on the Agent stating on their face: "Drawn under Morgan Guaranty Trust Company of New York, Irrevocable Letter of Credit No. S-868812", and accompanied in each case by your certificate

in the form of Schedule I hereto appropriately completed. Presentation of such drafts and certificates shall be made by hand delivery, telecopier or by tested telex at our office located at 500 Stanton Christiana Road, Newark Delaware 19713-2107, Attention: Core Processing/Daniel Holmes, ASC, Reference: Philadelphia Gas Works or at any other office or offices or number or numbers in the City and State of New York which may be designated by us by written notice delivered to you.

3. We hereby agree with you that, to the extent of our liability as provided herein, all drafts drawn under and in compliance with the terms of this Letter of Credit will be duly honored upon delivery of the certificate as specified in paragraph 2 hereof and if presented at the aforesaid office on or before the expiration or termination date hereof. We will pay all drawings under this Letter of Credit with our own funds. If a drawing is made by you hereunder at or prior to 3:00 p.m., New York City time, on a business day prior to the stated maturity date of the Notes (the "Payment Date") in respect of which such drawing is made, and provided that such drawing and the documents presented in connection therewith conform to the terms and conditions hereof, payment shall be made of the amount specified, in immediately available funds not later than 2:15 p.m., New York City time, on the Payment Date. If a drawing is made by you hereunder and received by the Agent at or prior to 11:00 a.m., New York City time, on the Payment Date, and provided that such drawing and the documents presented in connection therewith conform to the terms and conditions hereof, payment shall be made of the amount specified, in immediately available funds, not later than 4:30 p.m., New York City time, on such Payment Date. If a drawing is made by you hereunder and received by the Agent after 11:00 a.m., New York City time, on the Payment Date, and provided that such drawing and the documents presented in connection therewith conform to the terms and conditions hereof, payment shall be made of the amount specified, in immediately available funds, not later than 2:15 p.m., New York City time, on the business day next succeeding such Payment Date. Payment under this Letter of Credit shall be made by wire transfer of immediately available funds to the Fiscal Agent at its account at the Federal Reserve Bank of New York, U.S. Bank Trust National Association, ABN No. 091000022 for further credit to Account No. 1731-0185-1827, Attention: Rosalyn Callender, ref. City of Philadelphia. Such account may be changed only by presentation to us of a letter in form satisfactory to us specifying a different account with the Fiscal Agent executed by the Fiscal Agent. As used in this Letter of Credit, "business day" shall mean any day other than a Saturday, Sunday or a day on which banking institutions in the State of New York or the Commonwealth of Pennsylvania are authorized or required by law to close.

4. Multiple drawings may be made hereunder; provided that, subject to paragraph 5 hereof, each drawing honored by the Agent hereunder shall pro tanto reduce the amount available under this Letter of Credit. Payments made in respect of any drawing (whether or not complying with the terms of this Letter of Credit) shall reduce by the amount of such payment the amounts which the Fiscal Agent may draw hereunder notwithstanding any acts or omissions, whether authorized or unauthorized, of the Fiscal Agent or any officer, director, employee or agent of the Fiscal Agent in connection with any drawing hereunder or the proceeds thereof or otherwise in connection with this Letter of Credit.

5. The obligations of the Agent to honor drawings under This Letter of Credit will be automatically reinstated, concurrently with receipt by the Agent of (a) reimbursement of any drawing under this Letter of Credit or (b) repayment of a Loan, by an amount equal to such reimbursement or repayment. The Bank shall promptly notify the Fiscal Agent of any reinstatement. As used in this Letter of Credit, "Loan" shall mean any unreimbursed drawing under this Letter of Credit used to pay principal of the Notes which is converted to a Loan under the terms of the Credit Agreement.

6. Only the Fiscal Agent may make drawings under this Letter of Credit. Upon payment as provided in paragraph 3 hereof of the amount specified in a sight draft drawn hereunder, we shall be fully discharged of our obligation under this Letter of Credit with respect to such sight draft.

7. The Stated Amount shall be decreased upon our receipt of notice from you, in the form of Schedule 4 hereto, as a result of a reduction in the Stated Amount of the Notes by an amount equal to the amount stated in said notice and the amounts available to be drawn by you under any subsequent reduction shall be automatically decreased by the amounts stated in such notice.

8. Upon the delivery by the Fiscal Agent to the Agent of a written certificate in the form of Schedule 2 hereto, appropriately completed and signed by your duty authorized officer, accompanied by this Letter of Credit surrendered for cancellation, this Letter of Credit shall terminate. Upon the earlier of (a) the payment by us of the final drawing available to be made hereunder (not subject to reinstatement pursuant to paragraph 5 hereof), or (b) the expiration date hereof, this Letter of Credit shall automatically terminate.

9. This Letter of Credit shall be governed by the Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication No. 500 (the "UCP") and, to the extent not governed by the UCP, by the internal laws of the State of New York, including, without limitation, Article 5 of the Uniform Commercial Code as in effect in the State of New York; provided, however, that notwithstanding the provisions of Article 19 of the UCP which contains provisions to the contrary, if this Letter of Credit expires during an interruption of business (as described in Article 17 of the UCP), we agree to effect payment under this Letter of Credit if a drawing which strictly conforms to the terms and conditions of this Letter of Credit is made within 15 days after the resumption of business. Unless otherwise specified herein, communications with respect to this Letter of Credit shall be in writing and shall be addressed to the Agent at One Chase Plaza, New York, New York 10081, Reference: ABA# 02100021 for the credit of Philadelphia Gas Works Clearing Account 323224415, specifically referring thereon to this Irrevocable Letter of Credit by number. Any communication to the Agent which is made by tested telex as permitted hereby shall be immediately confirmed in writing delivered to the Agent at the address of the Agent set forth in paragraph 2 hereof, provided that failure to provide such written confirmation shall not affect the validity of such notice by tested telex.

10. You may transfer your rights under this Letter of Credit in their entirety (but not in part) to any transferee who has succeeded you as Fiscal Agent under the Fiscal Agent Agreement or the successor agreement thereto and such transferred rights may be successively transferred. Transfer of your rights under this Letter of Credit to any such transferee shall be effected upon the presentation to the Agent of this Letter of Credit accompanied by a transfer letter in the form attached hereto as Schedule 3.

11. This Letter of Credit sets forth in full our understanding, and such undertaking shall not in any way be modified, amended, amplified or limited by reference to any document, instrument or agreement referred to herein (including, without limitation, the Notes), except only the certificates, sight draft and letters referred to herein; and any such reference shall not be deemed to incorporate herein by reference any document, instrument or agreement.

Very truly yours,

MORGAN GUARANTY TRUST
COMPANY OF NEW YORK

By _____
Authorized Signatory

SCHEDULE I

CERTIFICATE FOR THE PAYMENT OF THE FACE
AMOUNT OF GAS WORKS REVENUE NOTES, CP SERIES C,
OF THE CITY OF PHILADELPHIA, PENNSYLVANIA

The undersigned, acting in its capacity as Fiscal Agent by its duly authorized officer, hereby certifies to Morgan Guaranty Trust Company of New York, with reference to Irrevocable Letter of Credit No. S-868812 (the "Letter of Credit"; any capitalized term used herein and not defined having its respective meaning as set forth in the Letter of Credit) issued by Morgan Guaranty Trust Company of New York, in favor of the Fiscal Agent, that:

(A) The undersigned is the Fiscal Agent under the Fiscal Agent Agreement for the holders of the Notes.

(B) The Fiscal Agent is making a drawing under the Letter of Credit with respect to the payment of the principal amount of and interest accrued on the Notes maturing on the date hereof [or insert date of maturity if Certificate presented prior to date of maturity].

(C) The aggregate principal amount of and interest accrued on the Notes maturing on the date hereof (or insert the date of maturity if this Certificate is presented prior to the date of maturity) is \$ _____ consisting of \$ _____ of principal amount of and \$ _____ of interest on the Notes, which is the amount hereby demanded under the Letter of Credit.

(D) The amount of the sight draft accompanying this Certificate was computed in accordance with the Fiscal Agent Agreement, and such amount equals the amount necessary to pay in full the aggregate principal amount of and interest accrued on the Notes maturing on the date hereof [or insert the date of maturity if this Certificate is presented prior to the date of maturity].

(E) Upon our receipt of the amount demanded hereby under the Letter of Credit we will deposit said amount to the credit of the Note Redemption Account established pursuant to the Fiscal Agent Agreement for use solely to pay the aggregate principal amount of and interest accrued on such Notes.

IN WITNESS WHEREOF, the Fiscal Agent has executed and delivered this Certificate as of the _____ day of _____, _____.

U.S. BANK TRUST NATIONAL ASSOCIATION

By _____
Title:

SCHEDULE 2

CERTIFICATE FOR CANCELLATION OF LETTER OF CREDIT
IN RESPECT OF GAS WORKS REVENUE NOTES, CP SERIES C
OF THE CITY OF PHILADELPHIA, PENNSYLVANIA

The undersigned, acting in its capacity as Fiscal Agent by its duly authorized officer, hereby certifies to Morgan Guaranty Trust Company of New York, with reference to Irrevocable Letter of Credit No. S-868812 (the "Letter of Credit"; any capitalized term used herein and not defined having its respective meaning as set forth in the Letter of Credit) issued by Morgan Guaranty Trust Company of New York, in favor of the Fiscal Agent, that:

(1) The undersigned is the Fiscal Agent under the Fiscal Agent Agreement for the holders of the Notes.

(2) All outstanding Notes have been paid, and the undersigned has been advised by the Issuer that no additional Notes will be issued. The Letter of Credit, which accompanies this Certificate, is hereby surrendered for cancellation.

IN WITNESS WHEREOF, the Fiscal Agent has executed and delivered this Certificate as of the _____ day of _____, _____.

[NAME OF FISCAL AGENT]

By _____
Title:

SCHEDULE 3

[Letterhead of Fiscal Agent]

[Date]

Morgan Guaranty Trust Company of New York,

Re. Morgan Guaranty Trust Company of New York
Irrevocable Letter of Credit No. _____

Ladies and Gentlemen:

For value received, the undersigned beneficiary hereby irrevocably transfers to

(Name of Transferee)

(Address)

all rights of the undersigned beneficiary to draw under the above-referenced Letter of Credit in its entirety. Such transferee has succeeded the undersigned as Fiscal Agent under the Fiscal Agent Agreement dated as of _____, between the City of Philadelphia, Pennsylvania (the "Issuer") and the undersigned, or the successor agreement thereto, relating to the Gas Works Revenue Notes, CP Series C, of the Issuer.

By this transfer, all rights of the undersigned beneficiary in such Letter of Credit are transferred to the transferee and the transferee shall have the sole rights as beneficiary thereof, including sole rights relating to any amendments whether increases or extensions or other amendments and whether now existing or hereafter made. All amendments are to be advised directly to the transferee without necessity of any consent of or notice to the undersigned beneficiary.

The transferee hereby directs you to make all payments of drafts by it under the Letter of Credit in immediately available funds to account number _____ at _____.

The advice of such Letter of Credit is returned herewith, and we ask you to endorse the transfer on the reverse thereof, and forward it directly to the transferee with your customary notice of transfer.

Yours very truly,

SIGNATURE AUTHENTICATED

[Name of Beneficiary]

(Agent)

By _____
(Authorized Officer)

(Authorized Signature)

SIGNATURE AUTHENTICATED

[Name of Transferee]

(Agent)

By _____
(Authorized Officer)

(Authorized Signature)

CERTIFICATE FOR THE REDUCTION
OF AMOUNTS AVAILABLE UNDER
IRREVOCABLE LETTER OF CREDIT
No. S-868812

The undersigned, acting in its capacity as Fiscal Agent by its duly authorized officer, hereby certifies to Morgan Guaranty Trust Company of New York, (the "Bank") with reference to Irrevocable letter of Credit No. S-868812 (the "Letter of Credit"; any capitalized term used herein and not defined having its respective meaning set forth in the Letter of Credit) issued by Morgan Guaranty Trust Company of New York, in favor of the Fiscal Agent, that:

(1) The Fiscal Agent is the Fiscal Agent under the Fiscal Agent Agreement for the holders of the Notes.

(2) The Fiscal Agent has been directed by the Issuer to send this certificate to you.

(3) The Fiscal Agent hereby notifies you that on or prior to the date hereof the principal amount of the Notes which have been paid is as follows:

\$ _____

(4) Following the reduction, referred to in paragraph (2) above the aggregate principal amount of all of the Notes outstanding is as follows:

\$ _____

(5) The amount now available to be drawn by the Fiscal Agent under the Letter of Credit pursuant to any reduction relating to such Notes is reduced to the amount set forth below upon receipt by the Bank of this Certificate:

\$ _____

IN WITNESS WHEREOF, the Fiscal Agent has executed and delivered this Certificate this _____ day of _____.

U.S. Bank Trust National Association

By _____

FORM OF
CITY OF PHILADELPHIA

MORGAN GUARANTY
PROMISSORY NOTE

\$100,000,000.00

FOR VALUE RECEIVED, the undersigned City of Philadelphia (the "City") hereby promises to pay to Morgan Guaranty Trust Company of New York (the "Agent"), or its registered assigns, to the account of the Agent in New York, New York, specified in the Credit Agreement dated as of May 28, 1999, (as amended and restated, together with any amendments thereto, the "Credit Agreement") between the City and the Agent in lawful money of the United States of America in immediately available funds, the principal sum of One Hundred Million Dollars (\$100,000,000) or, if less, the aggregate unpaid principal amount of the Loans (as defined in the Credit Agreement) made by the Agent to the City under the Credit Agreement. Such Loans shall be payable in the amounts and on the dates specified in the Credit Agreement.

The City also promises to pay interest to the account of the Agent specified in the Credit Agreement, in like money and funds, on the aggregate outstanding amount of the Loans made by the Agent on the dates and at the rates specified in the Credit Agreement.

Each Loan made by the Agent and each payment or prepayment with respect thereto shall be endorsed by the holder hereof on the grid attached hereto.

Presentation, demand, protest and notice of dishonor are hereby waived by the undersigned.

Neither the principal of this note or any part thereof nor any interest thereon is a general obligation of the City or pledges the general credit or taxing power of the City, or creates any debt or charge against the tax or general revenues of the City, but such amounts are payable solely from the Revenues (as defined in the Credit Agreement) and from the proceeds of the Commercial Paper (as defined in the Credit Agreement).

This note may be transferred only by surrender hereof to the City, together with an instrument of transfer reasonably satisfactory to the City, for registration of transfer whereupon the City, at its option, may either reissue this note or issue a new note to the transferee.

This note is subject to the terms and conditions contained in the Credit Agreement, which among other things provides for the acceleration of the maturity of any Loan upon the occurrence of certain events and for prepayments in certain circumstances and upon certain terms and conditions, and reference is made thereto for a complete statement of such

terms and conditions and of the security for this note, including the pledge of the Revenues, and the creation of a security interest therein. It is hereby certified and recited that any and all acts, conditions and things required to exist, to happen and to be performed precedent to and in the incurring of the indebtedness evidenced by this note and issuance of this note exist, have happened, and have been performed in due time, form and manner as required by the Constitution and laws of the Commonwealth of Pennsylvania including the Act (as defined in the Credit Agreement).

IN WITNESS WHEREOF, the City of Philadelphia has caused this note to be signed in its name and on its behalf and its official seal to be hereunto affixed this 28th day of May, 1999.

CITY OF PHILADELPHIA

By: _____
Mayor

By: _____
City Solicitor

By: _____
City Controller

Approved: _____
Director of Finance

Date of Loan	Loan Amt.	Interest Rate	Date of Repayment	Notation Made By
---------------------	------------------	----------------------	--------------------------	-------------------------

[FORM OF OPINION OF HAWKINS DELAFIELD & WOOD]

May 28, 1999

Morgan Guaranty Trust Company of
New York

Moody's Investors Service
99 Church Street
New York, New York 10007

City of Philadelphia, Pennsylvania
1650 Wall Street, Room 1760
Philadelphia, Pennsylvania 19103

Standard & Poor's Ratings Services
25 Broadway
New York, New York 10004

U.S. Bank Trust National Association
100 Wall Street, Suite 1600
New York, New York 10005

Fitch IBCA, Inc.
One State Street Plaza
New York, New York 10004

Goldman, Sachs & Co.
85 Broad Street
New York, New York 10004

PNC Bank, National Association
1600 Market Street, 22nd Floor
Philadelphia, Pennsylvania 19103

First Union National Bank
123 South Broad Street (PA 1220)
Philadelphia, Pennsylvania 19109-7558

Ladies and Gentlemen:

We have acted as special counsel to Morgan Guaranty Trust Company of New York, acting through its New York Agency (the "Agent"), in connection with the issuance of an irrevocable letter of credit dated May 28, 1999 (the "Letter of Credit") by the Agent in support of Gas Works Revenue Notes, CP Series C (the "Notes") of the City of Philadelphia, Pennsylvania (the "City"), in the original aggregate face amount of \$100,000,000. The Notes have been issued pursuant to the General Inventory and Receivables Gas Works Revenue Note Ordinance of 1998, Bill No. 980234, of the City, approved on May 4, 1998, and the Resolution dated May 4, 1998, adopted by the Committee of the City. In connection with the issuance of the Letter of Credit, the Agent, First Union National Bank and PNC Bank, National Association have entered into a Credit Agreement with the City, dated as of May 28, 1999 (the "Credit Agreement").

We have examined such records, documents, instruments, certificates of public officials and of the Agent and such questions of law as we have deemed necessary for the purpose of rendering the opinions set forth herein. In such examination, we have assumed the genuineness of all signatures and the authenticity of all items submitted to us as originals and the conformity to originals of all items submitted to us as certified copies and the authenticity of the originals of such copies.

Based upon and subject to the foregoing, we are of the opinion that:

1. The Agent is duly licensed by the Superintendent of Banks of the State of New York and authorized to transact business as a New York trust company and has the power to execute and deliver the Credit Agreement and to issue the Letter of Credit.

2. The Credit Agreement and the Letter of Credit have been duly authorized, executed and delivered by the Agent.

3. The Letter of Credit constitutes the legal, valid and binding obligation of the Agent, enforceable against the Agent in accordance with its terms, except as such enforceability may be limited by applicable insolvency, reorganization, liquidation, moratorium, readjustment of debt or other similar laws affecting the enforcement of creditors' rights generally, as such laws may be applied in the event of an insolvency, reorganization, liquidation, readjustment of debt or other similar proceedings of or moratorium affecting Morgan Guaranty Trust Company of New York, and subject to the application of general principles of equity regardless of whether such enforceability is considered in a proceeding at law or in equity. We express no opinion as to whether a court, in the exercise of its equitable powers, may temporarily restrain payment under the Letter of Credit.

We are qualified to practice law in the State of New York and we do not express any opinion concerning any law other than the law of the State of New York and the Federal law of the United States of America.

This opinion is furnished to you, is solely for your benefit and may not be used, circulated, quoted or otherwise referred to without our prior consent.

Very truly yours,

EXHIBIT D

ASSIGNMENT AND ACCEPTANCE

Dated _____, _____

Reference is made to the Credit Agreement dated May 28, 1999 as amended and restated as of June 12, 2001, as (the "Credit Agreement"), among the City of Philadelphia, (the "Borrower"), the Non-Agent Banks (as defined in the Credit Agreement) and Morgan Guaranty Trust Company of New York, as Agent (the "Agent"). Terms defined in the Credit Agreement are used herein with the same meaning.

_____ (the "Assignor") and _____ (the "Assignee") agree as follows:

1. The Assignor hereby sells and assigns without recourse the Assignee, and the Assignee hereby purchases and assumes from the Assignor, that interest in and to all of the Assignor's rights and obligations under the Credit Agreement as of the date hereof which represents the percentage interest specified on the signature page of the Credit Agreement of all outstanding its and obligations under the Credit Agreement, including, without limitation, such interest, in the Assignor's Subcommitment, the Payment Obligations owing to the Assignor, the outstanding Letters of Credit and the rights and obligations of the Assignor with respect to the Letters of Credit. After giving effect, to such sale and assignment, the Assignee's Commitment and the amount of the Payment Obligations owing to the Assignee will be as set forth on the signature page of the Credit Agreement.

2. The Assignor (i) represents and warrants that it is the legal and beneficial owner of the interest being assigned by it hereunder and that such interest is free and clear of any adverse claim; (ii) makes no representation or warranty and assumes no responsibility with respect to any statements, warranties or representations made in or in connection with the Credit Agreement or the execution, legality, validity, enforceability, genuineness, sufficiency or value of the Credit Agreement or any other instrument or document furnished pursuant thereto; (iii) makes no representation or warranty and assumes no responsibility with respect to the financial condition of the Borrower or the performance or observance by the Borrower of any of its obligations under the Credit Agreement or any other instrument or document furnished pursuant thereto.

3. The Assignee (i) confirms that it has received a copy of the Credit Agreement, together with copies of the Documents and information as it has deemed appropriate to make its own credit analysis and decision to enter into this Assignment and Acceptance and (ii) agrees that it will, independently and without reliance upon the Agent, the Assignor or any Non-Agent Bank make its evaluation of the transaction.

IN WITNESS WHEREOF, the parties hereto have caused this Assignment and Acceptance to be executed by their respective officers thereunto duly authorized, as of the date entered above written, such execution being made an Schedule 1 hereto.

[NAME OF ASSIGNOR]

By _____
Name:
Title:

[NAME OF ASSIGNEE]

By _____
Name:
Title:

Lending Office:
(Address]

Consented to this _____ day
of _____, _____

Contact for notices other than
Advances and Repayments:

MORGAN GUARANTY TRUST COMPANY
OF NEW YORK, As Agent

By _____
Name:
Title:

Lance Haver
6048 Ogontz Avenue
Philadelphia, PA 19141
(CEPA)

Brian Kalcic
Excel Consulting
Suite 720-T
225 S. Meramec Avenue
St. Louis, MO 63105
(OSBA)
Fax: (314) 725-2022

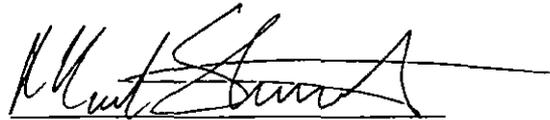
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Roswell, GA 30075
E-mail: Rbaudino@jkenn.com

Larry Speilvogel
203 Hughes Road
King of Prussia, PA 19406
(PICGUG)

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& Hippel LLP
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1617 John F. Kennedy Blvd.
Philadelphia, PA 19103-1895
E-mail: wfh@obermayer.com

Philip Bertocci, Esq.
Edward A. McCool, Esq.
Community Legal Services
1424 Chestnut Street
Philadelphia, PA 19102
Fax: (215) 981-0434
E-mail: pbertocci@clsphila.org

Dated: June 20, 2001



Mark S. Stewart, Esquire

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF SMALL BUSINESS ADVOCATE
Suite 1102, Commerce Building
300 North Second Street
Harrisburg, Pennsylvania 17101

KJR

Bernard A. Ryan, Jr
Small Business Advocate

(717) 783-2525
(717) 783-2831 (FAX)

June 21, 2001

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PA. P.U.C.
SECRETARY'S BUREAU

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HAND DELIVERED

James J. McNulty, Secretary
Pa. Public Utility Commission
Commonwealth Keystone Building
Harrisburg, PA 17105

Re: Pennsylvania Public Utility Commission v.
Philadelphia Gas Works
Docket No. R-00006042

DOCUMENT
FOLDER

Dear Mr. McNulty:

Enclosed for filing are the original and nine (9) copies of the Main Brief on behalf of the Office of Small Business Advocate in the above-docketed proceeding. As evidenced by the enclosed certificate of service, three copies have been served on all active parties in this case.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Steven C. Gray
Assistant Small Business Advocate

Enclosures

cc: Hon. Cynthia W. Fordham
Administrative Law Judge

Parties of Record

Brian Kalcic

55

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

:
:
:
:
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Docket No. R-00006042

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SECRETARY'S BUREAU

MAIN BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

DOCKETED

JUN 25 2001

Steven C. Gray
Assistant Small Business Advocate

Office of Small Business Advocate
Suite 1102, Commerce Building
300 North Second Street
Harrisburg, PA 17101
(717) 783-2525

DOCUMENT
FOLDER

Dated: June 21, 2001

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I. STATEMENT OF THE CASE

On January 5, 2001, Philadelphia Gas Works (“PGW” or “Company”) filed Supplement No. 7 to Tariff Gas – Pa. P.U.C. No. 1 (“Supplement No. 7”) to become effective March 6, 2001. PGW filing proposed an increase in rates calculated to produce an additional \$65,000,000 in annual revenues. On February 8, 2001, the Pennsylvania Public Utility Commission (“Commission”) suspended Supplement No. 7 until October 6, 2001, in order to conduct an investigation into the justness and reasonableness of PGW’s existing rates.

The Office of Small Business Advocate (“OSBA”) filed a formal complaint in this rate proceeding on February 6, 2001. The OSBA filed direct, rebuttal, and surrebuttal testimony in this case.

Evidentiary hearings were held on May 22, 23, and 24, 2001 in Philadelphia.

II. STATEMENT OF QUESTIONS

Does the Cost of Service Study presented by PGW in this rate proceeding demonstrate that PGW's Commercial class is over-recovering its cost of service revenue requirement?

Must PGW's firm customer classes be moved closer to recovering their respective cost-based revenue requirements in this rate proceeding?

Should the Commercial class customer charge be set at \$17.50?

Should the Commercial class commodity charge be set at \$7.1897 per Mcf?

Should the Commercial class commodity charge be proportionally scaled back if PGW is not granted its entire \$65 million revenue request?

III. SUMMARY

The Cost of Service Study filed by PGW demonstrates that the Residential class is significantly under-recovering its cost of service. PGW's Cost of Service Study also demonstrates that the Commercial class is significantly over-recovering its cost of service. The OCA’s proposed

modification to PGW's Cost of Service Study does not change the fact that the Residential class is under-recovering its cost of service, or the fact that the Commercial class is over-recovering its cost of service.

PGW's firm customer classes must be moved closer to their cost of service in this rate proceeding.

The Commercial class should have its customer charge set at \$17.50, and its commodity charge set at \$7.1897.

In the event that PGW is not granted its entire revenue request of \$65 million, the firm customer classes should have their revenue allocation scaled back based upon the percentages set forth in OSBA witness Brian Kalcic's Schedule BK-3. The Commercial class should receive its scaleback in the commodity charge component.

IV. ARGUMENT

A. Cost of Service Study

As part of its January 5, 2001 Base Rate Case filing, PGW filed a cost of service study ("COSS") that it describes as an "unbundled, fully allocated cost of service study...completed in December, 2000." PGW Statement No. 5 (Revised), at 2. The COSS was performed for PGW by R.J. Rudden Associates, and is described in detail beginning on page 6 of Mr. Gorman's direct testimony. Id.

For the purposes of this case, the OSBA accepts the COSS as filed. The OSBA takes no position, for example, on the issues raised by OCA Witness Miller regarding alleged defects in the allocation procedures used in PGW's COSS. See, e.g., OCA Statement No. 2, at 21.

PGW states that the purpose of its COSS is to "assign the total costs incurred by the utility to each Customer Class, and to compare the costs assigned to each Customer Class to the revenue produced by the rates proposed by the utility." PGW Statement No. 5 (Revised), at 2. Exhibit HSG-1, Schedules 1 through 5, summarizes in detail the results of the PGW COSS.

It is important to note, however, that the PGW COSS provides two distinct sets of results. First, the COSS sets forth a fully allocated result at PGW's requested revenue requirement of \$800.4 million. This calculated result is labelled "Total Tariff Requirement - Cost Causation Basis" as shown in Exhibit HSG-1, Schedule 1. Simply stated, this dollar amount is that portion of PGW's overall requested revenue requirement attributable to each customer class on a straightforward, cost-causation basis.

However, that straightforward result is not the end of the analysis. PGW's COSS then presents a new calculation of the class revenue requirements based upon the reassignment of the \$58.7 million of Customer Responsibility Program and Senior Citizen discounts ("discount programs"). This further calculation is labelled "Total Tariff Requirement – Re-Assignment Basis" in Schedule 1 of Exhibit HSG-1. This reassignment was performed using the methodology currently employed by PGW to recover those discounts, which is on a volumetric (non-cost) basis. See PGW Statement No. 5 (Revised), at 36.

The cost-of-service results contained in PGW Exhibit HSG-1 are summarized in Schedule BK-1 attached to the Direct Testimony of OSBA witness Brian Kalcic. Page 1 of Schedule BK-1 recaps the base revenue increases that would be required of each customer class in order for the customer classes to meet their cost of service on a pure "cost-causation basis" (to use PGW's phrase). Page 2 of Schedule BK-2 recaps the revenue increases that would be required of each customer class after the discount programs have been reassigned on the volumetric basis used by PGW.

Schedule BK-1, page 1, is of interest to all parties in this case because it sets forth the revenue requirement of the various customer classes absent the unique "reassignment" of the discount programs that are offered by PGW. Page 1 of Schedule BK-1 shows that the Residential class would require a base rate increase of 26.65% in order to fully recover its cost of service. All other rate classes would require base rate decreases. See OSBA Statement No. 1, at 4.

However, as interesting and illuminating as page 1 of Schedule BK-1 may be, even more telling is page 2 of Schedule BK-1, which shows the class “cost-of-service” results with the discount programs fully reassigned. Specifically, the fifth column in Schedule BK-1, page 2 (labelled “‘Cost-Based’ Increase”), shows that the Residential class would still require a 22.34% increase in rates for it to fully recover its cost of service. With the exception of the Housing Authority class, all remaining rate classes would again require base rate decreases in this proceeding in order to move to their respective “cost of service.”

This is an appropriate juncture to consider OCA witness Ralph Miller’s argument that PGW’s COSS contains defects in parts of its allocation methodology. See OCA Statement No. 2, at 21. To repeat, the OSBA takes no position in this case on the validity of Mr. Miller’s recommended changes to the PGW COSS. However, assume that Mr. Miller’s changes are correct in every detail, and that the PGW COSS is modified to reflect all of Mr. Miller’s changes in methodology. It would be expected that these allocation changes would make a difference in the cost of service results, and indeed they do.

Schedule BK-1S, attached to Brian Kalcic’s Surrebuttal testimony, summarizes the revenue increases that would be required of each customer class in order for them to meet their cost of service using Mr. Miller’s cost of service study methodology. For clarity and ease of comparison, Schedule BK-1S follows the same format as Schedule BK-1. Specifically, page 1 of Schedule BK-1S sets forth the customer class cost-of-service results using PGW’s cost causation basis. Page 2 of Schedule BK-1S shows the customer class cost-of-service results after the discount programs have been reassigned on a volumetric basis.

Clearly, Mr. Miller’s changes in allocation methodology have made a significant difference in the under- and over-recovery percentages in nearly all of PGW’s customer classes, particularly impacting PGW’s interruptible customer classes. However, little has changed for the Residential class where it is yet again chronically under-recovering its cost of service. Specifically, PGW’s COSS show that even with the discount programs assigned on a volumetric basis, the Residential

class needs a 22.34% revenue increase in order to fully meet its cost of service. Using Mr. Miller's COSS, that 22.34% revenue increase drops only slightly to 19.45%.

Ironically, Mr. Miller's cost allocation methodology has the greatest positive impact upon the Commercial class. The PGW COSS shows that the Commercial class needs a 1.18% decrease in order for it to stop over-recovering its cost of service, once again with the discount programs assigned on a volumetric basis. However, using Mr. Miller's methodology, the Commercial class needs a much larger 7.36% decrease in order to eliminate that over-recovery. See OSBA Schedule BK-1S, at 2.

Consequently, no matter which cost of service allocation methodology is chosen, the results are inescapable. The Residential class is grossly under-recovering its cost of service revenue requirement, and requires a double-digit percentage increase in its revenues in order to fully meet that cost of service. Further, the Commercial class is over-recovering its cost of service revenue requirement, and requires a decrease in its revenues in order for it to fully meet, and not overpay, its cost of service.

B. Revenue Allocation

PGW has filed this Base Rates Case requesting a \$65 million rate increase. As discussed above, the PGW COSS conclusively demonstrates that the non-residential firm rate customer classes are over-recovering their cost of service while the Residential class is under-recovering its costs. Significantly, even the cost allocation changes proposed by Mr. Miller on behalf of the OCA do not change these fundamental facts.

PGW has presented its proposal for allocating its requested base revenue increase from the various customer classes. See PGW Statement No. 4 (Revised), at 4. See also, PGW Exhibit CW-2. Schedule BK-2 summarizes PGW's proposed revenue distribution at the Company's requested revenue requirement level.

As shown in Schedule BK-2, the system average revenue increase is 15.1%.¹ Note that PGW is proposing no change in revenue requirement from the Interruptible / Transportation customers. What PGW is proposing, however, is to increase the Residential customer class revenue requirement 0.5% above the system average increase of 15.14%. OTS Exhibit No. 3, Schedule 1, page 1. The remaining customer classes then have their increases slightly reduced, in “an offsetting percentage reduction equal to the increase in the Residential class in order to maintain the overall \$65 million increase.” *Id.*

PGW’s own Cost of Service Study clearly demonstrates the complete inadequacy of PGW’s proposed allocation of the revenue increase. The Company’s COSS shows that the Residential class is woefully under-recovering its costs, and needs an increase of at least 22.34% in order to move to full cost of service. *See* OSBA Schedule BK-1, at 2. Instead, PGW offers up an anaemic proposal that only “moves us in the direction of eliminating the under contribution of costs by Residential customers.” OTS Exhibit No. 3, Schedule 1, at 2.

The OSBA is pleased that PGW recognizes that the Residential customers are “under contributing” their costs, and that movement towards the elimination of that under recovery is necessary. However, a mere 0.5% increase above the system average increase would move the Residential class closer to its cost of service at only the most miniscule of rates. Consequently, all other firm customer classes would receive no meaningful rate relief, and no end to their severe over-recovery of costs under PGW’s existing rate structure.

The OSBA’s proposed revenue allocation provides an appropriate balance of gradualism with the necessity of making real progress *in the present case* moving the firm customer classes closer to their cost of service. Specifically, the OSBA revenue allocation assigns the Residential class an increase of 18.9%, which is 3.8% over the system average increase of 15.1%, instead of the mere

¹PGW calculates this percentage as 15.14%. *See* OTS Exhibit No. 3, Schedule 1, page 1. Part of the Municipal and Housing Authority classes are billed on the Commercial and Residential tariffs, respectively. Schedule BK-2 keeps the “classes” on the same basis as the COSS. Exhibit CW-2 combines these customers, where applicable, and consequently the resulting percentages shown in Schedule BK-2 are slightly different.

0.5% differential proposed by PGW. The remaining firm, non-residential customer classes receive a downward adjustment in their revenue requirement in proportion to the level of their over-recovery of costs.

It is important to note what the OSBA proposal is truly suggesting. The OSBA proposal attempts to make real progress getting all of the firm customer classes closer to their cost of service, and to begin that progress immediately. The OSBA is not attempting to increase the Residential customer class revenue requirement by 22.34% in order to reach its total cost of service as shown in the PGW COSS. Nor is the OSBA proposal attempting to decrease the revenue requirement for the Commercial class as even Mr. Miller's COSS acknowledges would be fair. The OSBA proposal is, instead, gradually moving the Residential class closer to its costs, while providing the other firm customer classes with relief from their over-recovery of costs.

This disparity between the PGW COSS and the PGW revenue allocation proposal carries with it consequences beyond the basic unfairness of having the firm non-Residential classes over-recover their costs, while the Residential class under-recovers its costs. 66 Pa.C.S.A. Section 2212(g) requires PGW to submit a restructuring filing to the Commission no later than July 1, 2002. Furthermore, 66 Pa.C.S.A. Section 2212(j) requires that all retail customers of PGW have the opportunity to participate in a customer choice program shortly after the Commission's restructuring order takes effect. Clearly the day is fast approaching that PGW is going to have to offer cost-based transportation rates to all of its customer classes. Bringing PGW's customer classes closer to their cost of service therefore takes on an immediacy beyond a question of economic fairness – it is simply mandatory that action be taken now if PGW is to offer a customer choice program in the foreseeable future. Consequently, PGW's proposal to move the Residential class 0.5% closer to its cost of service is, at best, a de minimis attempt to “do something” in this case, and at worst, a failure to face the inevitable.

The OSBA proposal, which limits the Residential customer class increase to 1.25 times the system average, makes real progress in this case without violating the principle of gradualism. It

gradually moves the Residential class in the “direction of eliminating the under contribution of costs by Residential customers,” while providing a degree of relief from the severe over-recovery currently experienced by all firm rate classes. OTS Exhibit No. 3, Schedule 1.

C. Commercial Class Rate Design

PGW proposes to increase the Customer Charge of the Commercial class from \$10.00 to \$25.00. See PGW Statement No. 4, at 7. The Company's rationale for this customer charge increase includes, among its other arguments, a dubious comparison of PGW's customer charge to other natural gas utilities throughout Pennsylvania. Id., at 4-7.

In contrast, the OSBA proposes an increase in the Commercial customer charge from \$10.00 to \$17.50, and applies the residual increase necessary to recover the class revenue target to the Commercial commodity charge, which increases from \$7.1200 per Mcf to \$7.1897 per Mcf. See OSBA Statement No. 1, at 10. The OSBA proposal thus mitigates the rate impact that the \$25.00 charge would visit upon smaller Commercial ratepayers, while still providing the rate relief that PGW claims that it needs. In addition, moving the Commercial customer charge to \$17.50 brings PGW more in line with the current statewide Commercial customer charge average of \$16.79 as calculated by Mr. Metro. See OTS Exhibit No. 3, Schedule 5.

PGW's proposal to increase the Commercial customer charge from \$10.00 to \$25.00 is excessive for a number of reasons. First, PGW's proposal would result in a 150% increase to the Commercial customer charge. So much for any "application of the concept of gradualism" that PGW claims to adhere to. See OTS Exhibit No. 3, Schedule 1, page 2. Second, any 150% increase is suspect in and of itself. Consider how easy it would be, as an example, to move all firm customer classes to their cost of service if 150% changes were a reasonable and accepted way of allocating costs and designing rates. Finally, PGW evidently did not pay much attention to its own testimony where it compared its proposed Commercial customer charge to that of other Pennsylvania utilities.

A simple review of PGW Statement No. 4 shows that \$25.00 is far beyond the Commercial customer charge of nearly every utility that PGW chooses to list.

The OSBA rate design proposal in this proceeding also takes into account the possibility that PGW may be granted less than its requested amount of base rate relief. Specifically, the OSBA recommends that the Commercial customer charge remain fixed at \$17.50 regardless of the level of increase ultimately allowed. The reduced Commercial class revenue requirement should then be realized by scaling back the Commercial class commodity charge, thereby providing PGW with a 75% increase in its Commercial customer charge independent of the final level of rate relief granted by the Commission. Consequently, the OSBA's recommended rate design is responsive to PGW's revenue stability concerns. See PGW Statement No. 4 (Revised), at 5.

V. PROPOSED FINDINGS OF FACTS

The Cost of Service Study filed by PGW, as described by Howard S. Gorman in PGW Statement No. 5 (Revised), and as set forth in Volume III titled "Fully Allocated Cost of Service Study" in PGW's base rate proceeding filing, is an accurate representation of the costs to serve PGW's customer classes.

OSBA Witness Brian Kalcic's Schedule BK-1 accurately summarizes the over and under recovery of PGW's customer classes as set forth in the PGW Cost of Service Study.

The Residential class is substantially under-recovering its required revenues necessary to meet its cost of service.

The Commercial class is substantially over-recovering its required revenues necessary to meet its cost of service.

VI. PROPOSED CONCLUSIONS OF LAW

PGW's revenue allocation proposals are unjust and unreasonable in that they are insufficient to move PGW's firm customer classes closer to their respective cost of service, as they must given the impending customer choice program as required by Pa.C.S.A. Section 2212(j).

VII. PROPOSED ORDERING PARAGRAPHS

PGW shall set the Commercial class customer charge to \$17.50 per month.

PGW shall set the Commercial class commodity charge to \$7.1890 per Mcf, assuming that PGW is granted its entire revenue request of \$65 million.

PGW shall set the Commercial class commodity charge to a proportional scaleback of the revenue allocation as set forth in OSBA Schedule BK-3, if PGW is granted a revenue increase that is less than the requested \$65 million.

VIII. CONCLUSION

For the reasons set forth in the Direct, Rebuttal, and Surrebuttal testimony of OSBA witness Brian Kalcic, as well as the reasons set forth in this Main Brief, the OSBA requests that the ALJ and the Commission accept the rate design changes to PGW's Commercial class as described therein.

Respectfully submitted,



Steven C. Gray
Assistant Small Business Advocate

Date: June 21, 2001

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY :
COMMISSION :
 : Docket No. R-00006042
v. :
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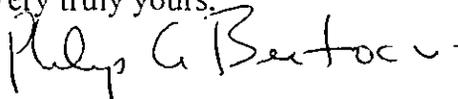
Re: CEPA et al. v. Philadelphia Gas Works, Docket No. R-00006042

Dear Secretary McNulty:

I represent the Consumers Education and Protective Association (CEPA), the Association of Community Organizations for Reform Now (ACORN), Action Alliance of Senior Citizens of Greater Philadelphia, and the Tenants Action Group (TAG) (collectively CEPA et al.) in the above-captioned matter.

Enclosed please find for filing an original and nine copies of CEPA et al.'s Main Brief in this case. I have also included a copy of the Main Brief on diskette.

Very truly yours,



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Enclosures

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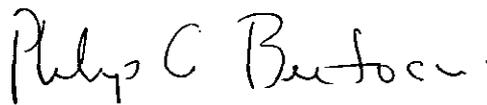
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Dear Secretary McNulty:

On behalf of Philadelphia Gas Works, enclosed please find an original and nine copies of its Main Brief with regard to the above referenced matter. All parties of record have been served as evidenced by the attached Certificate of Service.

If you should have any questions, please do not hesitate to contact me.

Very truly yours,



Daniel Clearfield
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v.
Philadelphia Gas Works
Docket No. R-00006042

Dear Secretary McNulty:

Enclosed for filing please find an original and nine (9) copies of the Main Brief of the Office of Consumer Advocate, in the above-referenced proceeding.

Copies of this document have been served upon all parties as evidenced by the attached Certificate of Service.

Sincerely yours,

James A. Mullins
James A. Mullins
Assistant Consumer Advocate.

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cc: All parties of record
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

DOCKET NO. R-00006042

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I. INTRODUCTION

On July 1, 2000, pursuant to The Natural Gas Choice and Competition Act (“Act”), the Pennsylvania Public Utility Commission (“Commission”) assumed jurisdiction over the public utility service being offered by Philadelphia Gas Works (“PGW”) within the City of Philadelphia. 66 Pa.C.S. §2212. Prior to the passage of the Act, PGW’s rates, terms and conditions of service were exempt from the jurisdiction, regulation and control of the Commission. Instead, PGW was regulated by the Philadelphia Gas Commission (“PGC”), a local agency of the City provided for by the Philadelphia Home Rule Charter, 351 Pa.Code §§3.3-100, 5.5-902.

This is the first full base rate case filed by PGW since the Commission assumed jurisdiction over the Company. Through this filing, PGW is requesting to increase its base rates by \$65 million.¹ This case comes on the heels of a series of staggering rate increases over the last 7 months resulting from an interim base rate proceeding before the Commission (Docket No. R-00005654), a Gas Cost Rate (“GCR”) proceeding before the Commission (Docket No. R-00005619) and a quarterly update to the Company’s GCR. These events have resulted in an overall increase in rates of \$248 million since last year, nearly a 50% increase, that has left PGW’s ratepayers struggling to pay for this essential service.

The impact of these rate increases on consumers was further compounded by the fact that the total annual increase in the GCR of \$237 million (\$97 million authorized as a result of the GCR proceeding, \$133 million from the January 1, 2001 quarterly update and \$7 million increase for bad debt

¹ The \$65 million base rate increase includes the \$11 million interim rate increase previously authorized by the Commission in approving the Joint Petition for Settlement of PGW’s Interim Rates proceeding more fully described below.

expense authorized in the Joint Petition for Settlement of the interim rates proceeding) and the interim base rate increase of \$11 million were compressed to recover the entire amount between the effective date of the new rates and the end of the Company's fiscal year, August 31, 2001. The OCA submits that in evaluating the instant request for a base rate increase, the Commission must be cognizant of the fact that the combined increase of the GCR by \$237 million and the \$11 million interim rate increase, both compressed to be recovered in less than a year, has already resulted in rate shock for PGW ratepayers and largely unaffordable rates as reflected in the dramatic increase in bad debt for the Company and demonstrated by the public input testimony.

Since this is the first full PGW base rate case before the Commission, it is critical that the appropriate ratemaking methodology be utilized to ensure that the rates established are just and reasonable and that the intent of the General Assembly in passing the Act is carried out. The Company has argued that the Commission's only role in this proceeding is to establish a revenue requirement which would meet all of PGW's identified needs, without any further application of any ratemaking principles or law, including the Constitutional standard that rates be just and reasonable. Under the Company's theory of the case, once the PGC approves PGW's budget, the Commission must then set rates at a level which will recover the budgeted amount. This would reduce the Commission's role in the rate-setting process to nothing more than a "rubber stamp" of the PGC's budgeting determinations. The OCA submits that this position is untenable and renders the Act meaningless.

The OCA submits that the appropriate ratemaking methodology to be utilized in this proceeding must be consistent with all provisions of the Act and the Public Utility Code. Paramount is the requirement that rates be just and reasonable. The Company's position that the Commission must simply

establish rates at a level necessary to recover all of the dollars that PGW chooses to spend cannot withstand the scrutiny of the just and reasonable standard. It is especially important to note that the Hearing Examiner in PGW's currently pending operating budget proceeding at the PGC also disagrees with PGW's interpretation of the Act.

A critical area of dispute is the Company's contention that rates must be established so as to provide the Company with a \$35-40 million cushion of cash at the end of the fiscal year. The OCA submits that this is an unreasonable requirement and one which has never been part of the ratemaking process at the PGC. In this proceeding, the OCA has recommended an increase in PGW's revenue requirement of \$21.5 million, inclusive of the \$11 million interim rate increase. The evidence presented by the OCA establishes that this level of rate increase will allow PGW to maintain its financial health, satisfy its bond coverages, continue its initiatives to improve the safety and adequacy of its service, and provide a reasonable level of ratepayer support of the Company's cash flow. To the extent that the Company needs additional cash, it should turn to its owner, the City of Philadelphia. As owner of the troubled utility, the City must attempt to resolve the current fiscal crisis which results from the failure to address these problems in the past. Ratepayers should not be asked to provide additional needed capital to remedy a temporary cash flow problem created by poor prior management. Instead, if necessary, the City should provide assistance through a grant back of the \$18 million City payment, an injection of additional capital or by facilitating the acquisition of additional debt. It is unreasonable to ask ratepayers to correct, through yet another substantial rate increase, a problem which took many years to develop, without asking the City, as owner and manager of the utility, to contribute as well.

Howard Gorman presents a class cost of service study (“COSS”) on behalf of PGW. Although the OCA does not take issue with many of the details of this study, three major allocations and several minor ones should be corrected. The OCA accepts PGW's proposal for spreading the allowed rate increase among its customer classes. However, the OCA recommends a \$21.5 million revenue increase, rather than the \$65 million recommended by the Company. Therefore, the increases for the individual customer classes should be calculated by proportionately reducing the class revenue increases proposed by the Company. Implementation of the OCA’s \$21.5 million increase includes a residential customer charge of \$11.50, rather than the \$15 charge proposed by the Company.

Finally, the OCA has identified significant concerns about the quality of service being provided by PGW. In considering whether any rate increase request is just and reasonable, the Commission must ensure that the utility is providing safe and adequate service. The law in Pennsylvania is clear that the Commission has the discretion to withhold, limit, or condition any rate relief granted on the quality of service. The OCA submits that any rate relief awarded in this proceeding should be specifically conditioned upon a Company commitment to proceed with its mains replacement program at a replacement rate of at least one percent, continue its commitment to correcting problems with its BCCS, especially the budget billing function; continue to work with the Commission and proceed with the implementation plan of the necessary recommendations from the Management Audit; improve customer service; and continue progress on its Transition to Excellence Plan.

II. HISTORY OF THE PROCEEDING

PGW is a municipal public utility company, owned by the City of Philadelphia and managed and operated by Philadelphia Facilities Management Corporation (“PFMC”), a non-profit Pennsylvania Corporation. The natural gas service being furnished or rendered by PGW became subject to the regulation and control of the Pennsylvania Public Utility Commission (“Commission” or “PUC”) on July 1, 2000, pursuant to the Natural Gas Choice and Competition Act, 66 Pa. C.S. §2212 and pursuant to Section IV of the Company’s existing Tariff.

PGW filed an interim base rate request on August 8, 2000, asking for an immediate \$52 million base rate increase. This request was designed to provide the Company with increased revenues until it was able to make its permanent base rate filing in early 2001. Numerous parties, including the OCA, participated in the litigation of this case before the PUC. PGW also filed a request for an increase in its gas cost rate (“GCR”) of \$97 million. After analysis of all positions presented, the Commission awarded PGW an interim rate increase of \$11 million. See Pa.P.U.C. v. Philadelphia Gas Works, Docket No. R-00005654 (Order entered November 22, 2000). The Commission also allowed implementation of the \$97 million GCR increase. See Pa.P.U.C. v. Philadelphia Gas Works, Docket No. R-00005619 (Order entered November 22, 2000). PGW was also permitted to file a quarterly update to increase its GCR by an additional \$130 million, effective January 1, 2001.

PGW deemed the \$11 million interim base rate award inadequate. Therefore, the Company challenged the Commission’s decision in the Commonwealth Court of Pennsylvania. As discussed in more detail below, the Commission’s Law Bureau and PGW settled the appeal allowing the \$11 million base rate increase to be implemented, as well as allowing recovery of \$7 million of bad debt

expense through the GCR. Both of these increases were compressed so that the full \$18 million annual amount of the increase would be recovered by the end of PGW's current fiscal year on August 31, 2001.

Concurrent with the interim rates proceeding, the Company also filed for a \$97 million increase in its GCR which was docketed with the Commission at Docket No. R-00005619. The GCR case was litigated on the same expedited schedule as the interim rates case. During the GCR proceeding, the Company presented updated gas costs that increased its requested GCR increase to \$172 million. On November 22, 2000 the Commission entered an order in the GCR proceeding which authorized an increase in the Company's GCR of \$97 million -- the amount requested by the Company in its original filing. Pa.P.U.C. v. Philadelphia Gas Works, Docket No. R-00005619 (Order entered November 22, 2000). Shortly thereafter, on December 12, 2000, the Company sought to update its GCR on one day's notice to reflect an additional increase in gas costs of \$103 million, in addition to the \$97 million already approved by the Commission in the November 22 GCR Order. The Commission rejected the Company's request since it was not in conformance with Section 1307(f) of the Public Utility Code or the Commission's November 22 Order in the GCR proceeding which authorized PGW to do its first quarterly GCR update on January 1, 2001. See, Secretarial Letter Dated December 13, 2000, Docket No. R-00005619. On December 29, 2000, the Company filed a quarterly update that increased its GCR, effective January 1, 2001, by \$133 million, in addition to the \$97 million already approved in the Commission's November 22 GCR Order. The Company also filed a Petition for approval to file updates to its GCR on February 1 and March 1, 2001. In an Order entered January 24, 2001, the Commission authorized PGW to do monthly updates to its GCR in February and March of 2001. Pa.P.U.C. v.

Philadelphia Gas Works, Docket No. R-00005619 (Order entered January 24, 2001). The Company has not, however, filed any updates to increase its GCR since the January 1, 2001 increase.

On January 5, 2001, PGW filed its current base rate case through Supplement No. 7 to its Tariff Gas - Pa. P.U.C. No. 1 at Docket No. R-00006042. The Company proposed to increase rates to produce additional annual operating revenues of \$65,000,000 by utilizing a cash flow methodology to determine its revenue requirement.² If implemented, this proposal would result in an increase of 9.4% in the overall rates of PGW from base rate levels of one year ago. As part of this increase, the Company proposed to increase the monthly customer charges for Residential General Service customers from \$8.00 per month to \$15.00 per month, or 87.5%. The Company also projected that the average residential heating bill will increase approximately 10.4% and the average residential non-heating bill will increase approximately 20.1%.

In a separate Petition filed at the same docket, PGW requested that the Commission expedite the base rate increase proceeding and allow the Company's requested base rate increase to become effective on June 1, 2001. The Company's Petition also requested the Commission to waive certain notification and filing requirements for base rate increase proceedings.

On January 22, the Office of Consumer Advocate ("OCA") filed an Answer to PGW's Petition. Additionally, on January 24, the OCA filed a complaint challenging the Company's rate request. CEPA et al. (the Consumers Education and Protective Association, Association of Community Organizations for Reform Now, Action Alliance of Senior Citizens of Greater Philadelphia and the Tenants'

²With the implementation of the \$11 million base rate increase, the Company's claim is for \$54 million of additional revenues above the level now in effect.

Action Group) also filed a complaint on this date. The Philadelphia Industrial and Commercial Gas Users Group ("PICGUG") and the Office of Small Business Advocate ("OSBA") filed complaints on February 2 and February 6, respectively.

On February 8, the Pennsylvania Public Utility Commission ("PUC" or "Commission"), issued an Order granting waivers of specific provisions of the Public Utility Code, but refusing a blanket waiver of other Code provisions. The Commission also denied the Company's request to expedite the instant proceedings.

Pursuant to the February 8 Order, the Company's filing was suspended until October 6, 2001. The Commission's February 8 Order was served upon the Commission's Office of Trial Staff ("OTS"), which became an active participant in the proceeding. The matter was subsequently assigned to the Office of Administrative Law Judge for investigation and eventually assigned to Administrative Law Judge Cynthia Williams Fordham ("ALJ" or "Judge").

February 8 was also the date on which PGW, the PUC's Law Bureau and the City of Philadelphia filed the Joint Petition for Full Settlement of Philadelphia Gas Works' Petition for the Establishment of Interim Rates and Related Appeal ("Joint Petition") to settle PGW's challenges to the Commission's Order entered November 22, 2000. The Joint Petition allowed PGW to increase its base rates by \$11 million (the amount awarded by the Commission initially), but also allowed the Company to include in its gas cost rate an additional \$7 million to account for bad debt expense (billed amounts that will not be collected), while also allowing PGW the ability to retain up to \$18 million in over-recovered gas cost revenues that would typically be returned to customers. The Joint Petition allowed such recovery and treatment from March 1 through August 31, 2001. PGW was required to withdraw its Petition for Review

with the Commonwealth Court. The OCA filed Comments expressing concern with the implementation of the Joint Petition, particularly the recovery of bad debt expense in a gas cost rate and the ability of the Company to retain up to \$18 million of over-recovered gas costs. The OCA argued that if gas costs went down, all over-recoveries should be returned to consumers immediately. The Commission adopted the Joint Petition without modification on February 22, 2001.

On March 21, 2001 in the instant base rate case, PGW filed a Motion in Limine requesting that Judge Fordham acknowledge a specific ratemaking methodology and budgetary requirements that should be applied to PGW in this proceeding. Specifically, PGW sought to have the “cash flow method” of ratemaking, as defined by PGW, declared the only acceptable method of ratemaking for PGW. Based on its reading of Section 2212(e) of the Public Utility Code, PGW asserted that the Commission is charged with following the same ratemaking methodology and requirements that the Philadelphia Gas Commission (“PGC”) used prior to the Commission assuming control under the Gas Choice Act. According to PGW, this section means that the Commission must employ the cash flow method of ratemaking as defined by PGW, *i.e.*, rates must cover operating and maintenance expenses and provide PGW with cash working capital and the ability to meet its financial obligations. PGW argued that the Commission may not employ any other ratemaking principles, including the just and reasonable standard. The Company also asserted that, as a logical extension of its argument, the Commission is bound by the determinations of the Philadelphia Gas Commission. In other words, if the Philadelphia Gas Commission approves a PGW budget, PGW argued that the Commission can do nothing more than approve rates to recover this budgeted amount.

On April 2, the OCA, PICGUG, CEPA et al, and OTS filed Answers to PGW's Motion in Limine. In its Answer, the OCA argued that the Gas Choice Act should not be interpreted in such a manner as would diminish the ability of the Commission to review PGW's expenses and set PGW's rates at just and reasonable levels. The OCA further stated that if the Commission's only function is to "rubber stamp" a budget approved by the Philadelphia Gas Commission, there was no point in bringing PGW under Commission jurisdiction to be subject to regulation and control by the Commission with the same force as if the service were rendered by a public utility.

On April 13, Judge Fordham issued an Order denying PGW's Motion. In her decision, Judge Fordham properly stated:

[T]he PUC should not rubberstamp the proposed rate increase. It is noted that the rate increase is based on a budget that has been submitted to but not approved by the PGC. Therefore, the record must contain information to allow the PUC to determine whether the rates are just and reasonable.

Pa. P.U.C. v. Philadelphia Gas Works, Docket No. 00006042 (Order #3 Denying PGW's Motion in Limine -- April 13, 2001).

The OCA filed the written direct testimonies of Richard LeLash and Ralph Miller on April 10 in the instant proceeding. The written rebuttal testimony of Mr. Miller was also filed on May 8 and the surrebuttal testimonies of Mr. LeLash and Mr. Miller were filed on May 16.

ALJ Fordham presided over three Public Input sessions held in the Company's service territory on March 28 and 29, as well as three days of evidentiary hearings held in this proceeding in Philadelphia from May 22-24. Judge Fordham also established due dates for Main Briefs and Reply Briefs

on June 21 and June 29, respectively. In accordance with the procedural schedule established in this proceeding, the OCA hereby files this Main Brief in support of its position.

III. LEGAL STANDARD

A. Burden of Proof

The OCA wishes to emphasize that the burden of proof to establish the justness and reasonableness of every element of the Company's rate increase request is upon PGW. As set forth in Section 315(a) of the Public Utility Code:

Reasonableness of rates. -- In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceeding upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

66 Pa. C.S. §315(a). This principle has been interpreted by the Commonwealth Court as follows:

Section 315(a) of the Public Utility Code, 66 Pa. C.S. §315(a), places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the utility. It is well-established that the evidence adduced by a utility to meet this burden must be substantial. [Citations omitted.]

Lower Frederick Twp. v. Pa. P.U.C., 48 Pa. Commw. 222, 226-27, 409 A.2d 505, 507 (1980) (emphasis added). See also, Brockway Glass v. Pa. P.U.C., 63 Pa. Commw. 238, 437 A.2d 1067 (1981). The Pennsylvania Supreme Court also has clearly stated that the party with the burden of proof has a formidable task before its position can be adopted by the Commission. Even where a party has established a *prima facie* case, the litigant still must establish that "the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail,

precluding all reasonable inferences to the contrary." Burleson v. Pa. PUC, 501 Pa. 433, 436; 461 A.2d 1234, 1236 (1983) (emphasis added).

With specific reference to base rate proceedings, it is well settled at the Commission and in the Courts that this burden does not shift to intervenors challenging a requested rate increase. The utility's burden of establishing the justness and reasonableness of every component of its rate request is an affirmative one. In contrast, there is no similar burden placed on an intervenor to justify a proposed adjustment to the company's filing. *See, e.g., Berner v. Pa. P.U.C.*, 382 Pa. 622, 116 A.2d 738 (1955).

In Berner, the Pennsylvania Supreme Court stated:

[T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden is, by statute, on the utility to demonstrate the reasonable necessity and cost of the installations and that is the burden which the utility patently failed to carry.

Berner, 382 Pa. at 631, 116 A.2d at 744.

This standard has been recognized by the Commission in its rate determinations:

[t]he Respondent, Equitable has the burden of persuasion in the issue of the reasonableness of an expense level. *Respondent must affirmatively establish, on the record, that the test-year claim is a reasonable and appropriate amount.*

Pa. P.U.C. v. Equitable Gas Co., 57 Pa. P.U.C. 423, 471 (1983) (emphasis added). *See also, University of Pennsylvania v. Pa. P.U.C.*, 86 Pa. Commw. 410, 485 A.2d 1217 (1984).

The OCA submits that it remains incumbent upon the Company to affirmatively demonstrate the reasonableness of every element of its claim and to demonstrate that its rates are just and reasonable. As set forth below, the Company has failed to satisfy this burden.

B. The Commission Must Determine A Level Of Rates For PGW That Is Just And Reasonable.

The Natural Gas Choice Act brought PGW under the jurisdiction of the Commission and provides that PGW is, with certain exceptions, “subject to regulation and control by the commission with the same force as if the service were rendered by a public utility.” 66 Pa.C.S. §2212(b). Under Section 2212(e) of the Act, the Commission is charged with establishing overall rates and charges for PGW. 66 Pa.C.S. §2212(e). Section 2212(e), in pertinent part provides:

[I]n determining the city natural gas operation’s revenue requirement and approving overall rates and charges, the commission shall follow the same ratemaking methodology and requirements that were applicable to the city natural gas distribution operation prior to the assumption of jurisdiction by the commission . . .

66 Pa.C.S. §2212(e). Throughout this proceeding, PGW has argued that this section of the Act requires that PGW’s Management Agreement with the Philadelphia Facilities Management Committee (PFMC) control all aspects of PGW’s request, leaving the Commission with little or no discretion. The Company argues that under the Act, the Management Agreement commits the Commission to setting rates to meet all of PGW’s identified needs, without the application of any ratemaking principles or law. The Company has gone so far as to argue that the Commission must simply accept any determination of the PGC, which approves PGW’s budgets under the Management Agreement, and implement rates to achieve the budget approved by the PGC, without any regard to whether the rates are just and reasonable. Under PGW’s logic, if the PGC approves a budget, the Commission can do nothing more than approve rates to recover this approved budgeted amount. The OCA submits that PGW’s interpretation of the Act is untenable and renders the Act meaningless.

If, in fact, the Commission's only function is to "rubber stamp" a budget approved by the Philadelphia Gas Commission, there was simply no point in bringing PGW under Commission jurisdiction to be "subject to regulation and control by the commission with the same force as if the service were rendered by a public utility." 66 Pa.C.S. §2212(b). Such an interpretation of the Act provides little or no protection to the ratepayers of Philadelphia and could not be what was intended by the General Assembly in bringing the operations of PGW under the Commission's jurisdiction.

The recently issued Recommended Decision of the Hearing Examiner in PGW's still-pending FY2001 Operating Budget proceeding before the PGC has aptly explained the flaw in PGW's interpretation:

PGW asserts that Section IV. of the Management Agreement (regarding operating budget approvals) must be read in conjunction with the Section VII. requirements (regarding rate-setting), but as PGW concedes, "[i]nterpretation of the Management Agreement must also be reconciled with the Gas Choice Act" (cites omitted). From this, PGW concludes that "[p]erforce...this Commission must assure that the budget incorporates sufficient revenues to pay operating and maintenance expenses and costs associated with the programs and policies approved by this Commission...; the City payment; and a reasonable allowance for cash working capital" (cites omitted).

PGW's interpretation of how the Gas Commission's remaining duties under the Management Agreement are to be reconciled with the Gas Choice Act is incorrect. While the Commission retains the obligation to adopt reasonable budgets which project sufficient revenues to cover reasonable operating expenses, as already discussed, the Commission cannot assure that "sufficient revenues" are provided via PGW's rates because it no longer has authority over the legal determination of PGW's revenue requirement, which is now with the PUC's purview (see 66 Pa.C.S. §2212(e)). In addition, there is no specific formula for the determination of PGW's year-end cash balance set forth in the provision for PGW's rates and other project revenues to provide a reasonable and necessary amount of cash or equivalent working capital. Under the

Management Agreement, this determination is left to be a matter of judgment, which is to be exercised in the overall exercise of [the Commission's former] rate-setting authority.

PGC Hearing Examiner Recommended Decision, FY2001 Operating Budget and Outyear Forecasts ("PGC R.D.") at 18-20 (May 17, 2001).³ The Hearing Examiner went on to conclude that for budgeting purposes, the PGC should conclude that the authorized rates from the Public Utility Commission which are in effect for FY2001 should be used in establishing a budget for PGW. PGC R.D. at 21-22.

The OCA submits that, similar to the conclusion of the PGC Hearing Examiner, a more appropriate reading of the Act is one that gives meaning to all provisions of the Act and the Public Utility Code. 1 Pa. C.S. §1922. The task, then, for the Commission is to harmonize and to reconcile the Public Utility Code with the ratemaking methodologies in place for PGW. It is critical to note that the fundamental principle of the Public Utility Code, which is also the fundamental principle applicable to PGW's ratemaking methodology, is that rates must be just and reasonable. 66 Pa. C.S. §1301; Public Advocate v. Philadelphia Gas Comm'n, 544 Pa. 129, 674 A.2d 1056 (1996). As the Supreme Court made clear in Public Advocate, the rates of PGW must be just and reasonable. Id. In Public Advocate, the Court stated that: "[w]hen examining the 1991-92 rates for PGW, this Court is mindful that no applicable constitutional requirement is more exacting than the requirement of 'just and reasonable' rates." Id. at 1061. The Pennsylvania Supreme Court went on to hold as follows:

³ A true and correct copy of the Philadelphia Gas Commission Hearing Examiner's Recommended Decision in PGW's FY2001 Operating Budget and Outyear Forecast proceeding is attached hereto and marked "Appendix A."

We hold today that the United States Supreme Court guidelines for determining the constitutionality of a rate are also applicable to examining rate disputes involving municipal utilities.

674 A.2d at 1062. See also, Action Alliance v. Philadelphia Gas Comm'n, 406 A.2d 1155, 1158 (Pa. Commw. 1979) and American Aniline Products, Inc. v. Lock Haven, 288 Pa. 420, 424, 135 A.2d 726, 727 (1927). Without such a standard, PGW would be subject to no control.

As such, PGW's argument that the Commission can only mechanically apply the Management Agreement and "rubber stamp" the findings of the PGC cannot withstand scrutiny. The Commission cannot simply be required to add up all of the dollars that PGW chooses to spend and pass them on to ratepayers. The Commission must have the authority and discretion to consider the Company's claim and to apply fundamental principles of ratemaking and regulation to any claim of PGW.

In this case, OCA witness LeLash summarized the balancing of interests which must occur in determining rates that are just and reasonable:

Under the PUC's mandate to set just and reasonable rates, I have recommended, for a variety of reasons which have already been presented, that rates be designed to share responsibility between the Company's owner and its ratepayers. The City of Philadelphia has a responsibility to protect the value of its operation. It needs to do so by augmenting the revenue flow from rates during a period when operational efficiency is low and wholesale gas prices are very high. When these factors are reversed, the PUC may be able to, justifiably, shift more responsibility onto ratepayers. An adequate revenue flow for PGW must reflect a reasonable mix of resources from all three of the revenue and capital components (rates, debt financing and common equity). Without such a mix, it is my belief that rates will not be just and reasonable.

OCA St. No. 1-S at 14 (explanation added).

Based on these considerations, the OCA recommends rate relief in the form of a \$21.5 million increase in the revenue requirement for PGW.⁴ The OCA's recommendation adheres to the fundamentals of the ratemaking methodology employed by the PGC, it properly recognizes the obligations and responsibilities of the owner of PGW, and it balances the interests of the company and its ratepayers.

IV. REVENUE REQUIREMENT

A. Introduction

As it did when it requested \$52 million in interim rate relief last Fall, PGW is now requesting rate relief in the context of a financial crisis -- one substantially of its own making. This request is being made despite unprecedented Gas Cost Rate (GCR) increases of \$237.0 million (inclusive of the interim \$7.0 million for Bad Debt Expense) and an interim base rate increase of \$11.0 million. PGW is again seeking to obtain higher revenues from its customers -- which would represent nearly one-third of a billion dollars in rate increases in less than a year. PGW continues to argue that the significant relief already granted has been insufficient to rectify its problems. Ratepayers are being asked to fund an operation which, by consensus, has been poorly run in the past, thereby contributing to its current financial crisis. Stratified Management and Operations Audit of Philadelphia Gas Works (Attachment 1 to Administrative Counsel St. No. 1) §III.E; OCA St. 1-S at 8-9; PGW St. 1.0 (rev.) at 23. Furthermore, the current service is poor and there is no clear indication of improved customer service any time soon. In deciding

⁴The \$21.5 million includes the \$11 million interim rate relief. Therefore, the OCA's recommendation represents a \$10.5 million incremental increase over rates now in effect.

the instant case, the Commission must take a careful look at both the affordability of the rates and the Company's service to determine what is just and reasonable.

Into these difficult circumstances, PGW now asks for a \$65 million rate increase, much of which is intended to remedy over the short term its current financial crisis. To get itself out of the hole that it has dug over the past eight years, PGW seeks to recover from ratepayers not only all of its expenditures, but the capital needed by the Company, including cash working capital, and additional cash of \$35-40 million at the end of the fiscal year. PGW St. 1.0 (rev.) at 20.

As was made abundantly clear in the testimony given by customers at the public input hearings, a significant increase in rates would present a financial hardship to many customers of PGW. In asserting a need for constant rates, customer Rhonda S. Smith testified that: "[w]e are not getting raises at the rates that these bills are going up. We can't choose not to have gas...The company's debt, we are like Jonah and they are like the whale. We get swallowed up by this big conglomerate because they have financial difficulty." Tr. at 283-284. With respect to the impact that the sudden and dramatic increases in rates has had on consumers, Ms. Rosemary Macklin testified that "[l]ast month I got a bill for \$474. When I got it for the first time in my 30 years I sat down and I cried because I was scared. It scares me." Tr. at 402. Regarding the impact of a significant increase on the service territory as a whole, customer Mary Cooper continued: "My concern is not only for myself, but others as a whole...People are going to try anything and everything to cook, try to keep warm. So I speak not only for myself but for the elderly, the children of families that are neglected." Tr. at 285-286. Customer Anne Rossi touched upon the long-term effect of a significant rate increase as she testified that: "I think there is going to be a mass exodus if this continues and these rates continue to rise. I myself don't know how people that live on a fixed income can

afford to live in this city any longer. And I have no intention when I retire of retiring in Philadelphia.” Tr. at 385. Ms. Teodozia Pepe, who is employed in the real estate business, also testified about the large number of Philadelphians moving into the suburbs to escape the high cost of gas service. Tr. at 418-19.

The Company, however, persists in trying to solve its long developing and long term financial problems in this case solely at the expense of ratepayers. OCA witness LeLash explained the problems with the Company’s request in this proceeding:

Unfortunately, in the current case, PGW is seeking to transfer ownership obligations to the Company’s ratepayers. While the City of Philadelphia is the direct owner and manager of the Company, its customers are being asked to provide needed “capital” to remedy a cash flow deficiency. Under traditional regulation, ratepayers are solely responsible for providing revenues to cover the cost of capital, not the capital itself. This places the responsibility on the City either to provide capital or to facilitate the acquisition of additional debt.

OCA St. 1 at 13.

As OCA witness LeLash testified, PGW’s impaired financial condition is mostly of its own making and a significant result of the ongoing failure by the City to make any significant equity contribution to PGW. OCA St. 1 at 7. Over years of financial deterioration, PGW never sought base rate relief from the PGC. Now, PGW has reached the maximum of its short term borrowing which it uses to provide cash flow and working capital, and asserts that its ability to issue further long term debt has been compromised. To remedy this situation, PGW turns to ratepayers to support all of its needs.

In support of its position, PGW offers up a tortured application of the ratemaking methodology of the PGC, referred to as the cash flow method, that would transfer any obligation of the owner of PGW, the City of Philadelphia, completely to ratepayers. The OCA submits that the Company’s

attempt to shift this responsibility to ratepayers must be rejected. The consequences of PGW's past management in failing to respond to the deterioration of the Company are not properly borne by ratepayers.

B. Ratemaking Methodology

As OCA witness LeLash testified, PGW has three sources of revenues and capital. It can derive revenue and capital through rates, from debt financing, and through the provision of common equity, *i.e.* the provision of cash from its owner, the City.⁵ OCA St. 1-S at 13. In this proceeding, the Company has argued that a "cash flow method" of ratemaking must be employed under the Act to set the rates and charges of PGW. PGW has interpreted this cash flow method of ratemaking to require that rates be set to meet all of its expenses as identified in the Management Agreement, including provisions for the Company's cash working capital needs as well as other capital requirements. In other words, under the Company's application of this method, the Company would not derive any revenue or capital from its owner, the City, but would derive all revenue from ratepayers. Under this position, if the Company's short term line of credit or debt financing failed, ratepayers would be required to provide this cash as well.

The OCA submits that from a regulatory perspective, this definition of the cash flow method proves too much. Of particular concern, the Company's definition of the cash flow method fails to

⁵Mr. LeLash is an independent financial and regulatory consultant. Prior to becoming an independent consultant, he was a principal with the Georgetown Consulting Group for twenty years. He has testified on cost of service, rate of return, and regulatory policy issues in more than 200 regulatory proceedings before the Philadelphia Gas Commission, the Federal Energy Regulatory Commission, the Pennsylvania Public Utility Commission and the commissions in numerous other states. Mr. LeLash has also participated and provided testimony on behalf of the Philadelphia Public Advocate in all of PGW's Gas Cost Rate (GCR) proceedings and in other related matters since 1990. A complete description of Mr. LeLash's background and experience can be found on pages 1-4 of his Direct Testimony and the Appendix attached to OCA St. No. 1.

recognize that the owner of PGW – the City – as well as the ratepayers are responsible for maintaining the utility’s operations. OCA St. 1 at 18. Instead, the Company’s application of this methodology shifts all burdens to ratepayers, whether or not that is just and reasonable. Mr. LeLash testified:

From the Company’s perspective, given its definition of the cash flow method of rate setting, the capital shortfall would be recoverable from ratepayers. However, even PGW must realize that its ratepayers’ ability to pay higher and higher rates has been limited because of the GCR increases. Such limits in the ratepayers’ ability to pay are amply illustrated by the Company’s currently requested rate increase which is justified, for the most part, by its growing bad debt expense.

As should be apparent, even if ratepayers had the responsibility to provide capital for PGW’s operations, which I believe they do not, they lack the ability to provide a never ending source of capital.

OCA St. 1 at 15.⁶

By progressive steps, the cash flow method urged by the Company would have this Commission set rates to ensure the fulfillment of PGW’s bond covenants, underwrite a dividend payment to the City, and finally, relieve the City of any responsibility to ensure the adequate financing of the operations. The method urged by the Company is to be employed without regard to any other ratemaking standards. OCA witness LeLash explained the flaw in the Company’s definition of the cash flow methodology as follows:

Finally, the Company argues that the Act requires the cash flow method of rate setting. The Company’s definition or application of this method has rates providing PGW’s capital as well as meeting revenue requirements. From a regulatory perspective, this interpretation of the Act and the cash

⁶ As explained by OCA witness LeLash, under traditional ratemaking, ratepayers pay only the cost of capital, including working capital, and do not provide the capital itself. OCA St. 1 at 13. Here, PGW interprets the cash flow method to require ratepayers to provide the capital itself.

flow method is fundamentally unreasonable. If it is followed, it would have the effect of absolving the City from any of its ownership responsibilities. In effect, the City would always be able to say that any PGW deficiencies were the result of insufficient revenues for costs and capital. Failure to rectify the Billing, Collections and Customer Service System (BCCS) problems, lack of adequate mains replacement, unreasonable levels of customer service could always be explained away by inadequate rate allowances.

OCA St. 1 at 26-27. Under the Company's definition, then, ratepayers are required to pay all operating expenses, the cash working capital, and other capital requirements, regardless of issues concerning prudence, service, or the reasonableness of the resultant rates. OCA St. 1 at 18. The OCA submits that such an interpretation cannot produce rates that are just and reasonable.

As OCA witness LeLash testified, a more appropriate application of the ratemaking methodology is to seek to ensure that PGW meets its coverage requirements on its bonds. OCA St. 1 at 26. After determining an appropriate level of expenses for PGW using PGW's own budgets, the Commission could then calculate an increase that would provide for bond coverages of 1.5x on the Company's bonds. The Commission should not, however, require ratepayers to provide for all of the company's cash flow needs or its capital requirements. The OCA submits that Mr. LeLash's analysis reaches a reasonable resolution and is consistent with the methodology employed by the PGC. This application of the cash flow method properly balances the interests of PGW and its ratepayers to ensure just and reasonable rates.

C. PGW Should Be Awarded A Rate Increase Of No More Than \$21.5 Million.

In this case, PGW has requested a \$65 million rate increase based on its fiscal year 2000-2001 (FY 2001) operating budget – the same operating budget that supported the Company's request in

the interim proceeding of \$52 million. OCA St. 1 at 20. The primary difference between the Company's interim request and its current base rate request relates to a \$19.3 million increase in bad debt expense that was occasioned by the Company's \$230 million increase in its Gas Cost Rate (GCR) during this fiscal year. Id.; PGW St. 3.0 (rev.) at 30. OCA witness LeLash put the Company's request in its proper context given the \$11 million rate relief awarded through a Settlement of the interim rates proceeding during this fiscal year:

Since the Company filed its base rate request, it has been granted \$11 million of interim base rate relief. Accordingly, the permanent request for \$65 million would represent a \$54.0 million increase over the base rates which are currently in effect [at the time the Company filed the instant base rate case].

OCA St. 1 at 20 (explanation added).

The Company seeks this level of rate increase to address a "massive financial crisis" that the Company asserts threatens its ability to maintain its present level of service through the remainder of the fiscal year. PGW St. 1.0 (rev.) at 3. PGW's request reflects the claim that the Company has reached the maximum short-term borrowing limit and the fact that the City has not provided the necessary working capital or permanent capital on an on-going basis to cover the financial shortfall. OCA St. 1 at 24.

Through this case, PGW seeks to remedy this financial crisis and restore its long term financial health. PGW witness Knudsen identified the Company's objectives for the Company's rate increase. Specifically, Mr. Knudsen testified that through this rate increase the Company seeks to:

- Satisfy its bond ordinance covenants;
- Maintain sufficient cash to meet obligations;
- Reduce dependence on short-term debt;

- Reduce level of long-term debt issues;
- Continue and enhance service improvement plan;
- Facilitate the restructuring/unbundling process.

PGW St. 1.0 (rev.) at 17; OCA St. 1 at 21. While the OCA does not disagree that these are goals that PGW should seek to achieve, the OCA submits that achievement of these goals in this one rate case will result in rates that are not just and reasonable. In this case, PGW should focus on the short term and take the necessary steps to *begin* to restore its financial health.

Given the circumstances that PGW and its ratepayers now face, the OCA submits that the Commission must determine an appropriate rate level to assist the Company with its present financial situation but not to remedy all problems of the past on a long term basis through this case. In particular, the Commission must be mindful of the circumstances that confront ratepayers. As Mr. LeLash explained:

First, ratepayers cannot be expected to pay for a large base rate increase in addition to the GCR increases which they are already having to absorb. Second, ratepayers should not be asked to pay for a rate increase before the Company has given guarantees that: the current level of service is actually being improved; PGW's information systems are fully supporting business operation; the call center is fully responsive to customer needs in a timely manner; and measures to improve productivity, included but not limited to greater workforce flexibility, are in place.

OCA St. 1 at 25.

To address these issues, OCA witness LeLash recommended that the Company's rates be set to meet their debt coverage requirements, after giving consideration to service considerations. Mr. LeLash developed an alternative revenue requirement that would allow the Company to meet its bond coverage based on the Company's analyses. Mr. LeLash started with PGW's Revised FY 2001 Budget,

which already included a significant increase in the bad debt expense, and continued to assume, as did the Company, that the Company will successfully issue its planned \$100 million of bonds and renew its \$100 million short term credit line.⁷ OCA St. 1 at 29-30. Mr. LeLash also assumed that the \$18 million payment would be made to the City as did the Company in its FY 2001 Budget. Mr. LeLash made certain accounting adjustments, which will be described in more detail below, that reduced the Company's operating budget by \$6.8 million. Mr. LeLash then made an offsetting increase in the Company's revised FY 2001 level of bad debt expense to increase further the bad debt expense by \$6.8 million. OCA St. 1 at 32. As set forth below, the OCA submits that these adjustments should be adopted. Since the adjustments offset each other, however, the adjustments do not change the analysis or the underlying budget revenue requirement.

Mr. LeLash then determined the revenue increase necessary for the Company to achieve a coverage on the 1998 Ordinance Bonds of 1.5 times, given the Company's assumed FY 2001 budget. As shown on Schedule 1 attached to OCA witness LeLash's Direct Testimony, a rate increase of \$21.5 million achieves this coverage requirement.⁸ OCA St. 1 at 30; Sch. 1, Line 2. This level of increase would allow the Company to meet its expenses, make the \$18 million payment to the City, achieve a bond

⁷ It is important to note that neither the Company's original FY 2001 Budget nor its revised FY 2001 Budget has received final approval by the Philadelphia Gas Commission ("PGC"). The Recommended Decision of the Hearing Examiner is pending before the PGC, however, as of the date that this Main Brief is filed, no PGC action has been taken on the Company's FY2001 budget. Under the Company's theory that the Commission must set rates to achieve the budget approved by the Philadelphia Gas Commission, it is not clear how the Company can even proceed with this case.

⁸ This increase represents an increase of \$10.5 million more than the \$11 million interim base rate level that is currently in effect. Since the budget utilized in the analysis did not reflect the rate increase provided by the Settlement, that rate increase must be accounted for when the final level of rates are determined.

coverage of 1.5x on the 1998 Ordinance Bonds, achieve a 2.01x bond coverage on its 1975 bonds, and end the year with \$34 million in cash. Id.; PGW St. 3.1 at 2. If the City grants back the \$18 million payment as project revenues to PGW, PGW would achieve bond coverages of 2.11x on its 1998 Bond Ordinance and 2.36x on its 1975 Bond Ordinance.⁹ OCA St. 1, Sch. 2, Lines 25 and 20.

The OCA submits that this level of rate increase will allow the Company to maintain its financial health, meet its debt service requirements, continue its initiatives to improve the safety and adequacy of its service, and provide a reasonable level of ratepayer contribution to the Company's cash flow. Initially, it is important to note that for FY 2001, with the anticipated bond issuance and the \$45 million loan from the City, under the Company's assumptions it will end the year with a cash balance of \$34 million even before implementing its requested \$65 million rate increase. PGW St. 3.1 at 2. What the Company desires, however, is to implement a rate increase that will have ratepayers provide an extra cash cushion of \$35 to \$40 million per year. As the Company acknowledges, it seeks this level of rate increase to address longer term objectives and to build up cash in the short run to improve its financial situation in the long run. Such a focus, however, will result in rates that are not just and reasonable. As OCA witness LeLash testified:

PGW is facing an atypical set of circumstances. Wholesale gas costs are at unprecedented levels, the Company's bad debt expense is escalating, and the Company has acknowledged that it will have another base rate investigation in its mandated restructuring case which has to be filed no more than 14 months from now. Under these circumstances, rates should

⁹ Project revenues represent funds supplied by the City, in this case the grant back of \$18 million payment, that qualifies for inclusion as above-the-line operating revenue in the coverage calculation. The City maintains a grant revenue fund as part of its operating budget. This fund is used to provide grants to various City agencies. Tr. at 785.

be set only to meet the Company's coverage requirements. The rates should not incorporate amounts to remedy past management and financial deficiencies. With a moderation in the wholesale cost of natural gas and measurable improvement in operations and service, some of PGW's long-term needs could be addressed differently.

OCA St. No. 1-S at 3-4.

The OCA submits that the Company's attempt to remedy its financial problems on the backs of ratepayers in this proceeding is improper. Through this case, the Company seeks to ensure that it has a year-end cash balance of between \$35 and \$40 million on a going forward basis, without the help of the City. PGW St.1.0 (rev.) at 20. As OCA witness LeLash testified, however, since FY1992 (the year of the Company's last rate case), year-end cash has only exceeded \$35.0 million twice, in FY1994 and FY1995. OCA St. No. 1 at 23. Since 1992, the Company's net earnings were never greater than \$17 million and in FY1998 through FY 2000 earnings were negative. OCA St. 1 at 22. As to bond coverage, over the past eight years, the debt coverage has never been higher than 1.67x and in several years, it approached the bond covenant minimum of 1.5x. OCA St. 1 at 22. In this case, however, the Company seeks a rate increase that will result in debt coverage of 2.87x on its 1975 bonds and 3.01 x on its 1998 bonds. Such a result is not required by the Act and is not just and reasonable.

The OCA submits that the OCA's recommendation properly addresses PGW's financial situation over the next 12 to 18 months, until its subsequent restructuring filing, which the Company states will also include a base rate filing. OCA St. 1-S at 3. By working from the Company's own budget, the OCA's recommendation recognizes PGW's planned expenditures, including expenditures for its Mains Replacement program, its LNG plant program, and its Transition to Excellence program. With this level of increase, the Company's progress towards correcting its financial crisis can continue, and its efforts to

improve safety and customer service can also continue. As OCA witness LeLash explained, this focus is critical at this time:

The emphasis of this proceeding should not be to build up enough cash in the short-run to ensure financial health in the long-term. Rather, the emphasis should be on what rates the Company requires to get through its present financial situation and this period of unprecedented wholesale gas costs.

OCA St. 1 at 25.

The OCA submits that its revenue requirement determination and the recommended short term focus of this proceeding produces rates which are just and reasonable. As such, the OCA submits that its \$21.5 million increase should be adopted. This level of increase allows the Company to meet its bond coverage requirements and its expenditures identified in its budget. Any additional cash needs of the Company should be provided by its owner, the City of Philadelphia.

D. The Company's Challenges To The OCA's Recommendation Should Be Rejected.

The Company has challenged the OCA's recommended level of increase. Based upon the Black & Veatch Engineering Report, the Company now argues that anything less than \$53 million will jeopardize the bond issuance and the renewal of the short term line of credit. The Company's arguments, however, are incorrect, ignore the responsibility of the City, and must be disregarded.

As noted, the OCA's recommended increase provides the Company with a 1.5x coverage on its 1998 bonds and a 2.01x coverage on its 1975 bonds. The Company argues that this minimum coverage level leaves them with no margin for error. The Company, however, ignores several options which are available to it. As OCA witness LeLash testified, the City as owner should backstop the Company during this financial crisis. This could be done through a waiver of the \$18 million City payment

or a grant back of all or a portion of the payment as project revenues. OCA St. 1-S at 14-15. PGW could also request that the City provide additional short-term advances to address any cash flow problems.

OCA witness LeLash explained:

While the City did advance \$45.0 million during the past winter, it should be requested to effectively provide “bridge” loans in order to help the Company with any month to month cash deficiencies. The Company could use such temporary advances to help it get over a period when cash is needed and then repay the advance when cash is less critical.

OCA St. 1 at 27-28.

The Company should also control expenditures during this time frame. OCA witness

LeLash explained this commonly used business practice:

It is a common business practice to prioritize operating expenditures so that especially in those months of low cash balances, only those expenses deemed absolutely essential to provide service and assure safety are made.

OCA St. 1 at 28.

The OCA does not dispute that the Company will need to aggressively pursue these other options if unexpected contingencies occur, but the OCA submits that it is not proper for ratepayers to provide ultimate protection for the Company from every possible occurrence.

PGW also argues that setting a rate level for PGW to meet its bond coverage requirements is inconsistent with the “ratemaking methodology” employed by the PGC. Tr. at 576-581; JRB Rejoinder Exh. 2. PGW argues that the PGC has not used a bond coverage test but rather requires ratepayers to provide revenue to meet the bond coverage, the capital requirements, and all cash requirements of the Company, including the provision of cash working capital. As set forth above, PGW’s interpretation of

the requirements of the Act and the ratemaking methodology of the PGC is tortured. The Company tries to support its claim by referencing Orders of the PGC from the early 1980's. JRB Rejoinder Exh. 2. As PGW witness Bogdonavage acknowledged on cross-examination, however, these orders were issued before the Company implemented its commercial paper program. Tr. at 607. Since the implementation of the commercial paper program, which provides the necessary working capital, the PGC has approved budgets using a debt service coverage test. Tr. at 607. As OCA witness LeLash testified, PGC's budgeting and rate setting process has been principally based on coverage of debt, not cash working capital, in his experience with PGW.¹⁰ OCA St. 1-S at 10. To the extent the Company needed additional cash working capital, it utilized the commercial paper program. Tr. at 751.

PGW next argues that if projected out to the end of FY 2002, a \$21.5 million rate increase would be insufficient. PGW St. 3.1 at 4-5. PGW attempts to support its argument through the presentation of forecasted financials for FY 2002. But PGW's presentation is seriously flawed, and violates its own principles as to the appropriate ratemaking methodology in this proceeding.¹¹ Initially, it must be noted that the Company selected FY 2001 as the "test year" for this case and has based its entire claim on its FY 2001 budget, as revised for an increase in uncollectible accounts. The Company presented no information on FY 2002 until the Rebuttal stage of this proceeding. The Company had to acknowledge

¹⁰ OCA witness LeLash has participated and provided testimony for the Public Advocate in all of PGW's Gas Cost Rate (GCR) proceedings and in other related matters since 1990. Last year, Mr. LeLash also presented testimony on behalf of the OCA in PGW's Interim Rates and GCR Proceedings. OCA St. 1 at 4.

¹¹ As OCA witness LeLash testified, the PGC always sets rates based on the forecast for the pending budget year only. It does not look out over several years when reviewing a fiscal year budget. OCA St. 1-S at 10. See also, Tr. at 606-607.

that it has not even developed a final FY 2002 budget or presented such a budget to the PGC for approval. Tr. at 632. Under its own theory, an unapproved and as yet undeveloped budget cannot form the basis of any rate relief. More fundamentally, its projections of FY 2002 financial consequences are untested in this proceeding and cannot form the basis for any decision in this matter.¹²

PGW also points to an Engineering Report by Black and Veatch that was conducted for the Company to accompany the bond issuance. The Commission, however, does not set rates on the basis of engineering reports. The Commission's task is to determine what level of rates is just and reasonable considering the interests of consumers and the Company. The Engineering Report did not attempt to consider ratepayer interests or what would be a just and reasonable level of rates. Tr. at 530.

Importantly, the Engineering Report is also based on achieving the same goals as the Company sets for its rate request. See Exhibit TJS-2 at B-44; PGW St. 1.0 (rev.) at 17. The Engineering Report also utilizes the same application of the cash flow method as did the Company. Mr. Sullivan, the witness in support of the Report, acknowledged on cross examination that his application and understanding of the methodology was developed with the assistance of the Company. Tr. at 513, 518. The Engineering Report provides no independent basis for increasing rates to PGW's customers. It suffers from the same flaws as the Company's analysis and completely ignores the requirement that rates be just and reasonable.

PGW's criticisms of the OCA's recommendation are unfounded and should be rejected. The OCA's recommendation allows the Company to meet its bond coverages and to move forward with

¹² The OCA would also note that the gas cost assumptions contained in the FY 2002 presentation are overstated. OCA St. 1-S at 10-11. When more recent gas prices are used, the Company's average price is potentially 23% overstated. Id. This also has the effect of overstating the bad debt expense. Id.

its planned expenditures. To the extent that additional cash is needed, it should be provided by the owner, the City of Philadelphia.

V. EXPENSE ADJUSTMENTS

A. Introduction

In his direct testimony, OCA witness LeLash proposed ten adjustments to the Company's claimed level of expenses in FY 2001. These adjustments are contained in Schedules 6-15 (appended to OCA St. No. 1). As for one-time expenditures to be normalized, Mr. LeLash made adjustments to BCCS Remediation (\$800,000), Consultant Studies/Costs (\$424,000), Non-Recurring Expenses (\$1,840,000), and Rate Case Expense (\$412,000). Regarding expenditures which are not representative of future operating conditions and, therefore, to be eliminated, Mr. LeLash made adjustments to Employee Consultants (\$258,000), Equipment Rentals and Leasing Information Technology (\$632,000), Lobbying Expenses (\$115,000), Operating Leases (\$601,000), and Non-Recurring Material Purchases (\$100,000). Finally, Mr. LeLash made an additional adjustment to partially offset the Company's amortization of its regulatory asset for CRP arrearages (\$1,637,000). In total, the above adjustments result in a downward adjustment of \$6.8 million to the Company's revenue requirement.

PGW has accepted Mr. LeLash's recommended adjustments for BCCS Remediation (Schedule 6), Consultant/Studies Costs (Schedule 7), Non-Recurring Expenses (Schedule 8), Equipment Rentals & Leasing Information Technology (Sch. 11), and amortization of PGW's regulatory asset for CRP arrearages (Sch. 15). The Company also accepts Mr. LeLash's adjustment for non-recurring material purchases. However, PGW desires to amortize the adjustment over 3 years, rather than normalize it.

Company witness Bogdonavage opposes Mr. LeLash's adjustment for lobbying expenses, but does not address Mr. LeLash's adjustment for rate case expense, employee consultants, or operating leases. Therefore, the OCA submits that these unaddressed adjustments should be adopted.

B. Expense Adjustments Accepted By PGW

In accepting Mr. LeLash's adjustments for BCCS Remediation, Consultant/Studies Costs, and Non-Recurring Expenses, Company witness Bogdonavage stated:

(e)ach of these adjustments reflects a determination that they are non-recurring and are applicable to a number of years. Therefore, PGW has determined that it will be amortizing on its books these items over the periods that Mr. LeLash has indicated. Accordingly, it is appropriate to make these adjustments for ratemaking purposes.

PGW St. 3.1 at 8. Witness Bogdonavage also accepted Mr. LeLash's adjustments for Equipment Rentals & Leasing Information Technology and amortization of PGW's regulatory asset for CRP arrearages. Id. at 9. Consequently, the OCA submits that Mr. LeLash's adjustments for BCCS Remediation, Consultant/Studies Costs, Non-Recurring Expenses, Equipment Rentals & Leasing Information Technology and amortization of PGW's regulatory asset for CRP arrearages be adopted by the Commission.

As for Non-Recurring Material Purchases, the Company made \$150,000 in Non-Recurring Material Purchases in anticipation of the work stoppage in May 2001. OCA witness LeLash proposed that this expense be normalized over a three year period. OCA witness LeLash explained:

Since this expense occurs only when the union contract is being renegotiated, it should be normalized for rate making purposes over the life of the contract. Accordingly, Schedule 14 shows the recommended normalization of three years which is based on the term of the existing contract.

OCA St. No. 1 at 39-40. PGW states that it accepts the adjustment, but as an *amortization* over 3 years rather than a *normalization*. PGW St. 3.1 at 9. The OCA submits that a normalization for ratemaking purposes is appropriate because renegotiation of the union contract and the need for material purchases is a normal operating expense.

C. Expense Adjustments Opposed Or Unaddressed By PGW

1. Lobbying Expenses

PGW has claimed recovery for lobbying expenses. PGW No. 3.1 at 8. PGW witness Bogdonavage testifies that the PGC has permitted the inclusion in rates of lobbying expenses, and therefore, argues that the Commission should continue to include these expenses. PGW St. 3.1 at 6-7. The Company further claims that PGW will violate its bond covenants if rates are not sufficient to cover its obligations in FY 2001. *Id.* at 9. PGW's argument is that because the Company spent \$115,000 for Lobbying, the Company should be able to recover the costs. As will be explained below, PGW's lobbying expense is not an appropriate item for recovery from ratepayers.

PGW's assertion that the PGC's allowance of recovery of lobbying expenses requires the Commission to allow such recovery demonstrates the unreasonableness of the Company's arguments in this case. As OCA witness LeLash explained:

I believe Mr. Bogdonavage's position is somewhat flawed as stated. The apparent corollary would be that if the PGC had not included some expense category in rates previously, it could not be recovered in the future. In my view, this appears to have the PGC, de facto, continuing to set rates by virtue of whatever it authorizes, eventually, within PGW's operating budget. This certainly does not appear to be compatible with the intent of the Act, and it appears to require the PUC to potentially grant rates which it would otherwise determine not to be just and reasonable.

OCA St. No. 1-S at 12. As set forth below, there is a strong history of Commission precedent disallowing the recovery of lobbying expenses from ratepayers. The Commission has often found the inclusion of these costs to be unjust and unreasonable and should hold the same here.

The Commission has ruled that lobbying expenses do not have a direct ratepayer benefit and as such cannot be included in rates. Several cases have examined this issue and reached the same conclusion. Pa.P.U.C. v. Pennsylvania-American Water Co., 79 Pa. P.U.C. 25, 66 (1993); Pa.P.U.C. v. Duquesne Light Co., 59 Pa. P.U.C. 67, 118 (1985); Pa.P.U.C. v. National Fuel Gas Dist. Corp., 84 Pa. P.U.C. 134, 196 (1995); Pa.P.U.C. v. Metropolitan Edison Co., 60 Pa. P.U.C. 349, 382 (1985). In the Pennsylvania-American case, the Commission disallowed the portion of membership dues to local organizations which related to “lobbying and legislative advocacy functions of those organizations.” Pennsylvania-American Water Co., 79 Pa. P.U.C. at 66. Approximately 31% of the dues were disallowed because of the relationship to lobbying and legislative advocacy of the organizations. Id.

In the Duquesne Light case, the Commission also disallowed lobbying expenses. Duquesne Light Co., 59 Pa. P.U.C. 67, 118 (1985). The Commission examined the dues paid to an association of investor-owned utilities (Edison Electric Institute). Id. at 117. Duquesne claimed \$213,377 in dues. Id. Approximately 20% of the organization’s activities were devoted to “legislative advocacy, broadly defined.” Id. at 118. The Commission held that “(w)e believe that the record establishes that a substantial portion of EEI’s activities are of no benefit to ratepayers.” Id. The Commission did not permit recovery from ratepayers of the percentage that related to the organization’s legislative advocacy activities. Id.

In the Met-Ed case, the Commission followed the Duquesne case with respect to Met-Ed’s and Penelec’s claims for membership dues to the same Edison Electric Institute (EEI). Metropolitan Edison

Co., 60 Pa. P.U.C. 349, 382 (1985). The expense was reduced to eliminate the percentage that went towards lobbying and legislative activities expenses. Id. at 382. The Commission again held that the excluded percentage for lobbying expenses did not provide a direct ratepayer benefit. Id. at 381-382.

In the NFGD case, the Commission followed the Metropolitan Edison case above and disallowed the expenditures of the Governmental Affairs Department that related to lobbying. Pa.P.U.C. v. National Fuel Gas Dist. Corp., 84 Pa. P.U.C. 134, 196 (1995). The Commission held that “NFGD did not prove that the services provided by New York Division’s Government Affairs, Marketing and Public Affairs and Public Relations Departments confer any benefit to ratepayers or are necessary for the provision of natural gas service.” Id. at 196. The Commission found that the Department in question served as a conduit of information between the government and the Company. Id. The Commission found that there was no ratepayer benefit to the lobbying expenses. Id.

The Commission has determined in the above-referenced cases that lobbying expenses should not be paid by ratepayers. As stated by the Duquesne, Metropolitan Edison, and National Fuel cases, ratepayers do not receive a direct benefit from these costs, and therefore, the OCA submits ratepayers should not be required to pay such expenses.

Based on the above, the Commission should hold PGW to the same standard as other regulated utilities and should not allow unreasonable expenditures that burden ratepayers. Therefore, in accord with prior Commission precedent, recovery of expenditures for lobbying expenses should be disallowed. Indeed, if the Company wants to lobby, its owner, the City of Philadelphia, should support the lobbying efforts, not the ratepayers.

2. Operating Leases

OCA witness LeLash recommended that the operating leases be capitalized rather than expensed. OCA St. No. 1 at 39. Mr. LeLash explained the issue as follows:

Included in PGW's FY 2001 Operating Budget is \$462,000 for operating leases for vehicle replacements and \$139,000 for operating leases for computer-related equipment. However, the Company has proposed that such expenditures be included under capital, rather than operating leases, mainly for the positive effect such inclusion would have on debt coverage.

Id. The Company, however, retained the \$601,000 of expenses in FY2001 even though it proposes to capitalize these leases. OCA St. 1 at 39. The OCA submits that the \$601,000 expense in FY2001 should be eliminated from the operating budget because these costs have been capitalized by the Company. Id. The Company did not respond to this adjustment. As such, a downward adjustment of \$601,000 should be adopted as reflected in Schedule 13.

3. Employee Consultants

The Company made a claim for \$258,000 for former employee consultants. OCA St. No. 1 at 38. The OCA submits that these former employee consultant salaries should be eliminated. OCA witness LeLash stated that:

PGW has hired several former employees on a temporary basis as consultants in order to retain needed operational experience. The reply to OCA-III-49 lists four employees whose contractual salaries are included in the FY 2001 test year budget. Of those listed, only one is expected to remain with the Company for an extended period of time, as a gas supply consultant. Since the other consultants will not be remaining with the Company and their duties are expected to be performed by other PGW employees, their budgeted salaries should be eliminated for ratemaking purposes. As shown on Schedule 10, elimination of

former employee consultant salaries results in a \$258,000 downward adjustment to expense.

Id.

The Company did not rebut this adjustment during the case. Therefore, the OCA's \$258,000 downward adjustment for the elimination of the former employee consultant salaries should be adopted as reflected on Schedule 10.

4. Normalization of Rate Case Expense

The Company made a claim for \$825,000 in rate case expenses for lawyers and consultants. OCA St. No. 1 at 37. The OCA submits that this rate case expense should be normalized. OCA witness LeLash stated that

PGW has included \$825,000 in the test year budget for rate case expenditures for lawyers and consultants. Though FY 2000 Rate Case Expense was amortized over a two-year period and included in the FY 2001 budget, FY 2001 Rate Case Expense was not amortized in the FY 2001 budget. It is normal ratemaking procedure to normalize such expenses over the period between rate cases. Since it is expected that PGW will file its next base rate case with its restructuring filing in 2003, it is proper to normalize Rate Case Expense over two years, the same normalization period utilized by the Company. Schedule 9 shows this normalization resulting in a \$412,000 downward adjustment to expense.

Id.

OTS witness Weakley also recommends that the rate case expense should be normalized over a two-year period. OTS St. No. 1 at 5. The Commission has ruled that rate case expenses are normal operating expenses, and normalization should, therefore, be based on the frequency of the utility's rate filings. Pa.P.U.C. v. Roaring Creek Water Co., 73 Pa. P.U.C. 373, 400 (1990); Pa.P.U.C. v.

National Fuel Gas Dist. Corp., 84 Pa. P.U.C. 134, 175 (1995); Pa.P.U.C. v. West Penn Power Co., 119 PUR4th 110, 149 (1990).

As such, the \$412,000 downward adjustment for normalization over two years should be adopted as reflected on Schedule 9.

D. Effect Of Bad Debt Expense

As Mr. LeLash explained, one of the most difficult PGW expense components to analyze is its Bad Debt expense, or more accurately, its Bad Debt Appropriation. OCA St. No. 1 at 42.¹³ In its filing, the Company has estimated this expense to be \$65.3 million (\$10.7 million higher than the actual expense for FY 2000). A majority of the expense increase is associated with the forecasted increase in Total Gas Revenues, which in the filing were estimated to be \$727.5 million or \$194.5 million higher than in the previous year. However, even the \$727.5 million estimate will understate the actual billed revenues. Therefore, as set forth by Mr. LeLash, a \$65.3 million Bad Debt Expense may represent a low estimate. OCA St. No. 1 at 42. Consequently, Mr. LeLash has proposed an increase of \$6.8 million to Bad Debt Expense given PGW's recent increases in bills, which may exceed customers' ability to pay. The estimated increase in bad debt expense offsets the effect on PGW's revenue requirement that would result from the adoption of Mr. LeLash's recommended expense adjustments.

¹³This expense is the amount which is added to the Company's Accumulated Provision for Uncollectible Accounts in order to cover Accounts Receivable which ultimately will not be collected.

VI. COST OF SERVICE

A. Cost of Service Study

1. Introduction

Company witness Gorman presents his class cost of service study (“COSS”) in Exhibit HSG-6. Although the OCA does not take issue with many of the details of this study, three major allocations and several minor ones should be corrected. OCA St. No. 2 at 21. Specifically, witness Gorman: 1) classifies 25% of distribution mains investment as customer-related and allocates it on the basis of the number of customers in each customer class; 2) allocates the entire amount of administrative and general (A&G) salaries (account 920) and office supplies and expenses (account 921) on the basis of labor; and 3) allocates A&G credit of \$12 million for duplicate charges in accord with his allocation of Construction Work In Progress. As will be explained below, these allocations should be modified. The result of the modifications is to allocate significantly less cost to the residential class than is allocated to residential customers in the Company’s study.

2. Investment In Distribution Mains

As set forth by OCA witness Miller, mains are constructed to deliver gas, not merely to connect customers to the system. OCA St. No. 2 at 22. Therefore, the entire investment in mains should be allocated on the basis of some measure of the gas they deliver or the loads they serve. However, witness Gorman classifies 25% of this investment as customer-related and allocates it on the basis of the number of customers in each customer class. PGW St. 5.0 at 18. His defense of his customer component is based on the premise that one reason for installing distribution mains is to attach customers to the distribution system. Id. at 10. In contrast to individual service lines, however, the length and cost of

distribution lines is not a separate product or service provided by PGW, and has no independent value to PGW's customers. OCA St. No. 2 at 22. In other words, PGW would not connect a customer to the distribution system if that customer were not going to purchase gas.

Mr. Miller explained the flaw in Mr. Gorman's premise through a comparison of distribution mains and service lines (service lines bring gas from the main to the point of use in the home or business) as follows:

The number of services does depend primarily upon the number of customers, because each customer generally has his own service. The diameter of each service pipe depends upon the customer's gas usage, and that is part of the reason why the total cost of services investment is not exactly proportional to the number of customers. For mains, in contrast, there is no evidence that the footage of mains actually depends upon the number of customers. It is not true that each customer has a segment of distribution main specifically dedicated to his own use, in the way that a specific segment of service pipe is dedicated to each customer's use. Instead, all customers share in using all of the footage of distribution mains. The total length is the footage required to reach from the supply source of gas at the city gate to the most distant customer, and this footage is essentially independent of the number of other customers situated along the way.

OCA St. No. 2 at 22-23. Thus, the footage and, thereby, the cost of a distribution main are unrelated to the number of customers served by the main and should not be allocated based on the number of customers.

In his COSS, Mr. Miller allocated the investment in distribution mains on the basis of the peak and average demand method. OCA St. No. 2 at 21. In the peak and average demand method, the demand allocation factors reflect both the class' average use of energy and its total usage on system peak days. This method of allocation has been accepted by the PUC. See Pa.P.U.C. v. West Penn Power Co.,

73 Pa. P.U.C. 454 (1990) and Pa. P.U.C. v. Philadelphia Elec.Co., 61 Pa. P.U.C. 589 (1986). As such, the OCA submits that the Commission should employ the peak and average method in the instant proceeding for allocating PGW's investment in distribution mains.

3. Allocation of A&G Salaries And Office Supplies And Expenses

Mr. Gorman allocated A&G expense on the basis of labor. As explained by Mr. Miller, however, some of these expenses are more closely related to PGW's plant investment and should be allocated on that basis. OCA St. No. 2 at 21. Among these activities are financial services, which include plant and general accounting and the treasury, and corporate information and legal services. As OCA witness Miller testified, labor is not the factor that causes PGW to incur these costs. OCA St. No. 2 at 23-24. In responding to witness Gorman's allocation, Mr. Miller stated:

The best alternative would have been for Mr. Gorman to make a special study of these A&G costs, to determine how they should have been allocated, instead of making the unreasonable assumption that they are all labor-related. A second alternative is to make a more reasonable assumption about the way A&G salaries and office expenses should be allocated to reflect the nature of PGW's business, instead of making the assumption that these costs are entirely labor-related. One such approach, which I have used, is to allocate one-half of the A&G costs as labor-related and one-half as plant-related. This approach is akin to the "Massachusetts formula" used for allocating common corporate costs in the absence of any cost of service study or equivalent basis for specific causal allocation.

OCA St. No. 2 at 24. Because utilities as a whole are capital intensive, the allocation of overhead costs like A&G salaries and office expense as related entirely to labor ignores this fundamental structure of the industry. OCA St. No. 2 at 24. Therefore, an allocation of part of these A&G costs on the basis of plant investment, as proposed by Mr. Miller, recognizes these realities of the way a utility works.

In his rebuttal testimony, PGW witness Gorman disputes the allocation of A&G salaries and office expenses in part on the basis of plant rather than labor. PGW St. 5.1 at 3. Witness Gorman states that his allocation reflects PGW's business because direct labor costs reflect PGW's business. He then states that use of plant investment to allocate some A&G costs is valid only if there are A&G costs incurred to manage assets without having direct labor involved. Id. However, as OCA witness Miller testified:

PGW's plant and general accounting costs and its treasury activity costs are costs incurred to manage (or finance) PGW's assets, and these plant accounting and treasury costs are all included in A&G expense. None of these plant accounting and treasury costs has any direct labor component because the direct costs of performing these activities are charged to A&G salaries in account 920, not to any of the O&M accounts 700-919, and the direct labor in accounts 700-919 is the way Mr. Gorman allocates all of PGW's A&G salaries and office expense. Plant accounting costs might arguably be related to construction outlays and to depreciation expense, but the direct labor component of construction outlays is not included in O&M expense, and depreciation does not have a labor cost component. By allocating all A&G salaries in proportion only to the direct labor costs in O&M accounts 700-919, Mr. Gorman has chosen an allocation factor which excludes all of the things to which plant accounting and treasury costs might reasonably be related.

OCA St. No. 2-S at 6. The OCA submits that this type of allocation is unreasonable.

In support of his allocation, Mr. Gorman states that FERC generally accepts an allocation of A&G expense based on direct labor costs. PGW St. 5.1 at 3. However, FERC's use of direct labor to allocate A&G salaries is not relevant to PGW because the situation of interstate pipelines is very different from that of gas distribution companies, including PGW. Mr. Miller explained the problem with Mr. Gorman's reliance on FERC procedure as follows:

... [T]he major problem in using the labor allocator is that it overemphasizes the customer accounts function, which is more than one-third of the direct labor allocator, and it gives too little weight to the distribution and storage functions that use much more plant than labor. This distortion is a problem because customer accounts costs are allocated almost entirely to the residential class, whereas distribution and storage costs are not. This distortion does not arise with interstate pipelines because their customer accounts expense is a much smaller [component] of their other direct labor costs. Further, even if the use of direct labor does cause some overweighting of customer accounts, it is much less of a problem for interstate pipelines because their customer accounts expense is allocated in much the same way as their other costs. The decreased importance of the customer accounts function and the similarity of its allocation to the pipelines' other costs are both due to the absence of a separate class of numerous small customers, which is characteristic only of the gas distribution business but not of interstate pipelines.

OCA St. No. 2-S at 6-7. Consequently, witness Gorman's reliance on FERC-approved allocations for interstate pipelines is misplaced.

Based on the above, the OCA submits that the Commission should adopt Mr. Miller's COSS. As explained, Mr. Miller's COSS deals more effectively with allocation of A&G salaries and office supplies and expenses.

4. Allocation Of A&G Credits

PGW's test year A&G expense includes a credit for \$12 million of duplicate charges. OCA St. No. 2-S at 2; See also, PGW Exh. HSG-2, Sch. 1, p. 3, lines 119-122, 124. Mr. Gorman allocates these credits in accord with his allocation of Construction Work In Progress. However, they should instead be allocated the same way as the costs they are reversing, and those costs are primarily A&G salaries and pensions and benefits. OCA St. No. 2 at 22.

As Mr. Miller explained in his surrebuttal testimony, PGW charges its plant construction costs to its capital account, rather than to its current operating expenses, and these capital outlays are not included in the test year revenue requirement. OCA St. No. 2-S at 2. The amounts charged to construction include \$16 million of labor costs for work performed by PGW employees on construction projects. This \$16 million of direct labor on construction projects is not part of the test year expense, and it does not appear anywhere in PGW's operation and maintenance (O&M) expense. OCA St. No. 2-S at 3.

PGW also incurs \$5.333 million of fringe benefits and \$6.815 million (for a total of \$12 million) of other overhead costs relating to this \$16 million of construction labor. However, unlike the direct construction labor itself, these fringe benefits and other construction overheads do appear in the test year (at least initially) where they are included as part of A&G expense. To remove them from the test year expense, PGW includes credits of \$12 million in account 929. The allocation of these credits is the issue contested by the OCA. Id.

In his rebuttal testimony, witness Gorman agreed with Mr. Miller that the \$12 million of credits should be allocated in accord with the costs they are reversing, not in accord with construction work in progress. PGW St. 5.1 at 4. His only defense for having allocated these costs in accord with construction work in progress is his statement that he "did not have the detailed data to determine which costs were reversed" and he therefore "assumed that the costs that were reversed [were] similar to the costs for ... the construction..." Id. However, as Mr. Miller explained, witness Gorman appears to be unclear as to what the credit for Duplicate Charges represents or how it was developed. OCA St. No. 2-S at 3. Mr. Miller testified that:

The essence of Mr. Gorman's claim is that he did not know which costs are being reversed by the credit for Duplicate Charges, and he made an assumption that seemed to him to be reasonable in relation to that lack of information. However, my direct testimony states explicitly that the costs being reversed "are primarily A&G salaries and pensions and benefits." (OCA Statement No. 2, page 22.) I used this additional information to guide the allocation of the credits for the Duplicate Charges. Nowhere in his rebuttal to my allocation of these credits does Mr. Gorman challenge the correctness of the additional information that I presented, nor does he dispute my claim that this additional information is the proper guide to the allocation of these credits. Instead he asserts that an unsupported assumption he made because he lacked this information is superior to the analysis that I made using the additional information which I presented.

OCA St. No. 2-S at 5. Therefore, these Duplicate Charge credits should be allocated the same way as the costs they are reversing, *i.e.*, primarily A&G costs, including employee benefits. Mr. Miller made this adjustment in his COSS, therefore, the OCA submits that Mr. Miller's COSS is more complete and should be relied upon by the Commission.

5. Other Modifications To PGW's COSS

Mr. Miller's allocation of PGW costs also differ from witness Gorman's in other areas besides those of investment in distribution mains and A&G salaries. See OCA St. No. 2 at 25. For example, Mr. Miller allocated the expense for Distribution Operation Supervision and Engineering half on distribution plant, to recognize the engineering component of this account. Id. Mr. Gorman's allocation entirely on labor recognizes only the supervision component. Since Mr. Gorman's rebuttal testimony does not address this modification or any of the other additional modifications, the OCA submits that these modifications have been accepted by the Company and should be adopted by the Commission.

6. Conclusion

Based on all of the above, the OCA submits that Mr. Miller's COSS should be adopted. Mr. Miller's COSS more accurately reflects the cost responsibility of each class and provides a more reasonable guide for determining class revenue responsibility.

B. Class Revenue Responsibility

PGW sought a revenue increase of \$65 million, which corresponds to an increase of \$66.8 million in the full tariff rates. See PGW St. 5.0 at 3-4 and PGW Exhibit HSG-6. The amount of the revenue increase is 9.4% above the "present" revenue at the rates in effect prior to the interim settlement, which had not yet been reached at the time PGW filed its rate increase application at the PUC in the present proceeding.¹⁴ See PGW Exhibit HSG-3.

PGW recommended an increase of 10.53% for residential customers and smaller increases of approximately 8.85% for commercial and industrial customers. PGW also recommended increases of 7.4% for the municipal customer and 4.7% for the Philadelphia Housing Authority. OCA Exh. 2-B, Table REM-2. PGW recommended that there be no changes in the existing rates for its non-firm customer classes. These class revenue responsibility recommendations were based on PGW's class cost of service study results.

The OCA accepts PGW's proposal for spreading the allowed rate increase among its customer classes. However, the OCA recommends a \$21.5 million revenue increase, rather than the \$65 million recommended by the Company. Therefore, the increases for the individual customer classes should

¹⁴The present rates are those rates that were in effect prior to implementation of the Joint Petition.

be calculated by proportionately reducing the class revenue increases proposed by the Company. As explained by Mr. Miller, this calculation should be developed from PGW's proposed increases above the "present" rates in effect prior to the interim settlement. This is necessary because the interim rates were designed to recover the entire "annual" amount of the interim increase in just six months, mostly outside of the winter period, and their use is a distortion of the rate structure appropriate for a full year.¹⁵ OCA St. No. 2 at 12.

In order to implement this proposed "scale-back", the allowed revenue increase should first be converted from a revenue requirement increase to a tariff requirement increase. This adjustment is necessary because tariff rates must also account for the amount of rate discounts offered under programs such as the Senior Citizen discount program and the Customer Responsibility Program.

Table REM-3 illustrates the conversion of the OCA's recommended net revenue increase of \$21.5 million into an increase of \$22,176,566 for the full tariff revenue requirement. This roughly

¹⁵As Mr. Miller explained, the interim settlement rates are irrelevant to a proper determination of class revenue responsibilities and are largely irrelevant to the development of a proper rate design. OCA St. No. 2 at 14. Mr. Miller testified:

The interim settlement was designed to provide a nominal \$18 million of additional revenue, but this amount is not a correct indication of its effect from a rate design perspective. On an annualized basis, the interim settlement rates represent a rate increase of \$52 million, because these interim rates would provide \$52 million of additional revenue if they were in effect for the entire test year. This amount is much larger than the nominal amount of the interim increase because the interim rates were designed to collect \$18 million in only six months, from March through August 2001.

Id. Therefore, the Company's present rates, prior to the interim settlement, are the appropriate starting point for the determination of class revenue responsibilities.

represents a third of the full tariff revenue increase of \$66,766,872 proposed by PGW. Therefore, each of PGW's proposed class tariff revenue increases can be multiplied by 0.332156 to derive the OCA's recommended class revenue increases. As the chart below illustrates, for the residential class, the resulting target increase is \$17.7 million. This represents nearly 80% of the OCA's total proposed revenue increase and is consistent with the Company's allocation of a recommended increase.

OCA Proposed Customer Class Revenues

Class	Increase	% above present rates
Residential	\$17,683,712	3.5%
Commercial	3,437,795	2.95%
Industrial	482,727	2.93%
Municipal	347,663	2.47%
Housing Authority	225,103	1.57%
Total	22,177,000	3.32%

Source: OCA Exhibit 2-B, Table REM-2

In their direct testimonies, OTS witness Metro, OSBA witness Kalcic and PICGUG witness Baudino recommend that the revenue responsibility of the residential class be substantially increased over the level recommended by the OCA or PGW. See OTS; OSBA; and PICGUG. OCA St. 2-R at 2-3. These witnesses base their class revenue responsibility recommendations on the PGW class cost of service study presented by Company witness Gorman.

As previously explained, however, the OCA disagrees with the Company's class cost of service study and has performed a COSS that more accurately reflects the costs caused by each class. Consequently, the OCA submits that the alternative class revenue responsibility recommendations of witnesses Metro, Kalcic and Baudino should be rejected since they are based on PGW's flawed class cost of service study. Because Company witness Gorman's allocation of several major items in his class cost of service study fails to recognize proper cost causation, Mr. Miller's COSS incorporates appropriate changes to recognize proper causation. After such recognition, the cost responsibility of classes is more accurately reflected.

Mr. Miller's COSS indicates that the residential class revenues at present rates are somewhat less than the costs allocated to the residential class, but the differences between class revenues and costs are much smaller in Mr. Miller's properly constructed COSS than the much larger disparities in the Company's COSS. The more extreme class revenue responsibility recommendations of the OTS, OSBA, and PICGUG witnesses are not consistent with the results of Mr. Miller's class cost of service study.

Witness Baudino even goes so far as to argue that the entire rate increase should be borne by the residential class. PICGUG St. No. 1 at 11. However, as Company witness White testified, increasing the residential allocation beyond the recommendation of the Company "would only serve to increase the burden on the customers who are having the most difficulty paying their bills." PGW St. 4.1 at 17. For example, regarding his homeowners' association, customer Michael Connell testified: "We have a lot of senior citizens in our association who are on fixed incomes and cannot really afford this, as most

of these people are here.” Tr. at 406. Therefore, the OCA submits that the revenue responsibility recommendations of witnesses Metro, Baudino and Kalcic be rejected.

C. Rate Design

1. Customer Charge

a. PGW’s Proposed Increase To The Residential Customer Charge Should Be Rejected.

i. Introduction

PGW is seeking to increase its residential customer charge to \$15.00 per month. See Exhibit HSG-1. The Company’s current customer charge is \$11.66 per month and is a result of implementation of the Joint Petition. The Joint Petition was implemented in March 2001, but prior to this implementation, the residential customer charge was \$8.00 per month. Therefore, PGW is proposing to increase the residential customer charge by nearly 88% over year-ago levels. As will be explained below, the Company’s request for a \$15.00 per month customer charge should be rejected.

ii. PGW’s Proposal Would Improperly Shift More Cost Recovery To The Customer Charge.

Company witness Craig White favors an increase in the customer charge in order to mitigate the impact of weather on the Company’s ability to collect revenues. See PGW-St. 4.0 (rev.) at 7. In other words, since weather can affect a commodity charge (a charge based on customer usage), witness White seeks to collect more “guaranteed” revenues via a fixed charge, i.e, the customer charge.

The PUC has stated that the purpose of a customer charge is to recover costs “up front” each month before a customer is charged for consumption. Pa.P.U.C. v. Pennsylvania-American Water Co., 82 Pa. P.U.C. 381. According to the Commission:

[c]ustomer charges appropriately recover billing and collection costs, meter reading costs and costs of meters and services.

Id at 429. See also, Pa. P.U.C. v. West Penn Power Co., 73 Pa. P.U.C. 454 (1990). Therefore, a residential customer charge should recover basic or “direct” customer costs and is not intended to provide protection against variation in weather. As explained by Mr. Miller, when determining customer costs for this charge, PGW witness Gorman included many costs that are not properly classified as customer-related. OCA St. No. 2 at 6. Specifically, Mr. Miller testified:

The only cost classifications recognized in Mr. Gorman's cost of service study (and most other cost of service studies) are Demand, Commodity, and Customer. Mr. Gorman classifies a cost as customer-related unless he deems it to be demand-related or commodity-related. But it does not follow that all costs which cannot be related directly to maximum demands or to commodity usage should therefore be recovered in monthly customer charges, yet that is what Mr. Gorman and Mr. White have assumed.

Id. Put another way, the costs appropriately included in the customer charges are the costs that a utility directly incurs each month to serve each of its customers. These are costs that increase when one customer is added, and decrease when one customer is lost. OCA St. No. 2 at 6.

As set forth by Mr. Miller, direct customer costs should represent the carrying costs of the Company's investment in services, meters, and house regulators, plus the cost of meter reading and part

of the costs of customer records and collection.¹⁶ Id. For privately owned gas utilities, the carrying costs of investment are depreciation, return, and taxes. For PGW, which is municipally owned and not subject to most taxes, the carrying costs are depreciation and the equivalent of return on investment. Therefore, in his calculations, Mr. Miller used the total budgeted income at PGW's proposed rates — *i.e.*, revenues less expenses — as the equivalent of return on rate base. OCA St. No. 2 at 7.

OCA Exhibit 2-B, Table REM-4 sets forth the direct costs calculated by Mr. Miller for PGW, in accord with Commission precedent. Table REM-4 illustrates (with the full amount of the Company's claimed financial requirements included, rather than the OCA's reduced recommendation) that the direct customer costs for the residential class are \$12.17 per customer per month. This is in stark contrast to the inflated costs of \$39.94 contained in the Company's Cost of Service Study (due to the Company's inclusion of costs not properly recovered via a customer charge).

As explained by Mr. Miller, the difference in direct costs calculated in PGW's Cost of Service Study and the calculations done by Mr. Miller is attributable to the fact that Mr. Miller excluded three large customer cost elements identified by Mr. Gorman. OCA St. No. 2 at 7. Specifically, Mr. Miller excluded witness Gorman's customer component of distribution mains investment; all types of overheads (specifically, administrative and general expense) and other supervisory costs; and a large amount of Customer Accounts expense, (specifically, collection costs—part of account 903) and uncollectibles expense (account 904). Id.

¹⁶This classification is in accord with Pa.P.U.C. v. Pennsylvania-American Water Co., supra and Pa. P.U.C. v. West Penn Power Co., supra.

First, exclusion of distribution mains investment from the category of direct costs is appropriate. As Mr. Miller testified, there is no justification for recovering any of the mains investment costs in the residential customer charge. OCA St. No. 2 at 8. Mr. Miller testified:

In any small geographical area, such as a residential subdivision, mains are installed to serve the entire community, and the investment cost does not depend in any way on the decision of an individual household whether to use gas service. The mains investment cost allocated to the residential class should therefore be recovered from all residential customers in accord with their gas usage and the benefit they derive from using the gas distribution system.

Id. Therefore, exclusion of distribution mains investment from the category of direct costs is appropriate.

Second, overhead costs should also be excluded from the category of direct customer costs for determining the customer charge. These costs, specifically administrative and general (A&G) expense and other supervisory costs, are system costs. OCA St. No. 2 at 8. As such, they are not incurred to provide service to individual customers, and do not increase or decrease when customers are gained or lost. Other examples of overhead costs are customer installations expense, the call centers for handling customer inquiries and complaints, sales expense, and even the fixed costs of the BCCS system software and other information technology aspects of customer accounts expense. All of these costs apply to the residential class and other customer classes in the aggregate, but not to each individual customer. As such, these costs are system overheads and should not be recovered in customer charges. OCA St. No. 2 at 9.

Likewise, collection costs and uncollectibles expense should be excluded from the category of direct costs recovered in the customer charge. Regarding uncollectibles, because the amount of write-offs depends upon revenues and not simply the number of bills written off, uncollectibles are not properly

considered a customer cost to be recovered in the customer charge. OCA St. No. 2 at 8-9.

Based on the above, it is clear that the Company's inflated category of direct costs has contributed to the unreasonably high level of the residential customer charge proposed by PGW. Therefore, the Commission should disregard the category of direct costs identified in PGW's Cost of Service when determining the appropriate residential customer charge that should be adopted in the instant proceeding. OCA St. No. 2 at 5.

b. The Commission Should Implement A Residential Customer Charge of \$11.50 for PGW.

As previously set forth, the residential customer charge now in effect under the Joint Petition is \$11.66 per month. This customer charge is consistent with the direct customer costs in Mr. Miller's Table REM-4 and residential customer charges of other Pennsylvania gas utilities.¹⁷ However, this current customer charge adds more revenue than the total tariff revenue increase recommended for the residential class by the OCA. Therefore, Mr. Miller recommended that the residential customer charge rate should be established by reducing the interim customer charge to \$11.50 per month. A rate of \$11.50 per month still yields an increase of more than \$20 million in residential customer charge revenues, therefore, it

¹⁷In support of the Company's proposal, witness White presents the customer charges of other Pennsylvania natural gas distribution companies, while also relying on the Company's Cost of Service Study results as they relate to the residential class. *Id.* at 7. However, although a comparison of residential customer charges of other Pennsylvania NGDCs may support an increase in PGW's residential customer charge, a \$15.00 residential customer charge is unsupportable. For example, although witness White did not provide the residential customer charges of all Pennsylvania NGDCs, his testimony does contain two tables depicting the residential customer charges of select Pennsylvania NGDCs. The average customer charge of the NGDCs contained in the first table is \$9.64, while the average residential customer charge of the NGDCs contained in the second table is \$10.89. See PGW-St. 4.0 (REVISED) at 6. Therefore, Mr. White's comparisons with other gas utilities may support a residential customer charge of up to \$11.00 per month, but no higher than \$12.00 per month.

necessitates a residential commodity charge decrease to achieve the residential revenue target of \$17.7 million that Mr. Miller recommends. OCA St. No. 2 at 16.

If a total residential revenue increase exceeds the \$17.7 million recommended by Mr. Miller, the customer charge should remain at \$11.50 and the commodity charge should be increased to meet the higher revenue target.

c. The OCA's Proposed Rate Design, Including A Residential Customer Charge Of \$11.50, Should Be Adopted.

With implementation of the OCA's recommended residential customer charge, a commodity charge must also be calculated. In order to achieve the residential revenue target of \$17.7 million, a commodity charge rate of \$10.3895 is required. This residential commodity charge is a base rate of \$3.3921 (rolling out \$3.18 of fuel costs), plus the *pro forma* test year GCR rate of \$6.9974 (with the rolled-in base rate fuel costs).¹⁸ See OCA Exhibit 2-B, Table REM-1. Mr. Miller's Table REM-2c--proof of revenue at OCA's recommended rates--forms the basis for this calculation. Table REM-2c utilizes a total revenue target of \$523,374,433 for the residential class. From this target, the \$66,362,820 of residential customer charge revenues at the recommended rate of \$11.50 is subtracted. The difference is then divided by the 43,988,023 Mcf residential usage to yield a rate per Mcf. The quotient of \$10.3895 is the result and should be used as the commodity charge for the residential class.

¹⁸If the \$3.18 is not rolled out of base rates, the residential commodity charge will be \$6.5559 and the GCR rate will be \$3.8336.

2. Gas Cost Rate

PGW's present base rates include \$3.18 per Mcf of fuel cost recovery. As explained by Mr. Miller, this amount is almost entirely for the recovery of purchased gas costs, but PGW also includes \$0.0162/Mcf of purchased electricity costs in its fuel cost calculations. OCA St. No. 2 at 18-19. As set forth by Mr. LeLash, the purchased gas component of the \$3.18 per Mcf should be rolled out of base rates and placed instead in the GCR rate. The purchased electricity cost should be a base rate item. Likewise, recovery of the \$7 million in uncollectibles that was permitted in the Joint Petition should be removed from the GCR rate when the new rates resulting from the present proceeding are implemented and should be included in base rates.¹⁹ Neither of these modifications affect the total rate paid by any customer.

Mr. Miller effectuated these changes in developing his base rate commodity charge. As shown in Table REM-1, \$3.1638/Mcf of purchased gas costs is shifted out of the base rate and into the GCR rate ($\$3.18 - \$0.0162 = \$3.1638$). This change reduces the base rate commodity charge for each customer class by \$3.1638 and it increases the GCR rate by the same amount, to \$6.9974. There is no effect on the non-fuel component of the base rate and no effect on the commodity charge total. With this shift, purchased electricity would be treated no differently for rate design purposes than any other purchases, such as office supplies, postage, and consulting services. All would be recovered together in the base rate. Therefore, both of these modifications can be incorporated into the rate design proposal of Mr. Miller without affecting the total rate paid by any customer.

¹⁹The Joint Petition allows the Company to recover \$7 million in uncollectibles expense via the GCR.

D. Tariff Changes

1. Introduction

Company witness Craig White has proposed two tariff changes in his testimony. One is a new Section 2.3 in the Rules and Regulations part the tariff. It would permit PGW to offer individual contracts with non-standard rates to select interruptible customers. PGW St. 4.0 at 11. The other change is a modification to the price ceiling provision in the boiler and power plant service (BPS) rate schedules. Id. at 14. As set forth below, the OCA is not opposed to the premises underlying these proposals, however, certain modifications and clarifications are necessary prior to Commission approval.

2. Non-Standard Rates

Mr. Miller recommends three changes to Section 2.3 dealing with non-standard rates. First, Section 2.3b should state, in its entirety, that "*The negotiated rate(s) shall not be less than 110% of the incremental gas cost for gas sold under the negotiated contract plus an adjustment for all applicable taxes, as determined by the Company.*" This language is the same as the corresponding part of the Commodity Charge provision in each of PGW's interruptible (BPS and LBS) rate schedules, except that the phrase "the negotiated contract" is substituted for the phrase "this rate schedule." OCA St. No. 2 at 26.

Second, there should be a further provision (in a new Section 2.3c) that the negotiated rate shall not be less than the rate that would otherwise be available to the customer, unless the contract also contains a minimum take or a full requirements provision. Also, if the provision qualifying the negotiated contract for a discount rate is a minimum take provision, the minimum take requirement must be at least 80% of the maximum volume for which the discounted rate is offered. This further provision is needed to

ensure that PGW obtains a benefit of additional sales volume in exchange for any discounts below the interruptible rates otherwise available to the customer. OCA St. No. 2 at 27.

Finally, Mr. Miller recommends a further provision relating to the use of a specific gas source for determining the incremental gas cost for gas sold under the negotiated contract. This further provision would become a new Section 2.3d. It should state that PGW may use a specific gas source purchased for a period of more than one month to determine the incremental gas cost for a negotiated contract, but only if the contract also includes a commitment by the purchaser to take and pay for at least 80% of the gas in that specific purchase. This provision is needed to prevent a purchaser from obtaining a long-term supply commitment from PGW at a specific price, and then walking away if gas prices happen to fall. Absent a multi-month minimum take commitment by the purchaser, the incremental gas cost would continue to be determined monthly, and the contract price in each month would have to be at least 110% of that month's incremental gas cost pursuant to Section 2.3b. OCA St. No. 2 at 27.

Company witness White deems the above recommendations as too restrictive. PGW St. 4.1 at 20-21. However, the OCA submits that incorporation of the above modifications will ensure that sales customers are not disadvantaged by any contracts entered into under Section 2.3. Therefore, the OCA submits that these modifications should be adopted.

3. BPS Price Ceiling

Rate Schedules BPS-S and BPS-L contain a requirement that the commodity charge rate shall not exceed 90% of the General Service (GS) rate for commercial and industrial customers, including the GCR charge. This threshold is referred to as the "BPS price ceiling" by Mr. Miller. As Mr. Miller testified, this price ceiling is a problem because in some months it may be lower than one or more of the price floors in

the BPS Commodity Charge provision. OCA St. 2 at 28. The two relevant floors are the requirements that the BPS price be at least 80% of a specified oil parity price, and that it be at least 110% of PGW's incremental gas cost. In months when the BPS price ceiling is below one (or both) of the floors, there is a question whether PGW may offer BPS gas for sale and, if so, at what price. *Id.* However, the Company's proposal to remedy this potential situation is unclear. Therefore, Mr. Miller recommends that the BPS price ceiling at 90% of the GS rate be removed from the tariff. In his surrebuttal testimony, Company witness White concurs with this recommendation. Consequently, the OCA submits that the Commission should adopt this recommendation.

VII. QUALITY OF SERVICE

A. Introduction

In considering whether any rate increase request is just and reasonable, the Commission must consider the quality of service being provided by the utility. As OCA witness LeLash explained:

The regulatory process has consistently followed the principle that a utility operation is only entitled to rate increases if its service is adequate and reasonable. Such a principle enforces the requirement that, in providing a monopoly service, utility owners have a responsibility to maintain and operate the utility in the most efficient and reasonable manner possible. Failure to fulfill these requirements can result in the withholding of rate relief. In effect, regulation requires that utility owners provide effective management and sufficient capital to fulfill the on-going obligation to serve.

OCA St. 1 at 13. In other words, "rates should follow service." OCA St. No. 1 at 60.

The long-term problems with PGW's service to customers and its progress towards improved service should be a primary determinant of whether customers should have to pay higher rates.

Id. Pennsylvania law is clear that the Commission has the discretion to withhold, to limit, or to condition rate relief on the quality of service. Section 526(a) of the Public Utility Code states that:

(a)The commission may reject, in whole or in part, a public utility's request to increase its rates where the commission concludes, after hearing, the service rendered by the public utility is inadequate in that it fails to meet quantity or quality for the type of service provided.

66 Pa. C.S. §526 (a). Section 523(a) also states that "the commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title. 66 Pa.C.S. §523(a). A utility's service must be considered in a determination of its rates.

In the instant case, the Commission's Stratified Management and Operations Audit of Philadelphia Gas Works by the Barrington-Wellesley Group, Inc. was admitted into the record. Stratified Management and Operations Audit of Philadelphia Gas Works (January 2001), Attachment 1 to Administrative Counsel Statement No.1. Further, Philadelphia Gas Works filed in March 2001 the Philadelphia Gas Works Implementation Plan for the Stratified Management and Operations Audit, which was also admitted into the record. Philadelphia Gas Works Implementation Plan for the Stratified Management and Operations Audit (March 2001). As the Management Audit has made clear, many areas of the Company's customer service are inadequate. For example, the Management Audit found that "PGW's level of service, as measured by abandonment phone rates and response time of the call center, is one of the worst in the industry." Stratified Management and Operations Audit of Philadelphia Gas Works at p. VIII-7 (January 2001). Other problems identified with PGW's service include insufficient staffing levels to meet Call Center levels (only 62% or 48 of 78 employees are on average present at one

time); inadequate training of employees on the billing system; lack of functioning billing system; overwhelmingly negative customer opinion of PGW; and poor responsiveness to customer complaints. Id. at p. VIII-11, VIII-16-17, VIII-26.

The public input testimony in this proceeding confirms these Audit findings and raises many concerns about the level of PGW's service. The OCA submits that if PGW is granted a rate increase, it must be subject to conditions to ensure the provision of safe and adequate service and to ensure that the rates are just and reasonable.

B. The Commission Should Only Grant Rate Relief Subject To Certain Conditions.

The OCA submits that basic protections are necessary to afford ratepayers appropriate protection if they are required to pay higher rates as a result of this rate proceeding. Specifically, the OCA submits that (1) the Company should be required to maintain at least a 1% replacement rate in its mains replacement program; (2) the Company should continue its commitment to correcting the problems with its BCCS, particularly the need to rectify the budget billing problems; (3) the Company should continue to work with the Commission to implement the necessary recommendations as per the Philadelphia Gas Works Implementation Plan for the Stratified Management and Operations Audit (March 2001); (4) improve its customer service in a timely manner; and (5) continue its progress on its Transition to Excellence Plan.

The Commission has often exercised its discretion to either reject a rate increase due to inadequate service or condition the receipt of a rate increase on a utility company's agreement to perform certain improvements. For example, in Pa.P.U.C. v. Pa. Gas and Water Co. ("PG&W"), the Commission concluded that no rate increase could be justified based on the poor quality of service being offered by

PG&W. Pa.P.U.C. v. Pa. Gas and Water Co., 68 Pa. P.U.C. 191, 197 (1988). In a case involving Pennsylvania-American Water Company (“PAWC”), the Commission went so far as to say PAWC “should have to demonstrate *actual evidence of improved service*” before its customers should have to pay an increased rate. Pa. P.U.C. v. Pennsylvania-American Water Co., 71 Pa. P.U.C. 210, 217 (1989) (emphasis added). See also, Pa. P.U.C. v. National Utilities, Inc., 87 Pa.P.U.C. 1, 6 (1997) (denying the Company’s rate increase entirely because of inadequate service); see also, Pa. P.U.C. v. Pa. Gas and Water Co., 68 Pa.P.U.C. 191 (1988), (denying a rate increase because of the Company’s failure to show that its customers were receiving adequate service).

The Commission has also used its authority under Sections 523 and 526 to provide a utility with the option of accepting no rate increase or a rate increase that was dedicated entirely to distribution system improvements to accelerate progress toward providing safe and adequate service. Pa.P.U.C. v. Pa. Gas & Water Co., 79 Pa. P.U.C. 349, 359 (1993).

The Courts have long held that service is an essential consideration in determining just and reasonable rates. See D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Comm’n, 466 F.2d 394, 422 (D.C. Cir. 1972). The U.S. Court of Appeals for the District of Columbia Circuit in D.C. Transit perhaps stated this consideration best when reviewing a decision of the Washington Metropolitan Transit Commission. In that case, the Transit Commission had made a fare increase contingent upon steps calculated to rectify serious deficiencies in the service that the Company furnished to the public. The Court summarized the Company’s argument and concluded as follows:

Transit’s argument has one central theme: its revenues cannot be permitted to fall below the level of fair return, and surely not below the breakeven point, no matter what the circumstances, and even if its management is

uneconomical and inefficient and its service inadequate. If Transit is correct, the Commission is powerless to sanction corrective measures by deferring further consideration of a fare increase. *If Transit is correct, it may disregard its public responsibilities at will . . . and yet insist that the public respond to its demands for higher rates. We cannot accept that position. We do not believe that the Constitution left the Commission impotent to deal with the situation confronting it in a sensible manner.*

D.C. Transit, 466 F.2d at 422 (emphasis added). As far back as Smythe v. Ames, 169 U.S. 466 (1898), the United States Supreme Court has recognized that service is an essential consideration in just and reasonable rates. The Court held:

[W]hat the public is entitled to demand is that no more be extracted from it for the use of a public highway than the services rendered by it are reasonably worth.

Id. at 547.

As the public input testimony, the Management Audit, and the Company's own studies make abundantly clear, PGW has failed to provide adequate and reasonable service to its customers for some time. Although the OCA acknowledges that current management has made improvements, there is much that remains to be done, particularly regarding the Company's billing system and its customer service.

C. Public Input Testimony Regarding Quality of Service

The OCA submits that the public input testimony demonstrates that PGW's quality of service needs to be improved. The public input testimony overwhelmingly demonstrated a dissatisfaction with PGW's service and brings critical evidence to the PUC on the impact on customers of the problems identified in the Management Audit and the Company's studies.

The public input testimony demonstrates that PGW's quality of service must be improved. Many individuals expressed concern about PGW's billing system and Call Center. Approximately 80 people testified at the three public input hearings on the afternoon and evening of March 28, 2001 and evening of March 29, 2001. Many of the people that testified also represented local community groups. Additionally, several State Senators and Representatives testified on behalf of constituents including State Representative John M. Perzel; Geoffrey Seay, Chief Counsel for Senator Anthony Williams; and Darnell M. Deans, Sr. from State Senator Shirley M. Kitchen's office.

A primary concern for customers and PGW has been billing problems, particularly since implementation of the new billing system, referred to as BCCS in July 1999. As both the Management Audit and OCA witness LeLash testified, this system has been fraught with problems and is still not fully operational even two years after the program's implementation. The Company still has problems with the accuracy and completeness of customer bills, which compromise its ability to enter into payment arrangements and properly implement budget billing. OCA St. 1 at 54; PGW St. 1.0 at 24. The public input testimony documents the negative impact and the hardship on consumers from these problems.

For example, Betty-Ann Workman testified about the "cavalier attitude the gas company has towards its customers" and the "appalling mismanagement that results in pain for the consumer." Tr.

at 90. Ms. Workman testified that PGW failed to send her a bill for four months. Tr. at 90. She testified that she contacted PGW on an average of three times per week, and when her neighbor finally received Ms. Workman's "overdue notice," the balance due was \$2,093.94. Id. Ms. Workman's average bill had been \$175 per month. She never received a bill, only the "overdue notice." Id. Consumer, Barbara Carey testified that "there is confusion, disorder, billing errors, incorrect bills or no bills at all in one or more billing periods." Tr. at 195. Eric S. Maron testified about the "sloppy handling of the billing process on the part of PGW." Tr. at 215. Maron testified that he contacted PGW to be sent a bill, but he was not sent a bill for four years and then received a \$4,000 bill with late charges. Tr. at 216. Another customer, Francis Sheffield, testified that after fire damage to his home, the gas was cut off for his home and the home was unoccupied. Tr. at 186-187. However, he testified that he still received three bills for those months of January, February, and March when the gas was turned off and no one was occupying the home. Id.

Many witnesses also testified as to the unresponsiveness of the customer call service. As the Management Audit found, the customer call center, when measured in terms of abandonment phone rates and response time of the call center is the worst in the industry. Attachment 1 to Administrative Counsel St. No. 1 at p. VIII-7. The Management Audit found that the average speed of answer for service calls is between 3 and 6 minutes, and for billing calls between 15 and 30 minutes. The industry standard is 25 to 30 seconds. Id. at p. VIII-2, VIII-8.

The impact of these failings on customers is significant. As Pennsylvania State Representative John Perzel testified, customers should be able to call the utility, have their phone calls answered properly, and have their bills be delivered on time with accuracy. Tr. at 184-185. Representative Perzel further stated that PGW "should be held to the same operating and customer service

standards as required for all other natural gas companies in Pennsylvania.” Id. at 183. Marge Benner testified that no matter what time of day she calls, she never receives a response from PGW’s customer service. Tr. at 356. Herb Sumsky testified that PGW hires incompetent and computer illiterate workers at customer service. Tr. at 372. Mr. Sumsky testified that “going down to the PGW to straighten out bills, you come in like a nice person and you walk out like a fighting tiger.” Id. Anne Rossi testified that she was yelled at by the customer service representative at PGW and spends hours on hold waiting for customer service on the phone. Tr. at 382. Vince Mullins, a formal complainant in this case, testified also about the poor customer service. Tr. at 390-392. Alice Wojciechowski, 83, brought 400 petitions that she had collected and testified that she has spent hours on the phone with customer service at PGW. Tr. at 410.

This public testimony puts a human face on the myriad of customer service problems identified by the Management Audit and identified by OCA witness LeLash through a review of the Company’s own studies. As set forth below, the Commission should require specific commitments in the areas of customer service, the BCCS system and the mains replacement program if any rate increase is awarded. Additionally, the Company should commit to continue its Transition to Excellence Plan and to timely work with the Commission to implement the necessary recommendations of the Management Audit.

D. Specific Commitments Necessary to Improve Quality of Service

1. BCCS

The OCA submits that the quality of service received by PGW’s customers should be a determinant in whether or not customers should be required to pay higher rates or whether conditions should be imposed on any rate increase requested. The record in this case demonstrates PGW’s service has suffered and fails to meet even the most rudimentary test of adequacy. Significant and far-reaching

changes are needed – many of which have been identified by the Management Audit. The Company has committed to many of these changes and improvements but only time will tell whether corrective actions will be properly implemented.

The OCA submits that part of these problems stem from the failed implementation of the BCCS. As OCA witness LeLash stated:

The problems associated with the BCCS system hampered all of PGW's operations and were particularly damaging to the Company's relationship with its customers. However, the problematic BCCS implementation was only the final element in a deterioration in operations extending back over several years which undermined the Company's financial and management capability to address new problems and provide customers with reasonable service.

Id. at 55-56.

While many of the basic problems have been addressed, the BCCS is still not fully operational and requires further improvement. PGW witness Thomas Knudsen stated in his prefiled testimony that:

We are also now billing our accounts albeit we still have problems with accuracy and completeness. As we have peeled away and dealt with major problem areas, we have exposed issues that were similar but in equal need of correction.

OCA St. 1 at 54; PGW St. 1.0 at 24.

As noted, several areas still require further improvement. OCA witness LeLash identified some of the specific areas that require further attention:

A review of the current status of the BCCS and associated systems shows that several specific areas need further improvement. Billing exceptions, while dramatically reduced, still are occurring at a rate somewhat less than 300 per day. (PGW St. 1.0, page 26). A large number of errors are

occurring with reference to payment arrangements and the bill calculation process (PGW St. 1.0, page 29). The Company has also acknowledged that, at least through February of this year, it was having problems making adjustments to customers' budget billing plans. (Response to CEPA-I-47)

OCA St. 1 at 54.

The Management Audit also identified problems with the BCCS and the poor training and insufficient staffing of employees who operate the BCCS. Attachment 1 to Administrative Counsel St. No. 1 at p. VIII-9-13, VIII-15-16. The Management Audit also concludes that these problems with the BCCS system are negatively affecting customer service. The Management Audit stated that April 2000 focus groups showed that "(m)ost participants did not trust PGW to provide either good customer service or accurate billing. The poor service conveys to customers that PGW does not have any regard for them." Id. at p. VIII-17. In the fall of 2000, BCCS was attempting to correct over 10,000 customer billing exceptions created by the BCCS system. Id. at p. VIII-17.

The OCA submits that PGW must continue to rectify its BCCS problems, particularly those regarding budget billing. The Company should commit to implementing corrective measures, including implementation of the necessary recommendations of the Management Audit regarding this system.

2. Customer Service

The Commission's Management Audit found that "PGW's level of service, as measured by abandonment phone rates and response time of the call center, is one of the worst in the industry." Attachment 1 to Administrative Counsel St. No. 1 at VIII-7. The Audit found that the average speed of answer for service calls was three to six minutes and the average speed for billing calls was 15 to 30

minutes. Id. at p. VIII-8. The industry standard is 25 to 30 *seconds*. Id. Only PGW's emergency call response fell within accepted standards.

Studies conducted by the Company last year confirm these findings of the Management Audit. OCA witness LeLash summarized the information from the Company's own study:

Vanguard reported last June that the industry standard for utilities was that 80% of incoming calls should be answered within 30 seconds. PGW met that standard only for emergency calls. As for service calls, Vanguard reported that the average service call by a customer was answered in 3 to 6 minutes; the average call for billing information was answered in 15 to 30 minutes (Vanguard Report, pp. 11. 36). Not surprisingly, 20% to 30% of PGW service calls by customers were abandoned, in contrast with the industry standard of 4%-5%. And 70% to 85% of calls for billing information by customers were abandoned, in contrast with the industry standard of 4%-5% (Vanguard Report, p. 11). Andersen confirmed that the Call Center provided a "seriously low ... service level" (Andersen Report, p. 10).

OCA St.1 at 58.

In addition to statistical information regarding the level of customer dissatisfaction, OCA witness LeLash noted the significant number of customer complaints that are being pursued against PGW.

Mr. LeLash testified:

There is also evidence that customers are lodging complaints with the PUC. As of February of this year, there were 3,513 informal complaints pending before the Commission's Bureau of Consumer Services (BCS). This level of pending complaints has been increasing at a rate of 300 to almost 700 per month and apparently PGW has been able to respond to only about 40% of them to date (Response to CEPA-I-52).

OCA St. 1 at 60. As discussed above, the public input testimony bears out this information and highlights the myriad of problems with PGW's service.

The OCA submits that long-term customer service improvements must be implemented before ratepayers can be expected to pay ever higher rates. The OCA submits that if any rate increase is granted, the Company must commit to timely improvements in customer service, including those identified in the Management Audit.

3. Mains Replacement

PGW has an extensive system of cast iron mains. As its cash flow increasingly became a problem, mains replacement became a discretionary item for PGW. OCA St. 1 at 51. As OCA witness LeLash testified, according to a Replacement Study developed last year by Navigant Consulting (“Navigant”), a replacement rate of 18 miles per year, or 1% for PGW is necessary to reduce the risk of main breaks and incidents. OCA St. 1 at 51. As a condition of the interim rate relief granted to the Company, PGW was required to maintain a 1% cast iron mains replacement program. Pa.P.U.C. v. Philadelphia Gas Works, Docket No. R-00005654 at 28 (November 22, 2000).

Through March 2001, the Company replaced or abandoned 6.2 miles of the cast iron mains. OCA St. No. 1 at 52. That equals approximately one-third of the 18.0 miles necessary to achieve a 1% replacement rate. Id. PGW has experienced 334 main breaks since March 2001 compared to 445 main breaks for the comparable period during the previous fiscal year. Id.

The OCA submits that it is vital that at least a 1% replacement rate be maintained in order for PGW to provide safe and adequate service. OCA St. No. 1 at 53. OCA witness LeLash testified about the impact of continuing the company’s mains replacement program at its current rate:

A low level of replacement increases the prospect for increased breaks and incidents. While breaks have averaged between 350 and 400 per year, the system has benefitted from the recent mild winters. As noted by

Navigant, "Since severe weather tends to cause breaks, and breaks tend to cause incidents, severe weather tends to cause incidents."

Id. at 52.

The OCA submits that PGW's mains replacement raises a serious public safety concern if not maintained at safe and adequate levels. Since the definition of a utility's performance benchmark is safe and adequate service, the OCA submits that it is vital that at least a 1% replacement rate is achieved and maintained. OCA St. 1 at 53. The Commission should establish as a prerequisite to any rate increase that PGW commit to maintaining at least a 1% replacement rate.

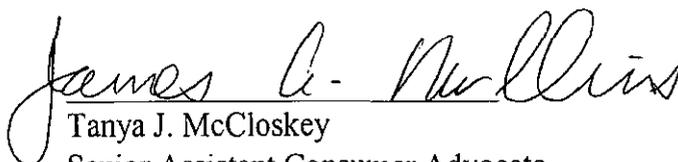
E. Conclusion

For the reasons set forth above, the OCA submits that any rate relief granted in this proceeding must be subject to certain conditions so that basic protections are afforded ratepayers as a result of this proceeding. The OCA submits the following five conditions must be met:

- PGW should be required to maintain at least a 1% replacement rate in its mains replacement program;
- PGW should continue its commitment to correcting the problems with the BCCS, particularly the need to rectify the budget billing problems;
- PGW should continue to work with the Commission to implement the recommendations as per the Philadelphia Gas Works Implementation Plan for the Stratified Management and Operations Audit (March 2001);
- PGW should improve its customer service in a timely manner, particularly its call center performance; and
- PGW should continue its progress on its Transition to Excellence Plan.

VII. CONCLUSION

For the reasons set forth above, the Office of Consumer Advocate submits that the Commission find that a \$21.5 million increase in revenues is appropriate for PGW in the instant proceeding subject to the conditions set forth herein.



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Philadelphia Gas Works

Base Rate Case - Docket No. R-00006042

The Company's filing and the OCA's recommended position in this proceeding were not based on traditional rate base and rate of return components. Indeed, no party presented either a rate base or a rate of return recommendation in order to determine its recommended revenue requirement for PGW.

For comparison purposes, the OCA position and the Company's position are shown on Schedule 1. This schedule contrasts the Company's \$65.0 million increase with the OCA's \$21.5 million increase and shows the impact of these revenue levels on the bond coverages of the Company. The data on Schedule 1 provides the calculation without any grant back of operating revenues by the City of Philadelphia, while Schedule 2 provides the same revenue comparison with an \$18.0 million grant by the City.

On Schedule 5 there is a breakdown of the operating expense adjustments which are recommended by the OCA. These adjustments would lower the revenue requirement by \$6.8 million. However, the OCA also recognized the potential for an increase in Bad Debt Expense of approximately \$6.8 million associated with the higher levels of billed revenues within the Company's GCR. Taking the initial ten expense reductions and the bad debt expense increase, the OCA recommends that no net expense adjustment be made to the Company's filed position.

Accordingly, the three referenced schedules, which are attached, show the equivalent data to that typically filed in the Table I Income Summary, and in the Table II Summary of Adjustments. The only additional consideration involves the fact that the itemized expense adjustments were offset by the referenced increase in Bad Debt Expense which is not shown on Schedule 5.

PHILADELPHIA GAS WORKS
Debt Service Coverage @1.5x
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
<u>FUNDS PROVIDED</u>			
1 Total Gas Revenues @Present Rates	\$662,459	\$0	\$662,459
2 Proposed Rate Increase	65,000	(43,502)	21,498
3 Appliance Repair & Turn-Ons	13,233	0	13,233
4 Other Operating Revenues	14,793	(849)	13,944
5 Total Opg Revenues @Proposed Rates	<u>755,485</u>	<u>(44,351)</u>	<u>711,134</u>
6 Other Income Less Restricted Funds	6,557	0	6,557
7 City Operating Grant	0	0	0
8 AFUDC	346	0	346
9 TOTAL FUNDS PROVIDED	<u>762,388</u>	<u>(44,351)</u>	<u>718,037</u>
<u>FUNDS APPLIED</u>			
10 Fuel Costs	394,586	0	394,586
11 Other Operating Costs	256,961	0	256,961
12 Total Operating Expenses	<u>651,547</u>	<u>0</u>	<u>651,547</u>
13 Capital Lease Costs	7,977	0	7,977
14 Less: Non-Cash Expenses	37,272	0	37,272
15 TOTAL FUNDS APPLIED	<u>622,252</u>	<u>0</u>	<u>622,252</u>
16 Funds Available to Cover Debt Service	140,136	(44,351)	95,785
17 Add-Back Lease Costs	7,977	0	7,977
18 Funds Available Excluding Lease Costs	<u>148,113</u>	<u>(44,351)</u>	<u>103,762</u>
19 1975 Ordinance Bonds Debt Service	\$51,611	\$0	\$51,611
20 Debt Service Coverage 1975 Bonds	<u>2.87</u>	<u>-0.86</u>	<u>2.01</u>
21 Net Available After Prior Debt Service	\$96,502	(\$44,351)	\$52,151
22 PMA & Other Capital Leases	7,977	0	7,977
23 Net Available After Prior Capital Leases	<u>\$88,525</u>	<u>(\$44,351)</u>	<u>\$44,174</u>
24 1998 Ordinance Bonds Debt Service	\$29,449	\$0	\$29,449
25 Debt Service Coverage 1998 Bonds	<u>3.01</u>	<u>(1.51)</u>	<u>1.50</u>
26 Net Available After 1998 Debt Service	\$59,076	(\$44,351)	\$14,725
27 1998 Ord. Subordinate Bond Debt Service	\$1,990	\$0	\$1,990
28 Debt Service Coverage Subord. Bond	<u>29.69</u>	<u>(22.29)</u>	<u>7.40</u>

PHILADELPHIA GAS WORKS
Debt Service Coverage @1.5x & \$18 Million Grant
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
<u>FUNDS PROVIDED</u>			
1 Total Gas Revenues @Present Rates	\$662,459	\$0	\$662,459
2 Proposed Rate Increase	65,000	(43,502)	21,498
3 Appliance Repair & Turn-Ons	13,233	0	13,233
4 Other Operating Revenues	14,793	(849)	13,944
5 Total Opg Revenues @Proposed Rates	755,485	(44,351)	711,134
6 Other Income Less Restricted Funds	6,557	0	6,557
7 City Operating Grant	0	18,000	18,000
8 AFUDC	346	0	346
9 TOTAL FUNDS PROVIDED	762,388	(26,351)	736,037
<u>FUNDS APPLIED</u>			
10 Fuel Costs	394,586	0	394,586
11 Other Operating Costs	256,961	0	256,961
12 Total Operating Expenses	651,547	0	651,547
13 Capital Lease Costs	7,977	0	7,977
14 Less: Non-Cash Expenses	37,272	0	37,272
15 TOTAL FUNDS APPLIED	622,252	0	622,252
16 Funds Available to Cover Debt Service	140,136	(26,351)	113,785
17 Add-Back Lease Costs	7,977	0	7,977
18 Funds Available Excluding Lease Costs	148,113	(26,351)	121,762
19 1975 Ordinance Bonds Debt Service	\$51,611	\$0	\$51,611
20 Debt Service Coverage 1975 Bonds	2.87	-0.51	2.36
21 Net Available After Prior Debt Service	\$96,502	(\$26,351)	\$70,151
22 PMA & Other Capital Leases	7,977	0	7,977
23 Net Available After Prior Capital Leases	\$88,525	(\$26,351)	\$62,174
24 1998 Ordinance Bonds Debt Service	\$29,449	\$0	\$29,449
25 Debt Service Coverage 1998 Bonds	3.01	(0.89)	2.11
26 Net Available After 1998 Debt Service	\$59,076	(\$26,351)	\$32,725
27 1998 Ord. Subordinate Bond Debt Service	\$1,990	\$0	\$1,990
28 Debt Service Coverage Subord. Bond	29.69	(13.24)	16.44

PHILADELPHIA GAS WORKS
Adjustments
(\$000)

	OCA	
	Revised	
	Budget	
	<u>2000-01</u>	<u>Schedule</u>
BCCS Remediation	(\$800)	6
Consultant/Studies Costs	(424)	7
Non-Recurring Expenses	(1,840)	8
Rate Case Expense	(412)	9
Employee Consultants	(258)	10
Equipment Rentals & Leasing-IT	(632)	11
Lobbying Expense	(115)	12
Operating Leases	(601)	13
Non-Recurring Material Purchases	(100)	14
Amortization-Regulatory Asset	<u>(1,637)</u>	15
 Total Adjustments	 <u><u>(\$6,819)</u></u>	

PROPOSED FINDINGS OF FACT,
CONCLUSIONS OF LAW, AND
ORDERING PARAGRAPHS

**PROPOSED FINDINGS OF FACT
AND
CONCLUSIONS OF LAW**

Proposed Findings of Fact:

1. During the period September 1, 1999 to August 31, 2000 (FY 2000) PGW's customers' actual GCR costs were \$236.7 million. OCA St. No. 1 at 8.
2. For fiscal year 2001, based on current forecasts, PGW's customers' applicable GCR costs will be \$241.0 million higher, or \$477.7 million, which reflects more than a 100% increase in the GCR. OCA St. No. 1 at 8.
3. The Company has requested a \$65 million base rate increase based on its fiscal year 2001 budget. PGW St. 1.0 at 5.
4. PGW has not sought a base rate increase since 1992. OCA St. No. 1 at 22.
5. With the requested \$65.0 million base rate increase, PGW ratepayers would be required to pay almost one-third of a billion dollars in total rate increases during this fiscal year. OCA St. No. 1 at 8.
6. Under the Company's requested \$65 million rate increase, debt coverage is projected to be 2.87 times on 1975 bonds and 3.01 times on 1998 bonds and produce \$35-40 million in cash at fiscal year end. PGW St. 1.0 (rev.) at 20.
7. Over the past eight years, debt coverage was never higher than 1.67 times and in several cases it approached the bond covenant minimum of 1.50 times. OCA St. No. 1 at 22.
8. In this proceeding, if granted the \$65.0 million request, net earnings are projected to be \$34 million. OCA St. No. 1 at 22.
9. Since 1992, the Company's net earnings were never greater than \$17 million and in FY1998 through FY 2000 earnings were negative. OCA St. No. 1 at 22.
10. Since FY1992, year-end cash has only exceeded \$35.0 million twice, in FY1994 and FY1995. OCA St. No. 1 at 23.
11. Since the Company filed its pending base rate request, it has been granted and implemented \$11.0 million of interim base rate relief. OCA St. No. 1 at 20.
12. The Company's current rates are designed to recover the \$11 million interim rate

increase in just six months (March 1 through August 31, 2001). OCA St. No. 2 at 12.

13. A \$21.5 million rate increase is sufficient to meet PGW's bond coverage requirements and its expenditures as set forth in its budget, including the \$18 million payment to the City. This represents an incremental increase of \$10.5 million over the interim rates now in effect. OCA St. No. 1 at 30-31.
14. With a \$21.5 million increase and no grant back of the \$18 million annual payment to the City, PGW's bond coverages for the 1975 bonds and the 1998 bonds will be 2.01 times and 1.50 times, respectively. Schedule 1 (appended to OCA St. No. 1).
15. A revenue requirement increase of \$21.5 million, along with a grant back of the \$18 million payment to the City, will result in a 2.36 times coverage on the 1975 Ordinance Bonds and a 2.11 times coverage on the 1998 Ordinance Bonds. OCA St. No. 1 at 10.
16. An award of \$21.5 million in additional revenues should be allocated among the individual customer classes by proportionally reducing the class revenue increases proposed by PGW. OCA St. No. 2 at 12.
17. The prevailing rolled-in factor for gas of \$3.18 per Mcf is currently recovered in base rates. OCA St. No. 1 at 11.
18. Of the \$3.18/Mcf of gas costs recovered in base rates, \$0.0162/Mcf is attributable to purchased electricity costs, which should remain in base rates. The remaining \$3.1638 should be rolled into the GCR. OCA St. No. 2 at 19.
19. For PGW, a replacement rate of at least 1% is necessary to reduce the risk of main breaks and incidents. OCA St. No. 1 at 51.
20. Between 1989 and 1994, PGW's average rate of replacement of mains was 18 miles per year, or 1%. OCA St. No. 1 at 51.
21. Through March of this year, the Company has replaced or abandoned 6.2 miles of cast iron mains which equals about one-third of the 18.0 miles which would achieve a 1% replacement rate, if continued. OCA St. No. 1 at 52.
22. PGW's service has failed to meet industry standards in regard to call center performance for response time and call abandonment. Attachment 1 to Administrative Counsel St. No. 1 at VIII-7.
23. While many of the basic problems have been addressed, the BCCS system is not fully operational, including the budget billing function. OCA St. No. 1 at 54.

24. As of February of this year, there were 3,513 informal complaints pending before the Commission's Bureau of Consumer Services (BCS). OCA St. No. 1 at 60.

Proposed Conclusions of Law:

1. All rates shall be just and reasonable. 66 Pa. C.S. § 1301.
2. Every public utility shall furnish and maintain adequate, efficient, safe, and reasonable service. 66 Pa. C.S. § 1501.
3. The Commission must consider the efficiency, effectiveness, and adequacy of service of each utility when determining just and reasonable rates. 66 Pa. C.S. § 523.
4. The Commission may reject, in whole or in part, a request to increase rates where the Commission concludes that the service rendered by the utility is inadequate. 66 Pa. C.S. § 526.
5. The Company must offer a budget billing option with the opportunity for adjustments three times a year. 52 Pa. Code § 56.12(7)

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OCA PROPOSED ORDERING PARAGRAPHS

1. PGW shall be allowed to implement rates enabling the Company to collect \$21.5 million in additional revenues.
2. The rate increase shall be allocated to the customer classes as proposed by the Company with a proportional scale-back to reflect the appropriate rate increase amount.
3. The residential GS customer charge shall be established at \$11.50 per month.
4. The purchased gas component of the commodity charge shall be removed from the base commodity charge and included in the gas cost rate.
5. The purchased electricity costs shall remain in the base commodity charge.
6. PGW shall maintain at least a 1% replacement rate in its mains replacement program.
7. PGW shall commit to correcting the problems with the BCCS, including the budget billing function.
8. PGW shall commit to continue to work with the Commission to implement the recommendations of the Management Audit consistent with the Implementation Plan.
9. PGW shall commit to improve its customer service in a timely manner.
10. PGW shall commit to continue its progress on its Transition to Excellence Plan.

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