

5/24/01

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Phb DD

PF

REBUTTAL TESTIMONY OF

JANICE DAVIS

ON BEHALF OF
PHILADELPHIA GAS WORKS

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PHILADELPHIA GAS WORKS
BASE RATE PROCEEDING

DOCKET NO. R-00006042

MAY 2001

DOCKETED
JUN 8 2001

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FOLDER

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

2

3 A. My name is Janice Davis. My business address is 1401 J.F. Kennedy Boulevard, Suite
4 1330, Philadelphia, PA 19102.

5 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

6

7 A. My testimony is presented on behalf of the City of Philadelphia as the owner of
8 Philadelphia Gas Works ("PGW").

9 **Q. PLEASE SUMMARIZE YOUR EDUCATION AND PROFESSIONAL**
10 **EXPERIENCE FOR THE RECORD.**

11

12 A. I was appointed as Director of Finance of the city of Philadelphia by Mayor John F.
13 Street. As a member of the Mayor's Cabinet and Chief Financial Officer of the City, I am
14 involved with financial and fiscal policy development and directly oversee all City
15 financial activities, including budget, accounting, revenue collection, treasury functions
16 and procurement, as well as activities related to risk management, the Minority Business
17 Enterprise Council and Bureau of Administrative Adjudication. I also serve as the
18 Chairman of the Philadelphia Board of Pensions and Retirement and as a member of
19 various boards and commissions, including City Planning Commission, Mayor's Office
20 of Community Services, Pennsylvania Intergovernmental Cooperation Authority,
21 Philadelphia Authority for Industrial Development, Philadelphia Housing Development
22 Corporation, Philadelphia Historical Preservation Corporation and the Sinking Fund
23 Commission. I also serve on the Board of Directors of the Philadelphia Facilities
24 Management Corporation. My curriculum vitae detailing my professional experience is
25 attached as Exhibit JD-1 to this testimony.

26 **Q. WHAT ARE YOUR RESPONSIBILITIES AS FINANCE DIRECTOR?**

1 A. As Director of Finance, I have responsibilities under the Management Agreement to
2 oversee the operations of PGW. Specifically, I assist in the preparation of the operating
3 budget and forecast and offer recommendations as to the form and extent of the capital
4 budget and forecast prior to its submission for City Council approval. My office further
5 receives plans for capital loans and participates in the approval process for short and
6 long-term borrowing, among other duties

7 **Q. PLEASE SUMMARIZE THE FINANCIAL ASSISTANCE THE CITY OF**
8 **PHILADELPHIA HAS PROVIDED TO PGW.**
9

10 A. The City has provided substantial financial support to PGW. In Fiscal Year 2000, the
11 City offered PGW a \$45 million interest free, revolving loan to assist it with its financial
12 problems. The cost to PGW of such a line of credit would be approximately \$2-3 million
13 annually if it had been obtained conventionally (which was not an option in any event).
14 In addition, also in Fiscal Year 2000, the City issued a commitment, which proved not to
15 be necessary, to grant PGW up to \$5 million in project revenues necessary to meet the
16 1.5x debt service coverage requirements in the event PGW experienced a shortfall and
17 was unable to satisfy those requirements. In order to help PGW through the 2000-2001
18 winter heating season and the financial problems PGW faced after the issuance of the
19 Commission's Order on PGW's requested interim rate increase, the City, the Philadelphia
20 Housing Authority, and the Board of Education all agreed to pre-pay certain remaining
21 annual natural gas bills.

22 **Q. DID THE CITY PROVIDE ANY INDIRECT FINANCIAL SUPPORT OR**
23 **SAVINGS TO PGW AND ITS CUSTOMERS?**
24

25 A. Yes. The City is funding a financial control audit being performed by KPMG, the results
26 of which will accrue to the benefit of PGW's customers. The audit will assure that the

1 implementation of the new computer and billing system is being properly accomplished
2 or identify areas where additional controls are required. The cost of this audit will
3 approach \$350,000. Furthermore, the City pays the salaries of the President and Chief
4 Executive Officer, Kumar Kishinchand. The City has also assisted PGW by allowing it
5 to defer until June 30, 2001 making its annual payment to the City for this Fiscal Year.
6 PGW's relationship with the City as a municipally owned utility has also provided
7 immense financial benefits to PGW and its customers. As a municipal utility, PGW is
8 not required to pay federal and state income taxes, is exempt from various other taxes,
9 and is able to issue tax exempt debt. Several studies have calculated the aggregate
10 savings to customers from municipal ownership to be in the tens of millions of dollars.

11 **Q. THROUGHOUT HIS TESTIMONY, OCA WITNESS RICHARD W. LELASH**
12 **ASSERTS THAT THE CITY OF PHILADELPHIA HAS FAILED TO MEET ITS**
13 **OWNERSHIP RESPONSIBILITIES IN REGARD TO PGW BECAUSE IT HAS**
14 **NOT MADE ANY SIGNIFICANT EQUITY CONTRIBUTIONS. PLEASE**
15 **RESPOND TO MR. LELASH'S ASSERTIONS.**

16
17 A. PGW is a municipally owned utility, which operates differently than an investor owned
18 utility and receives separate and distinct regulatory treatment. PGW, as a municipal
19 utility, is intended to be self-sufficient. This intention is realized through the
20 Management Agreement's cash flow ratemaking method which asks customers to pay in
21 rates the amount needed to fund its budget and to supply the amount of cash working
22 capital that PGW actually needs to pay its bills when they come due. PGW's cash
23 requirements are driven entirely by its operating expenses, and customers are not asked to
24 provide a return on the cash working capital or on equity. If a municipal utility is not self
25 sufficient, then the municipality would be forced to divert financial resources needed to
26 fund other taxpayer programs and services and governmental functions. Moreover, none

1 of the ordinances authorizing PGW's current financing mechanisms assumes or requires
2 the City to act like a conventional utility investor or owner.

3 **Q. IS THE CITY ABLE TO GRANT ADDITIONAL ASSISTANCE TO PGW TO**
4 **LESSEN ITS NEED FOR RATE RELIEF AS SUGGESTED BY SOME PARTIES?**
5

6 A. Unfortunately, no. The City is not in a position to offer any additional monetary
7 assistance to PGW. The annual \$18 million payment to the City, which was required by
8 the Management Agreement and is now also required by the Public Utility Code, has
9 already been budgeted for City programs and needs for the next several years. In its Ninth
10 Five-Year Plan (Fiscal Years 2001-2005), the City has anticipated a total of \$90 million
11 of revenues from PGW. The loss of some or all of this revenue would be a significant
12 financial hardship for the City. The City is required by the PICA law to coordinate its
13 budget with this state entity. It is not in a position to unilaterally eliminate such a large
14 budgeted amount.

15 **Q. IS IT APPROPRIATE FOR PARTIES TO ASSUME THAT THE CITY SHOULD**
16 **REALLOCATE ITS LIMITED FUNDS TO AVOID AN OTHERWISE**
17 **JUSTIFIED RATE INCREASE FOR PGW?**
18

19 A. No. In my opinion, a decision to set PGW's revenue requirement at inadequate levels,
20 with the assumption that the City will produce the necessary additional dollars to make
21 up for the inadequate award, would inappropriately transfer City policy decisions to a
22 state administrative agency – the PUC. I am sure the PUC itself would agree that such
23 decisions are more appropriately made by the local elected officials that have been given
24 that responsibility.

25 In addition, the City's contingency funds and reported "surpluses" have been
26 severely stressed by unforeseen expenses, particularly involving the City's school district.

27 Any redirection of City funds to PGW will result in the abandonment of planned

1 expenditures in support of the City's children and schools or other taxpayer services.
2 Neither the Commission nor any party should assume or contemplate additional City
3 financial support or any relinquishment of the annual payment mandated by the Public
4 Utility Code.

5 **Q. DOES THAT COMPLETE YOUR REBUTTAL TESTIMONY?**

6 A. Yes it does.

EXHIBIT JD-1

DOCKET NO. R-00006042

JANICE D. DAVIS

EXPERIENCE

May, 2000-
Present

City Of Philadelphia

Secretary of Financial
Oversight/Director of
Finance

Directs the financial operations of the City. Supervises the following departments: Purchasing, Accounting, Budget, Revenue, Minority Business Enterprise Commission, Treasury, Pension Trust, Risk Management, Board Of Administrative Review and the Sinking Fund Commission. Exercises financial oversight of related City entities such as the Philadelphia School District, Philadelphia Gas Works and the Philadelphia Parking Authority. Serves on the Board of Directors of several boards and commissions, including the Pennsylvania Convention Center, Penn's Landing, the Philadelphia Intergovernmental Cooperation Authority, the Philadelphia Facilities Management Corporation and the Philadelphia Industrial Development Authority. Participates in labor contract negotiations. Supervises the issuance of all debt of the City and its related entities. Serves on the City planning commission. Serves as a member of the Mayor's cabinet.

October 1998-
May, 2000

Dallas Independent School District

Chief Financial Officer

Directed the financial operations of the school district. Supervised the following departments: Purchasing, Finance and Accounting, Budget Development and Control, Risk Management, and Minority and Women Business Enterprise. Served as a member of the Superintendent's cabinet. Recommended policies and establishes procedures relating to the financial, cash management, risk management, debt management, procurement, minority business, budget and accounting operations of the District.

September 1995-
September 1998

Dallas/Fort Worth International Airport

Director of Finance
and Budget

Supervised Accounts Payable, Accounts Receivable, Payroll, Financial Planning, Grants Management, Cash Management, Cost Systems Budget and Risk Management. Established policies and procedures relating to the financial, cash management, risk management, debt management, budget and accounting operations of the Airport. Had responsibility for setting rates charged for use of Airport facilities. Evaluated borrowing alternatives and initiated all debt issuance. Served on the following committees: Investment, Capital, Information Technology Strategic Planning. Prepared monthly projections of revenues and expenses. Supervised the preparation of monthly report to the Board of Directors, quarterly report to the

airlines, the annual operating and capital budgets and the Comprehensive Annual Financial Report.

May 1993-
September 1995

**Finance and Administration
City of Houston, Texas**

**Deputy Director
Financial Services**

Supervised the Office of Budget and Management, Cash and Debt Management, Capital Improvement Management and Grants Management. Established policies and procedures relating to the financial, budget and debt operations of the City of Houston. Had responsibility for the development, preparation and management of all city budgets, which combined totaled in excess of one billion dollars. Supervised the preparation of the five year economic forecast and Capital Improvement Plan. Supervised capital spending to ensure compliance with IRS and other regulatory requirements. Evaluated borrowing alternatives and initiated all debt issuance. Appeared before rating agencies in conjunction with the issuance of debt. Supervised the preparation of monthly projections of revenues and expenditures for all City funds. Served as an advisor to the Mayor on matters relating to finance. Served on the following permanent committees: Investment, Arbitrage, Accounting Improvement. Appeared before the City Council and Council committees as needed. Served as City appointee and Treasurer on the Board of Directors of a tax increment/public improvement district.

August 1992-
May 1993

**City Controller's Office
City of Houston, Texas**

**Deputy Director/Director
General Accounting**

Directed, managed, planned and evaluated the accounting and financial reporting activities. Reviewed the analysis of revenue and expenditure projections for all fund types. Supervised the preparation of the Controller's Monthly Financial Report. Acted as the lead in the preparation, review and submission of the Comprehensive Annual Financial Report.

June 1989-
August 1992

**Sewerage and Water Board
New Orleans, Louisiana**

Utility Financial Administrator

Supervised the Finance, Payroll, Customer Accounting and General Accounting Departments. Established policies and procedures to provide for efficient operation of the financial and accounting functions. Served on various committees charged with designing and implementing new software systems. Served on the capital and operating budget committees. Supervised the preparation of the Comprehensive Annual Financial Report. Worked with the external auditors and the Computer Center to design an interface between the Customer Account Management

System and the general ledger. Appeared, as needed, before legislative, educational and community groups to address issues of fiscal importance to the Board. Participated in the Quality Management Project as a member of the implementation task force. Participated in the preparation of RFP's for a fixed asset inventory, computer management services and privatization of sewer treatment operations.

March 1979-
June 1989

New Orleans Public Schools

**Accounting Manager;
General Ledger Accountant;
Accountant II; Accountant I**

As Accounting Manager, directed the accounting functions of the Finance Department which included Accounts Payable, Payroll, Fixed Assets and General Ledger. Prepared cashflow/cash need projections. Served as the department's liaison to the various departments as it related to the MSA general Ledger and subsystems. Assisted in the preparation, review and submission of the Comprehensive Annual Financial Report. Assisted in bond sales.

As the General Ledger Accountant, developed the system for balancing the subsystem input into the general ledger posting. Supervised staff responsible for the data input and verification. Prepared departmental budget and monitored expenditures. Participated in the District's first audit.

As Accountant I and II, assisted in the installation and implementation of the computerized general ledger. Prepared and balanced all initializing input into the new general ledger. Supervised staff responsible for data input.

EDUCATION

University of New Orleans
Bachelor of Science in Accounting, 1978

PROFESSIONAL DESIGNATION

Licensed Certified Public Accountant, Louisiana, Texas; Certified Government Financial Manager

ORGANIZATIONS

American Institute of Certified Public Accountants; Texas Society of Certified Public Accountants; Government Finance Officers Association; Association of Government Accountants; 2001- 2003 Fellow, Urban Health Initiative

Normal weather 4555 degree days
 Rate increase \$ 21.5 MM
 Productivity/cost savings
 Deferred Natural Gas \$17.1 MM
 City Loan \$45.0 Outstanding @ 8/31/02

BUDGET OF CASH RECEIPTS AND DISBURSEMENTS
 FISCAL YEAR ENDING AUGUST 31, 2002
 (Millions of Dollars)

	BUDGET	TOTAL											
06/13/00	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	
OPENING BALANCE - CASH INCLUDES 97.0 TXCP RECEIPTS	\$34.1	\$29.8	\$30.1	\$18.7	\$17.8	\$17.9	\$12.2	\$28.1	\$49.3	\$59.7	\$60.5	\$16.3	\$34.1
Gas	33.8	35.7	40.9	50.9	64.1	71.4	80.1	74.1	60.6	44.4	37.6	35.6	629.1
Other	7.0	9.0	1.4	1.4	1.5	1.5	1.6	1.9	1.9	2.0	1.8	6.9	37.3
Drawn from Capital Funds - Principal	8.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	16.0	0.0	0.0	58.0
Drawn from Lease Funds - Principal	0.0	0.0	0.0	0.0	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.1
Pension Draw	0.0	6.9	0.0	0.0	6.9	0.0	0.0	6.9	0.0	6.9	0.0	0.0	27.6
TOTAL RECEIPTS	48.8	51.6	44.3	61.9	98.4	72.9	81.7	82.9	62.5	69.3	39.4	42.5	756.1
TOTAL	82.9	81.4	74.4	80.6	116.2	90.8	93.9	111.1	111.8	128.9	99.9	58.8	790.2
DISBURSEMENTS													
Labor	11.5	12.0	13.1	13.2	10.8	10.7	11.2	10.1	11.3	11.0	10.6	11.5	137.0
Natural Gas	32.4	26.2	32.6	39.0	49.2	53.5	43.5	37.0	29.1	27.8	26.0	25.2	421.5
Debt Service	0.0	3.9	0.0	0.1	26.5	2.7	0.0	4.0	1.6	1.4	37.5	13.3	91.0
TXCP: Interest	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.2	0.4	4.4
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.2	0.0	0.0	18.2
City Loan \$45.0 MM	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.0	0.0	0.0
Other Disbursements	8.9	9.0	9.6	10.1	11.4	11.3	10.7	10.2	9.7	9.6	9.3	9.6	119.3
TOTAL DISBURSEMENTS	53.1	51.4	55.7	62.8	98.3	78.6	65.8	61.7	52.1	68.4	83.6	60.0	791.4
MONTHLY CASH FLOW	(4.3)	0.3	(11.4)	(0.9)	0.1	(5.7)	15.9	21.2	10.3	0.8	(44.2)	(17.5)	(35.3)
CUMULATIVE CASH FLOW	(4.3)	(4.0)	(15.4)	(16.3)	(16.2)	(21.9)	(6.0)	15.2	25.6	26.4	(17.8)	(35.3)	
OPENING TXCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
TXCP ISSUED DURING MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TXCP ISSUED PAID DOWN DURING MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ENDING TXCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
OPENING BALANCE - CASH	34.1	29.8	30.1	18.7	17.8	17.9	12.2	28.1	49.3	59.7	60.5	16.3	34.1
MONTHLY CASH FLOW	(4.3)	0.3	(11.4)	(0.9)	0.1	(5.7)	15.9	21.2	10.3	0.8	(44.2)	(17.5)	(35.3)
NET TXCP ACTIVITY MONTHLY	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ENDING BALANCE - CASH	29.8	30.1	18.7	17.8	17.9	12.2	28.1	49.3	59.7	60.5	16.3	(1.2)	(1.2)
CASH POSITION NET OF TXCP	(67.2)	(66.9)	(78.3)	(79.2)	(79.1)	(84.8)	(68.9)	(47.7)	(37.3)	(36.5)	(80.7)	(98.2)	(98.2)

PROCTER
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 SECRETARY'S BUREAU

DOCKETED
 MAY 31 2001

DOCUMENT
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PGW CROSS EXAM EXHIBIT

R-00006042
 5-24-01 PHILA

R-00006042
 R-00006042 001
EXHIBIT
 PGWCE 1
 PHILA

Normal weather 4555 degree days
 Rate increase \$ 21.5 MM
 Productivity/cost savings
 Deferred Natural Gas \$17.1 MM
 City Loan \$45.0 Outstanding @ 8/31/02

BUDGET OF CASH RECEIPTS AND DISBURSEMENTS
 FISCAL YEAR ENDING AUGUST 31, 2002
 (Millions of Dollars)

	BUDGET	TOTAL											
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OPENING BALANCE - CASH INCLUDES 97.0 TXCP RECEIPTS	\$34.1	\$29.8	\$30.1	\$18.7	\$17.8	\$17.9	\$12.2	\$28.1	\$49.3	\$59.7	\$60.5	\$16.3	\$34.1
Gas	33.8	35.7	40.9	50.9	64.1	71.4	80.1	74.1	60.6	44.4	37.6	35.6	629.1
Other	7.0	9.0	1.4	1.0	1.3	1.5	1.6	1.9	1.9	2.0	1.8	6.9	37.3
Drawn from Capital Funds - Principal	8.0	0.0	0.0	10.0	24.0	0.0	0.0	0.0	0.0	16.0	0.0	0.0	58.0
Drawn from Lease Funds - Principal	0.0	0.0	2.0	0.0	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.1
Pension Draw	0.0	6.9	0.0	0.0	6.9	0.0	0.0	6.9	0.0	6.9	0.0	0.0	27.6
TOTAL RECEIPTS	48.8	51.6	44.3	61.9	98.4	72.9	81.7	82.9	62.5	69.3	39.4	42.5	756.1
TOTAL	82.9	81.4	74.4	80.6	116.2	90.8	93.9	111.1	111.8	128.9	99.9	58.8	790.2
DISBURSEMENTS													
Labor	11.5	12.0	13.1	13.2	10.8	10.7	11.2	10.1	11.3	11.0	10.6	11.5	137.0
Natural Gas	32.4	26.2	32.6	39.0	49.2	53.5	43.5	37.0	29.1	27.8	26.0	25.2	421.5
Debt Service	0.0	3.9	0.0	0.1	26.5	2.7	0.0	4.0	1.6	1.4	37.5	13.3	91.0
TXCP: Interest	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.2	0.4	4.4
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.2	0.0	0.0	18.2
City Loan \$45.0 MM	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	45.0	45.0
Other Disbursements	8.9	9.0	9.6	10.1	11.4	11.3	10.7	10.2	9.7	9.6	9.3	9.6	119.3
TOTAL DISBURSEMENTS	53.1	51.4	55.7	62.8	98.3	78.6	65.8	61.7	52.1	68.4	83.6	105.0	836.4
MONTHLY CASH FLOW	(4.3)	0.3	(11.4)	(0.9)	0.1	(5.7)	15.9	21.2	10.3	0.8	(44.2)	(62.5)	(80.3)
CUMULATIVE CASH FLOW	(4.3)	(4.0)	(15.4)	(16.3)	(16.2)	(21.9)	(6.0)	15.2	25.6	26.4	(17.8)	(80.3)	
OPENING TXCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
TXCP ISSUED DURING MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TXCP ISSUED PAID DOWN DURING MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ENDING TXCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
OPENING BALANCE - CASH	34.1	29.8	30.1	18.7	17.8	17.9	12.2	28.1	49.3	59.7	60.5	16.3	34.1
MONTHLY CASH FLOW	(4.3)	0.3	(11.4)	(0.9)	0.1	(5.7)	15.9	21.2	10.3	0.8	(44.2)	(62.5)	(80.3)
NET TXCP ACTIVITY MONTHLY	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ENDING BALANCE - CASH	29.8	30.1	18.7	17.8	17.9	12.2	28.1	49.3	59.7	60.6	16.3	(46.2)	(46.2)
CASH POSITION NET OF TXCP	(67.2)	(66.9)	(78.3)	(79.2)	(79.1)	(84.8)	(68.9)	(47.7)	(37.3)	(36.5)	(80.7)	(143.2)	(143.2)

Normal weather 4555 degree days
 Rate increase \$ 65.0 MM
 Productivity/cost savings
 Deferred Natural Gas \$17.1 MM
 City Loan Outstanding @8/31/01

BUDGET OF CASH RECEIPTS AND DISBURSEMENTS
 FISCAL YEAR ENDING AUGUST 31, 2002
 (Millions of Dollars)

	BUDGET	TOTAL											
06/13/00	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	
OPENING BALANCE - CASH INCLUDES 97.0 TXCP RECEIPTS	\$34.1	\$32.4	\$28.5	\$27.0	\$29.9	\$16.6	\$22.5	\$43.2	\$61.4	\$82.7	\$85.1	\$43.9	\$34.1
Gas	36.4	38.4	43.9	54.7	69.6	76.1	84.9	78.0	64.6	48.8	40.6	38.5	674.5
Other	7.0	9.0	1.4	1.0	1.3	1.5	1.6	1.9	1.9	2.0	1.8	6.9	37.3
Drawn from Capital Funds - Principal	8.0	0.0	0.0	10.0	12.0	0.0	0.0	0.0	0.0	20.0	0.0	8.0	58.0
Drawn from Lease Funds - Principal	0.0	0.0	2.0	0.0	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.1
Pension Draw	0.0	0.0	6.9	0.0	0.0	6.9	0.0	0.0	6.9	0.0	0.0	6.9	27.6
TOTAL RECEIPTS	51.4	47.4	54.2	65.7	85.0	84.5	86.5	79.9	73.4	70.8	42.4	60.3	801.5
TOTAL	85.5	79.8	82.7	92.6	114.9	101.0	109.0	123.1	134.8	153.5	127.4	104.2	835.6
DISBURSEMENTS													
Labor	11.5	12.0	13.1	13.2	10.8	10.7	11.2	10.1	11.3	11.0	10.6	11.5	137.0
Natural Gas	32.4	26.2	32.6	39.0	49.2	53.5	43.5	37.0	29.1	27.8	26.0	25.2	421.5
Debt Service	0.0	3.9	0.0	0.1	26.5	2.7	0.0	4.0	1.6	1.4	37.5	13.3	91.0
TXCP: Interest	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.2	0.4	4.4
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.2	0.0	0.0	18.2
City Loan \$45.0 MM	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Disbursements	8.9	9.0	9.6	10.1	11.4	11.3	10.7	10.2	9.7	9.6	9.3	9.6	119.3
TOTAL DISBURSEMENTS	53.1	51.4	55.7	62.8	98.3	78.6	65.8	61.7	52.1	68.4	83.6	60.0	791.4
MONTHLY CASH FLOW	(1.7)	(3.9)	(1.5)	2.9	(13.3)	5.9	20.7	18.2	21.3	2.4	(41.2)	0.4	10.1
CUMULATIVE CASH FLOW	(1.7)	(5.6)	(7.1)	(4.2)	(17.5)	(11.6)	9.1	27.3	48.6	51.0	9.8	10.1	
OPENING TXCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
TXCP ISSUED DURING MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TXCP ISSUED PAID DOWN DURING MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ENDING TXCP	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0	97.0
OPENING BALANCE - CASH	34.1	32.4	28.5	27.0	29.9	16.6	22.5	43.2	61.4	82.7	85.1	43.9	34.1
MONTHLY CASH FLOW	(1.7)	(3.9)	(1.5)	2.9	(13.3)	5.9	20.7	18.2	21.3	2.4	(41.2)	0.4	10.1
NET TXCP ACTIVITY MONTHLY	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ENDING BALANCE - CASH	32.4	28.5	27.0	29.9	16.6	22.5	43.2	61.4	82.7	85.1	43.9	44.2	44.2
CASH POSITION NET OF TXCP	(64.6)	(68.5)	(70.0)	(67.1)	(80.4)	(74.5)	(53.8)	(35.6)	(14.3)	(11.9)	(53.1)	(52.8)	(52.8)

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PGW CROSS EXAMINATION
Le Lash **EXHIBIT # 2**

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R-00006042
R-00006042
EXHIBIT
PGW CE LeLash
15-5-2001 PH

Philadelphia Gas Works
Docket Nos. R-00006042 and R-00006042C0001, et al.

Witness: Richard W. LeLash

Request 3

- a) Does Mr. LeLash agree that prior to the ratemaking jurisdiction being transferred to the PUC, the methodology used to establish the just and reasonable revenue requirement for PGW by the PGC was set forth in Section VII of the Management Agreement?
- b) If the answer to part a) is anything other than an unqualified "yes," please provide all facts and/or documentary evidence on which Mr. LeLash relies to support his opinion.
- c) Is Mr. LeLash aware of any Order or other statement of the PGC or a PGC Hearing Examiner setting rates for PGW which did not utilize the rate setting methodology set forth in the Management Agreement to determine the just and reasonable revenue requirement for PGW? If so, please provide the docket number, the date of issuance of any such order and specific page reference to the portion alleging utilization of a different method.

Response

- a) It is Mr. LeLash's understanding that the PGC did not establish long-term revenue requirements for PGW but rather established annual operating budgets.
- b) It is Mr. LeLash's understanding that the PGC evaluated and approved PGW's annual operating budget and set rates based on the resultant annual budget.
- c) It is Mr. LeLash's understanding that the Management Agreement does not set forth a methodology to determine a just and reasonable revenue requirement as opposed to an annual budget requirement.

Philadelphia Gas Works
Docket Nos. R-00006042 and R-00006042C0001, et al.

Witness: Richard W. LeLash

Request 4

Please identify all facts or documents on which Mr. LeLash relies to support his statement, on page 25 of his testimony, that setting rates that included an allowance for cash working capital in the current wholesale gas price environment would result in unaffordable rates for many of PGW's customers.

Response

The referenced statement is based on pages 60 through 435 of the transcript in this proceeding, on Mr. LeLash's opinion, and the current increases in PGW's receivables, provisions for uncollectibles and its estimated bad debt expense.

Philadelphia Gas Works
Docket Nos. R-00006042 and R-00006042C0001, et al.

Witness: Richard W. LeLash

Request 7

- a) Please confirm that Mr. LeLash's \$21.5 million recommendation makes no explicit allowance for any cash flow or working capital in the rates that PGW would be permitted to charge.
- b) If no working capital allowance is permitted in the revenue requirement recommended by Mr. LeLash, where does Mr. LeLash assume that PGW will obtain its working capital needs?

Response

- a) Mr. LeLash's \$21.5 million recommendation provides the Company with \$21.5 million of cash flow.
- b) Mr. LeLash has assumed that the Company's working capital will be provided from funds from operations, third party loans, and loans or equity provided by the City of Philadelphia.

Philadelphia Gas Works
Docket Nos. R-00006042 and R-00006042C0001, et al.

Witness: Richard W. LeLash

Request 8

- a) In Mr. LeLash's testimony at page 9, he states that PGW should have "estimated its revenue requirement in order to reflect the minimum level of revenues necessary to meet its bond coverages." Please provide a quantitative analysis that demonstrates how Mr. LeLash's recommendation satisfies the other bond covenants applicable to PGW, i.e. 1) the covenant that requires PGW and its owner, the City of Philadelphia, to charge rates that permit PGW to have sufficient cash to pay all of its obligations, including its debt service obligations, during each fiscal year in full when they are due; and 2) a covenant that requires PGW and the City to continuously maintain and operate the Gas Works (See, Joint Petition For Settlement of Interim Rate Proceeding, ¶ 10).
- b) Please state the revenue requirement that would be necessary to meet these additional covenants, if Mr. LeLash's primary recommendation will not do so. In answering each part of this question, assume that the City will receive the statutorily mandated \$18 million dollar annual payment and that all other assumptions made by Mr. LeLash continue to apply.

Response

- a) Please see the response to Request No. 7(b).
- b) It is Mr. LeLash's opinion that \$21.5 million from ratepayers and necessary capital provided by the City of Philadelphia will meet all requirements of the Covenants.

Philadelphia Gas Works
Docket Nos. R-00006042 and R-00006042C0001, et al.

Witness: Richard W. LeLash

Request 10

Please identify any order of the PGC or PGC hearing examiner that denied, in whole or in part, a PGW rate increase on the basis of: a) inadequate service; or b) previous rate increases.

Response

Mr. LeLash is not aware of any PGC order which denied rates, in whole or in part, on such bases. Mr. LeLash is also not aware that PGC hearing examiners issue orders.

Philadelphia Gas Works
Docket Nos. R-00006042 and R-00006042C0001, et al.

Witness: Richard W. LeLash

Request 27

- a) Please confirm that, absent other considerations, such as the perceived effect of the rate increase on customers, prudent management would seek to realize a level of net income that would exceed the minimum levels required by a utility's bond covenants, in order to allow for contingencies.

- b) Based upon Mr. LeLash's expertise and experience, what level of realized debt service coverages for PGW would be prudent to seek to achieve in order to allow for a contingency factor? Please provide this opinion without regard to other considerations, such as Mr. LeLash's perception of PGW customers' ability to pay or his belief that the City of Philadelphia should grant back its annual payment and/or provide loans to PGW.

Response

- a) Please see page 27, line 8 through page 28, line 6 of Mr. LeLash's testimony.

- b) Mr. LeLash believes that coverages, achieved through rates, of 1.5 times are reasonable. Taking all sources of funds for coverage into account, coverages of 1.75 times to 2.00 times also would be reasonable.

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OCA STATEMENT NO. 1

BEFORE THE PENNSYLVANIA
PUBLIC UTILITY COMMISSION
DOCKET NO. R-00006042

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IN THE MATTER OF THE FILING OF
PHILADELPHIA GAS WORKS
CONCERNING A
BASE RATE INCREASE

DIRECT TESTIMONY OF
RICHARD W. LELASH
ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

DOCUMENT
FOLDER

DOCKETED
MAY 31 2001

APRIL, 2001

R-00006042
R-00006042 Case
EXHIBIT
OC A Statement No. 1
5-14-01 P. 1/4

PHILADELPHIA GAS WORKS
DOCKET NO. R-00006042
TESTIMONY OF RICHARD W. LELASH

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1 I. STATEMENT OF QUALIFICATIONS

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.

3 A. My name is Richard W. LeLash and my business address is 18 Seventy Acre Road,
4 Redding, Connecticut.

5 Q. WHAT IS YOUR CURRENT BUSINESS AFFILIATION?

6 A. I am an independent financial and regulatory consultant working on behalf of several
7 state public utility commissions and consumer advocates.

8 Q. PRIOR TO YOUR WORK AS AN INDEPENDENT CONSULTANT, WHAT WAS
9 YOUR BUSINESS AFFILIATION, AND WHAT WAS YOUR REGULATORY
10 EXPERIENCE?

11 A. I was a principal with the Georgetown Consulting Group for twenty years. While
12 working with Georgetown, I testified on cost of service, rate of return, and regulatory
13 policy issues in more than 230 regulatory proceedings. These testimonies were
14 presented before the Philadelphia Gas Commission, the Federal Energy Regulatory
15 Commission and in the following jurisdictions: Alabama, Arizona, Colorado, Delaware,
16 District of Columbia, Georgia, Illinois, Kansas, Maine, Maryland, Minnesota, Missouri,
17 New Jersey, New Mexico, New York, Ohio, Oklahoma, Pennsylvania, Rhode Island,

1 U.S. Virgin Islands, and Vermont. Details concerning my recent testimonies are
2 included in the Appendix section of this testimony.

3 Q. PRIOR TO JOINING GEORGETOWN, WHAT WAS YOUR BUSINESS
4 EXPERIENCE?

5 A. For approximately five years I was employed by PepsiCo, Inc. in a series of positions.
6 I began work as a Senior Business Planner on the corporate staff and then transferred
7 to the Pepsi-Cola Company where I was Manager of Financial Services and later
8 Director of Financial Services. I also served as Director of Financial Planning and
9 Analysis for the Pepsi-Cola Bottling Group and as Vice-President of Finance for the
10 Pepsi-Cola Equipment Corp.

11 My positions in finance with various Pepsi-Cola operations involved capital
12 expenditure evaluation and budgeting, financial analysis, profit planning, financial
13 reporting, and strategic planning. As Vice-President of Finance, I was responsible for
14 all financial operations of the Pepsi-Cola Equipment Corp., a subsidiary of PepsiCo.

15 Prior to my work at PepsiCo, I was employed by Touche Ross & Co. in its
16 Management Services Division. While at Touche Ross & Co., I was a Project Manager
17 and worked on a broad range of consulting engagements. In addition to general financial
18 and accounting engagements, I was involved to a considerable degree in utility
19 regulation.

1 Q. COULD YOU SUMMARIZE SOME OF YOUR REGULATORY WORK WHILE AT
2 TOUCHE ROSS?

3 A. While with Touche Ross, I analyzed utility filings and assisted in preparing testimony
4 in approximately twelve state jurisdictions. I also worked for five city regulatory
5 authorities, the Civil Aeronautics Board, and the Federal Communications
6 Commission. In total, I was involved in about 40 rate investigations involving water,
7 electric, bus transit, sewer, gas, telephone, airline, and cable utilities. My work
8 involved rate of return, accounting, and tariff design for the majority of these utility
9 groups.

10 Q. MR. LELASH, WHAT IS YOUR EDUCATIONAL BACKGROUND?

11 A. I graduated in 1967 from the Wharton School with a BS in Economics and in 1969
12 from the Wharton Graduate School with an MBA.

13 Q. HAVE YOU WORKED WITH ANY PROFESSIONAL GROUPS OR
14 ORGANIZATIONS?

15 A. Yes. During the past thirty years I have been a member of and have worked with various
16 professional and trade organizations. I have conducted lectures and seminars involving
17 economic, financial, regulatory, and accounting topics such as return on investment,
18 cash forecasting, planning, cost accounting, project and cost control, and accounting

1 systems. Additionally, I serve as the President and Trustee of a private foundation
2 where my responsibilities include managing the foundation's overall operations.

3 Q. DO YOU HAVE ANY SPECIFIC EXPERIENCE WITH RESPECT TO THE
4 OPERATIONS OF PGW?

5 A. Yes, I have participated and provided testimony for the Public Advocate in all of PGW's
6 Gas Cost Rate (GCR) proceedings and in other related matters since 1990. Last year,
7 I also presented testimony on behalf of the Pennsylvania Office of Consumer Advocate
8 ("OCA") concerning PGW's interim rate request and its GCR filing.

9 Q. DO YOU HAVE ANY ADDITIONAL EXPERIENCE WITH RESPECT TO NATURAL
10 GAS COST RECOVERY AND THE RESTRUCTURING OF NATURAL GAS
11 DISTRIBUTION COMPANIES IN PENNSYLVANIA?

12 A. Yes, I have worked on and testified on behalf of the OCA concerning gas cost recovery
13 for seven of the Pennsylvania gas distribution companies in about a dozen purchased gas
14 cost proceedings. I also analyzed and presented testimony for the OCA concerning the
15 restructuring filings of Columbia and PECO Energy.

1 II. SCOPE AND PURPOSE OF TESTIMONY

2 Q. WOULD YOU PLEASE STATE THE SCOPE AND PURPOSE OF YOUR TESTIMONY
3 IN THIS PROCEEDING?

4 A. I was hired by the OCA to review the Base Rate filing made by the Philadelphia Gas
5 Works ("PGW" or "Company") and evaluate the requested rate increase in the context
6 of established regulatory standards. The purpose of my testimony is to present findings
7 and recommendations to the Public Utility Commission ("PUC" or "Commission")
8 concerning rate issues raised by the filing, PGW's ongoing level of service, and the
9 appropriate rate setting standards which should be followed in this proceeding.

10 Q. IN PERFORMING YOUR REVIEW AND ANALYSIS, WHAT DATA SOURCES DID
11 YOU UTILIZE?

12 A. My review and analysis encompassed the Company's filing, responses to discovery
13 requests, and information provided during a discovery meeting. I also utilized
14 information provided in previous proceedings before the Philadelphia Gas Commission
15 ("PGC") and general data concerning the operations and financial condition of PGW.

16 Q. WERE THERE ANY LIMITATIONS PLACED ON THE CONDUCT OF YOUR
17 REVIEW?

1 A. In all instances, my review utilized the data provided by the Company and no attempt
2 was made to verify or validate its accuracy. It also should be noted that as of the writing
3 of this testimony, the final Engineering Report was not available and there was
4 insufficient time to fully review and analyze the Management Audit. The timing for the
5 release of these documents, along with the fact that PGW still does not have an
6 authorized Operating Budget or a Capital Budget, necessitates the need to reserve the
7 right to supplement this testimony when such material becomes available. Finally, with
8 the passage of Natural Gas Choice and Competition Act ("Act"), there are several rate
9 related issues which are subject to legal interpretation. My testimony addresses such
10 issues based on regulatory practice rather than from a legal perspective.

11 Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR DIRECT
12 SUPERVISION?

13 A. Yes, it was.

1 III. SUMMARY OF FINDINGS AND RECOMMENDATIONS

2 Q. BASED ON YOUR INVESTIGATION CONCERNING THE INTERIM RATE REQUEST
3 FOR PGW, WHAT ARE YOUR FINDINGS AND RECOMMENDATIONS IN THIS
4 PROCEEDING?

5 A. As a result of my review and analysis, I submit the following findings and
6 recommendations:

7 1. PGW's impaired financial condition is the result of the ongoing failure by the
8 City of Philadelphia ("City") to meet its management and ownership
9 responsibilities. Over time, the City has failed to make any significant equity
10 contribution to PGW and, as a result, the utility operation is effectively financed
11 only with debt capital and retained earnings recovered from ratepayers. As
12 expected, without ongoing equity infusions from its owner, PGW now faces a
13 financial crisis because of a lack of adequate working capital. PGW's intent is
14 to have ratepayers bear the capital as well as operating expense responsibility
15 of the utility. Such a regulatory scheme, in the current wholesale gas price
16 environment, would result in unaffordable rates for many of PGW's customers.

17 2. The Company has cited the cash flow method of rate setting as the foundation
18 of its revenue deficiency claim. Given the record in this proceeding, it is

1 unclear whether the cash flow method, as interpreted and applied by PGW, is
2 required. By progressive steps, the cash flow method as defined by PGW would
3 have this Commission set rates to ensure the fulfillment of PGW's bond
4 covenants, underwrite a dividend payment to the City, and finally, relieve its
5 owner of any responsibility to ensure the adequate financing of the operation.
6 The Commission should not accept the Company's cash flow methodology of
7 rate setting in this proceeding, but rather, it should balance the interests of PGW
8 and its ratepayers to ensure just and reasonable rates.

- 9 3. With respect to the requested \$65.0 million base rate increase, it is necessary
10 that the Commission take into account the fact that PGW's ratepayers have
11 already been required to pay for unprecedented GCR increases as a result of the
12 escalating wholesale cost of gas. During the period September 1, 1999 to
13 August 31, 2000 (FY 2000) PGW's customers' actual GCR costs were \$236.7
14 million. This year, based on current forecasts, their applicable GCR costs will
15 be \$241.0 million higher, or \$477.7 million, which reflects more than a 100%
16 increase. With the requested \$65.0 million base rate increase, PGW ratepayers
17 would be burdened with almost one-third of a billion dollars in total rate
18 increases during this fiscal year - an amount which is clearly unreasonable.

1 4. The Company has not sought to mitigate its \$65.0 million rate request. It has
2 not sought approval from the City for a grant back of the \$18.0 million annual
3 payment in the form of non-operating revenues. Nor has it estimated its revenue
4 requirement in order to reflect the minimum level of revenues necessary to
5 meet its bond coverages. Rather, the Company has requested rates to make up
6 for past mistakes and to provide it with a financial cushion for the future. While
7 some augmentation of the Company's retained earnings will be necessary in the
8 future, the Company should have recognized that its customers cannot afford to
9 pay the associated incremental rates at this time.

10 5. To some degree, PGW's current financial position can be attributed to the
11 milder than normal weather experienced during the past three heating seasons
12 prior to this winter. As a result of this weather, PGW did not fully recover its
13 fixed costs, and that has contributed to more debt financing and working capital
14 shortages. While the weather clearly was beyond the Company's control, the
15 Company's failure to acknowledge PGW's deteriorating financial condition was
16 not. To the degree there is a current financial crisis, it is of PGW's own making.
17 Established regulatory remedies were available, and the Company, for as yet
18 unspecified reasons, did not seek rate adjustments.

1 6. What also has not been beyond the Company's control has been the level of
2 service being provided to its customers. Recent studies have shown that the
3 Company's customer service levels, its internal accounting and management
4 systems, and the maintenance of its distribution system have been inferior.
5 Thus, regardless of any showing of a revenue deficiency by the Company, the
6 Commission must assess whether or not increased rates are warranted under the
7 provisions of Section 526 of the Public Utility Code. With the established
8 regulatory benchmark that utilities must provide safe and adequate service, and
9 with the corollary that rates appropriately follow service, any PGW rate request
10 could be denied based on past and present service deficiencies.

11 7. At this time, any authorized rate increase should follow the standards set forth
12 in the Commission Order in Docket No. R-00005654. These standards may
13 provide additional revenues to satisfy PGW's bond coverage requirements. The
14 Commission may also conclude that it must allow the payment of the City's
15 annual payment. If the Commission decides to meet these two requirements, it
16 should then authorize a base rate increase of \$21.5 million (which would be
17 \$10.5 million higher than the \$11.0 million interim amount already being
18 recovered). This amount of rate relief, along with a grant back of the \$18
19 million payment to the City, will result in a 2.36 times coverage on the 1975
20 Ordinance Bonds and a 2.11 times coverage on the 1998 Ordinance Bonds. This

1 \$21.5 million revenue requirement reflects \$6.8 million of recommended
2 accounting adjustments which reduce operating expenses and a \$6.8 million
3 increase in Bad Debt Expense which reflects the increased uncertainty of
4 PGW's Accounts Receivable collection.

- 5 8. In this proceeding, the Company should be required to begin the restructuring
6 process by reallocating certain expenses between base rates and the GCR. The
7 prevailing rolled-in factor for gas of \$3.18 per Mcf should be transferred from
8 base rates to the GCR. In turn, electricity and bad debt expenses should be
9 reallocated from the GCR to base rates. While there are other such
10 reallocations, including the removal of low income assistance charges and rate
11 discounts from the GCR, which will be required to properly unbundle PGW's
12 rates, they should be deferred until the Company's restructuring proceeding. At
13 that time, analyses and allocations for commodity, distribution, and balancing
14 will be required and, therefore, that proceeding will be the more appropriate
15 venue for comprehensive rate restructuring.

1 IV. INTRODUCTION

2 Q. DO YOU HAVE ANY INITIAL COMMENTS CONCERNING PGW'S REQUEST FOR
3 A \$65 MILLION BASE RATE INCREASE?

4 A. Yes. As in the interim case last fall, PGW is requesting rate relief in the context of a
5 financial crisis. Despitc Gas Cost Rate (GCR) increases of \$237.0 million (inclusive
6 of the interim \$7.0 million for Bad Debt Expense) and an interim base rate increase of
7 \$11.0 million, the Company is again seeking to obtain higher revenues from its
8 customers arguing that the significant relief already granted has been insufficient.
9 Given the Company's weak financial position, it was unable to defer the recovery of
10 even a portion of its higher GCR costs as was done by some local distribution
11 companies (LDCs) in other states in order to maintain affordable customer rates.

12 Ratepayers are now being asked to fund an operation which, by consensus, has
13 been poorly run in the past, thereby contributing to its current financial crisis.
14 Whatever the major causes of the problem, the high payroll and benefits, the cost
15 overruns on computer systems, or the escalating bad debt expense, the fact remains that
16 current service rates are not now, even before the requested increase, affordable.
17 While high rates might be understandable and therefore tolerable if there was the real
18 prospect of improved performance and lower rates in the future, there is no clear
19 indication that either will be achieved prospectively.

1 During the hearings in the interim rate proceeding (Docket No. R-00005654),
2 the Company's witness acknowledged that the City's "administration has taken the
3 unprecedented step of indicating its willingness to voluntarily waive or grant back the
4 \$18 million mandatory payment on a one-time basis" (TR-173 and 174) in order to
5 meet all of the Company's legal and fiduciary requirements including cash for operating
6 expenses (TR-177). To my knowledge, however, the Philadelphia City Council has not
7 yet acted on that request.

8 As a result, the potential need for a revenue increase must be considered within
9 the context of the need to recover far higher gas commodity costs and within the
10 context of the service being provided. Therefore, a fundamental regulatory principle
11 is at issue. Do rates follow service or should service follow rates?

12 The regulatory process has consistently followed the principle that a utility
13 operation is only entitled to rate increases if its service is adequate and reasonable.
14 Such a principle enforces the requirement that, in providing a monopoly service, utility
15 owners have a responsibility to maintain and operate the utility in the most efficient and
16 reasonable manner possible. Failure to fulfill these requirements can result in the
17 withholding of rate relief. In effect, regulation requires that utility owners provide
18 effective management and sufficient capital to fulfill the on-going obligation to serve.

19 Unfortunately, in the current case, PGW is seeking to transfer ownership
20 obligations to the Company's ratepayers. While the City of Philadelphia is the direct
21 owner and manager of the Company, its customers are being asked to provide needed

1 "capital" to remedy a cash flow deficiency. Under traditional regulation, ratepayers are
2 solely responsible for providing revenues to cover the cost of capital, not the capital
3 itself. This places the responsibility on the City either to provide capital or to facilitate
4 the acquisition of additional debt.

5 Q. IN THE CURRENT CIRCUMSTANCES, IS THE CITY ABLE TO PROVIDE
6 INCREMENTAL CAPITAL, OR IN THE ALTERNATIVE, CAN IT FACILITATE THE
7 ACQUISITION OF ADDITIONAL DEBT?

8 A. Since the interim rate proceeding, the City has provided a \$45.0 million short-term
9 loan to PGW which allowed the Company to continue to operate through the past winter
10 season. This was a period in which all gas utilities were subject to increased working
11 capital requirements because of very high wholesale gas prices and the resultant
12 escalation in the levels of inventory and accounts receivable investment. However, the
13 City has indicated that its ability to finance PGW is limited.

14 As for facilitating additional debt from third parties, PGW has stated that the
15 City is legally barred from providing a cross guarantee on any PGW debt (Company
16 Response to Informal Request No. 2). This situation, along with the rating agencies
17 concerns about PGW, places the planned \$100 million bond issue and the renewal of
18 the \$100 million short-term credit line in question. Should the bond flotation and the
19 credit line renewal not be successful, there could be a \$200 million capital shortfall
20 which neither the City nor the ratepayers could realistically fund. While PGW will

1 probably be able to obtain insurance for the bond flotation and thereby make the credit
2 line renewal feasible, the City's role in providing capital for PGW apparently is very
3 limited.

4 Q. WHAT ARE THE RAMIFICATIONS FOR PGW'S ONGOING OPERATIONS IF THE
5 FLOTATION AND CREDIT LINE RENEWAL ARE NOT SUCCESSFUL?

6 A. From the Company's perspective, given its definition of the cash flow method of rate
7 setting, the capital shortfall would be recoverable from ratepayers. However, even
8 PGW must realize that its ratepayers' ability to pay higher and higher rates has been
9 limited because of the GCR increases. Such limits in the ratepayers' ability to pay are
10 amply illustrated by the Company's currently requested rate increase which is justified,
11 for the most part, by its growing bad debt expense.

12 As should be apparent, even if ratepayers had the responsibility to provide capital
13 for PGW's operations, which I believe they do not, they lack the ability to provide a
14 never ending source of capital. The deteriorating collection results show that PGW's
15 rates have ceased to be just and reasonable and further rate increases will more than
16 likely only increase PGW's accounts receivable and not its revenues.

17 Q. FROM A REGULATORY PERSPECTIVE, WHAT ACTIONS NEED TO BE TAKEN IN
18 ORDER TO ENSURE THAT PGW OPERATES EFFICIENTLY IN THE FUTURE?

1 A. The utility's owner has already taken a major step in replacing senior management and
2 providing direction to the new interim management to fix major deficiencies and
3 restore PGW's financial integrity. But, in the case of an investor owned utility, it is
4 probable that equity owners would also expect to receive reduced dividends and to
5 infuse additional capital into the operation if the utility were precluded from pursuing
6 additional debt financing.

7 However, the Company argues that regulatory authority in this proceeding may
8 be constrained by two major limitations. First, it may be required that PGW be allowed
9 "to impose, charge or collect rates and charges as necessary" to permit it to pay its
10 owner, the City, an annual amount as specified by applicable city ordinances or
11 agreements. Thus, the current \$18.0 million annual payment may be required unless
12 waived by the City of Philadelphia. The second limitation involves the potential
13 requirement that PGW be given the authority "to charge or collect rates or charges
14 necessary . . . to comply with its covenants to the holders of any approved bonds."

15 Accordingly, how base rates are set prospectively will be dependent upon how
16 the Commission interprets the Act's requirements with respect to rates at issue now
17 and, in the longer term, after the Company's restructuring filing.

18 Q. GIVEN THE FACT THAT CURRENT GAS PRICES WILL REQUIRE MUCH HIGHER
19 GAS COST RATE (GCR) CHARGES, IS THERE A NEED TO HOLD BASE RATES AS
20 LOW AS POSSIBLE TO LESSEN THE OVERALL IMPACT ON CUSTOMERS?

1 A. Yes. However, there always is a need to maintain the lowest possible level of base rates
2 and, indeed, “safe and adequate service at the lowest reasonable cost” is the traditional
3 benchmark of regulatory oversight. As a result, the allocation of revenue and capital
4 responsibility between the ratepayers and the City of Philadelphia must be resolved.

5 As will also be discussed later in this testimony, PGW needs to consider
6 whether there are any mitigation actions that can be taken to lessen the Company’s
7 overall revenue requirement. The Company should seek a return of its \$18.0 million
8 annual payment to the City in the form of a non-operating revenue grant. It should
9 likewise be willing to determine its revenue requirement, in the short term, based on
10 the minimum amount necessary to fulfill the bond coverages specified in its bond
11 covenants.

12 Q. FROM A BROADER PERSPECTIVE, ARE THERE ANY LESSONS WHICH SHOULD
13 BE LEARNED FROM PGW’S PAST OPERATION WHICH CAN GIVE GUIDANCE
14 FOR SETTING RATES IN THIS PROCEEDING?

15 A. Yes, there are. Apparently, for a variety of reasons, PGW’s past management and the
16 City did not respond to the serious deterioration in the operation of the Company and
17 the level of service being provided to its ratepayers. The consequences of this failure
18 are not appropriately borne by ratepayers. Therefore, the responsibilities of PGW’s
19 ratepayers must be defined and hopefully limited. Should this demarcation not be

1 established, then the City will be able to abrogate any real responsibility and the
2 deficiencies of the past will, more than likely, continue.

3 Q. THE COMPANY HAS CLAIMED THAT RATES FOR PGW SHOULD BE SET BASED
4 ON THE CASH FLOW METHOD OF RATE SETTING. IS THIS POSITION VALID?

5 A. This Company position appears to be based on certain provisions within the Act and
6 reliance on the assumption that the Management Agreement (“Agreement”) between the
7 Philadelphia Facilities Management Corporation (PFMC) and the City, as the owner of
8 PGW, is the controlling precedent for regulating PGW. Setting aside the validity of the
9 Company’s assumption and the legal arguments which will be made in Briefs, there still
10 is an issue concerning the applicability of the Agreement to rate setting and the
11 question as to its applicability in this proceeding.

12 The Company’s interpretation of the “cash flow” method is that ratepayers are
13 responsible for all PGW operating expenses and capital requirements regardless of
14 issues concerning prudence, service, or the reasonableness of the resultant rates. This
15 interpretation ignores the City’s past role in remedying prior coverage shortfalls, its
16 recent short-term loan, and its stated willingness to provide a grant of non-operating
17 revenues. In my opinion, these actions within the venue of PGC regulation,
18 appropriately recognize that the City as well as PGW’s ratepayers are responsible for
19 maintaining the utility operation. To the degree past actions by PGW’s owner caused

1 excessive financial leverage and inadequate working capital reserves, then it, rather than
2 ratepayers, should provide the needed funds.

3 In addition, it should be recognized that the Agreement provides that PFMC's
4 "primary obligation shall be to apply the highest standards of management practice and
5 diligence to the operation of the Gas Works" (Agreement, page 2). It was to do this so
6 that the City could "provide quality gas services to its citizens at reasonable rates"
7 (Agreement, page 1). Additionally, PFMC was to provide management personnel for
8 the operation of the Gas Works (Agreement, page 3).

9 Given PGW's performance during the past several years, it would appear that a
10 case could be made for the fact that PFMC has not met its contractual obligations for
11 several years. Results would indicate that the highest standards of management practice
12 and diligence were not applied. And certainly, PFMC did not provide adequate
13 management personnel given that PGW went without a chief executive officer for many
14 years. Accordingly, it may not be proper to base a PGW rate increase solely on the
15 terms of the Agreement, when the requirements of the same Agreement, which were
16 intended to benefit ratepayers, have not been met.

1 V. PGW'S RATE REQUEST

2 Q. PLEASE DISCUSS THE BASIC COMPONENTS OF THE COMPANY'S RATE
3 REQUEST.

4 A. PGW has made a request for a \$65.0 million rate increase in addition to the
5 \$230.0 million increase in its Gas Cost Rate (GCR) which was previously authorized
6 The proposed rate increase is principally based on the Company's fiscal year (FY)
7 2000-2001 operating budget. This is the same budget which was used to justify the
8 Company's interim rate request last fall for a \$52 million increase. The major
9 difference between the two filings is a \$19.3 million increase in the Company's Bad
10 Debt Expense. According to the Company, the need for the inclusion of a higher Bad
11 Debt Expense is directly related to higher natural gas expenses which, in turn, greatly
12 increased the Company's associated accounts receivables and the anticipated write-off
13 expense (PGW Revised Statement 3.0, page 30).

14 Since the Company filed its base rate request, it has been granted \$11.0 million
15 of interim base rate relief. Accordingly, the permanent request for \$65.0 million would
16 represent a \$54.0 million increase over the base rates which are currently in effect. In
17 order to put the Company's requested revenue increase into perspective, it is instructive
18 to first review why the Company believes a \$65.0 million increase is necessary to
19 address its "massive financial crisis that threatens the Company's ability to even

1 maintain its present levels of service through the rest of the fiscal year” (PGW St. 1.0,
2 p.3).

3 Q. WHAT ARE THE COMPANY’S STATED OBJECTIVES IN FILING FOR THE RATE
4 INCREASE?

5 A. Mr. Knudsen states at page 17 of his testimony that there are six objectives for the
6 Company’s rate increase:

- 7 • Satisfy its bond ordinance covenants
- 8 • Maintain sufficient cash to meet obligations
- 9 • Reduce dependence on short-term debt
- 10 • Reduce level of long-term debt issues
- 11 • Continue and enhance service improvement plan
- 12 • Facilitate the restructuring/unbundling process

13 However, what is not discussed, and is equally important, is what alternatives
14 besides the requested base rate increase were and are available to the Company to meet
15 its financial needs.

16 Q. IN ORDER TO PLACE THE COMPANY’S CURRENT FINANCIAL STATUS INTO
17 PERSPECTIVE, PLEASE DISCUSS THE COMPANY’S FINANCIAL PERFORMANCE
18 SINCE ITS LAST BASE RATE INCREASE.

1 A. It has been eight years since the Company's last rate increase in 1992. During that
2 period of time, the Company's net earnings were never greater than \$17 million and in
3 FY1998 through FY 2000 earnings were negative. In this proceeding, if granted the
4 \$65.0 million request, net earnings are projected to be \$34 million.

5 Q. WHAT HAS BEEN THE RECENT HISTORY OF DEBT SERVICE COVERAGE?

6 A. Over the past eight years, debt coverage was never higher than 1.67 times and in several
7 cases it approached the bond covenant minimum of 1.50 times. In this proceeding, debt
8 coverage is projected to be 2.87 times on 1975 bonds and 3.01 times on 1998 bonds.
9 Moreover, due to the 1998 Bond Ordinance, PGW's coverage requirements are less
10 stringent than they were under the 1975 Bond Ordinance.

11 Q. PLEASE COMMENT UPON THE COMPANY'S FINANCIAL STRATEGY SINCE ITS
12 1992 CASE.

13 A. For a significant portion of time since 1992, PGW has appeared to lack any financial
14 or operational strategy. This was never more apparent than during the past three years
15 when revenue shortfalls associated with milder than normal weather did not allow the
16 Company full recovery of its fixed costs. While milder than normal weather was
17 clearly not under the Company's control, PGW always retained the option to file for
18 rate relief to avoid the current financial situation. During this three year period, PGW

1 did not seek to remedy either its deteriorating financial condition or its deteriorating
2 service and operations.

3 Without reasonable financial and operational plans, the Company apparently may
4 not have fully understood its worsening financial position despite the fact that cash flow
5 constraints were forcing curtailment of necessary expenditures such as those for main
6 replacement. Had the Company requested timely rate relief during the last three years,
7 ratepayers would not now be facing what can only be termed catch up or retroactive rate
8 recovery.

9 Q. THE COMPANY CONSIDERS CASH FLOW TO BE THE FOCUS OF THIS
10 PROCEEDING. PLEASE DISCUSS PGW'S CASH BALANCES AND ITS FOCUS ON
11 CASH SUFFICIENCY.

12 A. The Company stated that one of its goals was to have a year-end cash balance at the end
13 of August 2001 of \$35.0 to \$40.0 million (PGW St. 1.0, p.20). However, since
14 FY1992, year-end cash has only exceeded \$35.0 million twice, in FY1994 and FY1995.
15 While it is understood that PGW's major focus must be on cash requirements, both at
16 year end and on a month to month basis, the Commission should not allow cash flow
17 and working capital to be the basis for any rate relief.

18 Q. WHAT INSIGHTS SHOULD BE GAINED FROM THESE FINANCIAL
19 COMPARISONS?

1 A. These comparisons show there is nothing unusual about the financial measures PGW
2 is forecasting in this proceeding to justify its base rate increase. Rather, the proposed
3 rate request apparently reflects the fact that the Company has reached its maximum
4 short-term borrowing limit, and the City has not provided necessary working capital or
5 permanent capital on an ongoing basis to cover the financial shortfall.

6 Q. THE REQUEST FOR ADDITIONAL REVENUES IS NOT DRIVEN, AS HAS BEEN
7 THE CASE IN THE PAST, BY DEBT SERVICE COVERAGE. WHAT, THEREFORE,
8 SHOULD BE THE CRITERIA IN EVALUATING PGW'S REQUEST?

9 A. As I stated previously, the regulatory process follows the principle that rate increases
10 are only warranted if and when utility service is safe and adequate and its rates are
11 reasonable. Accordingly, utilities such as PGW have a responsibility to maintain and
12 operate their operations in a safe and efficient manner. In the present case, the
13 Commission should therefore not only consider PGW's revenue requirement, but also
14 its level of service when establishing base rates. As will be discussed later in this
15 testimony, recent studies by PGW's consultants have described in detail why PGW's
16 present service level is not adequate.

17 Q. WHAT DO YOU BELIEVE SHOULD BE THE FOCUS OF THIS PROCEEDING?

18 A. Despite its emphasis on the immediate cash crisis, the Company has admitted that its
19 \$65 million rate request seeks to address longer term objectives. However, I do not

1 believe that the focus of this proceeding should be over such a long time period.
2 Rather, the focus should be on the short-term, that is, 12 to 18 months or, more
3 specifically, until the Company makes its restructuring filing and the Commission
4 authorizes unbundled rates, hopefully in an environment where wholesale gas prices are
5 more in line with historic levels.

6 Q. WHY SHOULD THE FOCUS BE ON THE SHORT-TERM?

7 A. First, ratepayers cannot be expected to pay for a large base rate increase in addition to
8 the GCR increases which they are already having to absorb. Second, ratepayers should
9 not be asked to pay for a rate increase before the Company has given guarantees that:
10 the current level of service is actually being improved; PGW's information systems are
11 fully supporting business operation; the call center is fully responsive to customer
12 needs in a timely manner; and measures to improve productivity, including but not
13 limited to greater workforce flexibility, are in place.

14 The emphasis of this proceeding should not be to build up enough cash in the
15 short-run to ensure financial health in the long-term. Rather, the emphasis should be
16 on what rates the Company requires to get through its present financial situation and
17 this period of unprecedented wholesale gas costs.

18 Q. HOW, THEN, SHOULD THE COMMISSION DETERMINE WHAT ARE THE
19 COMPANY'S INCREMENTAL REVENUE NEEDS?

1 A. Fundamentally, the revenue requirements issue is dependent upon the Commission's
2 interpretation of the standards it should apply as they relate to accepted regulatory
3 principles and the Natural Gas Choice and Competition Act ("Act"). I recommend that
4 rates be set subject to coverage requirements and service considerations. This would
5 prevent a technical default on the bonds which is not in the ratepayers' interests. I will
6 present rate recommendations which meet this standard.

7 If the City is willing to waive the \$18.0 million payment or return the \$18.0
8 million as a grant, PGW's cash position could be significantly improved. If the
9 Commission allows the \$18.0 million payment, PGW must be directed to aggressively
10 pursue such a grant from the City. I will present an analysis which meets the
11 Commission's standard and includes the \$18.0 million annual payment, with the
12 assumption that the \$18.0 million is then granted back to PGW as project revenues.

13 Finally, the Company argues that the Act requires the cash flow method of rate
14 setting. The Company's definition or application of this method has rates providing
15 PGW's capital as well as meeting its revenue requirements. From a regulatory
16 perspective, this interpretation of the Act and the cash flow method is fundamentally
17 unreasonable. If it is followed, it would have the effect of absolving the City from any
18 of its ownership responsibilities. In effect, the City would always be able to say that
19 any PGW deficiencies were the result of insufficient revenues for costs and capital.
20 Failure to rectify Billing, Collections and Customer Service System (BCCS) problems,
21 lack of adequate mains replacement, unreasonable levels of customer service could

1 always be explained away by inadequate rate allowances. In effect, the cash flow
2 method of setting rates as espoused by the Company would allow service to follow
3 rates. I do not recommend that the Company's application of the cash flow method be
4 adopted.

5 Q. YOU STATED THAT BEFORE RATEPAYERS ARE ASKED TO FUND A RATE
6 INCREASE, PGW SHOULD EXHAUST ALL REASONABLE ALTERNATIVES.
7 WOULD YOU GIVE EXAMPLES OF SOME OF THOSE ALTERNATIVES?

8 A. First, if the Company believes that the \$18.0 million City Payment is required by the
9 Act, the Company should seek a waiver from the City. Such a waiver has been
10 discussed for many years in various proceedings and it is understood that only the City
11 can make the decision to forego the payment. However, the Company should
12 aggressively pursue this option.

13 The City, as owner, should likewise stand behind the Company during this
14 interim period to address the financial problems. It can do so by pledging back to PGW
15 part or all of the \$18.0 million payment in order to stabilize PGW's cash position in
16 lieu of trying to make ratepayers address what should be an owner's responsibility.

17 Second, PGW should also request the City to provide additional short-term
18 advances to address cash flow problems. While the City did advance \$45.0 million
19 during the past winter, it should be requested to effectively provide "bridge" loans in
20 order to help the Company with any month to month cash deficiencies. The Company

1 could use such temporary advances to help it get over a period when cash is needed and
2 then repay the advance when cash is less critical.

3 Third, the Company must strictly control non-capital expenditures. It is a
4 common business practice to prioritize operating expenditures so that especially in
5 those months of low cash balances, only those expenses deemed absolutely essential
6 to provide service and assure safety are made. The prioritization of such expenditures
7 is addressed later in reference to PGW's revenue requirement.

1 VI. RATE INCREASE ALTERNATIVES

2 Q. IN EVALUATING ALTERNATIVE REVENUE REQUIREMENTS AND THEIR
3 ASSOCIATED DEBT SERVICE COVERAGES, WHAT FACTORS SHOULD THE
4 COMMISSION EVALUATE?

5 A. In this section, data will be presented concerning the debt service coverages associated
6 with several alternative revenue requirement scenarios. There are also derivations of
7 various accounting adjustments which are appropriately included in the current revenue
8 requirement evaluation. And finally, there is data provided concerning the Company's
9 budgeted bad debt expense and other aspects of the Company's related collection
10 efforts.

11 It should also be noted that all of these scenarios assume that the Company will
12 successfully float its planned \$100.0 million bond issue and renew its \$100 million
13 credit line during the late spring or early summer of this year.

14 - Debt Service Coverage Scenarios

15 Q. HAVE YOU DEVELOPED SOME SCENARIOS THAT SHOW THE COVERAGE
16 RESULTS FOR THE RATE INCREASE ALTERNATIVES THAT SHOULD BE
17 CONSIDERED BY THE COMMISSION?

1 A. Yes. I have developed financial scenarios utilizing PGW's revised FY2001 Budget of
2 Debt Service Coverage schedule, that was filed as Volume II, Revised Exhibit A-3 and
3 which is shown in the first column of Schedule 1. At the time of the writing of this
4 testimony, this was the latest information which was available. Therefore, I reserve the
5 right to amend my testimony if this information is subsequently revised.

6 Q. WHAT IS THE BASIC PREMISE BEHIND YOUR FINANCIAL SCENARIOS?

7 A. The basic premise is that PGW does not have to receive the full amount of its requested
8 \$65.0 million rate increase in order for the Company to meet the 1.50x coverage
9 required by its bond covenants and to provide funds for capital projects.

10 On Schedule 1, in addition to showing the coverages for the Company's rate
11 proposal in the first column, data is provided to show revenue requirements which will
12 result in coverage on the 1998 Ordinance Bonds of 1.50 times coverage. As the
13 schedule shows, if the Company's proposed increase of \$65.0 million is reduced by
14 \$43.5 million (see line 2), the resulting coverage equals the indicated 1.50 times
15 coverage on the referenced bonds (see line 25). With such a reduction, the
16 recommended revenue requirement becomes \$21.5 million which is \$10.5 million
17 higher than the interim base rate level now in effect. In my opinion, this is the amount
18 of revenue increase which should be authorized by the Commission.

1 Q. ISN'T IT TRUE THAT SUCH A REVENUE INCREASE WOULD PROVIDE THE
2 ABSOLUTE MINIMUM COVERAGES REQUIRED BY THE BOND COVENANTS?

3 A. Yes, that is correct. However, if the City were to grant back its \$18.0 million payment,
4 the coverages would be substantially above those required by the bond covenants. As
5 shown on Schedule 2, with the grant back of the \$18.0 million payment, the coverages
6 on the 1998 Ordinance Bonds would increase to 2.11 times. Thus, with the availability
7 of non-operating revenues from the City, the Company would fulfill its covenant
8 requirements with a substantial margin for possible contingencies.

9 Q. IN THE COURSE OF YOUR INVESTIGATION CONCERNING THE COMPANY'S
10 REVENUE REQUIREMENT, DID YOU EVALUATE THE COMPONENTS OF THE
11 COMPANY'S PROJECTIONS AND WERE THERE ANY ADJUSTMENTS WHICH
12 WERE INDICATED?

13 A. Based on a review, and as described in the next section of the testimony, \$6.8 million
14 of adjustments were identified which would indicate a reduction to the Company's
15 projected revenue requirement. On Schedules 3 and 4, the associated revenue
16 requirements are developed both with and without a grant from the City.

17 Q. THESE ARE ACCOUNTING ADJUSTMENTS WHICH HAD THE EFFECT OF
18 LOWERING THE REVENUE REQUIREMENT. WERE THERE ANY INDICATIONS
19 THAT THERE WERE FACTORS WHICH WOULD INCREASE THE REQUIREMENT?

1 A. Yes, there was one factor, Bad Debt Expense, which was shown to be potentially
2 understated in the Company's projections. Unfortunately, it is very difficult to
3 precisely quantify the amount of the appropriate adjustment, as will be discussed later
4 in the testimony. Based on this uncertainty, and with the belief that some adjustment
5 is required, I have assumed that increased bad debt will offset the favorable accounting
6 adjustments which were identified. Thus, on balance, my analysis showed that a revenue
7 requirement determination of \$21.5 million is reasonable.

8 - Accounting Adjustments

9 Q. WOULD YOU PLEASE DISCUSS THE COMPANY'S BASIS FOR ITS PROPOSED
10 REVENUE REQUIREMENT IN THIS PROCEEDING?

11 A. PGW has based its requested \$65.0 million rate increase on \$257.0 million of
12 operating expenses, exclusive of fuel, for the budgeted test year ending August 31,
13 2001. In PUC ratemaking proceedings, utilities normally make known and measurable
14 adjustments to test year data in order that the test year be representative of future
15 conditions. PGW, however, has basically presented its budget as its test year data. The
16 budget, by definition, includes no actual data and contains very few of the traditional
17 types of annualizing and normalizing adjustments usually found in a PUC base rate
18 proceeding.

1 Q. PLEASE DESCRIBE THE TYPES OF ANNUALIZATION ADJUSTMENTS THAT
2 PGW HAS NOT REFLECTED IN ITS FILING.

3 A. On the revenue side, for example, operating revenues are normally annualized utilizing
4 the number of customers at test year-end. PGW's budgeted methodology effectively
5 determines revenues based upon its average number of customers during the test year.

6 On the expense side, labor and related fringe benefits are normally annualized
7 utilizing the number of employees at test year-end. Again, PGW's methodology
8 determines labor and fringes based upon the average number of employees within its
9 budget. This is significant in the case of PGW because the number of employees at
10 year-end will be less than the average number of employees during the test period.
11 Thus, annualized labor expense would be lower than budgeted labor expense.

12 Q. ARE THERE ANY ADJUSTMENTS INCLUDED IN THE COMPANY'S TEST YEAR
13 AS FILED?

14 A. Yes. Schedules Revised SD-4-B and Revised SD-4-C from the Company filing show
15 that the test year includes a series of normalized expenses for amortization of
16 expenditures that occurred in FY 2000 and some that are budgeted to occur in FY 2001.
17 These amortizations are for information technology expenditures, the management
18 audit and FY 2000 rate case expense.

1 The budget also includes two lump sum amounts for Personnel
2 Reductions/Retirements and Cost Savings/Productivity Improvements, which though
3 not traditional adjustments, are included as offsets to budgeted operating expenses.

4 Q. IS IT IMPORTANT FOR THE COMMISSION TO RECOGNIZE ADJUSTMENTS TO
5 THE BUDGETED TEST YEAR?

6 A. Yes. It is an accepted regulatory principle that the test year must be representative of
7 future operating conditions. PGW's test year is simply its unadjusted budget and,
8 therefore, does not comply with this regulatory standard. Compliance is necessary in
9 order for the Commission and the parties to properly evaluate PGW's financial
10 condition and the need, if any, for an increase in rates on an on-going basis. The
11 Commission should require PGW to present an adjusted test year in its next base rate
12 proceeding as well as comply with the standard filing requirements as do all other
13 Pennsylvania utilities.

14 Q. WHAT TYPES OF OPERATING EXPENSE ADJUSTMENTS DO YOU PROPOSE
15 THAT THE COMMISSION CONSIDER FOR RATEMAKING PURPOSES?

16 A. I am proposing three types of adjustments. First, normalization of one-time
17 expenditures that were not amortized by PGW. Second, elimination of some
18 expenditures that are not representative of future operating conditions. Third,

1 miscellaneous adjustments for ratemaking purposes. As shown on Schedule 5, I have
2 identified \$6.8 million of adjustments to PGW's operating budget.

3 Q. PLEASE DESCRIBE THE BUDGETED EXPENSES THAT YOU RECOMMEND BE
4 NORMALIZED FOR RATEMAKING PURPOSES.

5 A. BCCS Remediation OCA Interrogatory III-21 requested the Company to provide
6 expenses included in the FY 2001 budget "for the remediation of the BCCS system, that
7 is, expenditures utilized to correct billing and other operating problems." The company
8 replied that the budget included \$1.0 million for payments to the Mara and SPL firms
9 for such work.

10 The Commission is well aware of the billing and accounting problems caused
11 by the 1999 implementation of the BCCS system. As originally approved, it was to
12 cost \$9.7 million. Recently, the Company has estimated its cost at over \$50.0 million
13 (OCA-I-20a). Since the \$1.0 million included in the budget has been identified by the
14 Company as being, hopefully, for one-time remediation purposes, it is proper to
15 amortize such expenditures for ratemaking purposes over a five-year period. As shown
16 on Schedule 6, the result is a \$800,000 downward adjustment to the expense.

17 Consultant/Studies Costs The reply to OCA I-23 lists a number of studies that are to
18 be undertaken by the Marketing Department or its consultants during FY 2001 and have
19 been included in the test year budget at a cost of \$530,000. As the Company states:

1 "These studies are being utilized in conjunction with the overall departmental initiative
2 to promote the use of natural gas in the market place." The studies listed are the
3 following: Residential Conversion Autopsy, Customer Satisfaction Survey, Restaurant
4 Longevity Scope, AGA Demographic Study, Appliance Saturation Study, PA State Data
5 Center, Energy USA, Residential Parts & Labor Plan and Web Consulting.

6 Since these studies are non-recurring, the cost to perform the studies should be
7 amortized for ratemaking purposes. As shown on Schedule 7, a five-year amortization
8 of such costs results in a \$424,000 downward adjustment to expense.

9 Non-Recurring Expenses OCA Interrogatory III-22 requested PGW to provide a listing
10 of FY2001 operating expense expenditures that the Company considers to be non-
11 recurring. Some of the items listed in the reply, such as Attendance Incentive,
12 Administrative Consulting, Management Audit and Rate Case/Witness Fees are adjusted
13 below or are included in PGW's Cost Savings/Productivity Improvement adjustment.
14 However, one-time expenditures for Emergency Operations (\$300,000) and Training
15 Costs V.P. Customer Affairs (\$2,000,000) which are not included in other adjustments
16 should be adjusted separately to properly amortize them for ratemaking purposes. Five-
17 year amortization of such Company identified non-recurring costs, as shown on
18 Schedule 8, results in a \$1,840,000 downward adjustment to expense.

1 Rate Case Expense PGW has included \$825,000 in the test year budget for rate case
2 expenditures for lawyers and consultants. Though FY 2000 Rate Case Expense was
3 amortized over a two-year period and included in the FY 2001 budget, FY 2001 Rate
4 Case Expense was not amortized in the FY 2001 budget. It is normal ratemaking
5 procedure to normalize such expenses over the period between rate cases. Since it is
6 expected that PGW will file its next base rate case with its restructuring filing in 2003,
7 it is proper to normalize Rate Case Expense over two years, the same normalization
8 period utilized by the Company. Schedule 9 shows this normalization resulting in a
9 \$412,000 downward adjustment to expense.

10 Q. EXCEPT FOR RATE CASE EXPENSE, WHY HAVE YOU UTILIZED A FIVE-YEAR
11 AMORTIZATION PERIOD?

12 A. PGW has not included the identified expenditures in its five-year forecast of revenues
13 and expenses shown in Volume II, Part III of the filing. Since the amortization period
14 should reflect the time period between expenditures and generally match the life of the
15 benefit, it is proper to amortize such non-recurring expenditures over at least a five-
16 year period.

17 Q. PLEASE DESCRIBE THE BUDGETED EXPENSES WHICH ARE NOT
18 REPRESENTATIVE OF FUTURE OPERATING CONDITIONS AND THEREFORE
19 SHOULD BE ELIMINATED FOR RATEMAKING PURPOSES.

1 A. Employee Consultants PGW has hired several former employees on a temporary basis
2 as consultants in order to retain needed operational experience. The reply to OCA-III-
3 49 lists four employees whose contractual salaries are included in the FY 2001 test
4 year budget. Of those listed, only one is expected to remain with the Company for an
5 extended period of time, as a gas supply consultant. Since the other consultants will not
6 be remaining with the Company and their duties are expected to be performed by other
7 PGW employees, their budgeted salaries should be eliminated for ratemaking purposes.
8 As shown on Schedule 10, elimination of former employee consultant salaries results
9 in a \$258,000 downward adjustment to expense.

10 Equipment Rentals & Leasing Information Technology As explained in the reply to
11 OTS-RE-102, the budget includes \$480,000 for personal computers and laptops.
12 However, the acquisition of this equipment has been deferred. Similarly, the budget
13 includes \$152,000 for additional computer storage space which has also been put on
14 hold in order "to find ways to more economically utilize the existing amount of storage
15 space." Since both of these budgeted expenditures have been postponed, they should
16 be excluded for ratemaking purposes. If and when the computers are acquired, they
17 should be capitalized rather than leased. It would be anticipated that such equipment
18 will have a three to five year useful life, and therefore it would be logical for it to be
19 a capital expenditure. This would be compatible with the Company's plan for vehicle
20 replacements and other computer equipment which, as discussed below, were

1 eliminated from the operating budget for debt coverage considerations. As shown on
2 Schedule 11, this elimination results in a \$632,000 downward adjustment to expense.

3 Lobbying Expense The FY 2001 test year budget includes \$115,000 which has been
4 identified by the company as being "for consulting services associated with lobbying
5 and related activities." (OTS-RE-23d) Lobbying expenditures are not allowed by the
6 Commission for ratemaking purposes (Pa. PUC v. Pa. American Water Co., 79 Pa. PUC
7 25, 4/21/93) and therefore they have been eliminated on Schedule 12.

8 Operating Leases Included in PGW's FY 2001 Operating Budget is \$462,000 for
9 operating leases for vehicle replacements and \$139,000 for operating leases for
10 computer-related equipment. However, the Company has proposed that such
11 expenditures be included under capital, rather than operating leases, mainly for the
12 positive effect such inclusion would have on debt coverage. Therefore, as shown on
13 Schedule 13, \$601,000 should be eliminated from the operating budget since such
14 costs will be capitalized rather than expensed.

15 Non-Recurring Material Purchases General Material expense for FY 2001 is budgeted
16 to increased \$526,000, or 11% over the prior year. Part of this increase is due to "non-
17 recurring material purchases in preparation of a possible work stoppage in May, 2001"
18 (OCA-II-15). The reply to OCA-V-11 quantified these purchases to be \$150,000.

1 Since this expense occurs only when the union contract is being renegotiated, it should
2 be normalized for rate making purposes over the life of the contract. Accordingly,
3 Schedule 14 shows the recommended normalization of three years which is based on
4 the term of the existing contract.

5 Q. PLEASE DESCRIBE OTHER OPERATING EXPENSE ADJUSTMENTS THAT YOU
6 RECOMMEND BE MADE FOR RATEMAKING PURPOSES.

7 A. Amortization-Regulatory Asset As described in the reply to OTS-RE-111, PGW
8 established a \$37.5 million regulatory asset in 1995 related to Customer
9 Responsibility Program arrearages. This asset was to be amortized over a ten-year
10 period resulting in annual amortization of \$3.8 million per year. However, in past
11 years, PGW has been able to offset some of this amortization with funds it receives
12 from CRISIS grants. For example, in FY 2000, \$1.8 million in CRISIS grants reduced
13 the \$3.8 million amortization resulting in a net \$2.0 million charge to the operating
14 statement.

15 PGW does not budget for the CRISIS grant offset and therefore it is reasonable
16 to reflect for ratemaking purposes a five-year average of CRISIS grants received as an
17 offset to the amortization of the regulatory asset. Schedule 15 reflects this average
18 offset of \$1.6 million.

1 Q. THE COMPANY IS CLAIMING \$10.0 MILLION OF COST SAVINGS/
2 PRODUCTIVITY ADJUSTMENTS, \$3.0 MILLION IN HEALTHCARE PREMIUM
3 ADJUSTMENTS AND \$2.5 MILLION OF WORKFORCE ATTRITION
4 ADJUSTMENTS IN THE TEST YEAR OPERATING BUDGET. DO YOU BELIEVE
5 THAT YOUR ADJUSTMENTS ARE EXCLUSIVE OF THESE CLAIMS?

6 A. Yes. My operating expense adjustments are mainly accounting adjustments for which
7 the Company does not budget or adjustments that are normally made for ratemaking
8 purposes. As such, they are not the types of productivity/labor adjustments which the
9 Company is anticipating can be accomplished during the test year. The adjustments
10 should be accepted in order that the claimed test year operating budget upon which rates
11 will be based reflect normal, known and measurable conditions.

12 Q. AT THE TIME OF THE WRITING OF THIS TESTIMONY, HAVE YOU RECEIVED
13 ALL THE REPLIES TO OCA ACCOUNTING RELATED INTERROGATORIES?

14 A. No. There are interrogatories outstanding, especially those from OCA Set V.
15 Therefore, I reserve the right to update this testimony and make additional adjustments
16 depending upon the information contained in the outstanding replies.

1 - Estimated Bad Debt Expense

2 Q. IN DEVELOPING YOUR REVENUE REQUIREMENT RECOMMENDATION, YOU
3 OFFSET YOUR ACCOUNTING ADJUSTMENTS WITH A HIGHER ALLOWANCE
4 FOR BAD DEBT EXPENSE. WOULD YOU NOW EXPLAIN THE BASIS FOR SUCH
5 AN ALLOWANCE?

6 A. One of the most difficult PGW expense components to analyze is its Bad Debt expense,
7 or more accurately, its Bad Debt Appropriation. This expense is the amount which is
8 added to the Company's Accumulated Provision for Uncollectible Accounts in order
9 to cover Accounts Receivable which ultimately will not be collected.

10 Even under normal circumstances, PGW's Bad Debt Expense is very difficult
11 to estimate. Within its base rate filing, the Company has estimated this expense to be
12 \$65.3 million which is \$10.7 million higher than the actual expense for FY 2000. A
13 majority of the expense increase is associated with the forecasted increase in Total Gas
14 Revenues, which in the filing were estimated to be \$727.5 million or \$194.5 million
15 higher than in the previous year.

16 In fact, with the subsequent increase in the GCR rate, even the \$727.5 million
17 estimate will understate the actual billed revenues. Accordingly, a \$65.3 million Bad
18 Debt Expense would appear to be a low estimate. In response to an informal discovery
19 request, the Company provided an Income Statement at current rates which showed Gas
20 Revenues of \$770.4 million and a Bad Debt Expense of \$72.4 million.

1 Q. WHAT ARE SOME OF THE FACTORS WHICH MAKE BAD DEBT EXPENSE
2 PARTICULARLY DIFFICULT TO ESTIMATE AT THE CURRENT TIME?

3 A. One of the major factors is the demographics of the Company's service area. With the
4 very large increases in gas rates, it is currently not possible to accurately estimate how
5 collections will vary from past experience. Even if the collection rates were to stay at
6 historical levels, the resultant uncollected balances and Bad Debt Expense could grow
7 because of the increase in revenue dollars. However, as more and more customers
8 receive bills which exceed their ability to pay, in some instances because they had not
9 received bills for several months, the collection rates will undoubtedly decline.

10 There are also questions concerning certain collection related issues. The
11 Company, because of billing system limitations, has not been able to substantially
12 increase the number of customers on budget billing despite the obvious greater need
13 for such levelized payment mechanisms.

14 Q. HAS THE DATA ON COLLECTIONS SHOWN A TREND WHICH WOULD
15 INCREASE THE ANTICIPATED BAD DEBT EXPENSE?

16 A. With the increase in wholesale gas prices and the resultant increases in the GCR, the
17 Company's Accounts Receivable balances have escalated materially. The data
18 contained on Schedule 16 shows the year to year change in Accounts Receivable.
19 Through February, Accounts Receivable have increased between 40% and 65% monthly
20 during the current fiscal year. On the favorable side, collections through the middle of

1 March have been on budget although the phase in of the full rate increases and their
2 collection are just beginning to be reflected. Finally, there is concern because of the
3 billing problems encountered by PGW. CRP arrearages were \$66.0 million at the
4 beginning of February, and under PGC rules customers will have 12 to 24 months to pay
5 amounts associated with the billing problems. Additionally, CRP customers have not
6 been suspended for default because of the billing system deficiencies. These billing
7 problems therefore could have an on-going impact on PGW's collections.

8 Q. OVERALL, WHAT WAS THE QUANTITATIVE BASIS FOR YOUR BAD DEBT
9 EXPENSE RECOMMENDATION?

10 A. On Schedule 17, there are year to year comparisons for certain collection related
11 statistics. As previously discussed, the Accounts Receivable levels, in this case at the
12 close of each fiscal year, have increased sharply, but generally in line with the increases
13 in Billed Gas Revenues. What is of major concern is the increase in the Bad Debt
14 Appropriation as a percentage of Billed Gas Revenues. From a level of just over 6.1%
15 in 1997, the Company experienced an 11.0% level in FY 2000. As would be expected,
16 this increased percentage is also reflected in the Company's Reserve For Bad Debt
17 which has essentially doubled from about \$70.0 million up to \$140.0 million.

18 Based on my and the Company's analysis, it appears that the budgeted Bad Debt
19 Expense of \$65.3 million is too low. In response to discovery request CEPA-1-48, the
20 Company believes that its collections as a percentage of gas billings will decline to

1 below 90%. Based on this expectation, the Company has identified between \$5.0
2 million and \$7.0 million of incremental Bad Debt Expense. This increase is compatible
3 with the Company revised budget amount for Bad Debt Expense of \$72.4 million vs. the
4 \$65.3 million in its filing. Therefore, my treatment of incremental Bad Debt Expense,
5 as an offset to the identified accounting adjustments to the revenue requirement,
6 appears reasonable and is compatible with the Company's collection estimates.

1 VII. COST ALLOCATION AND RECOVERY

2 Q. IN ADDITION TO ADDRESSING THE APPROPRIATE REVENUE REQUIREMENT
3 FOR PGW, ARE THERE ANY OTHER ISSUES WHICH SHOULD BE ADDRESSED
4 IN THIS PROCEEDING?

5 A. There is an issue concerning how PGW allocates and recovers certain of its operating
6 expenses. This issue was identified in the Interim Rate proceeding and was reaffirmed
7 by the Commission in its Order concerning the Joint Petition for Full Settlement. In
8 that order, the Commission affirmed its direction that PGW address the
9 appropriateness of including non-gas costs in its GCR (February 22, 2001 Order, page
10 6). PGW did not address to any material degree nor did it make any recommendations
11 concerning non-gas costs or other cost assignment and recovery issues in its filing.

12 Q. BASED ON YOUR REVIEW, WHAT NON-GAS COSTS SHOULD BE EVALUATED?

13 A. The current GCR recovery mechanism includes expenses for electricity, conservation
14 programs, the Customer Responsibility Program ("CRP"), and bad debt expense. In
15 addition, GCR volumes are adjusted to reflect the senior citizen discount. All of these
16 expenses should not be recovered through the GCR because they distort the true cost
17 of gas for the utility and are inappropriate for recovery under the GCR mechanism. As
18 a general matter, GCR components should be gas related. Based on this requirement,
19 all of the enumerated items should be reallocated.

1 Costs of programs such as those associated with the CRP, conservation and the
2 senior citizen discount, are not gas costs. With respect to electricity costs and bad
3 debts, they are also not gas costs and are controllable costs which are more
4 appropriately recovered in base rates. At the same time, it is appropriate to note that,
5 conversely, there are also expenses within base rates which should more properly be
6 recovered through the GCR mechanism. Also, there are interruptible margins which
7 are treated as base rate revenues when in fact they should be used as credits to the
8 Company's cost of gas.

9 Q. WOULD YOU PLEASE DISCUSS THE COSTS RELATED TO LOW INCOME AND
10 ASSISTANCE PROGRAMS?

11 A. Historically, the costs of PGW's low income and assistance programs were included
12 for recovery within the GCR. These costs distort the Company's actual cost of gas and
13 they therefore need to be removed in order to facilitate future restructuring and the
14 transition to a competitive market. Conceptually, these costs could be recovered in
15 base rates through a volumetric distribution charge, thereby allowing the cost to be
16 recovered from both sales and transportation customers.

17 Q. SHOULD THE COMMISSION CONSIDER MAKING ANY SUCH CHANGES IN THIS
18 CASE RATHER THAN IN THE RESTRUCTURING PROCEEDING WHICH WILL
19 COMMENCE NEXT YEAR?

1 A. The contemplated cost reallocations will affect both the GCR and base rates, and
2 therefore, it is necessary to be able to adjust both at the same time. The Company has
3 stated that it believes that its restructuring filing will incorporate a base rate filing as
4 well as its unbundling proposals. If this will be the case, then the Commission could
5 selectively do some cost reallocations in this proceeding and leave the more complex
6 allocations for the later proceeding.

7 Q. WHAT ARE SOME OF THE COST REALLOCATIONS ISSUES WHICH SHOULD BE
8 CONSIDERED IN THIS PROCEEDING?

9 A. There are several reallocations which could be considered at this time. As stated, bad
10 debt and electricity expenses are not gas costs and are controllable in nature and should
11 therefore be recovered through base rates. While it is understood that some bad debt
12 recovery through the GCR was authorized in the Interim Rate Settlement, this was more
13 a result of the extraordinary circumstances created by gas pricing rather than
14 established regulatory practice. Indeed, the Commission noted in its February Order
15 that GCR recovery of bad debt which was authorized "under the limited and specific
16 circumstances described in the Joint Petition does not reflect any intent to permit such
17 treatment in future GCR proceedings" (February 22, 2001 Order, page 6).

18 With the very clear need to have PGW actively manage its collections and bad
19 debt expense, and given the fact that gas utilities universally do not recover bad debt
20 expense within their fuel clauses, this cost reallocation needs to be considered.

1 Similarly, with respect to electricity costs, with the advent of competition and
2 customer choice, PGW has considerable control of the level of cost incurred.
3 Accordingly, electricity costs could likewise be reallocated and recovered through base
4 rates.

5 Other costs which need evaluation are associated with supplemental gas supply
6 and the rolled-in component of gas costs. As part of the unbundling of rates, all of
7 these cost components will need to be reallocated to commodity, distribution, or
8 balancing services. At the current time, \$3.18 per Mcf of gas costs are recovered
9 through base rates. This is as much a result of convention as it is any reflection of cost
10 allocation.

11 Q. TAKING THESE VARIOUS CONSIDERATIONS INTO ACCOUNT, WHAT IS YOUR
12 RECOMMENDATION CONCERNING COST REALLOCATION IN THIS
13 PROCEEDING?

14 A. Based in part upon the fact that PGW has not presented any proposals, despite the
15 Commission requirement in its interim order that PGW address the non-gas costs
16 within its GCR as part of its base rate filing, a full reallocation does not appear practical
17 at this time. Considerable analysis will be required for allocating certain costs and the
18 assignment of margins.

19 At this time it is recommended that the rolled-in gas costs of \$3.18 per Mcf be
20 allocated to the GCR and that bad debt expense and electricity costs be recovered

1 within base rates. The remaining allocation issues, which are more complex, should be
2 deferred until the restructuring proceeding where appropriate analyses can be
3 performed and all parties will have an appropriate venue for addressing allocations as
4 part of the unbundling process.

1 VIII. ADEQUACY OF SERVICE

2 - Main Replacement Program

3 Q. WOULD YOU PLEASE DISCUSS THE COMPANY'S PROGRAM CONCERNING
4 THE REPLACEMENT OF ITS CAST IRON MAINS?

5 A. PGW's cast iron mains replacement program offers perhaps the best example of the
6 interrelationship between management, cash flow and service. During the period
7 between 1989 and 1994, PGW annually replaced, on average, 18.2 miles of its existing
8 mains. This represented a replacement rate of about 1% per year which is typical for
9 an LDC of PGW's size.

10 However, beginning in 1995, the Company allowed the average replacement to
11 fall to 9.0 miles per year. Based on a Replacement Study developed last year by
12 Navigant Consulting ("Navigant"), a replacement rate of 1%, or about 18 miles per year
13 for PGW, is necessary to reduce the risk of main breaks and incidents. Incidents are
14 defined to be events where there is significant physical damage or injury from the
15 escape of gas, such as an explosion from a gas leak.

16 It is apparent from these statistics that, as cash flow increasingly became a
17 problem for PGW, mains replacement was treated as a discretionary item. What was
18 to be a temporary reduction in the annual replacement rate became an ongoing policy
19 that raised serious concerns about the safety of the Company's facilities. These

1 concerns were also addressed in the September 13, 2000 Statement of Chairman John
2 Quain which required immediate actions to address any deficiencies in PGW's gas
3 distribution system.

4 Q. WHAT WILL BE THE IMPACT OF CONTINUING THE COMPANY'S LOW MAINS
5 REPLACEMENT RATE?

6 A. A low level of replacement increases the prospect for increased breaks and incidents.
7 While breaks have averaged between 350 and 400 per year, the system has benefitted
8 from the recent mild winters. As noted by Navigant, "Since severe weather tends to
9 cause breaks, and breaks tend to cause incidents, severe weather tends to cause
10 incidents."

11 As a result of the Navigant study and the change in PGW's management, the 1%
12 replacement rate has been adopted as policy. Through March of this year, the Company
13 has replaced or abandoned 6.2 miles of cast iron mains which equals about one-third
14 of the 18.0 miles which would represent a 1% replacement rate. During this year,
15 through March, the PGW system has experienced 334 mains breaks vs. 445 for the
16 comparable period during the prior fiscal year.

17 At the present time "based on current circumstances and at present spending
18 levels and priorities within the Company", PGW expects to achieve its targeted 1%
19 replacement in FY 2001 (Response OCA-IV-26). However, the Company has cautioned
20 that the majority of mains replacements occur during the spring and summer and this

1 planned work would be dependent on the availability of sufficient capital during that
2 period.

3 Since the definition of a utility's performance benchmark is safe and adequate
4 service, it is vital that the 1% replacement rate is achieved and maintained. The
5 Commission in this proceeding should reiterate the requirement that PGW commit to
6 actually achieving a 1% replacement rate.

7 - BCCS Systems

8 Q. WOULD YOU PLEASE PROVIDE AN UPDATE CONCERNING THE ADEQUACY
9 OF THE COMPANY'S BILLING, COLLECTIONS, AND CUSTOMER SERVICE
10 (BCCS) SYSTEM?

11 A. To the credit of PGW's personnel, there have been tangible improvements to the BCCS
12 and its use in managing the operation. In his direct testimony, Mr. Knudsen has
13 summarized the various actions taken and the results obtained. Perhaps the greatest
14 testament to the progress achieved is the fact that Deloitte & Touche, the Company's
15 independent auditors, certified the FY 2000 financial results during this past winter.

16 Setting aside the BCCS cost issues, which were discussed at length in the
17 interim rate proceeding, there still is a need to focus on the adequacy of the BCCS
18 system. Mr. Knudsen, in his prefiled testimony, acknowledges that when he began work
19 at PGW in March 2000:

1 To be succinct, the billing system was in total disarray, no financial
2 statements were being generated that could be relied on and the only two
3 documents in which we could place any faith were the monthly bank
4 statements and the gas throughput calculations telling us how much gas
5 we were delivering to customers.

6 (PGW St. 1.0, page 23)

7 While many of the basic problems have been addressed, the BCCS system is not
8 fully operational:

9 We are also now billing our accounts albeit we still have some problems
10 with accuracy and completeness. As we have peeled away and dealt with
11 major problem areas, we have exposed issues that were similar but in
12 equal need of correction.

13 (PGW St. 1.0, page 24)

14 A review of the current status of the BCCS and associated systems shows that
15 several specific areas need further improvement. Billing exceptions, while dramatically
16 reduced, still are occurring at a rate somewhat less than 300 per day (PGW St. 1.0, page
17 26). A large number of errors are occurring with reference to payment arrangements
18 and the bill calculation process (PGW St. 1.0, page 29). The Company has also
19 acknowledged that, at least through February of this year, it was having problems with
20 making adjustments to customers' budget billing plans (Response to CEPA-I-47).

21 Within Mr. Knudsen's testimony he discusses the role of the Project
22 Management Office (PMO) to increase the functionality of the BCCS system. As he
23 discloses, while the PMO has addressed six specific problem areas, it is anticipated that

1 it will continue to address additional identified projects for at least six additional
2 months. Mr. Knudsen goes on to describe nine outstanding projects which will be
3 worked on during this year (PGW St. 1.0, pages 26 through 30).

4 Q. OVERALL, DO YOU BELIEVE THAT PGW HAS RESOLVED ITS BCCS PROBLEM
5 TO THE DEGREE THAT IT NO LONGER IS ADVERSELY AFFECTING
6 OPERATIONS AND SERVICE?

7 A. No, I do not. It is apparent that the Company has BCCS "under control" in many
8 important respects. However, it also would appear that a considerable amount of work
9 remains before the system will reach its full potential to help operate, control and plan
10 PGW's overall utility operation. Additionally, it will be necessary for the Company to
11 continue to train its employees in the use of the BCCS system, particularly as the
12 envisioned enhancements are brought on line. Until all of these BCCS tasks are
13 accomplished, ratepayers will not be receiving the benefits to which they are entitled.

14 - Customer Service

15 Q. IS PGW CURRENTLY OPERATING AT A LEVEL THAT IS COMPARABLE TO
16 OTHER UTILITIES IN PERFORMANCE, COST, OR LEVEL OF SERVICE?

17 A. No, it is not. The problems associated with the BCCS system hampered all of PGW's
18 operations and were particularly damaging to the Company's relationship with its

1 customers. However, the problematic BCCS implementation was only the final
2 element in a deterioration in operations extending back over several years which
3 undermined the Company's financial and management capability to address new
4 problems and provide customers with reasonable service.

5 The financial deterioration has been addressed in Mr. Knudsen's direct
6 testimony. However, the deterioration in the performance of the Company, in its ability
7 to gather and organize basic business information about itself and its customers, its
8 ability to maintain its systems of mains in an efficient and cost effective manner, and
9 its ability to perform customer service and billing functions is more difficult to
10 describe.

11 Historical evidence, while providing insights about how the Company
12 functioned, can be misleading. Last year, a more reliable basis for judgment was
13 developed. In late May and early June, three consultant studies concerning the present
14 state of the BCCS system, PGW's call center and PGW's Human Resources function
15 were issued. These studies, performed by teams which spent weeks at PGW
16 interviewing Company employees, observing operations, and reviewing records, provide
17 timely assessments of customer service at PGW.

18 These reports demonstrate more clearly than any previous information the
19 inadequate level of PGW's service and confirm the lack of long-term planning and
20 direction which underlies the deficiencies.

1 Q. ON THE BASIS OF THESE REPORTS, DOES IT APPEAR THAT THE CUSTOMER
2 INFORMATION SYSTEM, ITSELF, IS THE MAJOR PROBLEM?

3 A. No. Andersen Consulting ("Andersen"), which did a study on the BCCS system, stated
4 that the issue is not "fundamentally the hardware and basic interfaces" (Andersen
5 Report, p.4). Vanguard Communications ("Vanguard"), which did the study on PGW's
6 Call Center, stated that PGW has a "solid technology structure to build on," which is
7 "as good or better than most utilities." Vanguard Report, p. 3, 4. To be sure, Vanguard
8 recognized problems with the BCCS "application," but implied that such problems were
9 not insurmountable, over a reasonable period of time going forward.

10 Q. THE BCCS WAS TO ALLOW SERVICE REPRESENTATIVES TO FUNCTION AS A
11 SINGLE POINT OF CONTACT FOR EACH CUSTOMER CONCERNING CUSTOMER
12 AND ACCOUNT HISTORY, SERVICE REQUESTS, ORDER PROCESSING, FIELD
13 SERVICES INFORMATION, AND PROBLEM TRACKING AND STATUS. HAS
14 BCCS FULFILLED THESE EXPECTATIONS?

15 A. No. The truth is that PGW was totally unprepared for the new system when it was
16 introduced, without adequate testing, and in an incomplete form, in July 1999.
17 Andersen reported that "BCCS training was inadequate." Andersen Report, p. 10. A full
18 11 months after conversion to BCCS, Andersen stated: "Personnel not proficient with
19 system work flows. Limited PGW personnel with basic understanding of the SPL code
20 and underlying products." Andersen Report, p. 15. Andersen further stated: "Limited

1 knowledge of BCCS capabilities, data models and workflows; severe gaps in training
2 and user help support.” Andersen Report, p. 4.

3 Q. WHAT HAS BEEN THE IMPACT OF THIS LACK OF TRAINING FOR THE
4 FUNCTIONING OF THE PGW CALL CENTER?

5 A. This lack of training has been a factor which, when combined with other problems
6 associated with the Call Center, has produced today’s situation, where, substantial
7 numbers of customers believe that you just cannot get through to PGW.

8 Q. IS THERE ANY DATA ON HOW UNRESPONSIVE THE CALL CENTER HAS BEEN?

9 A. Yes. Vanguard reported last June that the industry standard for utilities was that 80%
10 of incoming calls should be answered within 30 seconds. PGW met that standard only
11 for emergency calls. As for service calls, Vanguard reported that the average service
12 call by a customer was answered in 3 to 6 minutes; the average call for billing
13 information was answered in 15 to 30 minutes (Vanguard Report, pp. 11, 36). Not
14 surprisingly, 20% to 30% of PGW service calls by customers were abandoned, in
15 contrast with the industry standard of 4%-5%. And 70% to 85% of calls for billing
16 information by customers were abandoned, in contrast with the industry standard of 4%-
17 5% (Vanguard Report, p. 11). Andersen confirmed that the Call Center provided a
18 “seriously low...service level” (Andersen Report, p. 10).

1 Q. YOU HAVE SUGGESTED THAT "OTHER FACTORS" PLAY AN IMPORTANT ROLE
2 IN THE LOW LEVEL OF SERVICE PROVIDED BY THE CALL CENTER. PLEASE
3 EXPLAIN.

4 A. The import of the Vanguard report was that the Call Center's problems are not merely
5 linked to the transition to BCCS which generated greater volumes of calls for personnel
6 untrained and unfamiliar with a new system which itself was not functioning very well.
7 To improve the performance of the Call Center, Vanguard stated that a broader approach
8 is required, a "full plan for organization, operational, and technical changes, and ongoing
9 reinforcement" (Vanguard Report, p.4). Vanguard further stated that the dominant
10 culture in the "call center" was not "typical," i.e., what is necessary to provide high
11 standards of service, but is yet to be instilled (Vanguard Report, p.3). The consultants
12 added that a "totally different mindset is required . . . that is focused on the customer,
13 and [which] permeates from the highest levels of leadership . . ." (Vanguard Report,
14 p.4). Clearly, Vanguard believed this customer oriented mindset did not exist in the
15 Call Center or in the Company at that time.

16 And the Hay Group supported Andersen's observation that PGW must focus on
17 developing a service orientation, the "desire and focus to personally 'do whatever it
18 takes' to meet a customer's needs, be they a gas customer, regulator, vendor or another
19 department" (Hay Group Report, p.27).

1 Q. SHOULD THE FINDINGS OF THESE CONSULTANTS' REPORTS BE CONSIDERED
2 IN DETERMINING THE PROPRIETY OF PGW'S RATE REQUEST?

3 A. Yes. As stated above, rates should follow service. The long-term inadequacy of PGW's
4 service to its customers and future progress to improve service should be a primary
5 determinant as to whether or not customers should have to pay higher rates.

6 Q. BASED ON CURRENT INFORMATION, HAS CUSTOMER SERVICE IMPROVED
7 FROM WHEN THE CONSULTANTS' REPORTS WERE SUBMITTED?

8 A. Certainly the comments from the public hearings would not indicate that all of the
9 deficiencies have been resolved. There still appear to be problems in the Company's
10 Call Center, and it is unclear whether the residual problems stem from staffing
11 problems (see PGW St. 1.0, page 31). There is also evidence that customers are
12 lodging complaints with the PUC. As of February of this year, there were 3,513
13 informal complaints pending before the Commission's Bureau of Consumer Services
14 (BCS). This level of pending complaints has been increasing at the rate of 300 to
15 almost 700 per month and apparently PGW has been able to respond to only about 40%
16 of them to date (Response to CEPA-I-52).

17 Q. DOES THIS CONCLUDE YOUR TESTIMONY IN THIS PROCEEDING?

18 A. Yes, it does, subject to possible revision based on additional information which may be
19 provided by the Company.

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IX. SUPPORTING SCHEDULES

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	755,485	(44,351)	711,134
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	762,388	(44,351)	718,037
<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	(44,351)	95,785
17 Add-Back Lease Costs	7,977	0	7,977
18 Funds Available Excluding Lease Costs	148,113	(44,351)	103,762
19 1975 Ordinance Bonds Debt Service	\$51,611	\$0	\$51,611
20 Debt Service Coverage 1975 Bonds	2.87	-0.86	2.01
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	\$88,525	(\$44,351)	\$44,174
24 1998 Ordinance Bonds Debt Service	\$29,449	\$0	\$29,449
25 Debt Service Coverage 1998 Bonds	3.01	(1.51)	1.50
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	29.69	(22.29)	7.40

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
Debt Service Coverage @1.5x & Adjustments
(\$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	(50,187)	14,813
3 Appliance Repair & Turn-Ons	13,233	0	13,233
4 Other Operating Revenues	14,793	(983)	13,810
5 Total Opg Revenues @Proposed Rates	755,485	(51,170)	704,315
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	762,388	(51,170)	711,218
<u>FUNDS APPLIED</u>			
10 Fuel Costs	394,586	0	394,586
11 Other Operating Costs	256,961	(6,819)	250,142
12 Total Operating Expenses	651,547	(6,819)	644,728
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	(6,819)	615,433
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	148,113	(44,351)	103,762
19 1975 Ordinance Bonds Debt Service	\$51,611	\$0	\$51,611
20 Debt Service Coverage 1975 Bonds	2.87	-0.86	2.01
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	\$88,525	(\$44,351)	\$44,174
24 1998 Ordinance Bonds Debt Service	\$29,449	\$0	\$29,449
25 Debt Service Coverage 1998 Bonds	3.01	(1.51)	1.50
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	29.69	(22.29)	7.40

PHILADELPHIA GAS WORKS
Debt Service Coverage @1.5x & \$18 Million & Adjustments
(\$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	(50,187)	14,813
3 Appliance Repair & Turn-Ons	13,233	0	13,233
4 Other Operating Revenues	14,793	(983)	13,810
5 Total Opg Revenues @Proposed Rates	755,485	(51,170)	704,315
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	(33,170)	729,218
<u>FUNDS APPLIED</u>			
10 Fuel Costs	394,586	0	394,586
11 Other Operating Costs	256,961	(6,819)	250,142
12 Total Operating Expenses	651,547	(6,819)	644,728
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	(6,819)	615,433
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	
	2000-01	<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>	

**PHILADELPHIA GAS WORKS
BCCS Remediation
(\$000)**

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
Expense	<u>\$1,000</u>		
Amortization over 5 years		<u>(\$800)</u>	<u>\$200</u>

Source: OCA-III-21

PHILADELPHIA GAS WORKS
Consultant/Studies Costs
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
Residential Conversion Autopsy	\$20		
Customer Satisfaction Survey	25		
Restaurant Longevity Scope	15		
AGA Demographic Study	56		
Appliance Saturation Study	100		
PA State Data Center	3		
Energy USA	141		
Residential Parts & Labor Plan	20		
Web Consulting	150		
TOTAL	<u>\$530</u>		
Amortization over 5 years		<u>(\$424)</u>	<u>\$106</u>

Source: OCA-I-23

PHILADELPHIA GAS WORKS
Non-Recurring Expenses
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
Emergency Operations	\$300		
Training Costs V.P. Customer Affairs	<u>2,000</u>		
TOTAL	<u>\$2,300</u>		
Amortization over 5 Years		<u>(\$1,840)</u>	<u>\$460</u>

Source: OCA-III-22

PHILADELPHIA GAS WORKS
Rate Case Expense
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
Total Expense	<u>\$825</u>		
Amortization over 2 years		<u>(\$412)</u>	<u>\$413</u>

Source: OTS-RE-91

PHILADELPHIA GAS WORKS
Employee Consultants
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
Employee A	\$110		
Employee B	83		
Employee C (@25 hours/week,\$50/hr.)	<u>65</u>		
Total	<u>\$258</u>	<u>(\$258)</u>	<u>\$0</u>

Source: OCA-III-49

PHILADELPHIA GAS WORKS
Equipment Rentals & Leasing Information Technology
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
Personal Computers & Laptops	\$480		
Storage	<u>152</u>		
TOTAL	<u><u>\$632</u></u>	<u><u>(\$632)</u></u>	<u><u>\$0</u></u>

Source: OTS-RE-102

PHILADELPHIA GAS WORKS
Lobbying Expense
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
Expense	<u>\$115</u>	<u>(\$115)</u>	<u>\$0</u>

Source: OTS-RE-23d

PHILADELPHIA GAS WORKS
Operating Leases
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
Transportation Services	\$462		
Information Technology	139		
TOTAL	<u>\$601</u>	<u>(\$601)</u>	<u>\$0</u>

Source: OTS-RE-103 &104

PHILADELPHIA GAS WORKS
Non-Recurring Material Purchases
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
Work Stoppage Purchases	<u>\$150</u>		
Amortization over 3 years		<u>(\$100)</u>	<u>\$50</u>

Source: OCA-II-15 & OCA-V-11

PHILADELPHIA GAS WORKS
Amortization-Regulatory Asset
(\$000)

	Revised Budget 2000-01 (1)	Adj. (2)	OCA Revised Budget 2000-01 (3)
Amortization	\$3,750	(\$1,637)	\$2,113
<u>Crisis Grants</u>			
1995-96	(\$1,160)		
1996-97	(\$2,397)		
1997-98	(\$2,269)		
1998-99	(\$594)		
1999-2000	(\$1,766)		
Average	<u>(\$1,637)</u>		

Source: OTS-RE-111

PHILADELPHIA GAS WORKS
Accounts Receivable Balances
(\$000)

	<u>FY2000</u>	<u>FY2001</u>	<u>\$ Change</u>	<u>% Change</u>
August	\$97,038	\$141,080	\$44,042	45.4%
September	101,769	141,185	39,416	38.7%
October	103,658	149,408	45,750	44.1%
November	118,560	167,760	49,200	41.5%
December	141,466	209,283	67,817	47.9%
January	159,146	263,739	104,593	65.7%
February	201,430	295,614	94,184	46.8%
March	188,084			
April	182,689			
May	165,258			
June	N/A			
July	155,333			
August	141,080			

Source: Company Monthly and Annual Financial Statements

PHILADELPHIA GAS WORKS
Bad Debt Analysis- Fiscal Years
(\$000)

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Billed Gas Revenues	\$548.5	\$498.0	\$482.7	\$495.5	\$793.1
Bad Debt Appropriation	33.5	34.1	39.0	54.6	75.0
Appropriation/Billed Rev	6.1%	6.8%	8.1%	11.0%	9.5%
Accounts Receivable	\$132.6	\$110.8	\$115.8	\$156.1	\$225.5
Reserve for Bad Debt	77.1	64.7	67.1	102.0	139.5
Reserve/Accounts Receivable	58.1%	58.4%	57.9%	65.3%	61.9%
Accounts Receivable/Billed Rev	24.2%	22.2%	24.0%	31.5%	28.4%

Source: Company Response to Request OTS-RE-83 & Exhibit II, Part One, Schedule 9

X. APPENDIX: PRIOR R.W. LELASH TESTIMONIES

R. W. LELASH'S REGULATORY TESTIMONIES
(1996 to Present)

194. Vermont, Green Mountain Power Corporation (Docket No. 5857) Rate of Return and Gas Remediation Recovery Testimony for the Vermont Department of Public Services (January, 1996).
195. Rhode Island, Providence Gas Company, (Docket No. 2374) Gas Tariff Restructuring Testimony for the Rhode Island Division of Public Utilities (February, 1996).
196. Rhode Island, Providence Gas Company (Docket No. 1673) Gas Price Hedging Testimony for the Rhode Island Division of Public Utilities (August, 1996).
197. Philadelphia Gas Commission, Philadelphia Gas Works (1997 Gas Cost Rate Filing) Gas Procurement and Policy Testimony for the Public Advocate (September, 1996).
198. Georgia, Atlanta Gas Light (Docket No. 6717-U) Gas Service Unbundling Testimony for the Georgia Public Service Commission (January, 1997).
199. FERC, Cleveland Electric and Toledo Edison (Docket No. ER97-529-000, Consolidated) Rate of Return Rebuttal Testimony for Centerior Energy (April, 1997).
200. Rhode Island, Providence Gas Company (Docket No. 2581) Price Stabilization Plan Testimony for the Rhode Island Division of Public Utilities (August, 1997).
201. New Jersey, New Jersey Natural Gas Company (Docket No. GT96070524) Gas Policy Testimony for the New Jersey Division of the Ratepayer Advocate (August, 1997).
202. Vermont, Green Mountain Power Corporation (Docket No. 5983) Gas Remediation Recovery Testimony for the Vermont Department of Public Service (October, 1997).
203. Philadelphia Gas Commission, Philadelphia Gas Works (1998 GCR Proceeding) Gas Procurement and Policy Testimony for the Public Advocate (December, 1997).
204. Vermont, Green Mountain Power Corporation (Docket No. 5983) Gas Remediation Surrebuttal Testimony for the Vermont Department of Public Service (December, 1997).
205. Delaware, Delmarva Power & Light Company (Docket No. 97-293F) Gas Price Hedging Testimony for the Delaware Public Service Commission (January, 1998).
206. Delaware, Artesian Water Company (Docket No. 97-340) Rate of Return Testimony for the Delaware Public Service Commission (February, 1998).
207. Georgia, Atlanta Gas Light Company (Docket No. 8390-U) Regulatory Policy Testimony for the Energy Service Providers Association (March, 1998).
208. New Jersey, Public Service Electric & Gas Company (Docket No. GR97110839) Gas Procurement and Policy Direct Testimony for the New Jersey Division of the Ratepayer Advocate (April, 1998).
209. New Jersey, Public Service Electric & Gas Company (Docket No. GR97110839) Gas Procurement and Policy Surrebuttal Testimony for the New Jersey Division of the Ratepayer Advocate (April, 1998).

210. Philadelphia Gas Commission, Philadelphia Gas Works (1998 GCR Proceeding) Gas Price Hedging Position Statement for the Public Advocate (May, 1998).
211. Philadelphia Gas Commission, Philadelphia Gas Works (1999 GCR Proceeding) Gas Procurement and Policy Testimony for the Public Advocate (October, 1998).
212. Georgia, Cumberland Pipeline Investigation (Docket No. 10064-U) Regulatory Policy Testimony for East Tennessee Natural Gas Company (March, 1999).
213. New Jersey, Generic Unbundling Proceeding (Docket No. GX99030121) Gas Policy Testimony for the New Jersey Division of the Ratepayer Advocate (July, 1999).
214. New Jersey, Public Service Electric & Gas Company (Docket No. GO99030124) Gas Unbundling Testimony for the New Jersey Division of the Ratepayer Advocate (July, 1999).
215. Philadelphia Gas Commission, Philadelphia Gas Works (2000 GCR Proceeding) Gas Procurement and Policy Testimony for the Public Advocate (September, 1999).
216. New Jersey, Generic Unbundling Proceeding (Docket No. GX99030121) Gas Policy Surrebuttal Testimony for the New Jersey Division of the Ratepayer Advocate (September, 1999).
217. New Jersey, Public Service Electric & Gas Company (Docket No. GO99030124) Gas Unbundling Surrebuttal Testimony for the New Jersey Division of the Ratepayer Advocate (September, 1999).
218. Pennsylvania, Columbia Gas of Pennsylvania, Inc. (Docket No. R-00994781) Restructuring Testimony for the Pennsylvania Office of Consumer Advocate (October, 1999).
219. Pennsylvania, Columbia Gas of Pennsylvania, Inc. (Docket No. R-00994781) Restructuring Surrebuttal Testimony for the Pennsylvania Office of Consumer Advocate (October, 1999).
220. Rhode Island, Narragansett Electric Company et al. (Docket No. 2930) Merger Policy Testimony for the Rhode Island Department of Attorney General (November, 1999).
221. Delaware, Delmarva Power & Light Company (Docket No. 99-425F) Evaluation of Price Hedging Testimony for the Delaware Public Service Commission (December, 1999).
222. Rhode Island, Narragansett Electric Company et al. (Docket No. D-99-12) Merger Policy Testimony for the Rhode Island Department of Attorney General (December, 1999).
223. Pennsylvania, PECO Energy Company (Docket No. R-00994787) Restructuring Testimony for the Pennsylvania Office of Consumer Advocate (January, 2000).
224. Pennsylvania, PECO Energy Company (Docket No. R-00994787) Restructuring Surrebuttal Testimony for the Pennsylvania Office of Consumer Advocate (February, 2000).
225. Rhode Island, Providence Gas Company and Southern Union (Docket No. D-00-3) Merger Policy Testimony for the Rhode Island Division of Public Utilities and Department of Attorney General (May, 2000).
226. Philadelphia Gas Commission, Philadelphia Gas Works (2001 GCR Proceeding) Gas Procurement and Policy Testimony for the Public Advocate (August, 2000).
227. Rhode Island, Providence Gas Company (Docket No. 2581) Price Stability Plan Testimony for the Rhode Island Division of Public Utilities (August, 2000).

228. Pennsylvania, Philadelphia Gas Works (Docket No. R-00005654) Interim Base Rate Testimony for the Pennsylvania Office of Consumer Advocate (September, 2000).
229. Pennsylvania, Philadelphia Gas Works (Docket No. R-00005619) Gas Procurement and Policy Testimony for the Pennsylvania Office of Consumer Advocate (September, 2000).
230. New Jersey, Generic Provisional Rate Proceeding (Docket Nos. GR00070491, et al.) Provisional Rate Statement for the New Jersey Division of the Ratepayer Advocate (October, 2000).
231. New Jersey, Public Service Electric & Gas Company (Docket No. GR00070491) Levelized Gas Adjustment Clause Testimony for the New Jersey Division of the Ratepayer Advocate (November, 2000).
232. New Jersey, Generic Provisional Rate Proceeding (Docket Nos. GR00070491, et al.) Provisional Rate and Price Hedging Testimony for the New Jersey Division of the Ratepayer Advocate (December, 2000).
233. Rhode Island, Providence and Valley Gas Companies (Docket Nos. 1673 and 1736) Gas Price Mitigation Testimony for the Rhode Island Division of Public Utilities (January, 2001).
234. Delaware, Delmarva Power & Light Company (Docket No. 00-463F) Gas Price Hedging Testimony for the Delaware Public Service Commission (February, 2001).

OCA STATEMENT NO. 1-S

BEFORE THE PENNSYLVANIA
PUBLIC UTILITY COMMISSION
DOCKET NO. R-00006042

IN THE MATTER OF THE FILING OF
PHILADELPHIA GAS WORKS
CONCERNING A
BASE RATE INCREASE

SURREBUTTAL TESTIMONY OF
RICHARD W. LELASH
ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

RECEIVED
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R-0000 6042
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EXHIBIT
Oca Statement 1-S
PT-5-24-01 1/1/01

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.

2 A. My name is Richard W. LeLash and my business address is 18 Seventy Acre Road,
3 Redding, Connecticut.

4 Q. ARE YOU THE SAME RICHARD W. LELASH WHO SUBMITTED DIRECT
5 TESTIMONY IN THIS PROCEEDING?

6 A. Yes, I am. My prefiled direct testimony has been identified as OCA Statement No. 1.

7 Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN THIS
8 MATTER?

9 A. This surrebuttal testimony addresses the rebuttal testimony filed on behalf of the
10 Philadelphia Gas Works ("PGW" or "Company"). Specifically, I will discuss the
11 testimonies filed by Barbara Bisgaier, Janice Davis, Thomas Sullivan, Joseph
12 Bogdonavage, and Thomas Knudsen.

13 Q. DO YOU HAVE ANY GENERAL COMMENTS TO MAKE CONCERNING THE
14 COMPANY'S REBUTTAL PRESENTATION?

15 A. Yes, I do. It is quite apparent from the Company's rebuttal testimony that it believes
16 that my interpretation of the methodology utilized to determine PGW's revenue
17 requirement in this proceeding is inconsistent with provisions of the Natural Gas
18 Choice and Competition Act ("Act"). While I still disagree with the Company's

1 interpretation of the applicable rate setting procedures, I will not directly address the
2 issue in this testimony because, to a large degree, it requires legal conclusions which
3 will be briefed by the attorneys.

4 In the following sections of this testimony I will address the witnesses'
5 statements based on their rebuttal testimony and previous testimonies presented to the
6 PUC.

7 Bisgaier Rebuttal Testimony

8 Q. MS. BISGAIER STATES THAT IF YOUR REVENUE REQUIREMENT WERE TO BE
9 ADOPTED IT WOULD BE A DISASTER FOR THE COMPANY'S FINANCIAL
10 CONDITION. DO YOU AGREE WITH HER ASSESSMENT?

11 A. Ms. Bisgaier appears to base her position on the assumption that if PGW does not
12 receive the \$53.0 million revenue increase assumed in the Black & Veatch Engineering
13 Report ("Engineering Report"), investors will conclude that PGW is not a going
14 concern and the rating agencies will likely downgrade PGW's bonds. Ms. Bisgaier
15 made the same kind of observations concerning the need for \$52.0 million in the
16 interim case. She has not addressed what needs to be investigated in this proceeding
17 however. Without question, PGW would be stronger financially if it were granted
18 \$53.0 million rather than \$21.5 million. The higher revenue authorization would make
19 both current and prospective investors more comfortable.

1 However, there is already ample evidence in this record which shows that a
2 \$53.0 million rate increase would not result in just and reasonable rates. It would not
3 properly balance the interest of both ratepayers and investors. Ms. Bisgaier has solely
4 provided the investor perspective without considering the ratepayers' interests. She
5 also has not addressed the role her client, the City of Philadelphia, should play in
6 resolving the alleged financial disaster.

7 Q. IS THERE ANY EVIDENCE THAT MS. BISGAIER'S VIEW OF THE SITUATION IS
8 ACCURATE?

9 A. Ms. Bisgaier acknowledges that in the next few months the Company anticipates the
10 successful issuance of its Third Series Revenue Bonds and the renewal of its
11 commercial paper line of credit. Under an assumption that we are dealing with
12 informed investors and competent bankers, it is reasonable to further assume that they
13 are familiar with the Engineering Report, the Act, and the procedures used in setting
14 utility rates.

15 In my opinion, they realize, and I have testified to, the fact that PGW is facing
16 an atypical set of circumstances. Wholesale gas costs are at unprecedented levels, the
17 Company's bad debt expense is escalating, and the Company has acknowledged that it
18 will have another base rate investigation in its mandated restructuring case which has
19 to be filed no more than 14 months from now. Under these circumstances, rates should
20 be set only to meet the Company's coverage requirements. The rates should not

1 incorporate amounts to remedy past management and financial deficiencies as was
2 assumed in the Engineering Report where a \$53.0 million revenue requirement was
3 claimed. With a moderation in the wholesale cost of natural gas and measurable
4 improvement in operations and service, some of PGW's long-term needs could be
5 addressed differently. However, in the current circumstances, investors must realize
6 that ratepayers cannot afford to pay more than the lowest possible base rates. To the
7 degree that causes investor concern during this interim period, PGW's need for
8 incremental capital should be addressed by its owner, the City of Philadelphia.

9 Davis Rebuttal Testimony

10 Q. MS. DAVIS STATES THAT "PGW, AS A MUNICIPAL UTILITY, IS INTENDED TO BE
11 SELF-SUFFICIENT" AND "THE CITY IS NOT IN A POSITION TO OFFER ANY
12 ADDITIONAL MONETARY ASSISTANCE TO PGW" (DAVIS TESTIMONY, PAGES
13 3 AND 4). DO YOU HAVE ANY COMMENTS CONCERNING HER STATEMENT?

14 A. My first comment is that PGW's ratepayers are also not in a position to offer any
15 additional monetary assistance to PGW. Ms. Davis has not considered what PGW's
16 customers have testified to concerning their financial position. While the City
17 obviously provides other essential services, clearly one of its greatest priorities must
18 be to supply safe and affordable natural gas so that City residents can have heat during
19 the winter.

1 Q. ON PAGE 3 OF MS. DAVIS' TESTIMONY, SHE STATES THAT "CUSTOMERS ARE
2 NOT ASKED TO PROVIDE A RETURN ON THE CASH WORKING CAPITAL OR ON
3 CAPITAL." IS THIS CORRECT?

4 A. No, if this were correct, PGW would not face the financial disaster predicted by Ms.
5 Bisgaier. PGW has paid the City its \$18.0 million "dividend" on an annual basis
6 regardless of performance, financial condition or service levels. As a result, PGW
7 increased its financial leverage by relying too heavily on both short and long-term debt.
8 As of the end of 2000, PGW's capitalization contained 82% debt and only 18% of
9 equity. The trend in PGW's capital accounts has shown a consistent deterioration in the
10 Company's financial position which should have been clear to its owner, the City.

11 On Schedule 1, data is provided which shows, as of the end of the Company's last
12 five fiscal years, the amounts for PGW's City Equity, Long-Term Debt, and Short-Term
13 Debt. While the City Equity (which represents only the Company's retained earnings
14 since the City has never provided any equity investment) declined by \$51.7 million
15 during this period, the Company's combined debt increased by \$195.7 million. The
16 result was a steady decline in the equity ratio from 26% down to 18%. Had the
17 Company dividends been waived during this period, the City Equity would have been
18 maintained at 26% of total capital and Short-Term Debt would have been reduced to a
19 far more reasonable \$41.8 million. Such an assumption, which effectively "grants
20 back" the City dividend is shown on the schedule as Alternative 2000. What this
21 alternative shows is that PGW could have been self-sufficient over the past five years,

1 as Ms. Davis states it should be, if it had been able to increase its retained earnings
2 rather than having to pay them out as a return on equity to the City.

3 Q. ON PAGE 4 OF HER TESTIMONY, MS. DAVIS STATES THAT YOUR
4 RECOMMENDED REVENUE REQUIREMENT “WOULD INAPPROPRIATELY
5 TRANSFER CITY POLICY DECISIONS TO A STATE ADMINISTRATIVE AGENCY-
6 THE PUC.” IS HER POSITION CORRECT?

7 A. There is a difference between operational management and rate setting. The Act gives
8 authority to the PUC to set PGW’s rates. From this it is clear that the PUC does not
9 have to authorize rate increases solely on the basis that PGW has or will spend a certain
10 amount of money regardless of need or prudence. In determining the appropriate level
11 of rates, the PUC has to consider not only the Company’s financial requirements but
12 also the level of service which it provides, its overall efficiency, and the reasonableness
13 of any resultant rate level. If the indicated rates are too high when prevailing wholesale
14 gas costs and service levels are taken into account, then rates should be restricted until
15 such time as they would be just and reasonable for ratepayers. If the City of
16 Philadelphia, as a result, needs to augment the rates above the minimum level required
17 to meet coverage, then that is an appropriate responsibility of the utility’s owner, and
18 it will have to reassess its available contingency funds and possible surpluses to meet
19 PGW’s needs.

1 Sullivan Rebuttal Testimony

2 Q. BASED ON YOUR REVIEW OF MR. SULLIVAN'S TESTIMONY, DO YOU BELIEVE
3 THAT HIS FIRM'S FINDING THAT \$53 MILLION IS THE MINIMUM BASE RATE
4 INCREASE NEEDED FOR PGW IS CORRECT?

5 A. No, I do not. Mr. Sullivan has presented a rate increase amount which was one of many
6 assumptions in his firm's Engineering Report. The referenced report does not develop
7 a revenue requirement, nor does it address PGW's service or the reasonableness of the
8 rates implicit within a \$53.0 million increase. As stated in the transmittal letter, the
9 report's assumptions may differ materially from actual results.

10 As stated on pages 2 and 3 of Mr. Sullivan's testimony, the report's \$53.0
11 million finding is "the minimum level of increase needed to satisfy PGW's bond
12 covenants and to meet the objectives of paying down commercial paper, funding more
13 of its construction from internally generated funds and meeting the other objectives
14 listed in the Report." These other objectives include establishing an adequate level of
15 working capital and repaying the \$45.0 million City loan. Mr. Sullivan goes on to state,
16 at page 4 of his testimony that, "The PUC has recognized its obligation to utilize
17 PGW's prior ratemaking methodology to set rates for PGW." Given this statement, it
18 is unclear why Mr. Sullivan believes that his firm's determination is compatible with
19 PGW's prior ratemaking methodology. The Philadelphia Gas Commission ("PGC") has
20 never based its rates on expenses or revenues outside of the current budget year. It

1 therefore has not developed rates for long-term revenue or cash flow requirements. On
2 this basis alone, Mr. Sullivan's analysis and conclusions violate the very standard that
3 he states is relevant.

4 Q. HAS MR. SULLIVAN OR HIS FIRM MADE ANY DETERMINATION THAT THE
5 RATES WHICH WOULD RESULT FROM A \$53.0 MILLION INCREASE ARE JUST
6 AND REASONABLE?

7 A. No. In particular, he has failed to consider what PGW's ratepayers would be receiving
8 in the form of service in return for such an increase.

9 Q. HAS THE COMPANY'S CURRENT MANAGEMENT ACKNOWLEDGED THAT IT
10 HAS SERVICE DEFICIENCIES?

11 A. Yes, in the FY 2001 budget proceedings before the PGC, which are still pending, Mr.
12 Knudsen was very specific on this issue. In his direct testimony he stated:

- 13 – The Company has been subjected to a decade of turmoil at the top (page 16).
14 – There was never a strategic vision that was either in place for long nor really
15 acted upon . . . PGW experienced indifference from the owner which allowed
16 a series of abuses to occur (page 16).
17 – One of the criticisms leveled at PGW in the past was the lack of strategic
18 thinking and direction. The truth is that there wasn't much of either (page 19).

1 - There is no question that PGW's performance in recent years in providing
2 customer service severely lags that of other Pennsylvania utilities (page 23)

3 As of today, PGW has yet to establish permanent management, it does not have
4 an approved operating budget (which Mr. Sullivan states should be the basis for rates),
5 the PGC has not accepted the Company's five year strategic plan, and its customer
6 service remains seriously deficient. While these management and operational
7 problems do not appear to concern Mr. Sullivan and his firm, it is clear that they are
8 unacceptable to PGW's ratepayers, and it is suggested that they should be relevant to
9 the PUC when it sets rates.

10 Bogdonavage Rebuttal Testimony

11 Q. MR. BOGDONAVAGE PRESENTS REVISED, UPDATED, FULLY FORECASTED
12 TEST YEAR FINANCIALS IN HIS REBUTTAL TESTIMONY. ARE THERE ANY
13 ISSUES CONCERNING HIS PRESENTATION?

14 A. It should be noted from the onset that Mr. Bogdonavage's updated forecast is not
15 compatible with the Company's theory of the case. On page 5 of his rebuttal he states
16 that my recommendation is not consistent with PGW's prior ratemaking methodology.
17 In that respect, Mr. Bogdonavage's presentation is likewise inconsistent. Thus, while
18 I do not subscribe to the Company's interpretation of the Act, I assumed that Mr.

1 Bogdonavage would. To my knowledge, the PGC always set rates based on the forecast
2 for the pending budget year. It did not base them on forecasts of prospective budget
3 years. Since the Company filed in January 2001, the relevant year under the Company's
4 prior ratemaking standard should therefore be FY 2001 and not FY 2002.

5 Mr. Bogdonavage also implies that PGW's prior ratemaking was predicated on
6 reasonable cash working capital. Again, to my knowledge, the PGC's budgeting and rate
7 setting was historical based principally on coverages. I do not believe that the PGC
8 routinely adjusted budgeted expenses to allow for additional rates to provide cash
9 working capital. Of course, capital and working capital were not historically the
10 Company's major concerns.

11 Q. HAVE YOU IDENTIFIED ANY OTHER PROBLEMS WITH HIS PRESENTATION
12 CONCERNING HIS UPDATES TO PREVIOUS DATA?

13 A. Yes, Mr. Bogdonavage has incorporated the gas cost assumptions from the Company's
14 recent GCR filing for FY 2002 into his updated January 5, 2001 filing. In doing so, he
15 notes that the gas cost level is higher by \$106.0 million. The problem is, the
16 Company's newest estimates for prospective wholesale gas prices are overstated. On
17 Schedule 2, the monthly PGW updated estimates are shown for the FY 2002 months.
18 For the twelve month strip, the revised estimates average \$5.73 per dth for Henry Hub
19 pricing. When these monthly prices are compared to the recent NYMEX Henry Hub
20 Strip and two other recognized third party forecasts, the Company's prices are shown

1 to be unreasonably high. Compared to the average of the NYMEX strip as settled on
2 May 9 and the two forecasts, PGW's average price is \$1.34 above the average or
3 potentially 23% higher. Accordingly, based on my analysis, the new wholesale gas
4 price forecast appears overstated for both the remainder of FY 2001 and for all of FY
5 2002.

6 Q. DO YOU HAVE ANY ADDITIONAL COMMENTS CONCERNING MR.
7 BOGDONAVAGE'S REBUTTAL TESTIMONY?

8 A. Yes. On page 4 of his testimony he states that my recommendation was derived by
9 refusing to consider the cash working capital, and therefore, I was not able to say
10 whether my recommendation would provide PGW with sufficient cash through FY 2001
11 and for the first four months of FY 2002. This statement by Mr. Bogdonavage is
12 inaccurate. As I stated in response to PGW's discovery Request No. 5:

13 Mr. LeLash has not developed any monthly cash flow statements. Based
14 on the Company's 5 months actual and 7 months budget projections, it
15 was forecasted that cash at the end of FY 2001 would be \$37.1 million.
16 Assuming that the Company's actual bond flotation this year is
17 somewhere between \$100 and \$180 million, the Company's cash
18 position should be at least the \$37.1 million amount.

19 Monthly cash flow statements were not developed because actuals were
20 only available through January and, given the uncertainties concerning
21 accounts receivable and collections, an accurate and more up-to-date
22 estimate (vs. the Company's cash flow referenced above) was not
23 feasible.

1 Accordingly, using the Company's \$37.1 million forecast, plus the prospect of
2 the credit line renewal and the flotation of more than \$100.0 million in new bonds, I
3 was confident that the Company would have sufficient cash for the future. Given the
4 Company's repeated updates and revisions, its uncertainty concerning collections, and
5 the pending loan and credit line, which as of this date are still not finalized, the
6 Company's criticism concerning monthly cash flows is misplaced. If, with all these
7 uncertainties, Mr. Bogdonavage is still concerned that my recommendation is \$5.1
8 million too low to meet coverages in, apparently, December 2001, he should note that
9 I expect the City of Philadelphia to be asked by PGW to grant back the \$18.0 million
10 City payment and to cover any month-to-month temporary cash working capital
11 deficiency.

12 And finally, I would like to comment on Mr. Bogdonavage's discussion in favor
13 of rate recovery for PGW's lobbying expense. Mr. Bogdonavage has noted that this
14 expense has always been permitted in rates by the PGC and, as such, must be included
15 by the PUC (Bogdonavage, page 8). First, I believe Mr. Bogdonavage's position is
16 somewhat flawed as stated. The apparent corollary would be that if the PGC had not
17 included some expense category in rates previously, it could not be recovered in the
18 future.

19 In my view, this appears to have the PGC, de facto, continuing to set rates by
20 virtue of whatever it authorizes, eventually, within PGW's operating budget. This
21 certainly does not appear to be compatible with the intent of the Act, and it appears to

1 require the PUC to potentially grant rates which it would otherwise determine not to
2 be just and reasonable.

3 Knudsen Rebuttal Testimony

4 Q. ON PAGE 2 OF HIS REBUTTAL TESTIMONY, MR. KNUDSEN CRITICIZES YOUR
5 POSITION. DO YOU AGREE WITH HIS ASSESSMENT?

6 A. No. I believe that Mr. Knudsen, in part, does not completely understand my position
7 and, in part, is relying upon incorrect principles for setting PGW's rates. As I stated
8 at the start of this testimony, the Company and I disagree concerning how PGW should
9 have its rates determined. Mr. Knudsen wants to follow his interpretation of the prior
10 ratemaking methodology. However, he also wants the PUC to follow the
11 recommendation of Black & Veatch as to a minimum level of rate increase. To my
12 knowledge, the PGC has never set PGW's rates based on an Engineering Report, and
13 therefore, by his own logic, the \$53.0 million investor requirement cannot form the
14 basis for a rate increase. That leaves Mr. Knudsen with the prior ratemaking
15 methodology as defined by the Company and its associated Management Agreement as
16 PGW's regulatory framework. However, such a framework leaves the PUC with
17 virtually no discretion in its rate setting role.

18 Fundamentally, PGW has three sources of revenues and capital, rates, debt
19 financing, and common equity. According to the Company and the City, common equity

1 is not a viable option. The Company, by its own admission, abstained from seeking
2 necessary rate relief in prior years, such that it has not accumulated adequate retained
3 earnings. Likewise, the City maintains its inability to make new infusions of equity
4 capital. Thus, according to the Company, common equity cannot remedy PGW's
5 current financial problems. As for incremental debt financing, the Company basically
6 states that investors will not provide capital unless the PUC places 100% of the revenue
7 and capital responsibility on PGW's ratepayers. Predictably, that leaves PGW with no
8 option but to rely on the PGC and the Management Agreement.

9 Q. WHAT ALTERNATIVE WILL PROVIDE THE APPROPRIATE LEVEL OF RATES
10 FOR PGW?

11 A. Under the PUC's mandate to set just and reasonable rates, I have recommended, for a
12 variety of reasons which have already been presented, that rates be designed to share
13 responsibility between the Company's owner and its ratepayers. The City of
14 Philadelphia has a responsibility to protect the value of its operation. It needs to do so
15 by augmenting the revenue flow from rates during a period when operational efficiency
16 is low and wholesale gas prices are very high. When these factors are reversed, the
17 PUC may be able to, justifiably, shift more responsibility onto ratepayers. An adequate
18 revenue flow for PGW must reflect a reasonable mix of resources from all three of the
19 revenue and capital components. Without such a mix, it is my belief that rates will not
20 be just and reasonable.

1 My recommendation seeks an additional \$21.5 million from ratepayers based
2 on the undeniable need for PGW to meet its coverage requirements. The City should
3 accept this level of additional resources from ratepayers and agree, in the short-term,
4 to utilize the City payments it receives to backstop the Company's financial position
5 until service and operations are improved discernibly and wholesale gas costs decline
6 to levels where reasonable rates can begin increasing the Company's retained earnings.
7 Setting aside the various legal positions of the parties, it is my belief that this rate
8 setting framework is fair and will allow PGW to rebuild its financial integrity, improve
9 its overall service, and augment the value of the operation to its owner.

10 Q. MR. LELASH, DOES THAT CONCLUDE YOUR SURREBUTTAL TESTIMONY IN
11 THIS MATTER?

12 A. Yes, it does.

13 00063738

SUPPORTING SCHEDULES

PHILADELPHIA GAS WORKS
CITY EQUITY AND DEBT
(\$000's)

<u>FYE</u>	<u>Long-Term Debt</u>	<u>Short-Term Debt</u>	<u>City Equity</u>	<u>Total Capital</u>	<u>Equity %</u>
2000	\$814,828	\$131,832	\$211,300	\$1,157,960	18.3%
1999	856,579	109,373	231,711	1,197,663	19.4%
1998	778,053	90,377	251,962	1,120,392	22.5%
1997	691,911	61,250	268,987	1,022,148	26.3%
1996	701,772	49,167	263,016	1,013,955	25.9%
Alternative 2000	\$814,828	\$ 41,832	\$301,300	\$1,157,960	26.2%

SOURCE:

PGW Audited Financial Statements and Auditors' Reports.

Philadelphia Gas Works
Comparative Price Forecasts
(Per dth)

	<u>PGW</u>	<u>Strip 5/9</u>	<u>2 Forecasts</u>	<u>Average</u>
September 2001	\$6.11	\$4.37	\$4.85	\$4.69
October	6.25	4.40	4.85	4.70
November	6.41	4.57	4.95	4.82
December	6.56	4.75	5.05	4.95
January 2002	5.67	4.81	5.05	4.97
February	5.17	4.69	4.88	4.81
March	5.08	4.51	4.10	4.24
April	5.37	4.20	3.80	3.93
May	5.54	4.13	3.70	3.84
June	5.65	4.17	3.73	3.87
July	5.51	4.22	3.75	3.91
August	5.41	4.24	3.75	3.91
Average	\$5.73	\$4.42	\$4.37	\$4.39

SOURCES: Data provided by Company, NYMEX Strip May 9, 2000 and April Forecasts from PIRA Energy Group and Cambridge Energy Research Associates. Forecasts were given 66.6% weighting in average.

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY)
COMMISSION)

DOCKET NO. R-00006042

v.)

PHILADELPHIA GAS WORKS)

DIRECT TESTIMONY OF RICHARD A. BAUDINO

QUALIFICATIONS AND SUMMARY

1 Q. Please state your name and business address.

2

3 A. My name is Richard A. Baudino. My business address is J. Kennedy and Associates,
4 Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia
5 30075.

6

7 Q. What is your occupation and by whom are you employed?

8

9 A. I am a utility rate and economic consultant holding the position of Director of
10 Consulting with the firm of Kennedy and Associates.

11

12 Q. Please describe your education and professional experience.

1
2 A. I received my Master of Arts degree with a major in Economics and a minor in Statistics
3 from New Mexico State University in 1982. I also received my Bachelor of Arts Degree
4 with majors in Economics and English from New Mexico State in 1979.

5
6 I began my professional career with the New Mexico Public Service Commission Staff
7 in October of 1982 and was employed there as a Utility Economist. During my
8 employment with the Staff, my responsibilities included the analysis of a broad range of
9 issues in the ratemaking field. Areas in which I testified included cost of service, rate of
10 return, rate design, revenue requirements, analysis of sale/leasebacks of generating
11 plants, utility finance issues, and generating plant phase-ins.

12
13 In October 1989 I joined the utility consulting firm of Kennedy and Associates as a
14 Senior Consultant where my duties and responsibilities covered substantially the same
15 areas as those during my tenure with the New Mexico Public Service Commission Staff.
16 I became Manager in July 1992 and was named to my current position in January 1995.

17
18 Exhibit ____ (RAB-1) summarizes my expert testimony experience.

19

1 **Q. On whose behalf are you testifying?**

2
3 A. I am testifying on behalf of the Philadelphia Industrial and Commercial Gas Users
4 Group.

5
6 **Q. What is the purpose of your testimony in this proceeding?**

7
8 A. The purpose of my testimony is to present my conclusions and recommendations to the
9 Pennsylvania Public Utility Commission (“PPUC” or “Commission”) regarding the
10 proposed revenue increase, cost allocation and tariff issues based on my review of the
11 prefiled testimony and exhibits of Philadelphia Gas Works (“PGW” or “Company”).

12
13 **Q. Please summarize your conclusions and recommendations.**

14
15 A. First, I will present my conclusions regarding PGW’s requested revenue increase.

16
17 Second, PGW’s Commercial and Industrial rates are significantly above the cost to
18 serve, resulting in considerable subsidies to the Residential rate classes (heat and non-
19 heat). The Company’s proposed increases to the customer classes fail to appropriately

20

1 remedy these subsidies. Thus, I recommend a more reasonable alternative that lowers
2 the subsidies currently being received by the Residential classes.

3
4 Third, PGW's transportation tariff contains certain provisions that are unclear and allow
5 for too much discretion by the Company. In addition, PGW's eligibility requirements
6 are overly restrictive and serve to thwart transportation on the Company's system. I will
7 recommend revisions to the Company's transportation tariff that remedy these problems.

8
9 **PGW'S REVENUE INCREASE REQUEST**

10
11 **Q. Have you reviewed the basis for PGW's requested \$65 million revenue increase?**

12
13 **A.** Yes. I have reviewed the Company's testimony and exhibits, including Volume II of
14 this Company's filing, which contains cash flow and income projections based on
15 various levels of rate relief.

16
17 **Q. PGW's Part One, Schedule 1 of Volume II presents a Statement of Income based**
18 **on three scenarios. What is your opinion of these scenarios?**

1 A. I recommend that the Commission focus on the scenario that includes \$11 million of
2 interim rate relief. This scenario matches the recent settlement that was approved by the
3 Commission in its Order dated February 21, 2001. The settlement included \$11 million
4 of base rate relief and a \$7 million increase in the Company's cost of gas.

5
6 **Q. With respect to the Company's financial indices, please comment on the \$11**
7 **million increase scenario.**

8
9 A. The \$11 million increase scenario shows negative net earnings of \$8 million after the
10 City Payment of \$18 million. PGW forecasts a cash shortfall under this scenario of
11 \$34.2 million, once again including the \$18 million payment to the City of Philadelphia.
12 PGW's forecasted ending cash position is a negative \$25.8 million. PGW's sources of
13 cash include a \$45 million loan from the City.

14
15 With respect to debt service coverage, Mr. Bogdonovage noted on page 7, lines 19
16 through 22 of his direct testimony that PGW would meet the minimum bond indenture
17 requirements, albeit with a negative cash balance and a \$45 million loan from the City.

1 Q. Based on your general review of the Company's forecasted financial statements,
2 what is your conclusion with respect to PGW's requested revenue increase of \$65
3 million?

4
5 A. My conclusion is that PGW does not require the full amount of the \$65 million revenue
6 increase it is requesting in the proceeding. It should be noted that with the \$11 million
7 interim increase, PGW expects to meet its bond indenture requirements and should thus
8 avoid default.

9
10 Further, PGW's cash flow and net earnings projections include an \$18 million payment
11 to the City of Philadelphia. I recommend that PGW and the City negotiate a moratorium
12 on this payment. Such a moratorium would ease the burden of significant base rate and
13 cost of gas increases on PGW's ratepayers. It should be noted that PGW current
14 financial circumstances are the result of actions (and inactions) that happened in the past
15 when PGW was regulated by the City of Philadelphia. It would be appropriate for the
16 City to shoulder some of the burden by foregoing its \$18 million payment from PGW, at
17 least for the short-term.

1 Foregoing the \$18 million payment to the City would result in positive earnings for
2 PGW of \$10 million and would enable the Company to almost break even on a cash
3 basis.
4

5 **Q. If other parties find that PGW's expenses and/or construction expenditures could**
6 **be reduced, what effect would those recommendations have on your opinion**
7 **regarding the Company's requested base revenue increase of \$65 million?**
8

9 **A.** If other parties find (and the Commission agrees) that PGW's expenses and/or
10 construction expenditures should be reduced, then PGW's projected financial situation
11 would be improved and any revenue increase would necessarily be lower.
12

13 In this regard, on page 10 of his direct testimony Mr. Bogdonovage described PGW's
14 problems with its bad debt and uncollectible reserve requirement. Mr. Bogdonovage
15 noted that many low-income customers, less than efficient collection activities, a
16 mandated collection moratorium, and problems with the new billing system worsened
17 PGW's problems with bad debt and uncollectible accounts. To the extent PGW
18 addresses its internal problems with its billing system and collection activities, the
19 Company will be able to improve its bad debt problems and mitigate the need for
20 current and future revenue increases.

1 current and proposed revenues, allocated cost of service, and subsidies for PGW's firm
2 service classes.

3
4 **Q. Please describe the results shown in Exhibit ____ (RAB-2) in more detail.**

5
6 A. Exhibit ____ (RAB-2) shows current and proposed revenues for each of PGW's General
7 Service ("GS") rate classes. The increases, based on total revenues including Gas Cost
8 Recovery ("GCR") revenues are fairly consistent across the board. For example, the
9 Residential classes receive an overall increase of 10.5% while the Commercial and
10 Industrial classes receive increases of about 8.8%.

11
12 Column 5 of Exhibit ____ (RAB-2) presents the allocated cost of service for each
13 customer class from the Company's cost of service study. Column 6 shows the
14 difference between PGW's proposed revenues and the allocated cost to serve each
15 customer class. A negative number indicates that a class is below its allocated cost to
16 serve, or that it is receiving a subsidy. A positive number indicates that a customer class
17 is paying more than its fair share of costs, or that it is paying a subsidy.

1 Q. What does Exhibit ____ (RAB-2) show regarding subsidies for PGW's GS classes?

2
3 A. Column 6 of the exhibit shows that the Residential class will be receiving a subsidy of
4 \$36.6 million at the Company's proposed rates. Commercial and Industrial customers
5 will provide the bulk of this subsidy.

6
7 Q. Based on the Company's cost of service study, what is your conclusion about
8 PGW's current and proposed rates?

9
10 A. PGW's Commercial and Industrial rates are unreasonably high. Ideally, Commercial
11 and Industrial rates should be reduced in this proceeding, not increased. Likewise,
12 Residential rates should be increased much more than the Company proposes in order to
13 reflect proper cost responsibility.

14
15 Q. Are you recommending that Commercial and Industrial rates be reduced in this
16 proceeding?

17
18 A. No. For purposes of this proceeding, PICGUG will not advocate that Commercial and
19 Industrial rates be reduced.

20

1 Q. Do you have an alternative class revenue increase recommendation for the
2 Commission to consider?

3
4 A. Yes. I have two recommendations for the Commission to consider. First, I recommend
5 that the Commission assign to the Residential class the total revenue requirement
6 increase found by the Commission to be just and reasonable in this case. Exhibit
7 ____ (RAB-3) presents the results of this proposal under the assumption that the
8 Commission grants the entire requested increase in revenue requirement. The overall
9 percentage increase for the Residential class rises from 10.5% (PGW proposal) to
10 13.2%. This is not an unreasonable increase when compared to the Company's proposal
11 and the increase would obviously be lower if the PUC reduces the Company's proposed
12 revenue requirement. *Even with an allocation of the entire increase to the Residential*
13 *classes, over \$23 million of subsidy remains in the Residential rates.*

14
15 If the Commission is concerned about the above outlined impact on the Residential
16 class, then I still recommend that the Residential class be given a larger increase than the
17 Company recommends in its revenue allocation proposal. For example, the
18 Commission could apportion the revenue increase such that the Residential class
19 receives three times the percentage increase given to the other classes. Such a decision
20 would mitigate the increase to the Residential class shown in Exhibit ____ (RAB-3), but

1 would show the proper direction in eliminating the subsidy underwritten by Commercial
2 and Industrial Customers to the Residential Class.

3
4 **Q. Do you have any further comments regarding the increases shown in Exhibits**
5 **____(RAB-2) and ____ (RAB-3)?**

6
7 **A.** Yes. These exhibits assume that the full amount of PGW's requested revenue increase
8 is granted. Of course, if the Commission lowers the Company's revenue increase
9 request, then the Commission has the flexibility to allocate more, if not all, of the
10 reduced revenue increase to the Residential classes.

11
12 **TRANSPORTATION TERMS AND CONDITIONS**

13
14 **Q. Have you reviewed PGW's transportation tariffs?**

15
16 **A.** Yes. I have reviewed both the firm and interruptible transportation tariffs.
17
18
19
20

1 **Q. Please summarize your recommendations with respect to PGW's tariffs.**

2
3 **A. First, PGW's transportation tariffs have certain restrictive eligibility requirements that**
4 inhibit transportation on its system. These requirements should be relaxed so that a
5 viable and vigorous transportation market can develop on the Company's system.
6 Second, certain vague language in the Company's tariffs should be clarified in order to
7 eliminate market uncertainties accentuated by the broad discretion provided to PGW.

8
9 Specifically, I recommend the following changes to the Company's transportation
10 tariffs:

- 11
12 1. The volume eligibility requirement should be lowered from 75,000 Mcfs per
13 year to 5,000 Mcfs per year.
14
15 2. Transportation customers should be allowed to aggregate their facilities that are
16 served by multiple accounts and account numbers for purposes of qualifying for
17 transportation service.
18
19 3. Buyer Groups should allow for inclusion of a minimum of two individual
20 customers and a maximum of at least 10 individual customers for purposes of
21 qualifying for transportation.
22
23 4. Buyers Groups and transportation customers should be allowed to make intra-
24 day nomination changes if their upstream pipeline suppliers allow such changes
25 to be made. PGW should have representatives available seven days a week to
26 accept nominations and nomination changes from transportation customers.
27
28

1 5. PGW should be required to provide timely lost and unaccounted for gas
2 percentage information to transportation customers.
3

4 6. PGW should be required to provide daily imbalance information to
5 transportation customers through the internet, electronic bulletin board, or other
6 suitable means.
7

8 **Q. Please address your first recommended change regarding PGW's volumetric**
9 **eligibility requirement.**

10
11 A. PGW's current eligibility requirement for transportation is 75,000 Mcf per year. This
12 requirement is inappropriate and most likely stifles transportation on PGW's system. It
13 is important to note that many of Pennsylvania's industrial customers have been
14 transporting since the mid 1980s. PGW has only seven transportation customers
15 currently, an unusually low number when compared with other Pennsylvania gas
16 distribution companies. As a point of comparison, PECO Energy Company's
17 transportation tariff provides for a minimum consumption level of 5,000 Mcf per year
18 for transportation eligibility. Obviously, this is a far cry from the excessive requirement
19 of 75,000 Mcf per year contained in PGW's tariff. Clearly, it is reasonable and
20 responsible to lower the eligibility requirement for transportation on PGW's system. I
21 recommend that the minimum eligibility requirement be set at 5,000 Mcf per year per
22 customer or Buyers Group.
23

1 Pennsylvania's regulations provide a much greater opportunity for customers to
2 transport gas than do PGW's transportation tariffs. Commission regulations state the
3 following with respect to eligibility for natural gas transportation:

4 **These volumes shall be set at a level which maximizes the**
5 **number of customers that can receive transportation service**
6 **while permitting the natural gas utility to effectively and**
7 **efficiently manage its natural gas distribution system. The**
8 **minimum volume of transported natural gas that entitles a**
9 **customer to transportation service may not be greater than**
10 **5,000 Mcf (thousand cubic feet) per customer or buyer group**
11 **per year. 52 Pa. Code § 60.3(a).**
12
13

14 Moreover, PGW's volume requirement is inconsistent with the move toward greater
15 competition in the provision of natural gas service embodied in Pennsylvania's Natural
16 Gas Choice and Competition Act ("the Act"). The Act provides the opportunity for
17 transportation for more customers, primarily residential and commercial, in
18 Pennsylvania.

19
20 **Q. Do you have any additional recommendations regarding the volume eligibility**
21 **requirement?**

22
23 **A.** Yes. If the PUC decides not to lower the eligibility requirement to 5000 Mcfs per year
24 in this proceeding, I recommend that the Commission require PGW lower its

1 transportation eligibility requirement in future 1307(f) gas cost proceedings. The
2 Company should be required to phase-in lower eligibility requirements in the future to
3 more closely mirror the eligibility requirements of other Pennsylvania gas distribution
4 companies.

5
6 **Q. Please discuss your recommendation regarding aggregation of facilities to qualify**
7 **for transportation.**

8
9 A. Currently, there is no provision in PGW's tariff that allows customers to aggregate their
10 facilities served by multiple accounts and account numbers in order to qualify for
11 transportation. The Company should be required to add specific language in the
12 Availability section of its tariff that would allow a customer with multiple facilities that
13 may be individually metered by the Company to aggregate these facilities for purposes
14 of qualifying for transportation. This provision is reasonable and could allow more
15 customers to qualify for transportation.

16
17 **Q. Please discuss your recommendation to modify PGW's current member limit for a**
18 **Buyers Group.**

1 A. Currently PGW only allows a maximum of three members in a Buyers Group. This is
2 an *unreasonably restrictive number* and should be increased consistent with what other
3 gas distribution companies in Pennsylvania are doing. For example, PECO Energy
4 Company allows for ten members in its Buyers Group.

5
6 **Q. What are the advantages of a larger Buyers Group?**

7
8 A. A larger Buyers Group would enable a customer or a marketer to acquire a larger
9 volume of gas and potentially reduce the cost for everyone in the group. In addition, a
10 larger Buyers Group would allow for offsetting imbalances among customers, thereby
11 reducing the potential daily and monthly imbalance for the group compared to a smaller
12 group or to one customer individually.

13
14 **Q. Please discuss your fourth recommendation regarding the ability to make intra-**
15 **day nomination changes.**

16
17 A. The Company's GTS tariffs allow for changes in the transportation customer's
18 nomination "in accordance with the monthly and daily nomination procedure of the
19 delivering pipeline." However, the GTS tariff also provides that the delivery
20 arrangements must be made with the Company's Gas Control Dispatcher in a manner

1 deemed acceptable by the Company. This provision is too vague and gives PGW too
2 much discretion. This provision could give the Company the ability to refuse an intra-
3 day nomination change based on the Company's determination of whether such a
4 change is acceptable.

5
6 **Q. What is your recommendation to the Commission regarding nomination changes?**

7
8 **A.** I recommend that the Commission order the Company to change its GTS tariff such that
9 the Company is required to make changes to the transportation customer's nomination
10 as long as the change is consistent with the customer's upstream pipeline supplier.
11 Further, PGW should have personnel and/or the technology available to accept
12 nomination changes seven days a week, 24 hours a day.

13
14 There may be times when, for purposes of maintaining system integrity, PGW may not
15 be able to accept intra-day nomination changes from its transportation customers. PGW
16 should be required to explicitly state the conditions and/or criteria under which it may
17 not accept intra-day nomination changes from transportation customers because of
18 system integrity concerns. This language will clarify the Company's transportation
19 tariffs and eliminate the undue discretion PGW currently has with respect to accepting
20 nomination changes from its customers.

1

2 **Q. Please discuss your fifth recommendation regarding the lost and unaccounted for**
3 **gas factor ("LUFG").**

4

5 A. Currently the LUFG factor is not stated in the GTS tariff and there is no mechanism by
6 which PGW is required to provide information regarding its LUFG factor to
7 transportation customers. I recommend that transportation customers be provided the
8 Company's LUFG factor on January 1 effective for the next 12 months. This will allow
9 transportation customers to plan their nominations and deliveries accurately.

10

11 **Q. Please discuss your sixth recommendation regarding the notification of**
12 **nominations and imbalances.**

13

14 A. The GTS tariff fails to specify how transportation customers check nominations or how
15 they are notified of their imbalances. Since PGW requires daily balancing with a +/-
16 10% tolerance range, it is essential that the Company provide timely daily information
17 regarding imbalances to its customers.

18

19

20

1 **Q. How is nomination and imbalance information handled by other distribution**
2 **companies?**

3
4 A. PECO Energy Company provides its transportation customers and marketers with daily
5 imbalance information via the Internet. Columbia Gas of Pennsylvania, Inc. has an
6 Electronic Bulletin Board that is used for nominating and scheduling gas deliveries on
7 its system.

8
9 **Q. To your knowledge, is PGW developing the ability to provide better information to**
10 **its transportation customers?**

11
12 A. PGW's response to PICGUG Interrogatories Set III, Question 1 indicates that the
13 Company has plans to develop a web site that will allow transportation customers the
14 opportunity to perform online nominations. I have attached this response to my
15 testimony as Exhibit ____ (RAB-4).

16
17 PGW indicated that it planned to have this web site available by September 1, 2003.
18 However, PGW did not provide any details regarding the web site, its accessibility, or
19 any information that would be provided on the site.

1 **Q. What is your recommendation regarding how PGW should notify its**
2 **transportation customers of daily imbalances and provide information regarding**
3 **nominations and scheduling?**
4

5 A. I recommend that the Commission require PGW to provide detailed daily imbalance
6 information to customers either through the internet or other reasonable source. PGW
7 should also be required to provide additional detailed information regarding its planned
8 web site and how it will be accessible to customers. The Commission should also
9 require PGW to make this web site available by January 1, 2002. It is not reasonable to
10 allow PGW to wait until 2003 to provide the sort of web site that is already available to
11 other transportation customers in Pennsylvania.

12
13 **Q. Do you have any concerns regarding the transportation rates themselves?**
14

15 A. Yes. PGW's Exhibit HSG-1, Schedule 3, page 3 of 3 shows that the GTS customers are
16 paying transportation rates that are \$1.5 million, or 57.8%, greater than the allocated cost
17 to serve. Similar to the GS Commercial and Industrial rate, transportation customers are
18 providing a significant subsidy to Residential customers.

1 PGW's GTS firm tariff provides that the maximum rate that the Company can charge is
2 the non-gas rate from the transportation customer's applicable rate schedule. Given that
3 transportation customers as a whole are paying rates grossly in excess of their cost to
4 serve, it is apparent that there is a very large gap that PGW must bridge in order to offer
5 transportation service at a reasonable price. This places prospective transportation
6 customers at a disadvantage because the tariff rate from which they must negotiate down
7 is so far above the cost to serve.

8
9 PGW needs to continue to negotiate downward from the applicable non-gas tariff rates
10 in order to provide economic, cost-based transportation to its customers.

11
12 **Q. Does this conclude your testimony?**

13
14 **A. Yes.**

BEFORE THE

PENNSYLVANIA PUBLIC SERVICE COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

)
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)
)

DOCKET NO. R-00006042

EXHIBITS

OF

RICHARD A. BAUDINO

ON BEHALF OF THE

PHILADELPHIA INDUSTRIAL AND COMMERCIAL

GAS USERS GROUP

J. KENNEDY AND ASSOCIATES, INC.
ROSWELL, GEORGIA

APRIL 10, 2001

RESUME OF RICHARD A. BAUDINO, DIRECTOR OF CONSULTING

EDUCATION

New Mexico State University, M.A.
Major in Economics
Minor in Statistics

New Mexico State University, B.A.
Economics
English

Eighteen years of experience in utility ratemaking. Broad based experience in revenue requirement analysis, cost of capital, utility financing, phase-ins and rate design. Has designed revenue requirement and rate design analysis programs.

REGULATORY TESTIMONY

Preparation and presentation of expert testimony in the areas of:

Electric and Gas Utility Rate Design
Cost of Capital for Electric, Gas and Water Companies
Ratemaking Treatment of Generating Plant Sale/Leasebacks
Electric and Gas Utility Cost of Service
Revenue Requirements
Gas industry restructuring and competition

J. KENNEDY AND ASSOCIATES, INC.

RESUME OF RICHARD A. BAUDINO, DIRECTOR OF CONSULTING

EXPERIENCE

1989 to

Present: Kennedy and Associates: Director of Consulting - Responsible for consulting assignments in the area of revenue requirements, rate design, cost of capital, economic analysis of generation alternatives, gas industry restructuring and competition.

1982 to

1989: New Mexico Public Service Commission Staff: Utility Economist - Responsible for preparation of analysis and expert testimony in the areas of rate of return, cost allocation, rate design, finance, phase-in of electric generating plants, and sale/leaseback transactions.

CLIENTS SERVED

Regulatory Commissions

Louisiana Public Service Commission

Industrial Groups

Ad Hoc Committee for a Competitive
Electric Supply System
Air Products and Chemicals, Inc.
Arkansas Electric Energy Consumers
Arkansas Gas Consumers
Armco Steel Company, L.P.
Association of Business Advocating
Tariff Equity
General Electric Company
Industrial Energy Consumers

Kentucky Industrial Utility Consumers
Large Electric Consumers Organization
Newport Steel
Northwest Arkansas Gas Consumers
Maryland Industrial Group
Occidental Chemical
PSI Industrial Group
Taconite Intervenors (Minnesota)
Tyson Foods

J. KENNEDY AND ASSOCIATES, INC.

**Expert Testimony Appearances
of
Richard A. Baudino
As of March 2000**

Date	Case	Jurisdct.	Party	Utility	Subject
3/83	1780	NM	New Mexico Public Service Commission	Boles Water Co.	Rate design, rate of return.
10/83	1803, 1817	NM	New Mexico Public Service Commission	Southwestern Electric Coop	Rate design.
11/84	1833	NM	New Mexico Public Service Commission	El Paso Electric Co.	Service contract approval, rate design, performance standards for Palo Verde nuclear generating system
1983	1835	NM	New Mexico Public Service Commission	Public Service Co. of NM	Rate design.
1984	1848	NM	New Mexico Public Service Commission	Sangre de Cristo Water Co.	Rate design.
02/85	1906	NM	New Mexico Public Service Commission	Southwestern Public Service Co.	Rate of return.
09/84	1907	NM	New Mexico Public Service Commission	Jornada Water Co.	Rate of return.
11/85	1957	NM	New Mexico Public Service Commission	Southwestern Public Service Co.	Rate of return.
04/86	2009	NM	New Mexico Public Service Commission	El Paso Electric Co.	Phase-in plan, treatment of sale/leaseback expense.
06/86	2032	NM	New Mexico Public Service Commission	El Paso Electric Co.	Sale/leaseback approval.
09/86	2033	NM	New Mexico Public Service Commission	El Paso Electric Co.	Order to show cause, PVNGS audit.
02/87	2074	NM	New Mexico Public Service Commission	El Paso Electric Co.	Diversification.
05/87	2089	NM	New Mexico Public Service Commission	El Paso Electric Co.	Fuel factor adjustment.
08/87	2092	NM	New Mexico Public Service Commission	El Paso Electric Co.	Rate design.
10/88	2146	NM	New Mexico Public Service Commission	Public Service Co. of New Mexico	Financial effects of restructuring, reorganization.
07/88	2162	NM	New Mexico Public Service Commission	El Paso Electric Co.	Revenue requirements, rate design, rate of return.
01/89	2194	NM	New Mexico Public Service Commission	Plains Electric G&T Cooperative	Economic development.

**Expert Testimony Appearances
of
Richard A. Baudino
As of March 2000**

Date	Case	Jurisdict.	Party	Utility	Subject
06/89	2253	NM	New Mexico Public Service Commission	Plains Electric G&T Cooperative	Financing.
08/89	2259	NM	New Mexico Public Service Commission	Homestead Water Co.	Rate of return, rate design.
10/89	2262	NM	New Mexico Public Service Commission	Public Service Co. of New Mexico	Rate of return.
09/89	2269	NM	New Mexico Public Service Commission	Ruidoso Natural Gas Co.	Rate of return, expense from affiliated interest.
12/89	89-208-TF	AR	Arkansas Electric Energy Consumers	Arkansas Power & Light Co.	Rider M-33.
01/90	U-17282	LA	Louisiana Public Service Commission	Gulf States Utilities	Cost of equity.
09/90	90-158	KY	Kentucky Industrial Utility Consumers	Louisville Gas & Electric Co.	Cost of equity.
09/90	90-004-U	AR	Northwest Arkansas Gas Consumers	Arkansas Western Gas Co.	Cost of equity, transportation rate.
12/90	U-17282 Phase IV	LA	Louisiana Public Service Commission	Gulf States Utilities	Cost of equity.
04/91	91-037-U	AR	Northwest Arkansas Gas Consumers	Arkansas Western Gas Co.	Transportation rates.
12/91	91-410-EL-AIR	OH	Air Products & Chemicals, Inc., Armco Steel Co., General Electric Co., Industrial Energy Consumers	Cincinnati Gas & Electric Co.	Cost of equity.
05/92	910890-EI	FL	Occidental Chemical Corp.	Florida Power Corp.	Cost of equity, rate of return.
09/92	92-032-U	AR	Arkansas Gas Consumers	Arkansas Louisiana Gas Co.	Cost of equity, rate of return, cost-of-service.
09/92	39314	ID	Industrial Consumers for Fair Utility Rates	Indiana Michigan Power Co.	Cost of equity, rate of return.
09/92	92-009-U	AR	Tyson Foods	General Waterworks	Cost allocation, rate design.

**Expert Testimony Appearances
of
Richard A. Baudino
As of March 2000**

<u>Date</u>	<u>Case</u>	<u>Jurisdct.</u>	<u>Party</u>	<u>Utility</u>	<u>Subject</u>
01/93	92-346	KY	Newport Steel Co.	Union Light, Heat & Power Co.	Cost allocation.
01/93	39498	IN	PSI Industrial Group	PSI Energy	Refund allocation.
01/93	U-10105	MI	Association of Businesses Advocating Tariff Equality (ABATE)	Michigan Consolidated Gas Co.	Return on equity.
04/93	92-1464-EL-AIR	OH	Air Products and Chemicals, Inc., Armco Steel Co., Industrial Energy Consumers	Cincinnati Gas & Electric Co.	Return on equity.
09/93	93-189-U	AR	Arkansas Gas Consumers	Arkansas Louisiana Gas Co.	Transportation service terms and conditions.
09/93	93-081-U	AR	Arkansas Gas Consumers	Arkansas Louisiana Gas Co.	Cost-of-service, transportation rates, rate supplements; return on equity; revenue requirements.
12/93	U-17735	LA	Louisiana Public Service Commission Staff	Cajun Electric Power Cooperative	Historical reviews; evaluation of economic studies.
03/94	10320	KY	Kentucky Industrial Utility Customers	Louisville Gas & Electric Co.	Trimble County CWIP revenue refund.
4/94	E-015/GR-94-001	MN	Large Power Intervenors	Minnesota Power Co.	Evaluation of the cost of equity, capital structure, and rate of return.
5/94	R-00942993	PA	PG&W Industrial Intervenors	Pennsylvania Gas & Water Co.	Analysis of recovery of transition costs.
5/94	R-00943001	PA	Columbia Industrial Intervenors	Columbia Gas of Pennsylvania	Evaluation of cost allocation, rate design, rate plan, and carrying charge proposals.
7/94	R-00942986	PA	Armco, Inc., West Penn Power Industrial Intervenors	West Penn Power Co.	Return on equity and rate of return.
7/94	94-0035-E-42T	WV	West Virginia Energy Users' Group	Monongahela Power Co.	Return on equity and rate of return.
8/94	8652	MD	Westvaco Corp.	Potomac Edison Co.	Return on equity and rate of return.

**Expert Testimony Appearances
 of
 Richard A. Baudino
 As of March 2000**

Date	Case	Jurisdct.	Party	Utility	Subject
9/94	930357-C	AR	West Central Arkansas Gas Consumers	Arkansas Oklahoma Gas Corp.	Evaluation of transportation service.
9/94	U-19904	LA	Louisiana Public Service Commission	Gulf States Utilities	Return on equity.
9/94	8629	MD	Maryland Industrial Group	Baltimore Gas & Electric Co.	Transition costs.
11/94	94-175-U	AR	Arkansas Gas Consumers	Arkla, Inc.	Cost-of-service, rate design, rate of return.
3/95	RP94-343-000	FERC	Arkansas Gas Consumers	NorAm Gas Transmission	Rate of return.
4/95	R-00943271	PA	PP&L Industrial Customer Alliance	Pennsylvania Power & Light Co.	Return on equity.
6/95	U-10755	MI	Association of Businesses Advocating Tariff Equity	Consumers Power Co.	Revenue requirements.
7/95	8697	MD	Maryland Industrial Group	Baltimore Gas & Electric Co.	Cost allocation and rate design.
8/95	95-254-TF U-2811	AR	Tyson Foods, Inc.	Southwest Arkansas Electric Cooperative	Refund allocation.
10/95	ER95-1042-000	FERC	Louisiana Public Service Commission	Systems Energy Resources, Inc.	Return on Equity.
11/95	I-940032	PA	Industrial Energy Consumers of Pennsylvania	State-wide - all utilities	Investigation into Electric Power Competition.
5/96	96-030-U	AR	Northwest Arkansas Gas Consumers	Arkansas Western Gas Co.	Revenue requirements, rate of return and cost of service.
7/96	8725	MD	Maryland Industrial Group	Baltimore Gas & Electric Co., Potomac Electric Power Co. and Constellation Energy Corp.	Return on Equity.
7/96	U-21496	LA	Louisiana Public Service Commission	Central Louisiana Electric Co.	Return on equity, rate of return.
9/96	U-22092	LA	Louisiana Public Service Commission	Entergy Gulf States, Inc.	Return on equity.
1/97	RP96-199-000	FERC	The Industrial Gas Users Conference	Mississippi River Transmission Corp.	Revenue requirements, rate of return and cost of service.

**Expert Testimony Appearances
of
Richard A. Baudino
As of March 2000**

Date	Case	Jurisdct.	Party	Utility	Subject
3/97	96-420-U	AR	West Central Arkansas Gas Corp.	Arkansas Oklahoma Gas Corp.	Revenue requirements, rate of return, cost of service and rate design.
7/97	U-11220	MI	Association of Business Advocating Tariff Equity	Michigan Gas Co. and Southeastern Michigan Gas Co.	Transportation Balancing Provisions
7/97	R-00973944	PA	Pennsylvania American Water Large Users Group	Pennsylvania- American Water Co.	Rate of return, cost of service, revenue requirements.
3/98	8390-U	GA	Georgia Natural Gas Group and the Georgia Textile Manufacturers Assoc.	Atlanta Gas Light	Rate of return, restructuring issues, unbundling, rate design issues.
7/98	R-00984280	PA	PG Energy, Inc.	PGE Industrial Intervenors	Cost allocation.
8/98	U-17735	LA	Louisiana Public Service Commission	Cajun Electric Power Cooperative	Revenue requirements.
10/98	97-596	ME	Maine Office of the Public Advocate	Bangor Hydro- Electric Co.	Return on equity, rate of return.
10/98	U-23327	LA	Louisiana Public Service Commission	SWEP, CSW and AEP	Analysis of proposed merger.
12/98	98-577	ME	Maine Office of the Public Advocate	Maine Public Service Co.	Return on equity, rate of return.
12/98	U-23358	LA	Louisiana Public Service Commission	Entergy Gulf States, Inc.	Return on equity, rate of return.
3/99	98-426	KY	Kentucky Industrial Utility Customers, Inc.	Louisville Gas and Electric Co.	Return on equity.
3/99	99-082	KY	Kentucky Industrial Utility Customers, Inc.	Kentucky Utilities Co.	Return on equity.
4/99	R-984554	PA	T. W. Phillips Users Group	T. W. Phillips Gas and Oil Co.	Allocation of purchased gas costs.
6/99	R-0099462	PA	Columbia Industrial Intervenors	Columbia Gas of Pennsylvania	Balancing charges.
10/99	U-24182	LA	Louisiana Public Service Commission	Entergy Gulf States, Inc.	Cost of debt.
10/99	R-00994782	PA	Peoples Industrial Intervenors	Peoples Natural Gas Co.	Restructuring issues.

J. KENNEDY AND ASSOCIATES, INC.

**Expert Testimony Appearances
 of
 Richard A. Baudino
 As of March 2000**

Date	Case	Jurisdct.	Party	Utility	Subject
10/99	R-00994781	PA	Columbia Industrial Intervenors	Columbia Gas of Pennsylvania	Restructuring, balancing charges, rate flexing, alternate fuel.
1/00	R-00994786	PA	UGI Industrial Intervenors	UGI Utilities, Inc.	Universal service costs, balancing, penalty charges, capacity assignment.
1/00	8829	MD	Maryland Industrial Gr. & United States Gypsum Company	Baltimore Gas & Electric Co.	Revenue requirements, cost allocation, rate design.
5/00	U-17735	LA	Louisiana Public Service Commission	Louisiana Electric Cooperative	Rate restructuring.
7/00	2000-080	KY	Kentucky Industrial Utility Consumers	Louisville Gas and Electric Co.	Cost allocation.
7/00	U-21453, U-20925(SC), U-22092(SC) (Subdocket E)	LA	Louisiana Public Service Commission	Southwestern Electric Power Co.	Stranded cost analysis.
9/00	R-00005654	PA	Philadelphia Industrial and Commercial Gas Users Group	Philadelphia Gas Works	Interim rate relief analysis.
10/00	U-21453 U-20925 U-22092 (Subdocket)	LA	Louisiana Public Service Commission	Entergy Gulf States, Inc.	Stranded cost analysis.
12/00	U-24993	LA	Louisiana Public Service Commission	Entergy Gulf States, Inc.	Return on equity.

PHILADELPHIA GAS WORKS

Company Proposed Class Revenue Increase

	<u>Current Revenues</u>	<u>Proposed Increase</u>	<u>Increase Pct.</u>	<u>Total Revenues</u>	<u>Revenue Requirement</u>	<u>Excess/ (Deficiency)</u>
Residential	505,690,722	53,239,261	10.53%	558,929,983	595,527,062	(36,597,079)
Commercial	116,602,351	10,349,957	8.88%	126,952,308	105,297,424	21,654,884
Industrial	16,484,621	1,453,316	8.82%	17,937,937	14,546,112	3,391,825
Municipal	14,089,332	1,046,642	7.43%	15,135,974	11,565,916	3,570,058
Philadelphia Housing Auth.	14,317,907	677,703	4.73%	14,995,610	13,218,307	1,777,303
Total	667,184,933	66,766,879	10.01%	733,951,812		

PHILADELPHIA GAS WORKS

Alternative Class Revenue Increase

	<u>Current Revenues</u>	<u>Proposed Increase</u>	<u>Increase Pct.</u>	<u>Total Revenues</u>	<u>Revenue Requirement</u>	<u>Excess/ (Deficiency)</u>
Residential	505,690,722	66,766,879	13.20%	572,457,601	595,527,062 ¹	(23,069,461)
Commercial	116,602,351	0	0.00%	116,602,351	105,297,424	11,304,927
Industrial	16,484,621	0	0.00%	16,484,621	14,546,112	1,938,509
Municipal	14,089,332	0	0.00%	14,089,332	11,565,916	2,523,416
Philadelphia Housing Auth.	14,317,907	0	0.00%	14,317,907	13,218,307	1,099,600
Total	667,184,933	66,766,879		733,951,812		

RESPONSE TO THE PHILADELPHIA INDUSTRIAL AND
COMMERCIAL GAS USERS GROUP (PICGUG) DATA REQUEST
REGARDING PGW'S RATE PROCEEDING

Question PICGUG-Set III-1 Please describe PGW's bulletin board, which is used by transportation customers for nominating purposes.

Response Provided By: Craig White – Sr. Vice President, Marketing & Supply Services

Response: PGW does not have a bulletin board system for use by the transportation customers for nominating purposes. While it may appear to some that PGW is behind the times with this issue, it is important to note that PGW has had less than ten (10) transportation customers on its system at any one time during the period where this service was offered.

PGW is in the process of developing a four (4) stage Web site project which will ultimately allow transportation customers to perform online nominations via the internet by the Commission's deadline for unbundling of services by September 1, 2003.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY)
COMMISSION)
v.)
PHILADELPHIA GAS WORKS)

DOCKET NO. R-00006042

SURREBUTTAL TESTIMONY
OF
RICHARD A. BAUDINO

REC'D
MAY 30 PM 2:27
P.A.P.U.C.
SECRETARY'S BUREAU

ON BEHALF OF THE
PHILADELPHIA INDUSTRIAL AND
COMMERCIAL GAS USERS GROUP

DOCUMENT
FOLDER

DOCKETED
MAY 31 2001

J. KENNEDY AND ASSOCIATES, INC.
ROSWELL, GEORGIA

MAY 2001

EXHIBIT
R-00006042
R-00006042 C 0001
PECGUB 1-S
R-5-2401-Philadelphia

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY)
COMMISSION)
)
 v.)
)
 PHILADELPHIA GAS WORKS)

DOCKET NO. R-00006042

SURREBUTTAL TESTIMONY OF RICHARD A. BAUDINO

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

2

3 A. My name is Richard A. Baudino. My business address is J. Kennedy and Associates,
4 Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia
5 30075.

6

7 **Q. Did you submit direct testimony in this proceeding?**

8

9 A. Yes. I submitted direct testimony on behalf of the Philadelphia Industrial and
10 Commercial Gas Users Group ("PICGUG").

11 **Q. What is the purpose of your surrebuttal testimony in this proceeding?**

12

13 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of Mr.
14 Ralph Miller, witness for the Office of Consumer Advocate ("OCA") and Mr. Craig
15 White, witness for Philadelphia Gas Works ("PGW" or "Company").

1

2 Response to Mr. Miller

3

4 **Q. On page 2 of his rebuttal testimony, Mr. Miller claimed that he “demonstrated” in**
5 **his direct testimony that PGW’s cost of service study “fails to recognize proper cost**
6 **causation.” Do you agree with Mr. Miller’s assertion?**

7

8 **A.** No. Mr. Miller failed to demonstrate that the Company’s cost of service study was
9 inappropriate. I support Mr. Gorman’s rebuttal testimony with respect to Mr. Miller’s
10 cost of service analysis. Mr. Miller allocated distribution mains investment based on the
11 peak and average method, which is completely inappropriate for a gas distribution
12 utility. First, as Mr. Gorman stated in his rebuttal testimony on page 2, gas distribution
13 companies plan and invest in distribution mains to attach customers to the system
14 regardless of how or when they take service. This fact justifies classifying part of
15 distribution main costs as customer-related. Second, mains must be in place and sized to
16 serve the system during peak winter periods. Classifying costs partly on the basis of
17 annual throughput as Mr. Miller did fails to account for the fact that the gas distribution
18 system is designed and sized to meet winter peak demands, not average usage
19 throughout the year.

20

21 **Q. What is the effect of Mr. Miller’s reclassification of distribution mains cost based**
22 **on the peak and average method?**

1

2 A. Mr. Miller's proposed reclassification of distribution mains cost improperly shifts cost
3 responsibility away from residential customers and on to high load factor industrial
4 customers. Because the residential class has the highest percentage of customers on
5 PGW's system, Mr. Miller's failure to recognize the customer component of distribution
6 mains reallocates those customer-related costs to commercial and industrial customers.
7 Further, since industrial customers use gas more evenly throughout the year than
8 residential customers, allocating a portion of distribution mains costs based on
9 throughput places even more costs on industrial customers. Mr. Miller's proposed
10 reallocation of distribution mains costs is unfounded, inappropriate, and should be
11 rejected by the Commission.

12

13 **Q. Beginning on page 3 of his rebuttal testimony, Mr. Miller asserts that subsidies are**
14 **not indicated by the difference between revenues and fully allocated costs. Please**
15 **respond to Mr. Miller's assertion regarding subsidies.**

16

17 A. The Commission should reject Mr. Miller's definition of subsidies out of hand. First, it
18 is a commonly accepted ratemaking principle to define customer class rate subsidies
19 based on the difference between revenues and fully allocated costs. Mr. Miller's
20 opinion notwithstanding, since rates are based on embedded costs, the best way to
21 determine class cost responsibility is with a fully allocated embedded cost of service
22 study.

1
2 Second, Mr. Miller provided no marginal cost study that would guide the Commission,
3 the Company, or the parties as to how to apportion costs in this proceeding. All Mr.
4 Miller offered is a rather general discussion of his views on economic theory and his
5 unsupported assertions regarding the alleged shortcomings of class cost of service
6 studies. Mr. Miller's "ivory tower" discussion of economics is no basis for allocating
7 costs and determining subsidies in the real world. If Mr. Miller believes that the
8 Company's rates should be based on marginal cost pricing, then Mr. Miller should have
9 prepared a marginal cost and pricing study for the parties to review. Instead, Mr. Miller
10 chose to invest his time in modifying the Company's embedded cost study.

11
12 Third, Mr. Miller's discussion of marginal costs undermines his stance against the use of
13 class cost of services studies to determine subsidies. On page 3 of his rebuttal
14 testimony, Mr. Miller recognizes that a gas utility's marginal costs are much less than its
15 total costs. However, Mr. Miller's statement begs the question of how the responsibility
16 for the difference between marginal costs and total costs should be divided amongst the
17 utility's rate classes. Of course, the only viable and widely accepted means for doing
18 this would be a class cost of service study. Mr. Miller offered no other means for
19 determining rates and prices in his marginal cost view of the world.

20
21 **Response to Mr. White**

22

1 **Q. On page 8 of his rebuttal testimony, Mr. White claimed that your recommended**
2 **changes to PGW's transportation tariffs are not timely and should not be**
3 **considered until PGW's restructuring filings. Please respond to his position.**
4

5 A. It is PICGUG's position that the changes I proposed to PGW's tariffs are timely and are,
6 in fact, past due. As I stated in my direct testimony, other Pennsylvania gas utilities
7 have allowed industrial customers to transport gas since the 1980s. PGW's restrictive
8 and anachronistic tariffs provide unreasonable barriers to transportation. My proposed
9 modifications to PGW's tariffs are designed to bring PGW's transportation policies
10 more in line with other gas utilities in Pennsylvania. There is no good reason not to
11 move forward with the changes I proposed in PGW's transportation tariffs.
12

13 **Q. On page 18, Mr. White stated that PGW is "concerned that its ability to coordinate**
14 **and balance a large amount of transportation load is inadequate." Please address**
15 **this concern.**
16

17 A. This is a rather vague concern and Mr. White provided no evidence that the Company
18 could not handle increased transportation on its system. Mr. White is attempting to
19 persuade the Commission that PGW is not capable of doing a job that other
20 Pennsylvania gas utilities have been doing successfully for years. This argument should
21 be rejected.
22

1 If the Company needs to expand its staff to handle implementation of transportation,
2 including the creation of an electronic bulletin board, then it should do so in a prudent
3 manner. Likewise, if the Company needs to adjust its gas supply contracts to handle
4 additional transportation customers, then it should be required to do so. PGW is so far
5 behind other Pennsylvania gas utilities with regard to transportation that the Company
6 should be required to begin these changes now, not in 2003.

7
8 **Q. Did the Company provide any good reason why it cannot implement the change**
9 **you recommended regarding combining consumption at various locations in order**
10 **to qualify for transportation?**

11
12 A. No. The Company should be able to accommodate this simple change to transportation
13 requirements.

14
15 **Q. Do you have a clarification regarding your recommendation for the allowed**
16 **number of customers in a Buyer's Group?**

17
18 A. Yes. In my direct testimony I recommended that the maximum number of customers in
19 a Buyers Group should be at least 10. This means that PGW could accept a number
20 larger than ten in a Buyer's Group. This is consistent with PECO Energy's
21 transportation tariff, which states that eleven or more customers may form a Buyer's
22 Group if PECO specifically agrees to such a group. I propose that PGW be required to

1 add language to its transportation tariff that would allow the formation of Buyer's
2 Groups larger than 10 if the Company agrees.

3
4 **Q. Do you have an alternative recommendation for the Commission to consider**
5 **regarding the expansion of transportation on PGW's system?**

6
7 A. Yes. If the Commission is concerned that PGW may not be able to handle all of the
8 additional transportation customers that could enroll for transportation at the 5,000 Mcf
9 yearly consumption level I proposed in my direct testimony, then I propose that the
10 Commission consider a higher alternative level of 15,000 Mcf. This level would enable
11 PGW to expand transportation to more of the Company's larger customers and would
12 allow the Company to have more experience in handling transportation customers before
13 its upcoming restructuring filing. It should be noted that the 15,000 Mcf alternative is
14 three times greater than the 5,000 Mcf eligibility requirement contained in the
15 Commission regulations that I cited in my direct testimony.

16
17 **Q. Does this conclude your surrebuttal testimony?**

18
19 A. Yes.

Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

Docket No. R-00006042

Philadelphia Industrial and Commercial

Gas Users Group

Direct Examination Exhibit No. 1

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GAS TRANSPORTATION SERVICE - GENERAL TERMS AND CONDITIONS - Continued

(Applicable to: Rate TS-I Gas Transportation Service-Interruptible and
Rate TS-F Gas Transportation Service-Firm.)

1.6 BUYER GROUP/LEAD CUSTOMER. A Buyer Group generally consists of up to ten individual Customers who voluntarily join together to obtain either firm or interruptible transportation service. The Company, at its discretion, may require all members of the Buyer Group to execute the same Transportation Service Agreement and make the same elections as to Standby Sales Service. One member of the Buyer Group may be designated by the Company as the Lead Customer who shall be responsible for the timely payment of all bills rendered to the Buyer Group, as well as all day-to-day dispatch scheduling coordination and administrative communication between the Company and all members of the Buyer Group. A member of one Buyer Group may not be a member of another Buyer Group. Eleven or more individual Customers may form a Buyer Group only upon specific agreement by the Company. Unless otherwise described, the term "Customer" as used throughout these general terms and conditions shall refer to an individual Customer or to a Buyer Group. The Company, at its discretion, may set the maximum Commodity Charge for a Buyer Group at the maximum which any member would be individually required to pay.

1.7 MINIMUM SIZE. The minimum total gas consumption capability required to be eligible for transportation service shall be 5,000 Mcf per year. This minimum shall apply to an individual Customer or to a Buyer Group which, in the aggregate, uses 5,000 Mcf of gas annually.

1.8 SOURCE OF GAS. Unless otherwise certified, all gas transported shall be presumed to be non-Pennsylvania produced gas. In order to qualify for billing as Pennsylvania produced gas, the Customer must provide an affidavit specifying the percentage by month of Pennsylvania produced gas to be transported during the term of the Service Agreement. The Customer is responsible to notify the Company of any change in the above percentage no later than the second working day after the conclusion of the billing month in which the change occurred.

2. BALANCING PROVISIONS

2.1 GENERAL. Transportation balancing is provided to adjust for the unavoidable minor variations between Customer usage and scheduled deliveries, and is not intended to function as a storage service or a standby sales service. Each Customer shall use best efforts to balance deliveries and usage at all times.

2.2 INTERRUPTED RECEIPTS. On days when no transportation gas is received for the Customer's account, all gas used by the Customer shall be billed as a purchase from the Company. For Customers which have elected Standby Sales Service, the usage shall be billed at the applicable rate. For Customers which have not elected Standby Sales Service, the usage shall be billed at the sum of the Variable Distribution Charge, Commodity Charge, Balancing Service Cost ("BSC") and, the Gas Cost Adjustment Charge ("GCA") of Rate GC and an additional \$25 per Mcf penalty charge will be imposed. Excess deliveries already being held for the Customer at the time of interruption will be tendered for delivery when transportation receipts resume. If the interruption of receipts continues for more than thirty days, the Company will tender excess deliveries as soon as practicable subject to operating and gas procurement considerations.

2.3 BALANCING CHARGE. A \$0.0196 per Mcf balancing charge shall be imposed on all transportation deliveries in a billing month.

2.4 ALLOWABLE DAILY VARIATION. In order to minimize the effect of transportation imbalances on the operation of the Company's system, the allowable daily variation between delivered quantities and Customer usage is the greater of ten percent of the TCQ or 50 Mcf.

If a Customer exceeds these limits, the Company shall: (a) in the case of excess deliveries, impose a \$0.25 per Mcf penalty charge on that portion of daily excess deliveries greater than the allowable daily variation and have the right to limit the receipt of Gas Transportation if a customer has excess deliveries greater than two times the Customer's TCQ; (b) in the case of deficient deliveries, have the right to bill such deficiency as a purchase from the Company. For Customers which have elected Standby Sales Service, the deficiency shall be billed at the applicable rate. For Customers which have not elected Standby Sales Service, the deficiency shall be billed at the sum of the Variable Distribution Charge, Commodity Charge, Balancing Service Cost ("BSC") and, the Gas Cost Adjustment Charge ("GCA") of Rate GC, and an additional \$25 per Mcf penalty charge will be imposed.

Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

Docket No. R-00006042

Philadelphia Industrial and Commercial

Gas Users Group

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- 1.42 "Storage" shall mean placing natural gas into an underground facility for removal and use at a later date.
- 1.43 "Transmission" shall mean the moving of natural gas through the interstate pipeline system for delivery to the NGDC.

2. RULES APPLICABLE TO ALL DISTRIBUTION SERVICE

- 2.1 This Paragraph applies to all distribution service on the Company's system, regardless of whether the Customer is acting as its own Shipper or whether the Customer has contracted with an NGS to provide this service.

2.2 ELECTRONIC COMMUNICATIONS.

- 2.2.1 All nominations must be performed through the Company's Nomination EBB.

2.3 INITIAL NGS APPLICATION

- 2.3.1 All NGSs must complete an Initial NGS Application in the form prescribed by the Company, and have it approved by the Company prior to being able to supply gas for either General Distribution Service or Choice Service on the Company's system. NGSs may be required by the Company to resubmit the Initial NGS Application in instances where changed circumstances cause the Initial NGS Application to no longer be applicable. Such changed circumstances include, but are not limited to circumstances such as: a change in the financial status of the NGS, a substantial change in the number of Customers being served by the NGS, or a substantial change in the amount of volumes being provided by the NGS.
- 2.3.2 All NGSs must be licensed by the Commission prior to the Company's approval of the Initial NGS Application to provide Natural Gas Supply Services on the Company's system. Pursuant to Section 2208 of the Public Utility Code, 66 Pa. C.S. §2208, no entity shall engage in the business of an NGS unless it holds a license issued by the PUC. NGS license application packages can be found on the PUC web site at <http://puc.paonline.com>. PA. P.U.C. Docket No. M-00991248F0002

2.7 DISTRIBUTION NOMINATIONS

- 2.7.1 For purposes of nomination and scheduling of Distribution deliveries, all Shippers must utilize the Nomination EBB. The Nomination EBB requires that the Customer or its NGS have a personal computer meeting the specifications of the Nomination EBB. All Shippers must have access to the Internet and must acquire a password and nomination identification number from the Company to access the Nomination EBB.

2.8 OPERATIONAL ALERTS (OAs)

- 2.8.1 An operational alert ("OA") may be called during periods of projected increased or decreased consumer demand for, or supply of, natural gas which may cause system stress or threaten applicable storage or other pipeline contract limitations. An OA is a request for specific action on the part of an individual Shipper, or all Shippers. The Shippers are expected to respond to OAs within 2 hours after the Company provided notice, informing the Company of their intended action. Where possible, an OA may be used to avoid an OFO or OMO but shall not be required as a condition to the issuance of an OFO or OMO.

2.9 EMERGENCY ALERTS (EAs)

- 2.9.1 If an unforeseen emergency situation arises which could threaten the continuous adequate delivery of natural gas to a Customer, the Company will provide the Shipper with as much notice as is reasonably possible under the emergency situation. Such notice shall be made by the medium most reasonably expected to reach the Shipper in a timely manner, including but not limited to: telephonic, e-mail, facsimile, Nomination EBB, or personal contact. In such notice, Columbia will advise the Shipper of the unforeseen emergency situation, and the Shipper is expected to comply with the Company's requests.

2.10 LATE PAYMENT CHARGE

- 2.10.1 The Company shall bill the NGS on a monthly basis and all bills shall be due and payable within fifteen (15) days of the date the bill is postmarked. Any bill not paid by the due date shall be increased by one and one-quarter percent (1-1/4%) of the amount not timely paid each month.