

ORIGINAL

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**PHILADELPHIA GAS WORKS
DOCKET No. R-00061931**

VOLUME II

Part 1 of 2

TESTIMONY & EXHIBITS

December 2006

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PA PUBLIC UTILITY COMMISSION
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

TESTIMONY OF

STEVEN P. HERSHEY

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ON BEHALF OF

PHILADELPHIA GAS WORKS

DOCKET No. R-00061931

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

December 2006

1 **I. QUALIFICATIONS AND PURPOSE OF TESTIMONY**

2 **Q. PLEASE STATE YOUR NAME AND POSITION WITH THE COMPANY.**

3 A. I am Steven P. Hershey. My title is Vice President Regulatory and External Affairs.

4 **Q. HOW LONG HAVE YOU HELD THIS POSITION?**

5 A. I was promoted to this position in January, 2006.

6 **Q. PLEASE SUMMARIZE YOUR WORK EXPERIENCE.**

7 A. I have been employed with PGW since January, 2004. Prior to that, I was an attorney at
8 *Community Legal Services* from 1976 to 1998. During that time I served as the Public
9 Advocate, representing PGW's residential customers, from 1986 to 1998. I practiced
10 law, specializing in energy and utility matters, at the firm of Eckert Seamans Cherin &
11 Mellott from 1998 through December, 2003.

12 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.**

13 A. I earned my B.A. from Hamilton College in 1966 and a law degree from Georgetown
14 University Law Center in 1969.

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

16 A. No.

17 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THESE PROCEEDINGS?**

18 A. The purpose of my testimony is to provide an overview and roadmap of PGW's filing,
19 including a summary of the reasons for the increase, and a summary of the testimony to
20 be presented by other witnesses. I will also provide support for PGW's proposal to help
21 fund needed capital improvements by utilizing revenue from natural gas off system sales
22 and capacity release transactions.

23 **II. OVERVIEW OF REASONS FOR RATE INCREASE REQUEST**

24 **Q. WHY IS PGW REQUESTING THIS RATE INCREASE?**

1 A. PGW is seeking this rate increase for three reasons. First, as described in detail by Mr.
2 Bogdonavage, PGW has experienced a significant increase in non-gas operating expenses
3 and interest expense since its last fully litigated case. PGW seeks rates that appropriately
4 reflect those increased expenses.

5 Second, as described in detail by Mr. Bogdonavage, without a substantial rate
6 increase, PGW will have inadequate earnings in FY 2009 to meet its debt service
7 obligations and will fall below "investment grade" coverage levels in FY 2008. Ms.
8 Bisgaier explains the dire implications if such a failure were to occur. Since 1992, PGW
9 has been completely dependent on borrowed funds both for long term investment in plant
10 as well as for short term liquidity. It is essential that the Company maintain access to the
11 long-term debt markets and to its Tax Exempt Commercial Paper Program to ensure
12 adequate cash for operating purposes and for capital spending.

13 The third reason for seeking a rate increase is to ensure that, in the long term,
14 PGW has adequate liquidity when needed without having to resort continually to
15 borrowing. PGW must break the ever-more expensive cycle of cash deficits which
16 require one-time fixes and even more borrowing. PGW is billing just under \$1 billion in
17 revenues and yet, for fourteen years, has had no internally generated funds. The
18 company has limped from one crisis to the next, never having the resources to address its
19 structural financial problems. In the last few years, PGW has found itself with only the
20 slimmest of cash balances – in one instance just \$4 million – and all of it from borrowed
21 funds. PGW cannot survive unless it is able to borrow, but, borrowing has only pushed
22 PGW and its customers deeper into the hole.

23 PGW has come to resemble the customer of a pay day lender who is unable to

1 sustain a cash flow sufficient to pay expenses and meet financial needs and is compelled
2 to borrow to make it to his next paycheck, piling on the cost of borrowing, and making
3 the situation worse. PGW is requesting sufficient funds so that, for the first time in a
4 generation, it can be a self-sustaining, viable gas distribution enterprise. Indeed, as Ms.
5 Bisgaier and Mr. Krellenstein testify, unless this downward spiral is meaningfully
6 addressed, PGW is in real danger of collapsing from the weight of its debt burden and the
7 enormous risk this situation imposes upon the Company and its customers.

8 **Q. HOW WILL THE PROPOSED INCREASE MITIGATE THESE RISKS?**

9 A. As Mr. Bogdonavage shows, over the next 5-6 years, the overwhelming bulk (96%) of
10 the rate increase plus the proceeds from off-system sales that PGW is proposing it be
11 permitted to retain will be used to fund necessary construction needed to maintain safety
12 and reliability or to maintain adequate customer service, and to pay off existing
13 outstanding debt and other loans. A summary of the information detailing the projected
14 "sources and uses" of the requested rate increase is set out in Exhibit SPH-1, attached
15 hereto.

16 There has been a lot of public conversation about PGW for more than ten years.
17 The question is always the same: "When is PGW going to be fixed?" This rate case is
18 intended to answer the question: now!

19 **Q. WHEN DID PGW LAST RECEIVE A BASE RATE INCREASE?**

20 A. PGW received its last rate increase in 2002.

21 **Q. WHY DID PGW NOT FILE EARLIER FOR A RATE INCREASE IF THE**
22 **SITUATION IS AS YOU AND OTHER WITNESSES DESCRIBE?**

23 A. Management has a special responsibility guiding the largest gas distribution company in
24 the state which is also a municipal, public enterprise. The first and most important

1 requirement is that management must ensure that the distribution system is safe and
2 reliable and that there are sufficient resources to maintain the system in that condition.
3 No customer is well-served if the system cannot be maintained. Second, management
4 must ensure that the price of providing service is fair and reasonable, that all possible
5 efficiencies have been realized, and that bills are paid by customers.

6 Until recently, management could not say that the collection effort was effective,
7 or that there were not material efficiencies that could still be realized. While there is
8 always room for improvement, management believes that, while the collection rate is
9 much improved, that rate is reaching its limit, related in part to the constraints of our
10 service territory. In addition, it is clear that greater efficiencies from operations cannot be
11 the remedy to PGW's problems.

12 PGW has delayed this filing until it was clear, not only that the need for rates
13 could be well-established, but also that reducing costs alone could no longer sustain the
14 Company. The City administration has done more for PGW than any in my memory, but
15 that effort, while substantial, has only served to stay the inevitable in the face of the
16 dramatic increase in commodity costs.

17 In summary, PGW is facing a looming crisis that, if not addressed now, will
18 threaten its ability to continue to operate as a going concern. While painful to all, the
19 only viable approach is to act now. Awarding PGW rates sufficient merely to avoid the
20 financial defaults that it will experience in FYs 2008 and 2009 will not serve PGW or its
21 customers well. Rates must be sufficient to address the systemic deficiencies that now
22 require borrowing for cash flow and the capital program. Failure to do so imposes higher
23 costs on customers through the debt service and multiplier effect of the debt coverage

1 requirement, does nothing to reduce risk and maintains PGW on a downward spiral of
2 failure that will inure to the detriment of its customers, its employees and the City and
3 Region.

4 **III. OFF SYSTEM SALES/CAPACITY RELEASE PROPOSAL**

5 **Q. WHAT IS PGW'S PROPOSAL FOR TREATING THE PROCEEDS**
6 **ASSOCIATED WITH OFF-SYSTEM SALES AND CAPACITY RELEASE**
7 **TRANSACTIONS?**

8 A. PGW proposes to change the regulatory treatment of revenue derived from these
9 activities. Instead of mandating that the proceeds flow through as a credit to the GCR,
10 PGW proposes that the proceeds flow through to customers by making them available to
11 fund necessary construction projects, rather than having to fund them through the
12 issuance of additional long term debt.

13 **Q. WHY IS PGW MAKING THIS PROPOSAL?**

14 A. PGW's situation is unique. Lowering gas costs by applying revenue from these sales
15 certainly helps customers in the short term, but it does nothing to change the underlying
16 financial structure of the Company, which would provide more fundamental benefit to
17 customers over the long term. Living off one's credit card increases risk. In this case,
18 PGW's "credit card" is pushing the Company and its customers deeper into a hole. PGW
19 must change that pattern in order to improve. Funding its construction program and
20 reducing its outstanding debt from these proceeds is cheaper to customers than the
21 present value of the stream of payments associated with issuing additional long term debt.
22 One need only look at the multiplier effect of the debt service coverage requirements, the
23 increasing costs of debt transactions, and the debt service required to carry the debt to
24 recognize the problem. Those issues are addressed by Mr. Bogdonavage, Ms. Bisgaier,
25 and Mr. Krellenstein.

1 In addition, as stated by Mr. Krellenstein and Ms. Bisgaier, using these proceeds
2 in this manner will help PGW's debt/equity ratio thereby reducing PGW's financial risk
3 and providing a better profile to the bond rating agencies.

4 **IV. SUMMARY OF FILING**

5 **Q. PLEASE INDICATE WHO THE WITNESSES WILL BE FOR PGW IN THIS**
6 **PROCEEDING AND THEIR RESPONSIBILITIES FOR THE FILING?**

7 A. PGW has two financial policy witnesses. The first is Ms. Barbara Bisgaier (PGW
8 Statement 3), a Managing Director of Public Financial Management, Inc. She has been
9 PGW's financial advisor for 14 years. She also a Financial Advisor to the
10 Commonwealth of Pennsylvania. She is familiar both with PGW's history and the
11 initiatives undertaken by this management to rebuild the utility. She is an expert on
12 financial markets and financial instruments, Ms Bisgaier testifies to the continuing risks
13 PGW is running without sufficient liquidity to operate safely and to the consequences of
14 there not being a plan for PGW to start to produce internally generated funds in order to
15 emerge from under the burden of its present debt. She describes the financial profile
16 PGW needs to attain in order to extricate itself from its liquidity crisis and why the entire
17 amount of the requested rate increase is needed if it is to achieve these goals.

18 The second financial policy witness is Mr. Gary Krellenstein (PGW Statement 4).
19 Mr. Krellenstein is a Managing Director of J. P Morgan who has participated in
20 structuring both our short term loans and long term bond sales over the last six years.
21 Mr. Krellenstein testifies as a representative of those who buy our bonds, rate our bonds
22 and insure our bonds. His testimony goes to the heart of PGW's need for rate relief to
23 assure continued access to the financial markets and to the need to reduce the costs that
24 the customer is bearing for the breadth and level of debt that the company has had to

1 undertake to survive. Mr. Krellenstein testifies that, today, PGW is viewed by the
2 financial community as the lowest rated large municipal utility in the Nation and a failure
3 to address PGW's structural deficiencies creates a very serious risk that the Company will
4 find itself barred from reasonable access to capital which will precipitate a major crisis.

5 The third witness is Mr. Joseph Bogdonavage, Senior Vice President for Finance
6 (PGW Statement 2). Mr. Bogdonavage provides the financial details that support the
7 need for the rate increase, shows the consequences of a failure to provide rate relief and
8 displays PGW's financial results both in the test year and for the next five years if it is
9 granted the rate relief requested.

10 The fourth witness is Mr. Craig White, Acting Chief Operating Officer of PGW
11 (PGW Statement 5). Mr. White's testimony explains PGW's proposal for allocating the
12 rate increase among customer classes. His testimony also supports the sales forecast and
13 the basis for PGW's interruptible sales and transportation rates. Finally, he describes the
14 impact of current resource constraints on PGW's capital budget.

15 The fifth witness is Mr. Randy Gyory, Vice President for Customer Affairs (PGW
16 Statement 6). Mr. Gyory proposes various changes to the PGW tariff to conform tariff
17 language to Act 201 as well as to simplify and make less complex PGW's customer rules.
18 He also provides a progress report on PGW's collection practices and responds to a
19 Commission directive to describe PGW's use of credit scoring and several other
20 customer-service related items. Finally, Mr. Gyory provides testimony on the
21 appropriateness of a proposal to require mandatory Electronic Funds Transfers for certain
22 delinquent customers.

1 The sixth witness is Ms. Cristina Coltro, Manager, Customer Affairs (PGW
2 Statement. 7). Ms. Coltro describes PGW's existing universal service programs and
3 projects the number of customers who will be enrolled in PGW's CRP program at the end
4 of the future test year. Her testimony also discusses data prepared for PGW which
5 analyzes whether PGW experiences increased expenses or expense offsets as the number
6 of customers enrolled in PGW's CRP program changes.

7 The last witness is Mr. Howard S. Gorman (PGW Statement. 8), a Principal
8 Consultant with R.J. Rudden Associates, a unit of Enterprise Management Solutions
9 Black & Veatch Corporation. Mr. Gorman testifies to the unbundled, fully allocated
10 class cost of service study that he performed as well as the assignment of the total costs
11 and other elements of the revenue requirements of the Company to each Rate Class. The
12 Cost of Service Study is Volume III of the Filing. In addition to these statements, PGW
13 is submitting data required by the PUC's filing requirements (Volume IV) and its Tariff
14 Supplement No. 16, (Volume I) which sets forth all of the changes and rate increases
15 proposed by PGW as part of this case.

16 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

17 **A. Yes.**

Rate Increase Spending
FY 2007 to 2012

	<u>BUDGET</u> <u>2006-07</u>	<u>FORECAST</u> <u>2007-08</u>	<u>FORECAST</u> <u>2008-09</u>	<u>FORECAST</u> <u>2009-10</u>	<u>FORECAST</u> <u>2010-11</u>	<u>FORECAST</u> <u>2011-12</u>	<u>Total</u>	<u>Annual</u> <u>Div. by</u> <u>6 years</u>	<u>% of</u> <u>Rate Incr</u> <u>+ C/R OSS</u>	
Rate Increase	100,000	100,000	100,000	100,000	100,000	100,000	600,000	100,000		
Capacity Release/Off-system Sales	10,000	10,000	10,000	10,000	10,000	10,000	60,000	10,000		
	110,000	110,000	110,000	110,000	110,000	110,000	660,000	110,000		
Less: Net Income	114,963	103,194	102,963	104,894	106,423	105,229	637,666	106,278		
Increase in Expenses	(4,963)	6,806	7,037	5,106	3,577	4,771	22,334	3,722	3.4%	
Distribution of Earnings w/o Grant Income					18,000	18,000	36,000	6,000	5.5%	
Debt Reduction Funding	40,000	15,000	55,000	35,000	20,000	40,000	205,000	34,167	31.1%	
Temporary Financing Repayment		40,000	20,000	10,000			70,000	11,667	10.6%	
City Loan Repayment	2,000	43,000					45,000	7,500	6.8%	
Internally Generated Funds	-	-	47,912	70,818	61,587	59,920	240,237	40,040	36.4%	
Funded Debt Reduction - Revenue Bonds - Amount Greater Than Test Year	-	10,335	9,855	11,245	2,804	(655)	33,584	5,597	5.1%	
TOTAL	37,037	115,141	139,804	132,169	105,968	122,036	652,155	108,693	98.8%	
							Difference between rate increase and total	7,845	1,307	1.2%
							Total rate increase	660,000	110,000	110.0%

Source: \$100.0M Rate Increase + 10.0M Off-System Sales - 95% - New Pension/New Capital - Cashflow Statement

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

TESTIMONY OF

JOSEPH R. BOGDONAVAGE

ON BEHALF OF
PHILADELPHIA GAS WORKS
DOCKET No. R-00061931

December 2006

1 I. **QUALIFICATIONS AND PURPOSE OF TESTIMONY**

2 Q. **PLEASE STATE YOUR NAME AND POSITION WITH THE COMPANY.**

3 A. My name is Joseph R. Bogdonavage. My position is Senior Vice President, Finance.

4 Q. **HOW LONG HAVE YOU HELD THIS POSITION?**

5 A. I was promoted to this position in December 2000.

6 Q. **PLEASE SUMMARIZE YOUR WORK EXPERIENCE.**

7 A. I have been employed with PGW since 1973, during which time I have held various
8 positions in the Finance area. I most recently held the position of Director – Budget &
9 Financial Forecasting.

10 Q. **PLEASE SUMMARIZE YOUR PRINCIPAL RESPONSIBILITIES AS SENIOR**
11 **VICE PRESIDENT- FINANCE.**

12 A. My principal responsibilities include the oversight of PGW's Accounting & Reporting,
13 Budget & Financial Forecasting, Treasury, and Procurement & Contract Services
14 Departments. I am currently responsible for the overall preparation of the Operating and
15 Capital Budgets, review of operating budgets prepared by the individual departments, and
16 the coordination, analysis issuance and overall control of the complete annual Operating
17 Budget filing. These activities include the preparation of analyses for the proposes of
18 generating financial data to support the company's financial planning and decision-
19 making processes. In addition, documentation is prepared regarding financial initiatives;
20 i.e., proposed revenues bonds, commercial paper program offerings and base rate case
21 presentations. Finally, in coordination with the Controller, the Budget area acts as a
22 liaison between all departmental budget representatives regarding budgeting and financial
23 forecasting procedures and variances analysis reporting.

24 Q. **PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.**

1 A. I received a Bachelor's Degree in Accounting from Temple University in 1972.

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

3 A. Yes, I testified before the Pennsylvania Public Utility Commission ("PUC") in
4 conjunction with PGW's 2001 base rate case (R-00006042), its 2002 base rate case
5 (including its request for extraordinary rates) (R-00017034), its 2003 Restructuring
6 Proceeding (M-00021612), and the 2004 Consolidated Proceeding (P-00042090). I have
7 also testified before the Philadelphia Gas Commission ("PGC") on numerous occasions,
8 most recently on matters associated with PGW's FY 2007 Operating Budget.

9 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THESE PROCEEDINGS?**

10 A. The purpose of my testimony is to: 1) provide the documentation and supporting
11 methodology for the schedules and exhibits that are included in PGW's base rate filing;
12 2) describe PGW's financial results for the test year (the 12 months ending August 31,
13 2007); and 3) detail and provide supporting justification for PGW's requested increase in
14 annual base rates of \$100 million.

15 **II. BACKGROUND FOR CONSIDERATION OF RATE REQUEST**

16 **Q. PLEASE PROVIDE THE BACKGROUND OF PGW'S CURRENT FINANCIAL**
17 **CONDITION.**

18 A. PGW last received an increase in base rates in April, 2002 when the Commission granted
19 its request for extraordinary rate relief in the amount of \$36 million. That same \$36
20 million increase was made permanent when, in August, 2002, the Commission approved
21 a settlement of PGW's \$60 million base rate request. PGW as a result of the Settlement,
22 was also permitted to implement a Weather Normalization Clause ("WNA"). The
23 settlement was a "black box" settlement in which only the overall increase was agreed to.

1 The 2002 rate increase followed a \$33.6 million base rate increase that had been
2 authorized by the Commission in the Fall of 2001, after a fully litigated proceeding.
3 After the 2002 case, PGW was hopeful that the two base rate increases and the
4 implementation of the WNA would stabilize PGW's earnings and cash flow and permit it
5 to reduce its outstanding short and long-term debt and begin to finance its capital
6 construction program from internal sources.

7 **Q. WAS PGW ABLE TO MEET THOSE GOALS?**

8 A. Unfortunately not. Historically high natural gas prices and higher than anticipated costs
9 in several areas, quickly reduced PGW's revenues and cash flow while increasing
10 uncollectibles. For example, in FY 2003, when the effect of the increase in gas costs was
11 first experienced, collections as a percent of the Company's billings dropped to a
12 historically low 86.60% (compared to its longer-term historic rate of approximately
13 92%). This decline cost PGW over \$40 million in revenues and put the Company in
14 danger of losing its barely investment grade bond rating. The Company was in a position
15 to respond immediately by stepping up an internal Collections Initiative that was already
16 in progress. This initiative was designed to find additional ways to improve collections
17 results and service. PGW also sought external regulatory and legal changes to give it
18 additional tools to improve collections. These various efforts, which are explained in
19 greater detail in Mr. Gyory's testimony, were successful and in FY 2004 PGW realized a
20 91.41% collections rate which improved to 96.01% in FY 2005 and 96.57% in FY 2006.

21 **Q. WHAT OTHER FACTORS HAVE CONTRIBUTED TO PGW'S REDUCED**
22 **FINANCIAL PERFORMANCE?**

23 A. The over 200 million increase in natural gas expense since the FY 2001 period (the test
24 year used in PGW's last, fully litigated base rate proceeding) has created a massive strain

1 on PGW's cash working capital and liquidity balances, increased its bad debt expense and
2 has contributed to a significant reduction in sales. Mr. White will explain the reductions
3 in sales per customer that PGW has experienced in the last several years. These
4 reductions in demand stem not only from much higher prices but also from reduced
5 population and industrial growth in Philadelphia, improved energy efficiency of homes
6 and improved efficiency of household appliances and commercial equipment installed by
7 customers. As a result, PGW's sales margin in the test year is some \$39 million less than
8 the margin in its 2001 fully litigated rate case (including the allowed rate increase),
9 adjusted upward to account for the 2002 permanent rate increase allowance. See, Exhibit
10 JRB-3.

11 Additionally, PGW has suffered a continued material increase in debt service
12 costs. In PGW's last fully litigated rate proceeding (2001), PGW was permitted to
13 include in rates total interest expense of \$57.8 million (Exhibit JRB-3). PGW has had no
14 internally-generated funds for capital expenditures since 1992. Accordingly, PGW
15 continues to rely completely on the long term capital markets to fund its capital program,
16 and the use of its short term debt to cover day-to-day operations, and this has resulted in a
17 FY 2007 total interest expense of \$74 million, more than a \$16 million increase. Finally,
18 though PGW has managed most costs effectively, certain costs that affect many large
19 companies and cannot be locally contained have increased dramatically. For example,
20 health insurance costs have risen \$11.5 million compared to the level allowed in PGW's
21 last rate case, and pension costs have risen some \$13.7 million. Overall, PGW's
22 operating and maintenance expenses and depreciation have increased approximately \$29
23 million since its last fully litigated case in 2001.

1
2 **Q. HOW HAVE THESE FACTORS AFFECTED PGW'S ABILITY TO FINANCE**
3 **CONSTRUCTION AND OPERATIONS?**

4 A. It has had a very negative effect. PGW must expend \$60-70 million annually simply to
5 maintain the safety and reliability of its gas distribution and storage systems and meet
6 customer load growth requests. Unfortunately, because of PGW's need to rely
7 exclusively upon the issuance of long-term debt to fund this necessary construction
8 PGW's debt-to -"equity"¹ ratio is extremely unbalanced – 83% in the test year, where it
9 has been since FY 2005. Without rate relief, the percentage of PGW's plant-in-service
10 funded by debt is projected to reach 89% by FY 2012. Of course, without appropriate
11 rate relief, PGW will have long since violated its required debt service coverage
12 requirements and defaulted on its bond covenants, causing a financial crisis that will
13 threaten its ability to operate safely and reliably.

14 **Q. HAS THE CITY OF PHILADELPHIA TAKEN ANY STEPS TO ADDRESS**
15 **PGW'S DETERIORATING FINANCIAL CONDITION?**

16 A. Yes, and without its contribution, PGW would have had to file for a base rate increase
17 well before now. The City of Philadelphia, in conjunction with City Council, assisted
18 PGW in improving its liquidity by foregoing the \$18.0 million annual payment in fiscal
19 years 2004, 2005 and 2006. The Mayor has announced his intention to forego this
20 payment for an additional four years. The City also delayed the final repayment date of
21 the \$45.0 million City loan until August 2008. Partly as a result of these concessions as
22 well as higher collections, and operations improvements, in January 2006 PGW was able

¹ The "equity" in this equation is the amounts that have been built up in past years in which PGW has produced a positive surplus after remitting to the City the legally mandated City Payment, or, in the last several years, when the City payment has been waived.

1 to increase the size of its Commercial Paper program to \$150.0 million, an increase of
2 \$50.0 million, through negotiations with its lending banks to provide additional liquidity.

3 **Q. HAS PGW HAD TO TAKE ANY OTHER STEPS TO IMPROVE LIQUIDITY?**

4 A. Yes. As it has had to do in the past, PGW avoided liquidity crises by the use of a series
5 of "one-time fixes" such as interest rate swaps, and natural gas forward purchases. Most
6 of these opportunities are no longer available. Those that might be available in the future
7 will be very expensive. In all instances such transactions merely were timing differences,
8 moving obligations into a future period – for a cost – and provided no net incremental
9 earnings or liquidity.

10 **III. PRO FORMA FINANCIAL RESULTS**

11 **Q. HAVE YOU PREPARED A PRO FORMA TEST YEAR INCOME STATEMENT
12 THAT PROJECTS THE COMPANY'S STATUS IN FY 2007?**

13 A. Yes. Exhibit JRB-1 provides the base test year data at present rates. I will describe the
14 development of these data below. Also, I am sponsoring Exhibit JRB-2, which is the
15 detailed schedules and supporting material for PGW's original budget submitted to the
16 Philadelphia Gas Commission ("PGC").

17 As can be seen, PGW's projected net income for the test year is just \$8.9 million.
18 This level will permit PGW to make its required 1.5x bond ordinance debt coverage (on
19 its 1998 Ordinance bonds) and satisfies the total fixed coverage charge as calculated by
20 S&P,² necessary to maintain an investment grade debt rating.

21 However, without rate relief, the Company will quickly fall below minimum
22 requirements in FY 2008. PGW's projection for the next fiscal year shows that, without
23 rate relief, earnings go to less than \$1 million and PGW's debt service coverage will fall

² S&P's calculation looks at income verses all external funding.

1 below minimum levels for investment grade securities (1.11 times, where the minimum
2 requirement is 1.2-1.3 times), and just at the legally mandated bond ordinance
3 requirements of 1.5x. PGW's debt-to-equity ratio climbs to 84% in FY 2009, and moves
4 up progressively until it reaches 89% in FY 2012. Failure to grant rate relief in this case
5 would, thus, quickly set off a financial crisis that would threaten PGW's ability to
6 function as a going concern.

7 **Q. HOW DOES PGW'S PROJECTED TEST YEAR CASH BALANCE AND**
8 **LIQUIDITY BALANCE AT YEAR END COMPARE TO NECESSARY LEVELS?**

9 A. They are inadequate. By way of background, PGW utilizes its year end cash balance as a
10 snapshot measure of the adequacy of its cash, needed to fund day-to-day operations in
11 anticipation of the receipt of revenues. In the past, PGW witnesses testified that PGW
12 needed \$35-40 million of year end cash in order to have sufficient cash to fund the next
13 several months' expense obligations – most particularly, the purchases of gas supply and
14 the payment of debt service during the period prior to receipt of revenue from winter
15 sales. This historical goal is no longer adequate, given the growth in PGW's expense
16 responsibilities. For example, its natural gas costs have increased by 52% since 2001. Its
17 total interest expense costs has increased 28%. In order to meet these enormously
18 increased obligations when due, PGW's end of year cash target needs also to grow by a
19 corresponding amount. The level of year end cash that PGW should have on hand,
20 considering today's heightened obligations, is \$55-60 million. Moreover, PGW's short-
21 term letter of credit, which supports its commercial paper program should be fully
22 available at fiscal year end. PGW currently has a \$150 million letter of credit ("LOC")
23 which, as I mentioned above, was recently increased from \$100 million. For example,
24 PGW's natural gas inventory has increased by approximately \$63 million since its last

1 fully litigated base rate case. The commercial paper program is PGW's only legitimate
2 safety net if an unanticipated crisis were to create extraordinary cash needs.

3 Unfortunately, in contrast to those needs, year end cash exists entirely from
4 utilization of the Company's commercial paper program in order to pay its obligations
5 throughout the year. By FY 2008, the Company will experience a \$1.2 million cash
6 shortfall and will have its commercial paper program virtually completely utilized. Its
7 available liquidity will be exhausted after FY 2009. PGW will end the test year with
8 some \$90 million in commercial paper outstanding and virtually all of the \$45 million
9 City loan utilized. While the projection shows \$51 million in year end cash, that is very
10 deceiving because no part of this amount was generated from PGW operations, i.e.,
11 100% of the cash on hand is borrowed. Indeed, this has been the case for several years.
12 That is both expensive and risky, leaving PGW with no legitimate safety net should gas
13 prices spike or other unexpected events occur. The Company is utilizing its commercial
14 paper not only to provide liquidity but to actually fund its operating budget. Using the
15 Commercial Paper program in this way is not only enormously expensive but it also
16 creates an unacceptable level of risk. If PGW were to lose its commercial paper program
17 or be faced with some other emergency requiring its use, it would have no liquidity and
18 would be thrust into a financial crisis.

19 **Q. HOW LIKELY IS IT THAT PGW COULD FIND ITSELF WITHOUT ANY**
20 **WORKING CAPITAL?**

21 A. Unfortunately, the potential is very real. On January 25 of this year, the Company had
22 approximately \$4 million of cash on hand and its commercial paper program was fully
23 utilized, after the payment of a natural gas supply bill that was due on that day. At that
24 time there was no other prudent sources of funds available should the need have arisen.

1 Fortunately, PGW had no other obligations that required payment until its cash receipts
2 were built back up. If PGW had had such obligations it would have had to default or
3 resort to some other "one-time fix" to meet them, if any were available. Obviously, such
4 a default would have had serious negative implications for PGW and its relationship with
5 its suppliers and lenders.

6 **Q. HAS PGW'S ABILITY TO PROVIDE SAFE AND RELIABLE SERVICE BEEN**
7 **COMPROMISED BY ITS FINANCIAL CONDITION?**

8 A. PGW has not compromised the safety or reliability of the system. However, over the last
9 several years the financial condition of the Company has required it to exclude from its
10 capital budget many projects that were not directly needed to meet this goal. Mr. White
11 explains the effect that these cutbacks have had on the Company's ability to enhance its
12 operations. This "only the absolute necessities" approach to capital improvements has
13 forced the Company to extend the use of a variety of structures, equipment, vehicles and
14 facilities well beyond their normal, useful life, increasing maintenance costs and making
15 them more susceptible to costly failure. Should such equipment fail suddenly, PGW
16 would have to spend unbudgeted funds for replacement and customer service could be
17 affected.

18 **Q. WHAT IS YOUR CONCLUSION BASED UPON A REVIEW OF THESE**
19 **FINANCIAL DATA?**

20 A. At the very least, PGW is in serious need of significant rate relief to avoid violating its
21 bond ordinance requirements, to prevent a downgrade to "junk" status, to pay off its City
22 Loan, to have sufficient cash to meet day-to-day obligations, to have an adequate amount
23 of short term borrowing ability to meet its liquidity needs and to provide an adequate
24 cushion for unforeseen events and emergencies. As I will explain below, PGW believes
25 that the rate increase granted here should not only repair the present deficiencies but also

1 recognize the level of revenues needed over the longer term (the next 5-6 years) to give
2 the Company the opportunity to address its current liquidity shortfall and extricate itself
3 from this recurring pattern of financial crisis. As explained by other witnesses, these
4 problems could have a direct impact on customer service and system reliability unless
5 they are addressed now.

6 **IV. EXPLANATION OF RATE INCREASE REQUEST**

7 **Q. PLEASE EXPLAIN THE BASIS ON WHICH YOU HAVE CALCULATED THE**
8 **\$100 MILLION REVENUE REQUIREMENT.**

9 A. As the Gas Choice Act and prior Commission orders established, PGW's revenue
10 requirement is determined on the basis of the "Cash Flow Method." The Commission has
11 characterized its obligations under the Cash Flow Method as to "determine the reasonable
12 level of revenues and expenses, including a reasonable amount of cash requirement, and
13 balance the interests of customers and PGW. . . ." ³ That standard in operational terms,
14 requires that PGW be permitted to bill a level of revenues that: permits it to pay all
15 reasonable expenses including debt service in a timely manner; permits it to finance or
16 pay for necessary construction; provides sufficient income to produce necessary bond
17 coverage requirements; and provides for sufficient cash and liquidity both during and at
18 the end of the year so that it will be able to pay its expenses in the first several months of
19 the next fiscal year. ⁴ Indeed, in a separate part of the statute, an affirmative duty is
20 imposed on the Commission to assure that PGW has sufficient income to satisfy its bond
21 ordinance requirements to satisfy debt service coverage minimums and to pay all of its

³ R-0006042 Opinion and Order at 26.

⁴ PGW has explained in past cases that PGW needs a sufficient balance of cash at the end of its fiscal year (August) so that it can pay its various expenses in the first several months of the next fiscal year (prior to the winter) when PGW's revenues are low.

1 obligations when due. In the Company's extraordinary rate relief proceeding, the
2 Commission also recognized the importance of permitting PGW to realize earnings that
3 satisfy at least minimum standards for an investment rating for its long term debt.
4 Obviously, PGW recognizes that these standards should be satisfied at the lowest
5 reasonable cost to customers.

6 **Q. WHAT STANDARD HAVE YOU UTILIZED TO DETERMINE THE LEVEL OF**
7 **RATE INCREASE OVER PRO FORMA PRESENT RATES TO MEET THIS**
8 **STANDARD?**

9 A. The Company has analyzed its financial needs and is requesting the amount that will
10 permit it to: (1) attain the minimum financial results required for PGW to continue to
11 operate as going concern in the short-term; and (2) obtain sufficient internally generated
12 funds for capital to reduce reliance on long term debt, improve its debt-to-equity ratio and
13 reduce borrowing costs and riskiness, thereby putting the Company and its customers on
14 firmer footing in the longer term.

15 PGW needs approximately \$80 million in additional revenues just to replicate the
16 levels of contribution margin and recovery of O&M, depreciation and interest expense
17 that the Commission authorized as reasonable in the Company's last two rate
18 proceedings. That comparison is set out in Exhibit JRB-3. Note that increasing revenues
19 by this amount would only place the Company in the same position it was in 2002 in
20 terms of coverages and internally generated cash. Given that its liquidity needs have
21 grown with the increase in natural gas prices it is clear that this level would prove to be
22 inadequate even to simply maintain the Company in a "just getting by" position.

23 **Q. HOW WILL THE REQUESTED RATE INCREASE ADDRESS THE SECOND**
24 **GOAL DISCUSSED ABOVE: TO IMPROVE THE COMPANY'S INTERNAL**
25 **CAPITAL GENERATION AND IMPROVE ITS DEBT-TO-EQUITY RATIO?**

1 A. As explained above, even an increase of \$80 million, while crucially necessary, will do
2 no more than permit PGW to return to the marginal status in which it has found itself
3 since 2002.

4 As explained by Ms. Bisgaier and Mr. Krellenstein, it is crucially important that
5 the Company break out of this cycle of financial vulnerability. To do this it must be able
6 to create internally generated funds; that is, not rely exclusively on long term debt to fund
7 the capital program, and achieve a more balanced capital structure. It must also start
8 producing enough cash from operations that the commercial paper program is not
9 utilized at the end of the year but is available to meet the Company's intra-year cash
10 needs, and it has an adequate amount of internally generated cash on hand to supplement
11 its short-term borrowing capability. To reach these goals, it is essential that the
12 Commission authorize a revenue level that, on a projected basis, will permit PGW to
13 realize approximately a 50/50 capital structure in the next five to six years. Such a
14 capital structure will mean that PGW will have financed more and more of its capital
15 program from internally generated funds rather than from expensive long-term borrowing
16 and will give the Company enough cash to utilize its own funds to finance its intra-year
17 cash working capital needs. The impact of that evolution will lower costs to the
18 customer, improve customer service by permitting upgrades of plant and equipment and
19 make PGW less vulnerable to risk.

20 **Q. WHY IS IT IMPORTANT FOR THE COMPANY TO INCREASE THE**
21 **PORTION OF ITS ASSETS THAT ARE PAID FOR BY INTERNAL CAPITAL**
22 **RATHER THAN BY EXTERNAL FINANCING?**

23 A. For at least two reasons. First, when all factors are considered, it is actually more
24 expensive for PGW customers to fund construction projects via long term debt rather
25 than through internal capital funds generated by additional revenues. Attached (Exhibit

1 JRB-4) is an analysis that compares the discounted present value cost to customers of
2 funding two projects that the Company recently has determined will be required in the
3 next few years: an upgrade to the Company's billing system, its BCCS system, and the
4 construction of phase 2 of the expansion of PGW's Richmond gas liquefaction plant.
5 PGW's preliminary estimate is that these two projects will require about \$50 million in
6 capital improvements. Exhibit JRB-4 compares the total present value cost of obtaining
7 this \$50 million through customer rates (internal generation) compared to borrowing the
8 funds by issuing additional long term debt. This chart shows that increasing rates to
9 finance these projects through internal capital is less expensive to customers than if the
10 Company would fund the construction by the issuance of additional debt. This is because
11 while the interest rate on the debt is relatively low, the transaction costs and the
12 additional earnings needed to meet bond ordinance coverage requirements makes the
13 borrowing option much more expensive.

14 **Q. ARE THERE OTHER ALTERNATIVES TO PROVIDING ADDITIONAL**
15 **INTERNALLY GENERATED FUNDS?**

16 A. Aside from raising revenues, the answer is no because most of PGW's operating costs can
17 not be reduced without affecting service or safety. For example, as shown on Exhibit
18 JRB-5 only about 14-15% – are within its direct control. In other words, approximately
19 \$142 million of PGW's total annual expenses of almost \$1 billion could be characterized
20 as controllable in FY 2006. PGW, at least theoretically, has the ability to control the
21 levels of its operating labor (and associated taxes), losses, utilities and purchased services
22 (such as outside consultants). The bulk of its expenses, such as fuel costs, depreciation
23 and interest can not be reduced through independent actions on PGW's part. However,
24 even if one assumes that PGW could be able to fund any material portion of its necessary

1 capital improvements through reductions in these expenses it would require PGW to
2 reduce its controllable expenses by a huge amount to make any dent in its needed internal
3 funds generation. There is no reputable analysis that suggests that a natural gas utility
4 such as PGW could continue to operate safely and reliably if it drastically reduced its
5 labor expenses, for example, by laying off workers. Moreover, PGW's collective
6 bargaining agreement contains a "no layoff" clause that further limits any realistic
7 opportunity that PGW might have to try to find the necessary internal capital by drastic
8 force reductions.

9 **Q. HOW DOES PGW PROPOSE TO IMPLEMENT ITS PLAN TO NORMALIZE**
10 **ITS CAPITAL STRUCTURE?**

11 A. PGW has utilized its five-year forecast to project its financial results under several rate
12 relief award scenarios. PGW's five-year forecast is the product of a rigorous and
13 intensive process and is prepared annually as a strategic planning tool for the Company.
14 Its forecasts, including those that are reflected in my exhibits, are reviewed and approved
15 by PGW's Board of Directors, the Philadelphia Facilities Management Corporation, as
16 well as the Philadelphia Gas Commission. Hence PGW believes that they provide
17 projections that can be utilized by the PUC to judge the effect of granting the requested
18 rate increase on the Company's future financial results. Using this tool, PGW has
19 analyzed its projected financial results to determine the level of revenues it needs now to:
20 (a) fund its necessary operations; (b) reduce its existing level of debt; (c) fund necessary
21 capital improvements, rather than incurring even more long term debt; and (d) reduce its
22 annual level of outstanding commercial paper. PGW's goal, as indicated above, is to seek
23 to obtain as close to a 50/50 capital structure as reasonable while maintaining or reducing
24 its long and short term debt service costs in order to position itself over the long term as a

1 financially viable going concern. The Company has characterized this as its "Financial
2 Stability Plan." To implement this plan, PGW proposes that a portion of the revenues
3 produced by this requested base rate increase be placed in a restricted fund, that would be
4 used to retire existing long term debt, commercial paper and other outstanding loans.
5 PGW has been advised that it should have a plan to accomplish these goals in no more
6 than 5 years. In order to do this, PGW needs to be able to place into a restricted fund
7 over \$200 million over this period.

8 **Q. WHAT LEVEL OF CONTRIBUTION TO THE DEBT REDUCTION FUND**
9 **WILL PGW BE ABLE TO MAKE IF IT RECEIVES A \$100 MILLION**
10 **INCREASE?**

11 A. I have calculated that implementing the full request will generate contributions of \$145
12 million to the restricted fund. While this level of funding will permit the Company to
13 almost attain its target debt-equity relationship, it is \$60 million less than if PGW is
14 granted the right to use off-system sales proceeds to reduce debt and PGW's debt level
15 would still be almost \$800 million, which, in our view, is too high.

16 **Q. WHY ISN'T PGW REQUESTING A LEVEL OF RATE INCREASE THAT WILL**
17 **ASSURE THAT IT WILL BE ABLE FULLY TO FUND ITS DEBT REDUCTION**
18 **PLAN?**

19 A. PGW management and its supervising board, the Philadelphia Facilities Management
20 Corporation, have attempted to balance the immediate needs of vulnerable customers and
21 PGW's dire financial requirements and determined that the maximum burden it believes
22 appropriate to impose on its customers is a \$100 million increase in base rates.

23 **Q. HOW DOES PGW PROPOSE TO RAISE THE ADDITIONAL AMOUNTS TO**
24 **ADEQUATELY FUND ITS CAPITAL BUDGET AND DEBT REDUCTION**
25 **PLAN?**

26 A. PGW projects that \$10 million annually could be produced by permitting PGW to retain
27 (i.e., not pass through in its Gas Cost Rate) the proceeds from off-system sales and

1 capacity release transactions. These proceeds are about \$8 million this year but are being
2 used entirely to reduce the cost of natural gas in PGW's Gas Cost Rate. While this
3 certainly has some value, PGW believes it would be far better for both the Company and
4 its customers to employ this source to fund necessary capital improvements and reduce
5 outstanding debt, which is imposing such enormous costs and risks on the Company.
6 Every dollar used in this way reduces the Company's need to borrow through the issuance
7 of long term debt which already has been shown to be a more cost-effective way to fund
8 PGW's capital construction. I have provided the Company's best estimate of the amount
9 of capacity release and off-system sales proceeds it projects it will realize over the next
10 five years. Mr. Hershey provides additional testimony supporting this proposal. More
11 importantly, PGW commits to depositing into the restricted fund 100% of any proceeds
12 from these transactions not utilized to fund its approved capital budget, so that the
13 Commission will have assurance that these funds will be used for their intended purposes.

14 **Q. WHAT ARE THE CONSEQUENCES IF PGW RECEIVES A LOWER RATE**
15 **INCREASE?**

16 A. On Exhibit JRB-6, I have depicted the five-year forecast for PGW assuming that it
17 receives an \$80 million rate increase, effective FY 2007, and there is no change in the
18 treatment of off-system sales proceeds. This level of rate increase will reduce PGW's
19 ability to fund its Financial Stability Plan by \$125 million. Ms. Bisgaier and Mr.
20 Krellenstein explain why it is so crucial that PGW be given the opportunity to implement
21 a plan that could achieve all the benefits of a 50/50 capital structure over the next five
22 fiscal years, (recalling that the movement to achieving this goal cannot start in actuality
23 until FY 2008 as any rate increase authorized by the Commission here authorized will
24 likely not go into effect until approximately the end of calendar 2007). Of course, if

1 PGW were authorized an even smaller increase, its ability adequately to address this
2 serious problem will be correspondingly lessened.

3 **Q. HOW DO THOSE RESULTS COMPARE TO PGW'S PROJECTED**
4 **PERFORMANCE IF IT RECEIVES ITS FULL REQUEST?**

5 A. Exhibit JRB-1, Schedule 2 shows PGW's projection of its financial performance if it
6 receives the full \$100 million rate increase and is able to retain proceeds from off system
7 sales. As can be seen, only when PGW has available the full rate increase request and the
8 off-system sales/capacity release proceeds (projected at \$10 million a year) does it have a
9 good chance of achieving its goal of a 50/50 capital structure by FY 2012.

10 **Q. MR. BOGDONAVAGE ISN'T IT POSSIBLE THAT AWARDDING THE**
11 **COMPANY THE ENTIRE RATE INCREASE IT IS REQUESTING COULD**
12 **RESULT IN IT ACHIEVING A 50/50 CAPITAL STRUCTURE SOONER THAN**
13 **FY 2012?**

14 A. Unfortunately, it is more likely that it will not achieve this goal. The most obvious
15 reasons are that the five year projection assumes that PGW will experience a 95%
16 collections rate and that there will be a slight increase in firm gas sales over the forecast
17 period. A 95% collections rate is not at all certain, given past experience, and all
18 indications are that non-weather related sales will continue to decline, given the increased
19 trends towards conservation and the population reductions in the Philadelphia area.
20 Moreover, other assumed sources of revenue, such as LIHEAP and CRISIS, are uncertain
21 due to annual changes in public policy at the state and federal level. These and other
22 external factors could cause PGW's collections experience to be less than projected. In
23 turn, PGW's projected income and internal financing capability would be negatively
24 affected compared to this projection.

25 In addition, PGW's revised 5-year capital budget includes preliminary estimates
26 of the cost of two major projects – an update of the Company's BCCS system and the

1 construction of the second phase of its Richmond liquefaction plant expansion. If the
2 final level of construction expenditures for these items turn out to be greater than
3 projected, or if expenditures are required for other equipment failures, additional
4 internally generated funds will have to be allocated to fund these construction items
5 rather than paying down existing debt.

6 However, to eliminate any concern in this regard, if PGW is authorized to put into
7 effect the full amount it has requested and to retain the proceeds from off-system sales
8 and capacity release, it would commit to affirmatively triggering a PUC rate modification
9 as soon as its debt ratio reached 50% at the end of any fiscal year.

10 **IV. CALCULATION OF PRO FORMA TEST YEAR**

11 **Q. MR. BOGDONAVAGE, PLEASE EXPLAIN THE DERIVATION OF THE PRO**
12 **FORMA TEST YEAR INFORMATION AT PRESENT RATES.**

13 A. As indicated, those schedules are displayed in Exhibit JRB-1. In that Exhibit, I have
14 provided schedules which show PGW's Income Statement, Cash Flow Statement, Debt
15 Service Coverage Statement and Balance Sheet derived from the approved budget for the
16 test year, the 12 months ending August 31, 2007. The development of the test year starts
17 with the "fully forecasted" budget as approved by the PGC for that fiscal year as a
18 starting point and then makes certain budget and pro forma adjustments. My supporting
19 data also includes the detailed schedules and data that were presented to the PGC in
20 support of PGW's FY 2007 operating budget (Exhibit JRB-2).

21 **Q. PLEASE EXPLAIN THE REVISIONS TO PGW'S APPROVED BUDGET THAT**
22 **WERE MADE AND THE REASON FOR MAKING THEM?**

23 A. Three major revisions were made:

24 1. Revision to Revenues and Expenses to Reflect Modified "Soft Off"
25 Accounting. PGW has recently modified its billing treatment for this program. PGW has

1 a policy of avoiding the substantial operating cost associated with discontinuing service
2 at a premise by ending the customer's responsibility but without actually physically
3 disconnecting natural gas service at the location. Earlier this year, PGW determined to
4 change the way in which it accounted for this natural gas usage. Rather than treating the
5 "soft off" used gas as a "sale," PGW is now accounting for the gas as "company used."
6 To implement this change, PGW modified its revenues and expenses starting in FY 2004
7 through the FY 2007 budget. The direct revenue and expense adjustments needed to
8 modify the FY 2007 budget to reflect the new "soft off" accounting is shown on Exhibit
9 JRB-1, p. 11. The revision to revenues for "soft off" accounting also resulted in a
10 revision to pro forma uncollectible expense, compared to the level approved in PGW's
11 approved budget.

12 2. I have adjusted future test year data to reflect a 96% collections factor.
13 PGW's approved budget utilized a 94% rate. Since PGW submitted its budget to the
14 PGC, PGW's collections factor has increased both due to increased collections and the
15 affect of the new "soft off" methodology. As a result, PGW believes that it is now
16 reasonable to project that PGW will experience a 96% rate in FY 2007, prior to any rate
17 increase.

18 3. Pension expense has been adjusted downward by approximately \$2.5
19 million (compared to the amount originally presented in the budget) to reflect a revised
20 actuarial expense provided by PGW's pension consultant.

21 **Q. MR. BOGDONAVAGE, WHAT ASSUMPTIONS AND EXPENSE**
22 **ADJUSTMENTS DID YOU MAKE TO PGW'S APPROVED BUDGET TO MAKE**
23 **THE TEST YEAR REPRESENTATIVE OF FUTURE PERIODS?**

24 **A.** Several "pro forma" adjustments have been made to the revised, FY 2007 test year to
25 account for ratemaking conventions. The are as follows:

1 1. Rate Case Expense. PGW's present estimate of rate case expense has been
2 included on a three year amortized basis. The detail of these adjustments are shown on
3 Exhibit JRB-1,, p. 11.

4 2. Normalization of Expenses. The test year has been adjusted by removing
5 certain expenses, totaling \$353,000, associated with prior period, one-time, non-recurring
6 activities.

7 3. Annualized Union Wage Increase. Two union wage increases that will
8 take effect during the test year were annualized to reflect their full, 12 month impact.
9 The net effect of all of these adjustments is \$217,000.

10 **Q. CAN YOU PROVIDE AN EXPLANATION OF THE DERIVATION OF THE 5-**
11 **YEAR BUDGET PROJECTIONS THAT APPEAR IN YOUR EXHIBIT?**

12 **A.** Yes. The five year budget projections are consistent with similar projections that PGW
13 prepared and submitted with its budget review process to the PGC, although the budgets
14 have been adjusted to: (1) reflect the above adjustments and revisions; and (2) to revise
15 future capital budget projections to include two new projects discussed above – phase 2
16 of the LNG liquefaction plant expansion and upgrade of its BCCS system. One
17 significant difference in the forecast data is that I have shown the financial results
18 assuming a 95% collections rate, to reflect the effect of the requested \$100 million rate
19 increase.

20 **V. RESTRUCTURING SURCHARGE**

21 **Q. CAN YOU EXPLAIN HOW THE COMPANY HAS TREATED THE**
22 **RESTRUCTURING SURCHARGE?**

23 **A.** Yes. In PGW's Restructuring Proceeding it was permitted to establish a Restructuring
24 Surcharge to recover in an automatic adjustment clause the costs associated with
25 unbundling its rates and allowing Choice as well as costs associated with complying with

1 certain PUC regulations. In a Stipulation entered into by the parties and approved by the
2 PUC in that proceeding, it was agreed that PGW would roll into base rates any such costs
3 when it filed its next base rate case. PGW has done this. Any such ongoing costs of
4 regulatory compliance or restructuring are reflected, as appropriate, in PGW's FY 2007
5 test year. Accordingly, PGW's proposed tariff revisions eliminate the Restructuring
6 Surcharge for any new costs, effective upon the implementation of the proposed tariff in
7 this proceeding. If there is any over or under collection from this year's Restructuring
8 Surcharge, PGW proposes that this amount be recovered by revising the Surcharge to
9 recover or credit back to customers any such amount over the next 12 months and then
10 eliminate the Surcharge once the total amount of the over/under recovery is fully paid
11 back or collected.

12 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

13 **A. Yes.**

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	FORECAST 2007-08	FORECAST 2008-09	FORECAST 2009-10	FORECAST 2010-11	FORECAST 2011-12
OPERATING REVENUES								
Non-Heating	\$ 114,880	\$ 114,212	\$ 114,834	\$ 116,734	\$ 112,487	\$ 106,113	\$ 105,845	\$ 105,471
Gas Transport Service	4,679	6,147	7,256	7,889	8,461	8,983	9,465	9,908
Heating	713,159	821,190	820,732	845,817	816,568	762,697	757,378	749,166
Proposed Base Rate	-	-	-	-	-	-	-	-
Weather Normalization Adjustment	(1,365)	12,500	-	-	-	-	-	-
Unbilled Adjustment	(803)	2,513	(732)	521	(377)	(714)	(59)	(91)
Total Gas Revenues	830,550	956,562	942,090	970,961	937,139	877,079	872,629	864,454
Appliance Repair & Other Revenues	10,895	10,669	10,532	10,743	10,957	11,400	11,177	11,628
Other Operating Revenues	21,912	17,865	18,032	18,438	17,813	16,678	16,581	16,426
Total Other Operating Revenues	32,807	28,534	28,564	29,181	28,770	27,855	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	1,000,142	965,909	904,934	900,610	892,508
OPERATING EXPENSES								
Natural Gas	509,700	639,180	630,836	658,487	623,363	562,396	558,243	550,889
Other Raw Material	4	5	5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	658,492	623,368	562,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	339,813	341,650	342,541	342,533	342,362	341,614
Gas Processing	18,584	16,206	15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,455	27,377	34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125	14,168	14,398	14,657	14,863	15,152
Account Management	7,695	7,928	7,625	7,690	7,787	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	52,258	47,729	43,864	40,087	36,854	34,124
Marketing	2,592	2,470	2,992	3,088	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	41,944	45,904	49,654	53,719	58,126
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)	(7,258)	(7,529)	(7,379)	(7,220)	(7,008)
Amortization of Restructuring Costs	1,087	1,087	-	-	-	-	-	-
Pensions	14,702	17,297	15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-	-	383	507	639	753
Pro Forma Adjustments	-	-	217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	229,932	238,697	239,559	241,072	243,473	247,170
Depreciation	35,904	36,928	38,213	39,565	40,825	42,091	43,531	43,515
Cost of Removal	3,643	3,200	3,200	3,200	3,200	3,200	3,200	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	268,128	278,151	280,407	283,136	286,993	290,653
TOTAL OPERATING EXPENSES	793,012	917,374	898,969	936,643	903,775	845,537	845,241	841,547
OPERATING INCOME	70,345	67,722	71,685	63,499	62,134	59,397	55,369	50,961
Other Income	4,778	8,198	11,212	11,343	9,620	7,723	7,820	7,160
INCOME BEFORE INTEREST	75,123	75,920	82,897	74,842	71,754	67,120	63,189	58,121
INTEREST								
Long-Term Debt	53,856	51,778	56,437	56,698	61,578	61,236	65,202	64,046
Other	6,123	9,561	13,186	13,229	13,643	13,684	14,076	14,059
AFUDC	(907)	(1,168)	(1,202)	(1,002)	(1,036)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	74,131	79,036	78,430	82,466	81,074
NET INCOME	11,272	10,417	8,919	711	(7,282)	(11,310)	(19,277)	(22,953)
City Payment	-	-	-	-	-	-	-	-
Net Earnings	<u>\$11,272</u>	<u>\$10,417</u>	<u>\$8,919</u>	<u>\$711</u>	<u>(\$7,282)</u>	<u>(\$11,310)</u>	<u>(\$19,277)</u>	<u>(\$22,953)</u>

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	FORECAST 2007-08	FORECAST 2008-09	FORECAST 2009-10	FORECAST 2010-11	FORECAST 2011-12
FUNDS PROVIDED								
Total Gas Revenues	\$830,550	\$956,562	\$942,090	\$970,961	\$937,139	\$877,079	\$872,629	\$864,454
Other Operating Revenues	32,807	28,534	28,564	29,181	28,770	27,855	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	1,000,142	965,909	904,934	900,610	892,508
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,097	11,250	11,343	9,620	7,723	7,820	7,160
City Grant	18,000	18,000	18,000	18,000	18,000	18,000		
AFUDC (Interest)	907	1,168	1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,001,106	1,030,487	994,565	931,665	909,415	900,627
FUNDS APPLIED								
Fuel Costs	509,704	639,185	630,841	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	268,128	278,151	280,407	283,136	286,993	290,653
Total Operating Expenses	793,012	917,374	898,969	936,643	903,775	845,537	845,241	841,547
Less: Non-Cash Expenses	39,338	40,554	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	857,082	893,343	859,163	799,630	797,856	794,143
Funds Available to Cover Debt Service	130,103	139,541	144,024	137,144	135,402	132,035	111,559	106,484
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	4.03	3.99	4.18	4.38	3.63	3.31
Net Available after Prior Debt Service	91,297	97,592	108,276	102,776	103,034	101,880	80,814	74,320
Other Capital Leases	1,998	-	-	-	-	-	-	-
Net Available after Prior Capital Leases	89,299	97,592	108,276	102,776	103,034	101,880	80,814	74,320
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	67,813	71,727	84,111	85,579	92,016
New Proposed Bond Debt Service	-	-	-	-	-	-	-	-
Total New Debt Service	45,999	32,467	53,313	67,813	71,727	84,111	85,579	92,016
Debt Service Coverage 1998 Bonds	1.94	3.01	2.03	1.52	1.44	1.21	0.94	0.81
Net Available after 1998 Debt Service	43,300	65,125	54,963	34,963	31,307	17,769	(4,765)	(17,696)
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	27.66	17.60	15.73	8.95	(2.40)	(8.92)
Net Available To Service Aggregate Debt Serv	111,075	114,154	122,295	115,298	113,638	110,192	107,694	102,563
Aggregate Debt Service	88,790	76,402	91,048	104,167	106,085	116,252	118,312	126,164
Fixed Coverage Charge	1.25	1.49	1.34	1.11	1.07	0.95	0.91	0.81
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	1.12	0.94	0.92	0.82	0.79	0.71

PHILADELPHIA GAS WORKS
BALANCE SHEET
(Dollars in Thousands)

	<u>Actual</u> <u>8/31/05</u>	<u>Estimate</u> <u>8/31/06</u>	<u>Budget</u> <u>8/31/07</u>	<u>Forecast</u> <u>8/31/08</u>	<u>Forecast</u> <u>8/31/09</u>	<u>Forecast</u> <u>8/31/10</u>	<u>Forecast</u> <u>8/31/11</u>	<u>Forecast</u> <u>8/31/12</u>
<u>ASSETS</u>								
Utility Plant Net	981,722	1,012,851	1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940
Sinking Fund Reserve	104,530	93,800	102,050	102,050	110,300	110,300	118,550	118,550
Capital Improvement Fund	102,701	39,732	99,843	39,843	108,993	47,993	120,143	62,143
Cash	15,221	10,820	51,616	50,327	41,366	21,624	(17,053)	(72,876)
Gas	273,805	264,254	243,806	226,927	211,043	195,196	181,647	170,269
Other	12,522	785	506	352	350	350	350	350
Accrued Gas Revenues	8,787	11,300	10,568	11,089	10,712	9,998	9,939	9,848
Reserve for Uncollectible	(207,480)	(191,631)	(183,489)	(173,618)	(162,382)	(149,869)	(136,623)	(123,247)
Accounts Receivable:	87,634	84,708	71,391	64,750	59,723	55,675	55,313	57,220
Materials & Supplies	129,984	183,784	180,389	176,809	162,083	159,236	155,999	152,694
Other Current Assets	(164)	2,986	3,056	3,236	3,441	3,596	3,751	3,906
Deferred Debits	2,796	8,448	3,228	2,487	2,362	2,262	2,337	2,387
Unamortized Bond Issuance Expense	39,094	42,089	46,912	43,166	47,671	43,651	47,920	43,676
Unamortized Extraordinary Loss	38,494	55,859	50,301	45,095	40,244	35,726	31,552	27,624
Deferred Environmental	9,513	9,513	9,513	8,000	6,500	5,000	3,500	2,000
Other Assets	8,297	3,411	2,881	2,925	3,030	3,138	3,250	3,365
TOTAL ASSETS	<u>1,519,822</u>	<u>1,548,001</u>	<u>1,670,970</u>	<u>1,627,510</u>	<u>1,721,465</u>	<u>1,652,680</u>	<u>1,707,797</u>	<u>1,599,629</u>
<u>EQUITY & LIABILITIES</u>								
City Equity	222,646	233,063	241,982	242,693	235,411	224,101	186,824	145,871
Revenue Bonds	1,045,371	1,042,430	1,154,385	1,105,945	1,207,915	1,151,820	1,254,251	1,203,616
TECA Accretions	14,313	12,608	13,913	15,314	16,818	18,434	10,933	
Unamortized Discount	(9,484)	(5,113)	(5,583)	(5,201)	(5,732)	(5,217)	(5,733)	(5,220)
Unamortized Premium	22,901	20,797	18,826	16,956	15,183	13,516	11,996	10,550
Capital Equipment Leasing	-	-	-	-	-	-	-	-
Long Term Debt:	1,073,101	1,070,722	1,181,441	1,133,014	1,234,184	1,178,553	1,271,447	1,208,946
Notes Payable	49,900	70,000	90,000	145,000	150,000	150,000	150,000	150,000
City Loan	45,000	45,000	43,000	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468	57,930	52,987	53,688	53,234	52,826
Customer Deposits	6,280	8,250	9,000	8,750	8,500	8,000	7,500	7,000
Other Current Liabilities	3,734	3,431	2,129	2,137	2,195	2,254	2,313	2,372
Deferred Credits	14,608	5,814	4,724	1,323	1,326	1,331	1,336	1,341
Accrued Interest	9,591	12,224	14,374	13,945	15,963	15,427	17,387	16,837
Accrued Taxes & Wages	3,861	4,231	2,796	2,817	3,088	3,609	4,130	2,900
Accrued Distribution to City	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Other Liabilities	24,183	19,981	19,056	16,901	14,811	12,717	10,626	8,536
TOTAL EQUITY & LIABILITIES	<u>1,519,822</u>	<u>1,548,001</u>	<u>1,670,970</u>	<u>1,627,510</u>	<u>1,721,465</u>	<u>1,652,680</u>	<u>1,707,797</u>	<u>1,599,629</u>

Capitalization

	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012
Total Capitalization	1,295,747	1,303,785	1,423,423	1,375,707	1,469,595	1,402,654	1,458,271	1,354,817
Total Long Term Debt	1,073,101	1,070,722	1,181,441	1,133,014	1,234,184	1,178,553	1,271,447	1,208,946
Debt to Equity Ratio	0.83	0.82	0.83	0.82	0.84	0.84	0.87	0.89
Capitalization Ratio	4.82	4.59	4.88	4.67	5.24	5.26	6.81	8.29
Plant in Service	1,517,046	1,573,346	1,641,403	1,716,555	1,795,152	1,882,907	1,953,725	2,015,312
Regulatory Asset Securitization Capital - 106&107	56,300	68,057	75,152	78,597	87,755	70,818	61,587	59,920
Total Plant	1,573,346	1,641,403	1,716,555	1,795,152	1,882,907	1,953,725	2,015,312	2,075,232
Accumulated Depreciation	(591,624)	(628,552)	(666,765)	(706,330)	(747,155)	(789,246)	(832,777)	(876,292)
Net Utility Plant	981,722	1,012,851	1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	FORECAST 2007-08	FORECAST 2008-09	FORECAST 2009-10	FORECAST 2010-11	FORECAST 2011-12
OPERATING REVENUES								
Non-Heating	\$ 114,880	\$ 114,212	\$ 115,126	\$ 117,022	\$ 112,771	\$ 106,389	\$ 106,117	\$ 105,739
Gas Transport Service	4,679	6,147	7,256	7,889	8,461	8,983	9,465	9,908
Heating	713,159	821,190	824,440	849,529	820,284	766,421	761,106	752,898
Proposed Base Rate	-	-	100,000	100,000	100,000	100,000	100,000	100,000
Weather Normalization Adjustment	(1,365)	12,500	-	-	-	-	-	-
Unbilled Adjustment	(803)	2,513	505	522	(376)	(713)	(58)	(89)
Total Gas Revenues	830,550	956,562	1,047,327	1,074,962	1,041,140	981,080	976,630	968,456
Appliance Repair & Other Revenues	10,895	10,669	10,532	10,743	10,957	11,177	11,400	11,628
Other Operating Revenues	21,912	17,865	20,008	20,414	19,789	18,654	18,557	18,402
Total Other Operating Revenues	32,807	28,534	30,540	31,157	30,746	29,831	29,957	30,030
Total Operating Revenues	863,357	985,096	1,077,867	1,106,119	1,071,886	1,010,911	1,006,587	998,486
OPERATING EXPENSES								
Natural Gas	509,700	639,180	630,838	658,487	623,363	562,396	558,243	550,889
Other Raw Material	4	5	5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	658,492	623,368	562,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	447,026	447,627	448,518	448,510	448,339	447,592
Gas Processing	18,584	16,206	15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,455	27,377	34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125	14,168	14,398	14,657	14,863	15,152
Account Management	7,695	7,928	7,625	7,690	7,787	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	59,546	58,962	56,235	52,563	48,645	46,943
Marketing	2,592	2,470	2,992	3,088	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	41,944	45,904	49,654	53,719	58,126
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)	(7,258)	(7,529)	(7,379)	(7,220)	(7,008)
Amortization of Restructuring Costs	1,087	1,087	-	-	-	-	-	-
Pensions	14,702	17,297	15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-	-	383	507	639	753
Pro Forma Adjustments	-	-	217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	237,220	249,930	251,930	253,548	255,264	259,989
Depreciation	35,904	36,928	38,213	39,565	40,825	42,091	43,531	43,515
Cost of Removal	3,643	3,200	3,200	3,200	3,200	3,200	3,200	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
	35,045	37,066	38,196	39,454	40,848	42,064	43,520	43,483
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	275,416	289,384	292,778	295,612	298,784	303,472
TOTAL OPERATING EXPENSES	793,012	917,374	906,257	947,876	916,146	858,013	857,032	854,366
OPERATING INCOME	70,345	67,722	171,610	158,243	155,740	152,898	149,555	144,120
Other Income	4,778	8,198	17,131	19,082	18,437	20,343	21,881	22,907
INCOME BEFORE INTEREST	75,123	75,920	188,741	177,325	174,177	173,241	171,436	167,027
INTEREST								
Long-Term Debt	53,856	51,778	56,437	56,698	54,265	51,809	48,884	46,024
Other	6,123	9,561	13,186	13,229	13,134	13,028	12,941	12,805
AFUDC	(907)	(1,168)	(1,202)	(1,002)	(1,036)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	74,131	71,214	68,347	65,013	61,798
NET INCOME	11,272	10,417	114,763	103,194	102,963	104,894	106,423	105,229
City Payment	-	-	-	-	-	-	-	-
Net Earnings	\$11,272	\$10,417	\$114,763	\$103,194	\$102,963	\$104,894	\$106,423	\$105,229

PHILADELPHIA GAS WORKS
CASHFLOW STATEMENT
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	FORECAST 2007-08	FORECAST 2008-09	FORECAST 2009-10	FORECAST 2010-11	FORECAST 2011-12
SOURCES								
Net Income	\$11,272	\$10,417	\$114,763	\$103,194	\$102,963	\$104,894	\$106,423	\$105,229
Depreciation & Amortization	42,281	43,928	46,007	47,128	47,959	48,821	49,864	49,501
Earnings on Restricted Funds	(3,265)	3,899	(381)	(2,239)	(3,970)	(6,225)	(7,763)	20,616
Elimination of Accrued Interest on Refunded Debt	-	3,186	-	-	-	-	-	-
Increased/(Decreased) Other Assets/Liabilities	(6,917)	(1,024)	911	716	808	915	(8,203)	(11,639)
Available From Operations	43,371	60,406	161,300	148,799	147,760	148,405	140,321	163,707
Funds Required for Capital	68,000	60,195	72,000	60,000	39,843	-	-	-
Grant Income	18,000	18,000	18,000	18,000	18,000	18,000	-	-
Capital Leasing Funds Debt Service	2,005	-	-	-	-	-	-	-
Capitalized Interest Debt Service	2,283	5,924	-	-	-	-	-	-
Release of Sinking Fund Asset	6,038	3,680	-	-	-	-	-	-
Temporary Financing	-	20,100	-	-	-	-	-	-
TOTAL SOURCES	139,697	168,305	251,300	226,799	205,603	166,405	140,321	163,707
USES								
Net Construction Expenditures	66,910	68,057	75,152	62,597	64,755	63,018	61,587	59,920
LNG & BCCS	-	-	-	16,000	23,000	7,800	-	-
Funded Debt Reduction:								
Revenue Bonds	35,387	29,906	36,675	47,010	46,530	47,920	39,479	36,020
PMA Lease/Subordinate Debt	1,255	1,310	1,370	1,430	1,500	1,565	1,640	1,715
Capital Lease	1,947	-	-	-	-	-	-	-
Debt Reduction Funding	-	-	40,000	15,000	55,000	35,000	20,000	40,000
Post Retirement Benefit Funding	-	-	-	-	-	-	-	-
Temporary Financing Repayment	850	-	40,000	20,000	10,000	-	-	-
City Loan Repayment/Status	-	-	2,000	43,000	-	-	-	-
Distribution of Earnings	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000
Additions To (Reductions of)								
Non-Cash Working Capital	3,793	55,433	1,159	(873)	(11,595)	(5,138)	99	2,840
Cash Needs	128,142	172,706	214,356	222,164	207,190	168,165	140,805	158,495
Cash Surplus (Shortfall)	11,555	(4,401)	36,944	4,635	(1,587)	(1,760)	(484)	5,212
TOTAL USES	139,697	168,305	251,300	226,799	205,603	166,405	140,321	163,707
Cash - Beginning of Period	3,666	15,221	10,820	47,764	52,399	50,812	49,052	48,568
Cash - Surplus (Shortfall)	11,555	(4,401)	36,944	4,635	(1,587)	(1,760)	(484)	5,212
ENDING CASH	15,221	10,820	47,764	52,399	50,812	49,052	48,568	53,780
Outstanding Commercial Paper	49,900	70,000	30,000	10,000	-	-	-	-
City Loan Outstanding	45,000	45,000	43,000	-	-	-	-	-
Internally Generated Funds	-	-	-	-	47,912	70,818	61,587	59,920

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

	ACTUAL <u>2004-05</u>	ESTIMATE <u>2005-06</u>	BUDGET <u>2006-07</u>	FORECAST <u>2007-08</u>	FORECAST <u>2008-09</u>	FORECAST <u>2009-10</u>	FORECAST <u>2010-11</u>	FORECAST <u>2011-12</u>
FUNDS PROVIDED								
Total Gas Revenues	\$830,550	\$956,562	\$1,047,327	\$1,074,962	\$1,041,140	\$981,080	\$976,630	\$968,456
Other Operating Revenues	32,807	28,534	30,540	31,157	30,746	29,831	29,957	30,030
Total Operating Revenues	863,357	985,096	1,077,867	1,106,119	1,071,886	1,010,911	1,006,587	998,486
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,097	16,750	16,843	14,467	14,118	14,118	43,523
City Grant	18,000	18,000	18,000	18,000	18,000	18,000	18,000	
AFUDC (Interest)	907	1,168	1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,113,819	1,141,964	1,105,389	1,044,037	1,021,690	1,042,968
FUNDS APPLIED								
Fuel Costs	509,704	639,185	630,841	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	275,416	289,384	292,778	295,612	298,784	303,472
Total Operating Expenses	793,012	917,374	906,257	947,876	916,146	858,013	857,032	854,366
Less: Non-Cash Expenses	39,338	40,554	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	864,370	904,576	871,534	812,106	809,647	806,962
Funds Available to Cover Debt Service	130,103	139,541	249,449	237,388	233,855	231,931	212,043	236,006
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	6.98	6.91	7.22	7.69	6.90	7.34
Net Available after Prior Debt Service	91,297	97,592	213,701	203,020	201,487	201,776	181,298	203,842
Other Capital Leases	1,998	-	-	-	-	-	-	-
Net Available after Prior Capital Leases	89,299	97,592	213,701	203,020	201,487	201,776	181,298	203,842
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	67,813	68,852	67,966	65,143	60,885
New Proposed Bond Debt Service	-	-	-	-	-	-	-	-
Total New Debt Service	45,999	32,467	53,313	67,813	68,852	67,966	65,143	60,885
Debt Service Coverage 1998 Bonds	1.94	3.01	4.01	2.99	3.01	2.97	2.78	3.35
Net Available after 1998 Debt Service	43,300	65,125	160,388	135,207	134,635	133,810	116,155	142,957
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	80.72	68.08	67.66	67.38	58.43	72.05
Net Available To Service Aggregate Debt Serv	111,075	114,154	228,139	217,781	216,061	216,313	215,941	211,469
Aggregate Debt Service	88,790	76,402	91,048	104,167	101,210	100,107	97,876	95,033
Fixed Coverage Charge	1.25	1.49	2.51	2.09	2.13	2.16	2.21	2.23
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	2.09	1.78	1.81	1.83	1.86	1.87

**PHILADELPHIA GAS WORKS
BALANCE SHEET
(Dollars in Thousands)**

	<u>Actual</u> <u>8/31/05</u>	<u>Estimate</u> <u>8/31/06</u>	<u>Budget</u> <u>8/31/07</u>	<u>Forecast</u> <u>8/31/08</u>	<u>Forecast</u> <u>8/31/09</u>	<u>Forecast</u> <u>8/31/10</u>	<u>Forecast</u> <u>8/31/11</u>	<u>Forecast</u> <u>8/31/12</u>	
<u>ASSETS</u>									
Utility Plant Net	981,722	1,012,851	1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	
Sinking Fund Reserve	104,530	93,800	102,050	102,050	102,050	102,050	102,050	102,050	
Capital Improvement Fund	102,701	39,732	99,843	39,843	-	-	-	-	
Debt Reduction Funding	-	-	40,419	57,658	116,628	157,853	185,616	-	
Cash	15,221	10,820	47,764	52,399	50,812	49,052	48,568	53,780	
Gas	273,805	264,254	254,134	240,307	224,591	205,778	186,746	167,304	
Other	12,522	785	506	352	350	350	350	350	
Accrued Gas Revenues	8,787	11,300	11,805	12,327	11,951	11,238	11,180	11,091	
Reserve for Uncollectible	(207,480)	(191,631)	(185,777)	(174,639)	(160,774)	(143,237)	(121,782)	(98,725)	
Accounts Receivable:	87,634	84,708	80,668	78,347	76,118	74,129	76,494	80,020	
Materials & Supplies	129,984	183,784	180,389	176,809	162,083	159,236	155,999	152,694	
Other Current Assets	(164)	2,986	3,056	3,236	3,441	3,596	3,751	3,906	
Deferred Debits	2,796	8,448	3,228	2,487	2,362	2,262	2,337	2,387	
Unamortized Bond Issuance Expense	39,094	42,089	46,912	43,166	39,574	36,138	32,868	29,740	
Unamortized Extraordinary Loss	38,494	55,859	50,301	45,095	40,244	35,726	31,552	27,624	
Deferred Environmental	9,513	9,513	9,513	8,000	6,500	5,000	3,500	2,000	
Other Assets	8,297	3,411	2,881	2,925	3,030	3,138	3,250	3,365	
TOTAL ASSETS	1,519,822	1,548,001	1,716,814	1,700,837	1,738,594	1,792,659	1,828,520	1,656,506	
<u>EQUITY & LIABILITIES</u>									
City Equity	222,646	233,063	347,826	451,020	553,983	658,877	747,300	834,529	<u>Normal</u> 834,529
Revenue Bonds	1,045,371	1,042,430	1,154,385	1,105,945	1,057,915	1,008,430	967,311	724,576	929,576
TECA Accretions	14,313	12,608	13,913	15,314	16,818	18,434	10,933		
Unamortized Discount	(9,484)	(5,113)	(5,683)	(5,201)	(4,738)	(4,295)	(3,885)	(3,509)	(3,509)
Unamortized Premium	22,901	20,797	18,826	16,956	15,183	13,516	11,996	10,550	10,550
Capital Equipment Leasing	-	-	-	-	-	-	-	-	-
Long Term Debt:	1,073,101	1,070,722	1,181,441	1,133,014	1,085,178	1,036,085	986,355	731,617	936,617
Notes Payable	49,900	70,000	30,000	10,000	-	-	-	-	-
City Loan	45,000	45,000	43,000	-	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468	57,930	52,987	53,688	53,234	52,826	
Customer Deposits	6,280	8,250	9,000	8,750	8,500	8,000	7,500	7,000	
Other Current Liabilities	3,734	3,431	2,129	2,137	2,195	2,254	2,313	2,372	
Deferred Credits	14,608	5,814	4,724	1,323	1,326	1,331	1,336	1,341	
Accrued Interest	9,591	12,224	14,374	13,945	13,526	13,097	12,725	12,385	
Accrued Taxes & Wages	3,861	4,231	2,796	2,817	3,088	3,609	4,130	2,900	
Accrued Distribution to City	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	
Other Liabilities	24,183	19,981	19,056	16,901	14,811	12,718	10,627	8,536	
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,716,814	1,700,837	1,738,594	1,792,659	1,828,520	1,656,506	

Capitalization

	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	<u>Normal</u> <u>Amortiz.</u> FY2012
Total Capitalization	1,295,747	1,303,785	1,529,267	1,584,034	1,639,161	1,694,962	1,733,655	1,566,146	1,771,146
Total Long Term Debt	1,073,101	1,070,722	1,181,441	1,133,014	1,085,178	1,036,085	986,355	731,617	936,617
Debt to Equity Ratio	0.83	0.82	0.77	0.72	0.66	0.61	0.57	0.47	0.53
Capitalization Ratio	4.82	4.59	3.40	2.51	1.96	1.57	1.32	0.88	1.12
Plant in Service	1,517,046	1,573,346	1,641,403	1,716,555	1,795,152	1,882,907	1,953,725	2,015,312	2,015,312
Capital - 106&107	56,300	68,057	75,152	78,597	87,755	70,818	61,587	59,920	59,920
Total Plant	1,573,346	1,641,403	1,716,555	1,795,152	1,882,907	1,953,725	2,015,312	2,075,232	2,075,232
Accumulated Depreciation	(591,624)	(628,552)	(666,765)	(706,330)	(747,155)	(789,246)	(832,777)	(876,292)	(876,292)
Net Utility Plant	981,722	1,012,851	1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	1,198,940

**PHILADELPHIA GAS WORKS
BASE RATE PRO FORMA ADJUSTMENTS**

Base Rate Case Expenses

Cost of Service Study	\$100,000	
Legal Counsel Costs	500,000	
Expert Witness Costs	100,000	
Miscellaneous	50,000	
Total	<u>(\$750,000)</u>	

Normalized Expenses

ADP Payroll Costs	\$ 126,818	
Oracle Upgrade Expenses	191,035	
Noetix Report Writing Costs	4,214	
Business Continuity Costs	30,933	
Total	<u>\$ (353,000)</u>	\$ (1,103,000)

Annualization of Union Wage Increase

3% Effective 9/1/06		
2.5% Effective 5/15/07		
Impact in FY 2007 1.037511%		
Annualized Impact 1.05575%		
Differential 1.018239%		
Union Payroll \$72,400,000	\$ 1,320,504	\$ 1,320,504
Total	<u>\$ 217,504</u>	

Revenue & Expense Adjustments Soft-Off Program

	<u>FY 2006-07</u>	<u>FY 2007-08</u>	<u>FY 2008-09</u>	<u>FY 2009-10</u>	<u>FY 2010-11</u>	<u>FY 2011-12</u>
Non-Heating Revenues	\$ (722,000)	\$ (727,000)	\$ (690,000)	\$ (625,000)	\$ (610,000)	\$ (594,000)
Heating Revenues	<u>(9,168,000)</u>	<u>(9,371,000)</u>	<u>(9,024,000)</u>	<u>(8,427,000)</u>	<u>(8,366,000)</u>	<u>(8,267,000)</u>
Total	<u>(9,890,000)</u>	<u>(10,098,000)</u>	<u>(9,714,000)</u>	<u>(9,052,000)</u>	<u>(8,976,000)</u>	<u>(8,861,000)</u>
Field Services Gas Used by Utility 600,000 Mcf	5,778,000	6,018,000	5,646,000	4,998,000	4,932,000	4,830,000
Administrative & General	<u>(5,778,000)</u>	<u>(6,018,000)</u>	<u>(5,646,000)</u>	<u>(4,998,000)</u>	<u>(4,932,000)</u>	<u>(4,830,000)</u>
Natural Gas Commodity Rate	9.63	10.03	9.41	8.33	8.22	8.05
Non-Heating Sales Mcf	<u>(44,000)</u>	<u>(43,000)</u>	<u>(42,000)</u>	<u>(41,000)</u>	<u>(40,000)</u>	<u>(39,000)</u>
Heating Sales Mcf	<u>(556,000)</u>	<u>(557,000)</u>	<u>(558,000)</u>	<u>(559,000)</u>	<u>(560,000)</u>	<u>(561,000)</u>
Total Mcf	<u>(600,000)</u>	<u>(600,000)</u>	<u>(600,000)</u>	<u>(600,000)</u>	<u>(600,000)</u>	<u>(600,000)</u>

Off System Sales & Capacity Release Revenues

	<u>FY 2006-07</u>	<u>FY 2007-08</u>	<u>FY 2008-09</u>	<u>FY 2009-10</u>	<u>FY 2010-11</u>	<u>FY 2011-12</u>
Non-Heating Revenues	\$ 292,000	\$ 288,000	\$ 284,000	\$ 276,000	\$ 272,000	\$ 268,000
Heating Revenues	3,708,000	3,712,000	3,716,000	3,724,000	3,728,000	3,732,000
Other Income	6,000,000	6,000,000	6,000,000	6,000,000	6,000,000	6,000,000
Total	<u>\$ 10,000,000</u>	<u>\$ 10,000,000</u>	<u>\$ 10,000,000</u>	<u>\$ 10,000,000</u>	<u>\$ 10,000,000</u>	<u>\$ 10,000,000</u>

Pension Expense Reduction

	<u>FY 2006-07</u>	<u>FY 2007-08</u>	<u>FY 2008-09</u>	<u>FY 2009-10</u>	<u>FY 2010-11</u>	<u>FY 2011-12</u>
Approved Budget & 5 Year Forecast	\$ 17,400,000	\$ 17,257,000	\$ 16,933,000	\$ 16,600,000	\$ 16,281,000	\$ 15,964,000
Revised Budget & 5 Year Forecast	15,075,000	14,611,000	14,265,000	13,911,000	13,571,000	13,233,000
Difference	<u>\$ (2,325,000)</u>	<u>(2,646,000)</u>	<u>(2,668,000)</u>	<u>(2,689,000)</u>	<u>(2,710,000)</u>	<u>(2,731,000)</u>

In The Matter Of:

PHILADELPHIA GAS WORKS'
FISCAL YEAR 2006-2007
OPERATING BUDGET FILING

Filed: May 26, 2006

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Exhibit A-1

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars in Thousands)

Line No.	Actual <u>2004-05</u>	Budget <u>2005-06</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
OPERATING REVENUES				
1. Non-Heating	\$114,880	\$110,823	\$114,212	\$115,556
2. Gas Transportation Service	4,679	7,210	6,147	7,256
3. Heating	713,159	797,812	821,190	829,900
4. Weather Normalization Adjustment	(1,365)	-	12,500	-
5. Unbilled Gas Adjustment	(803)	319	2,513	(732)
6. Total Gas Revenues	830,550	916,164	956,562	951,980
7. Appliance Repair & Other Service Revenues	10,895	10,975	10,669	10,532
8. Other Operating Revenues	21,912	21,793	17,865	18,219
9. Total Other Revenues	32,807	32,768	28,534	28,751
10. Total Operating Revenues	\$863,357	\$948,932	\$985,096	\$980,731
OPERATING EXPENSES				
11. Natural Gas	\$509,701	\$578,362	\$639,180	\$630,836
12. Other Raw Material	3	5	5	5
13. Sub-Total Fuel	509,704	578,367	639,185	630,841
14. Contribution Margins	\$353,653	\$370,565	\$345,911	\$349,890
15. Labor & Fringe Benefits	\$136,719	\$139,023	\$139,727	\$147,305
16. Bad Debt Expense	70,424	55,132	61,519	60,737
17. Other Expenses & Depreciation	76,165	71,535	76,943	73,139
18. Sub-Total Other O&M & Depreciation	283,308	265,690	278,189	281,181
19. Total Operating Expenses	\$793,012	\$844,057	\$917,374	\$912,022
20. Operating Income	\$70,345	\$104,875	\$67,722	\$68,709
21. Other Income	\$4,778	\$24,635	\$8,198	\$9,627
22. Income Before Interest	\$75,123	\$129,510	\$75,920	\$78,336
INTEREST				
23. Long Term Debt	\$53,856	\$53,589	\$51,778	\$56,437
24. Other Interest	6,123	7,496	9,561	13,186
25. AFUDC	(907)	(986)	(1,168)	(1,202)
26. Loss from Extinguishment of Debt	4,779	4,535	5,332	5,557
27. Total Interest Expense	\$63,851	\$64,634	\$65,503	\$73,978
28. Net Earnings	\$11,272	\$64,876	\$10,417	\$4,358

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars in Thousands)

Line No.		Actual 2004-05	Budget 2005-06	Estimate 2005-06	Budget 2006-07
	<u>OPERATING REVENUES</u>				
1.	Non-Heating	\$114,880	\$110,823	\$114,212	\$115,556
2.	Gas Transportation Service	4,679	7,210	6,147	7,256
3.	Heating	713,159	797,812	821,190	829,900
4.	Weather Normalization Adjustment	(1,363)	-	12,500	-
5.	Unbilled Gas Adjustment	(803)	319	2,513	(732)
6.	Total Gas Revenues	<u>830,552</u>	<u>916,164</u>	<u>956,562</u>	<u>951,980</u>
7.	Appliance Repair & Bill Paid Turn-Ons	10,895	10,975	10,669	10,532
8.	Other Operating Revenues	21,912	21,793	17,865	18,219
9.	Total Other Operating Revenues	<u>32,807</u>	<u>32,768</u>	<u>28,534</u>	<u>28,751</u>
10.	Total Operating Revenues	<u>\$863,359</u>	<u>\$948,932</u>	<u>\$985,096</u>	<u>\$980,731</u>
	<u>OPERATING EXPENSES</u>				
11.	Natural Gas	\$509,701	\$578,362	639,180	630,836
12.	Other Raw Material	3	5	5	5
13.	Sub-Total Fuel	<u>509,704</u>	<u>578,367</u>	<u>639,185</u>	<u>630,841</u>
14.	CONTRIBUTION MARGINS	<u>\$353,655</u>	<u>\$370,565</u>	<u>\$345,911</u>	<u>\$349,890</u>
15.	Gas Processing	18,584	15,590	16,206	15,715
16.	Field Services	28,455	30,768	27,377	29,391
17.	Distribution	15,115	16,130	15,382	16,566
18.	Collection	10,971	10,540	9,225	7,944
19.	Customer Service	12,512	12,918	12,026	14,125
20.	Account Management	7,695	7,824	7,928	7,625
21.	Bad Debt Expense	70,424	55,132	61,519	60,737
22.	Marketing	2,592	3,399	2,470	3,217
23.	Administrative & General	43,391	47,958	47,931	50,623
24.	Health Insurance	33,571	36,461	34,804	37,884
25.	Capitalized Fringe Benefits	(10,348)	(9,714)	(10,099)	(11,261)
26.	Capitalized Administrative Charges	(6,706)	(7,142)	(6,603)	(7,950)
27.	Amortization of Restructuring Costs	1,087	1,087	1,087	-
28.	Pensions	14,702	15,192	17,297	17,593
29.	Taxes	6,218	6,296	5,678	6,574
30.	Labor/Cost Savings	-	(12,891)	(1,105)	(5,798)
31.	Sub-Total Other Oper. & Maintenance	<u>248,263</u>	<u>229,548</u>	<u>241,123</u>	<u>242,985</u>
32.	Depreciation	35,904	37,589	36,928	38,213
33.	Cost of Removal	3,643	3,200	3,200	3,200
34.	To Clearing Accounts	<u>(4,502)</u>	<u>(4,647)</u>	<u>(3,062)</u>	<u>(3,217)</u>
35.		35,045	36,142	37,066	38,196
36.	Sub-Total Other Oper. & Maint. & Depreciation	<u>283,308</u>	<u>265,690</u>	<u>278,189</u>	<u>281,181</u>
37.	TOTAL OPERATING EXPENSES	<u>\$793,012</u>	<u>\$844,057</u>	<u>\$917,374</u>	<u>\$912,022</u>
38.	OPERATING INCOME	70,347	104,875	67,722	68,709
39.	Other Income	4,778	24,635	8,198	9,627
40.	INCOME BEFORE INTEREST	<u>\$75,125</u>	<u>\$129,510</u>	<u>\$75,920</u>	<u>\$78,336</u>
	INTEREST				
41.	Long-Term Debt	\$53,856	\$53,589	\$51,778	\$56,437
42.	Other	6,123	7,496	9,561	13,186
43.	AFUDC	(907)	(986)	(1,168)	(1,202)
44.	Loss From Extinguishment of Debt	4,779	4,535	5,332	5,557
45.	Total Interest	<u>63,851</u>	<u>64,634</u>	<u>65,503</u>	<u>73,978</u>
46.	NET EARNINGS	<u>\$11,274</u>	<u>\$64,876</u>	<u>\$10,417</u>	<u>\$4,358</u>

Exhibit A-2

**PHILADELPHIA GAS WORKS
CASH FLOW STATEMENT
(Dollars in Thousands)**

Line No.	<u>SOURCES</u>	Actual 2004-05	Budget 2005-06	Estimate 2005-06	Budget 2006-07
1.	Net Income	\$11,272	\$64,876	\$10,417	\$4,358
2.	Depreciation & Amortization	42,281	43,655	43,928	46,007
3.	Earnings on Restricted Funds	(3,265)	69	3,899	38
4.	Elimination of Accrued Interest on Refunded Debt	-	-	3,186	-
5.	Increased/(Decreased) Other Assets\Liabilities	(6,917)	(1,015)	(1,024)	911
6.	Available From Operations	43,371	107,585	60,406	51,314
7.	Funds Required for Capital	68,000	65,751	60,195	72,000
8.	Grant Income	18,000	-	18,000	18,000
9.	Lease Funds Debt Service	2,005	-	-	-
10.	Capitalized Interest	2,283	5,924	5,924	-
11.	Release of Sinking Fund Asset	6,038	-	3,680	-
12.	Temporary Financing	-	19,900	20,100	-
13.	TOTAL SOURCES	<u>\$139,697</u>	<u>\$199,160</u>	<u>\$168,305</u>	<u>\$141,314</u>
	USES				
14.	Net Capital Expenditures	\$66,910	\$65,751	\$68,057	\$75,152
	Funded Debt Reduction:				
15.	Revenue Bonds	35,387	36,651	29,906	36,675
16.	Subordinate Revenue Bonds	1,255	1,310	1,310	1,370
17.	Capital Lease	1,947	-	-	-
18.	Temporary Financing Repayment	850	40,000	-	-
19.	City Loan Repayment/Status	-	-	-	2,000
20.	Distribution of Earnings	18,000	18,000	18,000	18,000
	Additions to (Reductions of)				
21.	Non-Cash Working Capital	3,793	31,293	55,433	2,900
22.	Cash Needs	128,142	193,005	172,706	136,097
23.	Cash Surplus (Shortfall)	11,555	6,155	(4,401)	5,217
24.	TOTAL USES	<u>\$139,697</u>	<u>\$199,160</u>	<u>\$168,305</u>	<u>\$141,314</u>
25.	Cash - Beginning of Period	\$3,666	\$46,215	\$15,221	\$10,820
27.	Cash - Surplus (Shortfall)	11,555	6,155	(4,401)	5,217
28.	Ending Cash	<u>\$15,221</u>	<u>\$52,370</u>	<u>\$10,820</u>	<u>\$16,037</u>
29.	Outstanding Commercial Paper	\$49,900	\$59,700	\$70,000	\$70,000
30.	City Loan Outstanding	\$45,000	\$45,000	\$45,000	\$43,000

**PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)**

Line No.	Actual <u>2004-05</u>	Budget <u>2005-06</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
<u>FUNDS PROVIDED</u>				
1. Total Gas Revenues	\$830,550	\$916,164	\$956,562	\$951,980
2. Other Operating Revenues	32,807	32,768	28,534	28,751
3. Total Operating Revenues	863,357	948,932	985,096	980,731
4. Other Income Less Restricted Funds	1,513	24,704	12,097	9,665
5. Grant Income	18,000	-	18,000	18,000
6. AFUDC (Interest)	907	986	1,168	1,202
7. TOTAL FUNDS PROVIDED	\$883,777	\$974,622	\$1,016,361	\$1,009,598
<u>FUNDS APPLIED</u>				
8. Fuel Costs	\$509,704	\$578,367	\$639,185	\$630,841
9. Other Operating Costs	283,308	265,690	278,189	281,181
10. Total Operating Expenses	793,012	844,057	917,374	912,022
11. Less: Non-Cash Expenses	39,338	41,371	40,554	41,887
12. TOTAL FUNDS APPLIED	\$753,674	\$802,686	\$876,820	\$870,135
13. Funds Available to Cover Debt Service	130,103	171,936	139,541	139,463
14. 1975 Ordinance Bonds Debt Service	\$38,806	\$41,949	\$41,949	\$35,748
15. Debt Service Coverage 1975 Revenue Bonds	3.35	4.10	3.33	3.90
16. Net Available After Prior Debt Service	\$91,297	\$129,987	\$97,592	\$103,715
17. PMA and Other Capital Leases	1,998	-	-	-
18. Net Available After Prior Capital Leases	89,299	129,987	97,592	103,715
19. 1998 Ordinance Bonds Debt Service	\$45,999	\$49,580	\$32,467	\$53,313
20. Debt Service Coverage 1998 Revenue Bonds	1.94	2.62	3.01	1.95
21. Net Available After 1998 Debt Service	\$43,300	\$80,407	\$65,125	\$50,402
22. 1998 Ordinance Subordinate Bond Debt Service	1,987	1,986	1,986	1,987
23. Debt Service Coverage Subordinate Bond	21.79	40.49	32.79	25.37
24. Net Available To Service Aggregate Debt Service	\$111,075	\$166,638	\$114,154	\$117,734
25. Aggregate Debt Service	\$88,790	\$93,515	\$76,402	\$91,048
26. Fixed Coverage Charge on Long Term Debt	1.25	1.78	1.49	1.29
27. Fixed Coverage Charge including \$18.0 M City Fee	1.04	1.49	1.21	1.08

PHILADELPHIA GAS WORKS
BALANCE SHEET
(Dollars in Thousands)

Line No.	Actual <u>8/31/2005</u>	Budget <u>8/31/2006</u>	Estimate <u>8/31/2006</u>	Budget <u>8/31/2007</u>	
<u>ASSETS</u>					
1.	Utility Plant Net	\$981,722	\$1,012,338	\$1,012,851	\$1,049,790
2.	Sinking Fund Reserve	104,530	101,615	93,800	102,050
3.	Capital Improvement Fund	102,701	32,479	39,732	99,843
4.	Cash	15,221	52,370	10,820	16,037
Accounts Receivable:					
5.	Gas Receivable	273,805	282,506	264,254	259,256
6.	Other	12,522	436	785	506
7.	Accrued Gas Revenues	8,787	9,935	11,300	10,568
8.	Reserve for Uncollectible	(207,480)	(210,119)	(191,631)	(186,988)
9.	Accounts Receivable Net	87,634	82,758	84,708	83,362
10.	Materials & Supplies	129,984	146,547	183,784	180,389
11.	Other Current Assets	(164)	3,081	2,986	3,056
12.	Deferred Debits	2,796	2,175	8,448	2,275
13.	Unamortized Bond Issuance Expense	39,094	36,227	42,089	46,912
14.	Unamortized Extraordinary Loss	38,494	33,959	55,859	50,301
15.	Other Assets	8,297	4,985	3,411	2,881
16.	Deferred Environmental	9,513	-	9,513	9,513
17.	TOTAL ASSETS	<u>\$1,519,822</u>	<u>\$1,508,534</u>	<u>\$1,548,001</u>	<u>\$1,646,409</u>
<u>EQUITY & LIABILITIES</u>					
18.	City Equity	\$222,646	\$275,996	\$233,063	\$237,421
Long Term Debt:					
19.	Revenue Bonds	1,048,290	1,007,410	1,042,430	1,154,385
20.	TECA Accretions	11,394	12,608	12,608	13,913
21.	Unamortized Discount	(9,484)	(8,816)	(5,113)	(5,883)
22.	Unamortized Premium	22,901	20,843	20,797	18,826
23.	Notes Payable	49,900	59,700	70,000	70,000
24.	City Loan	45,000	45,000	45,000	43,000
Accounts Payable:					
25.	Natural Gas	49,185	38,803	56,465	43,033
26.	General	14,733	21,190	15,820	16,435
27.	Customer Deposits	6,280	6,000	8,250	9,000
28.	Other Current Liabilities	3,734	1,578	3,431	2,129
29.	Deferred Credits	14,608	(1,528)	5,814	4,724
Accrued Credits:					
30.	Interest	9,591	10,984	12,224	14,374
31.	Taxes & Wages	3,861	3,769	4,231	2,796
32.	Distribution to City	3,000	3,000	3,000	3,000
33.	Other Liabilities	24,183	11,997	19,981	19,056
34.	TOTAL EQUITY & LIABILITIES	<u>\$1,519,822</u>	<u>\$1,508,534</u>	<u>\$1,548,001</u>	<u>\$1,646,409</u>

Exhibit B

PHILADELPHIA GAS WORKS
OPERATING REVENUES
(Dollars in Thousands)

Line No.	<u>Actual</u> <u>2004-05</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
1. Non-Heating	\$114,880	\$114,212	\$115,556
2. Gas Transportation Service	4,679	6,147	7,256
3. Heating	713,159	821,190	829,900
4. Weather Normalization Adjustment	(1,365)	12,500	-
5. Unbilled Gas Adjustment	<u>(803)</u>	<u>2,513</u>	<u>(732)</u>
6. Sub-Total Gas Revenues	830,550	956,562	951,980
7. Appliance Repair & Other Service Revenues	10,895	10,669	10,532
8. Other Operating Revenues	<u>21,912</u>	<u>17,865</u>	<u>18,219</u>
9. Sub-Total Other Revenues	32,807	28,534	28,751
10. Total Operating Revenues	<u><u>\$863,357</u></u>	<u><u>\$985,096</u></u>	<u><u>\$980,731</u></u>

Exhibit B-1

PGW
RECONCILIATION OF BILLED REVENUES
(Dollars in Thousands)

Line No.	2004-05 ACTUAL	Billed <u>Revenues</u>	2003-04 GCR <u>Under Recovery</u>	2004-05 GCR <u>Over Recovery</u>	Total <u>Revenues</u>
1.	Firm Non-Heating	\$71,415	(\$595)	(\$617)	\$70,203
2.	Interruptible	44,677			44,677
3.	Total Non Heating	116,092	(595)	(617)	114,880
4.	Gas Transportation Service	4,679			4,679
5.	Heating *	725,958	(7,197)	(6,967)	711,794
6.	Total Revenues	<u>\$846,729</u>	<u>(\$7,792)</u>	<u>(\$7,584)</u>	<u>\$831,353</u>
2005-06 ESTIMATE					
		Billed <u>Revenues</u>	2004-05 GCR <u>Over Recovery</u>	2005-06 GCR <u>Under Recovery</u>	Total <u>Revenues</u>
7.	Firm Non-Heating	\$79,640	\$617	\$499	\$80,756
8.	Interruptible	33,456			33,456
9.	Total Non Heating	113,096	617	499	114,212
10.	Gas Transportation Service	6,147			6,147
11.	Heating	821,013	6,967	5,710	833,690
12.	Total Revenues	<u>\$940,256</u>	<u>\$7,584</u>	<u>\$6,209</u>	<u>\$954,049</u>
2006-07 BUDGET					
		Billed <u>Revenues</u>	2005-06 GCR <u>Under Recovery</u>		Total <u>Revenues</u>
13.	Firm Non-Heating	\$74,863	(\$499)		\$74,364
14.	Interruptible	41,192			41,192
15.	Total Non Heating	116,055	(499)		115,556
16.	Gas Transportation Service	7,256			7,256
17.	Heating	835,610	(5,710)		829,900
18.	Total Revenues	<u>\$958,921</u>	<u>(\$6,209)</u>		<u>\$952,712</u>

* The 2004-2005 fiscal period reflects a \$1.4 million WNA credit to customers reflecting the impact of the colder winter heating season, while the 2005-2006 fiscal period reflects a \$12.5 million WNA charge to customers reflecting the significantly warmer winter heating season.

Exhibit B-1-1

PHILADELPHIA GAS WORKS
GAS REVENUES
(Dollars in Thousands)

Line No.		Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
<u>NON HEATING</u>				
1.	Residential	\$37,132	\$34,732	\$30,764
2.	CRP Residential	-	3,326	3,148
3.	CRP Shortfall	(1,595)	(1,844)	(1,483)
4.	Commercial	26,980	32,907	31,665
5.	Industrial	5,036	6,073	6,315
6.	Municipal	3,862	4,443	4,454
7.	Housing Authority	-	3	-
8.	Total Firm Non-Heating	<u>\$71,415</u>	<u>\$79,640</u>	<u>\$74,863</u>
9.	BPS - Small	\$2,705	\$2,408	\$2,597
10.	BPS - Large	29,289	21,688	26,317
11.	BPS - A/C	-	1,359	1,111
12.	BPS - H Indirect	-	-	-
13.	LBS-L Direct	765	197	220
14.	LBS-L Indirect	3,165	2,285	4,089
15.	LBS-S Indirect	6,502	4,666	6,051
16.	LBS-XL Direct	83	54	30
17.	LBS-XL Indirect	512	488	599
18.	Co-Generation - Indirect	371	213	172
19.	GTS - Sales	1,285	98	6
20.	Total Interruptibles	<u>44,677</u>	<u>33,456</u>	<u>41,192</u>
21.	Total Non Heating	<u>\$116,092</u>	<u>\$113,096</u>	<u>\$116,055</u>
<u>HEATING</u>				
22.	Residential	\$626,071	\$541,730	\$547,532
23.	CRP Residential	0	157,839	163,777
24.	CRP Shortfall	(59,493)	(87,496)	(77,172)
25.	Commercial	129,073	153,393	155,817
26.	Industrial	11,048	12,621	13,472
27.	Municipal	12,041	15,503	16,903
28.	Housing Authority	8,583	14,923	15,281
29.	WNA	(1,365)	12,500	-
30.	Total Heating	<u>725,958</u>	<u>821,013</u>	<u>835,610</u>
31.	Net Billed Revenues	842,050	934,109	951,665
32.	GTS Revenues	4,679	6,147	7,256
33.	Total Billed Revenues	<u>\$846,729</u>	<u>\$940,256</u>	<u>\$958,921</u>
34.	Degree Days	4,327	3,825	4,525

Exhibit B-2

**PHILADELPHIA GAS WORKS
GAS SALES
(MCF's)**

Line No.		Actual 2004-05	Estimate 2005-06	Budget 2006-07
<u>NON HEATING</u>				
1.	Residential	1,955	1,444	1,346
2.	CRP Residential	-	158	160
3.	Commercial	1,755	1,673	1,705
4.	Industrial	327	310	345
5.	Municipal	278	243	263
6.	Housing Authority	-	-	-
7.	Total Firm Non-Heating	<u>4,315</u>	<u>3,828</u>	<u>3,819</u>
8.	BPS - Small	205	148	163
9.	BPS - Large	2,795	1,486	1,931
10.	BPS - A/C	-	123	109
11.	LBS - L Direct	97	17	21
12.	LBS - L Indirect	391	191	375
13.	LBS - S Indirect	787	371	528
14.	LBS - XL Direct	10	4	2
15.	LBS - XL Indirect	62	37	54
16.	Co-Generation - Indirect	47	22	16
17.	GTS - Sales	116	5	-
18.	Total Interruptibles	<u>4,510</u>	<u>2,404</u>	<u>3,199</u>
19.	Total Non Heating	<u>8,825</u>	<u>6,232</u>	<u>7,018</u>
<u>HEATING</u>				
20.	Residential	39,033	26,635	28,887
21.	CRP Residential	-	7,759	8,676
22.	Commercial	8,363	7,806	8,498
23.	Industrial	711	640	735
24.	Municipal	826	850	1,006
25.	Housing Authority	560	754	830
26.	Total Heating	<u>49,493</u>	<u>44,444</u>	<u>48,632</u>
27.	Net Billed Sales	58,318	50,676	55,650
28.	GTS Volumes	<u>11,624</u>	<u>11,140</u>	<u>13,323</u>
29.	Total Billed Sales	<u>69,942</u>	<u>61,816</u>	<u>68,973</u>
30.	Firm Sales	53,808	48,272	52,451
31.	Residential Sales	40,988	35,996	39,069

PHILADELPHIA GAS WORKS
NATURAL GAS EXPENSE
2004-05 ACTUAL
(Dollars in Thousands)

Line No.		<u>Billed</u>	<u>(To) Inventory</u>	<u>From Inventory</u>	<u>Refunds</u>	<u>Seasonal Adjustment</u>	<u>Total</u>
1.	September	\$ 30,341	\$ (14,975)	\$ 457	\$ -	\$ (3,558)	\$ 12,265
2.	October	31,719	(7,802)	2,966	(35)	(1,505)	25,343
3.	November	50,343	(5,082)	2,153	(50)	1,514	48,878
4.	December	61,863	(219)	15,170	(14)	5,090	81,890
5.	January	62,753	(377)	30,631	-	7,378	100,385
6.	February	57,958	(179)	18,059	-	5,355	81,193
7.	March	72,955	(13,541)	10,487	(55)	3,366	73,212
8.	April	34,957	(2,403)	4,707	(55)	(948)	36,258
9.	May	44,085	(27,474)	648	(55)	(3,425)	13,779
10.	June	32,791	(18,904)	383	(55)	(4,458)	9,757
11.	July	33,450	(16,184)	480	(207)	(4,403)	13,136
12.	August	<u>29,231</u>	<u>(13,023)</u>	<u>1,866</u>	<u>(63)</u>	<u>(4,406)</u>	<u>13,605</u>
13.	Total	<u>\$542,446</u>	<u>\$ (120,163)</u>	<u>\$ 88,007</u>	<u>\$ (589)</u>	<u>\$ -</u>	<u>\$ 509,701</u>

PHILADELPHIA GAS WORKS
NATURAL GAS EXPENSE
2005-06 ESTIMATE
(Dollars in Thousands)

Line No.		<u>Billed</u>	<u>(To) Inventory</u>	<u>From Inventory</u>	<u>Refunds</u>	<u>Seasonal Adjustment</u>	<u>Total</u>
1.	September	\$ 36,293	\$ (16,826)	\$ 1,091	\$ (51)	\$ (3,570)	\$ 16,937
2.	October	66,982	(28,212)	2,211	-	(1,743)	39,238
3.	November	80,975	(21,786)	7,468	-	1,151	67,808
4.	December	107,432	(4,090)	26,376	-	4,617	134,335
5.	January	77,499	(1,212)	26,570	(186)	6,695	109,366
6.	February	62,023	(1,281)	33,671	-	4,676	99,089
7.	March	62,689	(5,413)	18,179	-	2,801	78,256
8.	April	45,692	(12,869)	5,903	-	(531)	38,195
9.	May	45,072	(23,904)	656	-	(2,788)	19,036
10.	June	38,095	(23,114)	624	-	(3,812)	11,793
11.	July	36,743	(21,023)	640	-	(3,747)	12,613
12.	August	<u>32,465</u>	<u>(16,842)</u>	<u>640</u>	<u>-</u>	<u>(3,749)</u>	<u>12,514</u>
13.	Total	<u>\$691,960</u>	<u>\$ (176,572)</u>	<u>\$ 124,029</u>	<u>\$ (237)</u>	<u>\$ -</u>	<u>\$ 639,180</u>

PHILADELPHIA GAS WORKS
NATURAL GAS EXPENSE
2006-07 BUDGET
(Dollars in Thousands)

Line No.		<u>Billed</u>	(To) <u>Inventory</u>	From <u>Inventory</u>	<u>Refunds</u>	Seasonal <u>Adjustment</u>	<u>Total</u>
1.	September	\$ 26,433	\$ (9,702)	\$ 620	\$ -	\$ (3,406)	\$ 13,945
2.	October	35,465	(4,261)	644	-	(1,489)	30,359
3.	November	42,184	(5,482)	23,054	-	948	60,704
4.	December	68,188	(2,689)	33,032	-	4,793	103,324
5.	January	81,114	-	40,491	-	6,839	128,444
6.	February	65,092	-	33,355	-	4,622	103,069
7.	March	62,254	(2,077)	21,659	-	2,738	84,574
8.	April	60,022	(17,837)	644	-	(709)	42,120
9.	May	53,955	(29,705)	666	-	(2,886)	22,030
10.	June	44,286	(27,324)	644	-	(3,859)	13,747
11.	July	43,670	(26,222)	666	-	(3,795)	14,319
12.	August	43,033	(25,702)	666	-	(3,796)	14,201
13.	Total	<u>\$625,696</u>	<u>\$ (151,001)</u>	<u>\$ 156,141</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 630,836</u>

Exhibit C-3

PHILADELPHIA GAS WORKS LABOR & FRINGE BENEFITS

(Dollars in Thousands)

Line No.	Actual 2004-05	Estimate 2005-06	Budget 2006-07
OPERATING LABOR			
1.	\$102,821	\$101,277	\$105,887
2.	(22,187)	(21,429)	(22,733)
3.	80,634	79,848	83,154
PENSIONS			
4.	31,204	31,478	32,454
5.	(16,502)	(14,181)	(14,861)
6.	14,702	17,297	17,593
INSURANCE			
7.	1,594	2,100	2,100
8.	33,571	34,804	37,884
9.	35,165	36,904	39,984
TAXES			
10.	6,290	6,207	6,436
11.	1,485	1,485	1,530
12.	116	100	150
13.	0	0	0
14.	0	(614)	0
15.	(1,673)	(1,500)	(1,542)
16.	6,218	5,678	6,574
17.	<u>\$136,719</u>	<u>\$139,727</u>	<u>\$147,305</u>

PHILADELPHIA GAS WORKS
DETAIL OF DIRECT LABOR EXPENSES
(Dollars in Thousands)

Line No.	Actual 2004-05		Estimate 2005-06		Budget 2006-07		
	Average Personnel	Payroll	Average Personnel	Payroll	Average Personnel	Payroll	
1.	Administration	50	\$5,050	50	\$5,605	50	\$5,587
2.	Finance	45	2,260	46	2,340	46	2,451
3.	Customer Activities	383	20,004	383	19,642	383	20,629
4.	Marketing & Planning	65	3,750	64	3,710	63	3,730
5.	Operations	983	57,366	963	56,459	958	59,074
6.	Systems & Services	246	14,049	253	14,311	253	14,849
7.	Cost Savings/Retirements	-	-	(19)	(1,105)	(13)	(798)
8.	Philadelphia Gas Commission	5	342	5	315	5	365
9.	Total Personnel & Payroll	1,777	\$102,821	1,745	\$101,277	1,745	\$105,887
10.	Allocated to Capital & Clearing Accounts		(22,187)		(21,429)		(22,733)
11.	Net Operating Labor	1,777	\$80,634	1,745	\$79,848	1,745	\$83,154

Exhibit C-4

**PHILADELPHIA GAS WORKS
DETAIL OF OTHER EXPENSES
(Dollars in Thousands)**

LINE NO.	<u>OTHER EXPENSES</u>	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
1.	Appropriation for Reserves and Other Losses	\$3,083	\$3,340	\$2,847
2.	Advertising	1,400	1,745	1,977
3.	General Material	6,051	6,720	6,454
4.	Insurance	3,485	3,478	3,827
5.	Contracted Maintenance	7,610	5,644	6,008
6.	Utilities	3,801	3,669	3,616
7.	Rentals	804	784	790
8.	Purchased Services	21,154	20,885	23,740
9.	Postage	2,163	2,433	2,601
10.	Promotion	25	-	532
11.	Non-Utility Revenues	(128)	(147)	(141)
12.	Labor Related Fringe Benefits and A&G Charged to Capital	(17,054)	(16,702)	(19,211)
13.	Depreciation	39,547	40,128	41,413
14.	Less: Cleared to Capital	(1,022)	(349)	(458)
15.	Miscellaneous	5,246	5,315	(856)
16.	Total Other Expenses	<u>\$76,165</u>	<u>\$76,943</u>	<u>\$73,139</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

**APPROPRIATION FOR RESERVE
AND OTHER LOSSES**

	Actual	Estimate	Budget
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Risk Management	\$3,000	\$3,062	\$2,257
Compensated Absences	60	218	115
Corporate Settlements	23	60	475
Grand Total	<u>\$3,083</u>	<u>\$3,340</u>	<u>\$2,847</u>

	Actual	Estimate	Budget
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
ADVERTISING			
Field Services	\$266	\$283	\$377
Collection & Revenue Recovery	561	350	350
Marketing	2	10	35
Corporate Communications	119	651	725
Human Resources	58	75	110
VP Customer Affairs	300	300	300
PUC	21	25	25
VP Compliance & Bus Trans	-	-	-
Gas Commission	6	10	10
Information Services	1	-	1
Telecommunications	10	7	10
Materials Management	56	34	34
Grand Total	<u>\$1,400</u>	<u>\$1,745</u>	<u>\$1,977</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

GENERAL MATERIAL	Actual	Estimate	Budget
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Gas Processing	\$2,113	\$2,079	\$2,134
Distribution	2,346	2,031	2,131
Field Services	2,976	2,730	2,730
Collection & Revenue Recovery	324	182	242
Commercial Resource Center	1	-	1
Customer Service	56	56	69
Account Management	394	735	667
Marketing	28	18	30
Corporate Communications	18	18	18
Gas Control & Acquisition	12	19	19
Human Resources	20	20	20
Risk Management	2	2	2
Accounting & Reporting	12	13	13
Treasury	18	10	11
President & CEO	2	3	3
Sr VP Legal & Genl Counsel	17	24	24
VP Customer Affairs	37	39	39
COO	1	2	4
Security	13	5	5
VP Reg & External Affairs	1	1	1
Sr VP Finance	1	2	2
Strategic Planning	1	1	2
Rates & Gas Planning	3	4	4
Customer Review	4	4	7
PMO	1	1	-
VP Gas Management	1	1	2
VP Labor, Safety, Preparedness	10	29	46
Internal Auditing	-	2	2
Sr VP Operations	5	4	-
VP Marketing & Corp Comm	-	1	1
Operation System Support	1	-	-
VP Support Services	1	1	1
VP Compliance & Bus Trans	3	6	6
Policies & Compliance	1	5	6
Chemical Laboratory Services	15	16	20
Organization Development	-	60	15
Gas Commission	3	7	12
Utility Gas Use	(702)	(708)	(708)
Emergency Operations	(16)	-	-
LNG Terminal Project	1	-	-
Income Tax Program	-	-	-
Facilities Management	529	662	644
Engineering Services	13	22	23
Information Services	152	212	204
Telecommunications	21	20	20
Fleet Operations	1,168	1,636	1,506
Materials Management	(3,556)	(3,255)	(3,524)
Grand Total	<u>\$6,051</u>	<u>\$6,720</u>	<u>\$6,454</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

INSURANCE	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
Human Resources	\$35,155	\$36,904	\$39,984
Risk Management	3,435	3,418	3,757
VP Labor, Safety, Preparedness	17	17	20
Gas Commission	43	43	50
Sub-Total	38,650	40,382	43,811
Less Group Life & Health	35,165	36,904	39,984
Grand Total	<u>\$3,485</u>	<u>\$3,478</u>	<u>\$3,827</u>

CONTRACTED MAINTENANCE

	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
Maintenance Contractors	\$4,424	\$3,272	\$3,588
Maintenance Software	1,460	1,604	1,706
Maintenance - Capital	876	20	26
Maintenance Office Equipment	850	748	688
Grand Total	<u>\$7,610</u>	<u>\$5,644</u>	<u>\$6,008</u>

UTILITIES

	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
Electric	\$2,052	\$2,108	\$2,093
Purchased Telephone	1,306	1,177	1,127
Water	443	384	396
Grand Total	<u>\$3,801</u>	<u>\$3,669</u>	<u>\$3,616</u>

RENTALS

	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
Other Rents	\$293	\$298	\$302
Equipment Rentals & Leasing	511	486	488
Grand Total	<u>\$804</u>	<u>\$784</u>	<u>\$790</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

Maintenance Contractors	Actual	Estimate	Budget
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Gas Processing	\$3,663	\$2,120	\$2,245
Distribution	285	346	606
Account Management	-	-	-
Human Resources	4	10	6
Security	-	-	-
Chem Lab	1	2	2
Emergency Operations	-	-	-
Environmental	-	-	-
Facilities Management	302	465	439
Engineering Services	4	9	7
Information Services	40	68	59
Telecommunications	1	3	3
Fleet Operations	97	155	130
Materials Management	27	94	91
Grand Total	<u>\$4,424</u>	<u>\$3,272</u>	<u>\$3,588</u>

Maintenance Software	Actual	Estimate	Budget
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Distribution	5	30	28
Field Services	26	43	44
Customer Service	37	44	45
Gas Control & Acquisition	42	86	84
Risk Management	-	19	19
Accounting & Reporting	21	22	22
Rates & Gas Planning	25	26	28
Facilities Management	6	12	13
Engineering Services	7	9	10
Information Services	1,245	1,254	1,356
Telecommunications	14	16	14
Fleet Operations	8	15	14
Materials Management	24	28	29
Grand Total	<u>1,460</u>	<u>\$1,604</u>	<u>\$1,706</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

Maintenance Office Equip	Actual	Estimate	Budget
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Customer Service	8	-	-
Account Management	134	115	-
Corporate Communications	-	1	1
Legal	-	5	5
VP Customer Affairs	-	-	-
Gas Commission	1	1	2
Maintenance Office Equip	-	-	-
Facilities Management	9	9	9
Engineering Services	4	3	3
Information Services	260	174	283
Telecommunications	373	388	333
Fleet Operations	5	7	7
Materials Management	56	45	45
Grand Total	<u>\$850</u>	<u>\$748</u>	<u>\$688</u>

Electric	Actual	Estimate	Budget
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Gas Processing	\$1,070	\$1,054	\$1,071
Distribution	33	40	40
Facilities Management	770	797	788
Engineering	9	14	13
Information Services	103	116	107
Telecommunications	4	6	6
Fleet Operations	29	43	33
Materials Management	34	38	35
Grand Total	<u>\$2,052</u>	<u>\$2,108</u>	<u>\$2,093</u>

Purchased Telephone	Actual	Estimate	Budget
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Facilities Management	\$24	\$20	\$20
Engineering Services	9	6	6
Information Services	72	66	62
Telecommunications	1,158	1,044	1,002
Fleet Operations	10	16	13
Materials Management	33	25	24
Grand Total	<u>\$1,306</u>	<u>\$1,177</u>	<u>\$1,127</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

<u>Water</u>	<u>Actual</u> <u>2004-05</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
Gas Processing	\$296	\$251	\$263
Facilities Management	119	104	107
Engineering Services	2	2	2
Information Services	16	15	14
Telecommunications	1	1	1
Fleet Operations	4	6	4
Materials Management	5	5	5
Grand Total	<u>\$443</u>	<u>\$384</u>	<u>\$396</u>

<u>Other Rents</u>	<u>Actual</u> <u>2004-05</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
Distribution	\$18	\$8	\$9
Customer Service	223	242	243
Gas Commission	52	48	50
Grand Total	<u>\$293</u>	<u>\$298</u>	<u>\$302</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

<u>Equipment Rentals & Leasing</u>	<u>Actual</u> <u>2004-05</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
Gas Processing	\$90	\$62	\$78
Distribution	57	61	72
Field Services	14	7	7
Collection & Revenue Recovery	18	32	30
Customer Service	20	23	22
Account Management	5	5	5
Marketing	10	10	10
Gas Control & Acquisition	1	1	1
Human Resources	13	8	10
Risk Management	10	4	4
Accounting & Reporting	4	3	3
President & CEO	16	12	12
Sr VP General Counsel & Legal	14	14	14
VP Customer Affairs	3	5	7
COO	7	10	10
Security	7	5	5
VP Reg & External Affairs	1	1	1
Sr VP Finance	2	3	3
Strategic Planning	8	3	3
Customer Review	3	1	4
VP Gas Management	1	1	1
VP Labor, Safety, Preparedness	5	4	4
Internal Auditing	3	2	2
Sr VP Operations	2	1	-
VP Marketing & Corp Comm	-	1	1
VP Compliance & Bus Trans	-	1	2
Policies And Compliance	-	-	-
Chemical Lab	6	4	4
Gas Commission	16	16	17
Maintenance Office Equip	-	-	-
Facilities Management	4	10	9
Engineering Services	2	2	2
Information Services	69	66	43
Telecommunications	-	-	-
Fleet Operations	48	59	50
Materials Management	52	49	52
Grand Total	<u>\$511</u>	<u>\$486</u>	<u>\$488</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

Purchased Services

	<u>Actual</u> <u>2004-05</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
Gas Processing	\$470	\$765	\$505
Distribution	260	447	571
Field Services	763	531	965
Collection & Revenue Recovery	1,962	868	626
Commercial Resource Center	-	-	3
Customer Service	200	172	368
Account Management	2,312	2,221	1,794
Marketing	158	120	165
Corporate Communications	191	425	360
Gas Control & Acquisition	54	46	45
Human Resources	734	760	880
Risk Management	821	766	750
Accounting & Reporting	50	23	25
Treasury	274	309	443
President & CEO	6	5	5
Officers/PFMC	1	-	-
Sr VP Gen'l Counsel & Legal	277	170	170
VP Customer Affairs	2,751	2,693	3,375
COO	20	1	28
Security	2,334	2,123	2,616
VP Reg & External Affairs	-	45	130
Sr VP Finance	1	5	5
Public Utility Commission	462	500	1,050
Strategic Planning	50	5	5
Rates & Gas Planning	92	100	100
Customer Review	242	165	105
PMO	293	335	-
VP Gas Management	1	2	5
VP Labor, Safety, Preparedness	373	409	465
Internal Auditing	78	50	350
Sr VP Operations	35	20	-
VP Marketing & Corp Comm	-	1	4
VP Support Services	183	83	10
VP Compliance & Bus Trans	2	30	20
Policies & Compliance	132	59	75
Chemical Laboratory Services	7	38	13
Organization Development	-	425	450
Gas Commission	398	338	408
FERC Matters	180	105	160
Special Legal	281	381	750
Administrative Consultants	793	1,093	1,341
Emergency Operations	15	-	-
LNG Terminal Project	844	514	-
Utility Merger	305	504	50
Executive Search	10	-	-
Environmental	-	-	-
Facilities Management	268	439	1,067
Engineering Services	473	554	598
Information Services	1,756	1,914	2,162
Telecommunications	11	3	9
Fleet Operations	96	147	400
Materials Management	135	176	314
Grand Total	<u>\$21,154</u>	<u>\$20,885</u>	<u>\$23,740</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

POSTAGE

	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
Gas Processing	-	-	-
Distribution	2	3	2
Field Services	124	272	336
Collection & Revenue Recovery	110	99	105
Customer Service	3	8	9
Account Management	1,619	1,782	1,894
Marketing	6	6	25
Corporate Communications	1	1	1
Human Resources	6	8	6
Risk Management	-	1	1
Treasury	17	24	24
President & CEO	-	1	1
Sr VP General Counsel & Legal	3	5	5
VP Customer Affairs	257	205	174
Metered Mail	11	5	5
VP Reg & External Affairs	1	-	-
Strategic Planning	-	1	-
Customer Review	2	1	1
VP Gas Management	-	-	1
VP Labor, Safety, Preparedness	-	1	1
VP Support Services	-	1	1
Gas Commission	-	1	1
Materials Management	1	8	8
Grand Total	<u>\$2,163</u>	<u>\$2,433</u>	<u>\$2,601</u>

PROMOTION

	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
Marketing	\$25	-	\$532
Grand Total	<u>\$25</u>	<u>-</u>	<u>\$532</u>

NON-UTILITY REVENUE

	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
Customer Service	(63)	(60)	(60)
Account Management	(63)	(57)	(60)
Facilities Management	-	(1)	-
Information Services	-	(2)	(1)
Telecommunications	-	(24)	(17)
Material Management	-	(2)	(2)
Fleet Operations	(2)	(1)	(1)
Grand Total	<u>(\$128)</u>	<u>(\$147)</u>	<u>(\$141)</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

LABOR RELATED FRINGE BENEFITS & A&G CHARGED to CAPITAL	Actual 2004-05	Estimate 2005-06	Budget 2006-07
Construction Overheads	(\$10,348)	(\$10,099)	(\$11,261)
A & G Additive	<u>(6,706)</u>	<u>(6,603)</u>	<u>(7,950)</u>
Grand Total	<u>(\$17,054)</u>	<u>(\$16,702)</u>	<u>(\$19,211)</u>

MISCELLANEOUS

	Actual 2004-05	Estimate 2005-06	Budget 2006-07
Expense of Employees	\$453	\$840	\$954
Dues & Subscriptions	2,881	3,294	3,676
Taxes	24	24	28
PFMC - Management Fee	325	371	372
Deferred Compensation	334	343	355
Amortization Restructuring Costs	1,087	1,087	-
Cost Savings	-	-	(5,000)
LNG Inventory	(290)	(1,083)	(1,568)
Capital Lease Amortization	-	-	-
Amortization	432	439	327
PA State Sales Tax	-	-	-
Grand Total	<u>\$5,246</u>	<u>\$5,315</u>	<u>(\$856)</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

<u>Expense of Employees</u>	<u>Actual 2004-05</u>	<u>Estimate 2005-06</u>	<u>Budget 2006-07</u>
Gas Processing	\$27	\$29	\$32
Distribution	35	53	53
Field Services	35	44	44
Collection & Revenue Recovery	5	9	9
Commercial Resource Center	1	1	1
Customer Service	9	12	16
Account Management	-	1	2
Marketing	23	35	49
Corporate Communications	2	10	10
Gas Control & Acquisition	14	40	39
Human Resources	16	20	20
Risk Management	1	3	3
Accounting & Reporting	16	13	15
Treasury	3	15	10
President & CEO	9	10	10
Sr VP General Counsel & Legal	14	22	22
VP Customer Affairs	27	73	53
COO	14	15	47
Security	3	5	10
VP Reg & External Affairs	21	8	8
Sr VP Finance	3	10	15
Strategic Planning	10	30	19
Rates & Gas Planning	-	5	10
Customer Review	-	2	3
PMO	1	-	-
VP Gas Management	2	1	3
VP Labor, Safety, Preparedness	3	16	16
Internal Auditing	5	10	10
SR VP Operations	1	1	-
VP Marketing & Corp Comm	1	5	22
VP Support Services	1	10	5
VP Compliance & Bus Trans	6	30	37
Policies & Compliance	7	14	15
Chemical Laboratory Services	1	7	8
Organization Development	-	12	12
Gas Commission	1	1	3
Relocation Expense	23	25	25
Facilities Management	4	7	8
Engineering Services	3	8	8
Information Services	91	193	247
Telecommunications	8	5	5
Fleet Operations	2	11	10
Materials Management	5	19	20
Grand Total	<u>\$453</u>	<u>\$840</u>	<u>\$954</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

<u>Dues & Subscriptions</u>	<u>Actual</u> <u>2004-05</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
Gas Processing	\$2	\$2	\$2
Distribution	1	2	3
Field Services	1	2	2
Commercial Resource Center	-	-	1
Customer Service	2	1	1
Account Management	-	1	1
Marketing	21	24	25
Corporate Communications	2	3	3
Gas Control & Acquisition	25	38	36
Human Resources	106	20	15
Risk Management	-	1	1
Accounting & Reporting	1	2	2
Treasury	1	1	1
President & CEO	-	1	1
Sr VP Genl Counsel & Legal	26	18	18
VP Customer Affairs	1	1	4
COO	2	2	3
Security	1	1	2
VP Reg & External Affairs	1	1	1
Sr VP Finance	-	2	2
PUC	2,084	2,388	2,450
Strategic Planning	-	1	1
Rates & Gas Planning	25	24	25
PMO	-	-	-
VP Gas Management	-	-	1
VP Labor, Safety, Preparedness	2	5	7
Internal Auditing	-	10	25
Sr VP Operations	1	1	-
VP Marketing & Corporate Comm	-	1	1
VP Support Services	-	2	2
VP Compliance & Bus Trans	-	6	6
Policies & Compliance	-	1	1
Chemical Laboratory Services	-	-	-
Organization Development	-	142	410
Gas Commission	2	2	3
Company Dues & Subscriptions	551	551	585
Facilities Management	4	2	2
Engineering Services	7	9	9
Information Services	3	7	6
Fleet Operations	5	9	7
Materials Management	4	10	11
Grand Total	<u>\$2,881</u>	<u>\$3,294</u>	<u>\$3,676</u>

DETAIL OF OTHER OPERATING EXPENSES C-4

<u>Taxes</u>	<u>Actual</u> <u>2004-05</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
Gas Commission	\$24	\$24	\$28
Grand Total	<u>\$24</u>	<u>\$24</u>	<u>\$28</u>

<u>Amortization</u>	<u>Actual</u> <u>2004-05</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
Human Resources	\$21	\$21	\$21
Accounting & Reporting	(59)	68	68
Treasury	-	127	127
Public Utility Commission	134	111	
VP Labor, Safety, Preparedness	21	21	21
Policies & Compliance	31	31	31
Environmental	-	-	-
Emergency Operations	-	-	-
Relocation Expenses	-	-	-
Regulatory Asset	-	-	
Facilities Management	1	-	
Engineering Services	1	-	
Information Services	161	39	39
Fleet Operations	1	1	
Materials Management	120	30	30
Grand Total	<u>\$432</u>	<u>\$449</u>	<u>\$337</u>

Exhibit D

PHILADELPHIA GAS WORKS
OTHER INCOME
(Dollars in Thousands)

Line No.	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
<u>Interest Earnings On:</u>			
1. Capital Improvement Fund	\$ 2,804	\$ 1,957	\$ 3,107
2. Capital Lease Fund	1	-	-
3. Revenue Bond Sinking Fund	429	1,684	1,766
4. Temporary Investments	644	3,441	4,000
5. Natural Gas Refunds	2	1	-
6. Notes Receivable - Intl House	12	9	5
Total Interest Earnings	\$ 3,892	\$ 7,092	\$ 8,878
7. Miscellaneous Income	\$ (54)	\$ 35	\$ 35
8. Rental Income	65	64	64
9. Penalties Suppliers Gas Choice	67	100	75
10. Penalties Regulatory	-	(101)	(50)
11. Guaranteed Investment Contract Proceeds	625	625	625
12. Capitalized Interest	156	73	-
13. Swap Option Proceeds	27	-	-
14. Dept. of Energy Oil Refund	-	108	-
15. Demutualization Proceeds Life Insurance	-	202	-
Total Other Income	\$ 4,778	\$ 8,198	\$ 9,627

Exhibit E-1

**PHILADELPHIA GAS WORKS
REVENUE BOND DEBT SERVICE**
(Dollars in Thousands)

Line No.	Year Issued	Series	Actual 2004-05	Estimate 2005-06	Budget 2006-07
<u>Interest Payments</u>					
1.	1989	11th C TECA	-	-	-
2.	1990	12th A TECA	3,023	3,144	-
3.	1994	15th	1,031	812	777
4.	1999	16th	3,152	2,746	2,320
5.	2003	17th	9,534	9,309	8,837
6.	2004	18th	2,275	2,833	2,784
7.	1998	1st A	7,026	6,538	6,181
8.	1998	1st B	5,190	2,595	-
9.	1999	2nd	5,285	3,178	1,166
10.	2001	3rd	6,221	901	901
11.	2003	4th	6,184	6,010	6,010
12.	2004	5th	2,283	6,000	6,000
13.	2004	5th Variable	497	900	1,050
14.	2006	6th	-	5,544	11,485
15.	2006	7th	-	-	4,875
16.	Total Interest Payments		<u>\$51,701</u>	<u>\$50,510</u>	<u>\$52,386</u>
<u>Interest Accruals</u>					
17.	1989	11th C TECA	\$1,131	\$1,215	\$1,305
18.	1990	12th A TECA	521	224	-
19.	1994	15th	1,649	808	777
20.	1999	16th	3,084	2,675	2,245
21.	2003	17th	9,496	9,231	8,748
22.	2004	18th	2,511	2,828	2,777
23.	1998	1st A	6,944	6,479	6,080
24.	1998	1st B	5,190	2,079	-
25.	1999	2nd	5,269	2,777	1,148
26.	2001	3rd	6,213	2,990	897
27.	2003	4th	5,287	6,047	6,006
28.	2004	5th	5,284	6,000	6,000
29.	2004	5th Variable	546	900	1,050
30.	2006	6th	-	6,859	11,485
31.	2006	7th	-	-	7,312
32.	Total Interest Accruals		<u>\$53,125</u>	<u>\$51,112</u>	<u>\$55,830</u>

PHILADELPHIA GAS WORKS
OTHER LONG TERM DEBT SERVICE
(Dollars in Thousands)

Line No.	Year <u>Issued</u>	<u>Series</u>	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
<u>Interest Payments</u>					
1.	1997	Capital Lease	\$ 51	\$ -	\$ -
2.	1998	1st C Subordinate	<u>732</u>	<u>676</u>	<u>617</u>
3.	Total Interest Payments		<u>\$ 783</u>	<u>\$ 676</u>	<u>\$ 617</u>
<u>Interest Accruals</u>					
4.	1997	Capital Lease	\$ 9	\$ -	\$ -
5.	1998	1st C Subordinate	<u>722</u>	<u>666</u>	<u>607</u>
6.	Total Interest Accruals		<u>\$ 731</u>	<u>\$ 666</u>	<u>\$ 607</u>

Exhibit E-3

PHILADELPHIA GAS WORKS
OTHER INTEREST
(Dollars in Thousands)

Line No.	<u>Other Interest</u>	<u>Actual 2004-05</u>	<u>Estimate 2005-06</u>	<u>Budget 2006-07</u>
1.	Tax-Exempt Commercial Paper	\$2,759	\$6,585	\$8,935
2.	Variable Rate - 5th Series A-2	560	552	552
3.	Variable Rate - 6th Series	-	261	922
4.	Bond Discount, Issuance & Premium Expense	1,703	1,668	2,237
5.	Customer Deposits	211	495	540
6.	Miscellaneous Interest Expense	<u>890</u>	<u>-</u>	<u>-</u>
	Total Other Interest	<u>\$ 6,123</u>	<u>\$ 9,561</u>	<u>\$ 13,186</u>
7.	Extraordinary Loss	<u>\$ 4,779</u>	<u>\$ 5,332</u>	<u>\$ 5,557</u>
8.	AFUDC *	<u>\$ (907)</u>	<u>\$ (1,168)</u>	<u>\$ (1,202)</u>
9.	* Total AFUDC	(\$907)	(\$1,168)	(\$1,202)

**PHILADELPHIA GAS WORKS
CAPITAL FUNDING & EXPENDITURES
(Dollars In Thousands)**

Line No.		<u>Actual 2004-05</u>	<u>Estimate 2005-06</u>	<u>Budget 2006-07</u>
SOURCES:				
1.	Capital Improvement Fund	\$68,000	\$60,195	\$72,000
2.	Other Funding Sources	(1,090)	7,862	3,152
3.	Total Sources	<u>\$66,910</u>	<u>\$68,057</u>	<u>\$75,152</u>
USES:				
Capital Expenditures:				
4.	Gas Processing	\$5,008	\$4,262	\$4,486
5.	Distribution	43,572	45,211	45,224
6.	Field Services	5,288	6,111	9,398
7.	Information Technology	2,965	3,119	4,817
8.	Transportation	2,918	3,685	4,640
9.	Field Operations Initiative	5,129	1,766	2,454
10.	Other Departments	2,030	3,903	4,133
11.	Total Uses	<u>\$66,910</u>	<u>\$68,057</u>	<u>\$75,152</u>

Exhibit G-1

**PHILADELPHIA GAS WORKS
REVENUE BOND DEBT SERVICE**
(Dollars in Thousands)

Line No.	Year Issued	Series	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
<u>Principal Payments</u>					
1.	1989	11th C	\$ -	\$ -	\$ -
2.	1990	12th A	1,632	1,511	-
3.	1994	15th	4,395	705	-
4.	1999	16th	7,735	8,120	8,525
5.	2003	17th	5,610	11,795	10,715
6.	2004	18th	420	975	1,790
7.	1998	1st A	9,280	6,800	11,080
8.	1999	2nd	2,120	-	2,315
9.	2001	3rd	2,130	-	965
10.	2003	4th	2,065	-	1,285
11.	Total Principal Payments		<u>\$ 35,387</u>	<u>\$ 29,906</u>	<u>\$ 36,675</u>

PHILADELPHIA GAS WORKS
OTHER LONG TERM DEBT SERVICE
(Dollars in Thousands)

Line No.	Year <u>Issued</u>	<u>Series</u>	<u>Actual</u> <u>2004-05</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
<u>Principal Payments</u>					
1.	1997	Capital Lease	\$ 1,947	\$ -	\$ -
2.	1998	1st C Subordinate	<u>1,255</u>	<u>1,310</u>	<u>1,370</u>
3.		Total Principal Payments	<u>\$ 3,202</u>	<u>\$ 1,310</u>	<u>\$ 1,370</u>

Exhibit H-1

PHILADELPHIA GAS WORKS
WORKING CAPITAL DETAIL
(Dollars in Thousands)

Line No.	Actual Balance <u>8/31/05</u>	Estimate Balance <u>8/31/06</u>	Budget Balance <u>8/31/07</u>	
ASSETS				
1.	Accounts Receivable	\$286,327	\$265,039	\$259,762
2.	Accrued Gas Revenues	8,787	11,300	10,568
3.	Uncollectible Reserve	<u>(207,480)</u>	<u>(191,631)</u>	<u>(186,968)</u>
4.	Net Accounts Receivable	87,634	84,708	83,362
5.	Materials & Supplies	129,984	183,784	180,389
6.	Other Current Assets	<u>2,632</u>	<u>11,434</u>	<u>5,331</u>
7.	Total Assets	<u><u>\$220,250</u></u>	<u><u>\$279,926</u></u>	<u><u>\$269,082</u></u>
LIABILITIES				
Accounts Payable:				
8.	Natural Gas	\$49,185	\$56,465	\$43,033
9.	General	<u>14,733</u>	<u>15,820</u>	<u>16,435</u>
10.	Total Accounts Payable	63,918	72,285	59,468
11.	Other Current Liabilities	<u>38,074</u>	<u>33,950</u>	<u>33,023</u>
12.	Total Liabilities	<u><u>\$101,992</u></u>	<u><u>\$106,235</u></u>	<u><u>\$92,491</u></u>
13.	Total Working Capital	<u><u>\$118,258</u></u>	<u><u>\$173,691</u></u>	<u><u>\$176,591</u></u>
14.	Net Increase/(Decrease)	\$3,793	\$55,433	\$2,900

PHILADELPHIA GAS WORKS
WORKING CAPITAL CHANGES
(Dollars in Thousands)

Line No.	Actual Change <u>8/31/05</u>	Estimate Change <u>8/31/06</u>	Budget Change <u>8/31/07</u>	
ASSETS				
1.	Accounts Receivable	(\$27,423)	(\$21,288)	(\$5,277)
2.	Accrued Gas Revenues	(803)	2,513	(732)
3.	Uncollectible Reserve	<u>22,736</u>	<u>15,849</u>	<u>4,663</u>
4.	Net Accounts Receivable	(\$5,490)	(\$2,926)	(\$1,346)
5.	Materials & Supplies	\$31,517	\$53,800	(\$3,395)
6.	Other Current Assets	<u>(\$11,385)</u>	<u>\$8,802</u>	<u>(\$6,103)</u>
7.	Total Assets	<u><u>\$14,642</u></u>	<u><u>\$59,676</u></u>	<u><u>(\$10,844)</u></u>
LIABILITIES				
Accounts Payable:				
8.	Natural Gas	(\$3,682)	\$7,280	(\$13,432)
9.	General	<u>(5,427)</u>	<u>1,087</u>	<u>615</u>
10.	Total Accounts Payable	(\$9,109)	\$8,367	(\$12,817)
11.	Other Current Liabilities	<u>\$19,958</u>	<u>(\$4,124)</u>	<u>(\$927)</u>
12.	Total Liabilities	<u><u>\$10,849</u></u>	<u><u>\$4,243</u></u>	<u><u>(\$13,744)</u></u>
13.	Total Working Capital	<u><u>\$3,793</u></u>	<u><u>\$55,433</u></u>	<u><u>\$2,900</u></u>

PHILADELPHIA GAS WORKS
MATERIALS & SUPPLIES BALANCE @ 8/31

<u>Non-Gas inventory</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
	<u>Dollars</u>	<u>Dollars</u>
Storerooms:		
Belfield	\$ 85,000	\$ 87,000
Castor	60,000	61,000
Field Operations / Tioga	2,250,000	2,295,000
Meter Shop	80,000	81,000
Montgomery	975,000	995,000
Passyunk Mini	45,000	45,000
Passyunk Plant	1,050,000	1,071,000
Porter	100,000	102,000
Richmond Plant	3,750,000	3,825,000
Stationery	75,000	77,000
Transportation	400,000	408,000
Other Miscellaneous	21,000	21,000
Sub Total	\$ 8,891,000	\$ 9,068,000

<u>Natural Gas Storages</u>	<u>Estimate</u> <u>2005-06</u>			<u>Budget</u> <u>2006-07</u>		
	<u>Volume (Mcf)</u>	<u>Dollars</u>	<u>Avg. Price</u>	<u>Volume (Mcf)</u>	<u>Dollars</u>	<u>Avg. Price</u>
GSS - Transco	3,725,894	\$ 31,398,544	\$ 8.43	2,963,151	\$ 27,721,119	\$ 9.36
WSS	3,213,785	26,866,879	8.36	2,417,844	21,224,554	8.78
SS 1A	2,545,687	22,036,939	8.66	1,901,714	18,091,579	9.51
GSS - Tetco	3,316,496	27,795,468	8.38	2,923,667	27,924,962	9.55
Equitrans - Keystone	387,206	3,302,526	8.53	367,532	3,628,867	9.87
S-2	383,651	3,069,230	8.00	318,809	2,920,953	9.16
SS 1B	2,367,811	20,448,648	8.64	1,843,398	17,674,886	9.59
Eminence 1	465,118	3,648,679	7.84	459,058	4,277,773	9.32
Eminence 2	631,997	5,158,319	8.16	577,792	5,236,868	9.06
Sub Total	17,037,645	\$143,725,232	\$ 8.44	13,772,965	\$ 128,701,561	\$ 9.34
Richmond LNG	3,038,777	26,904,227	8.85	3,985,538	36,712,298	9.21
Passyunk LNG	258,669	1,991,085	7.70	258,669	2,066,471	7.99
Processing Costs	-	2,272,456		-	3,840,670	
Sub Total	3,297,446	31,167,768		4,244,207	42,619,439	
Total Gas Storage	20,335,091	\$174,893,000	\$ 8.60	18,017,172	\$ 171,321,000	\$ 9.51
Total Material & Supplies		\$183,784,000			\$ 180,389,000	

SD-1

PHILADELPHIA GAS WORKS
DETAIL OF NON-CASH EXPENSES
(Dollars in Thousands)

Line No.	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
DEPRECIATION			
1. Depreciation on Historical	\$39,547	\$40,128	\$41,413
2. Less to Capital	<u>(1,022)</u>	<u>(349)</u>	<u>(458)</u>
	38,525	39,779	40,955
SUBORDINATE PAYMENTS			
3. Gas Commission	909	830	973
4. City Payments	556	570	584
5. Swap Option Proceeds	<u>(652)</u>	<u>(625)</u>	<u>(625)</u>
	813	775	932
6. Total Non-Cash Expenses	<u><u>\$39,338</u></u>	<u><u>\$40,554</u></u>	<u><u>\$41,887</u></u>
DETAIL OF DEPRECIATION & AMORTIZATION			
	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
7. Depreciation Excluding Cost of Removal	\$35,904	\$36,928	\$38,213
8. Discount, Premium & Issuance Expense	1,598	1,668	2,237
9. Extraordinary Loss	<u>4,779</u>	<u>5,332</u>	<u>5,557</u>
10. Total	<u><u>\$42,281</u></u>	<u><u>\$43,928</u></u>	<u><u>\$46,007</u></u>
NET CHANGE OTHER LONG TERM			
	Actual <u>2004-05</u>	Estimate <u>2005-06</u>	Budget <u>2006-07</u>
11. (Increase)/Decrease Other Assets	(\$8,142)	\$4,809	\$530
12. Increase/(Decrease) Other Liabilities	2,596	(4,128)	(924)
13. TECA Accretions	<u>(1,371)</u>	<u>(1,705)</u>	<u>1,305</u>
14. Total	<u><u>(\$6,917)</u></u>	<u><u>(\$1,024)</u></u>	<u><u>\$911</u></u>

SD-2

**PHILADELPHIA GAS WORKS
INSURANCE EXPENSE**
(Dollars in Thousands)

Line No.	<u>Insurance Type</u>	<u>Actual 2004-05</u>	<u>Estimate 2005-06</u>	<u>Budget 2006-07</u>
1.	Property	\$827	\$1,067	\$1,067
2.	Public Liability	2218	2,002	2,289
3.	Workers' Compensation	390	349	401
4	Miscellaneous	50	60	70
5	Sub-Total	<u>\$3,485</u>	<u>\$3,478</u>	<u>\$3,827</u>
6	Employees' Health	33,571	34,804	37,884
7	Employees' Group Life	1,594	2,100	2,100
8	Sub-Total	<u>\$35,165</u>	<u>\$36,904</u>	<u>\$39,984</u>
9.	Total Insurance	<u><u>\$38,650</u></u>	<u><u>\$40,382</u></u>	<u><u>\$43,811</u></u>

**PHILADELPHIA GAS WORKS
PERSONNEL & PAYROLL DETAIL
(Dollars in Thousands)**

DEPARTMENTS	Actual 2004-05		Estimate 2005-06		Budget 2006-07	
	Average Personnel	Payroll	Average Personnel	Payroll	Average Personnel	Payroll
ADMINISTRATION						
Officer's Salaries	0	\$2,212	0	\$2,367	0	\$2,340
Incentive Bonus	0	\$0	0	\$500	0	\$500
President & Chief Executive Officer	3	60	2	62	2	63
Internal Auditing	2	121	3	213	3	222
Senior VP General Counsel & Legal	15	940	14	826	14	766
Human Resources	13	733	9	484	9	500
VP Labor, Safety, Preparedness	10	521	9	445	9	458
Organizational Development	0	0	4	156	4	165
Policies & Compliance	3	207	4	248	4	256
Corporate Communications	4	256	5	304	5	317
Total	50	\$5,050	50	\$5,605	50	\$5,587
FINANCE						
Chief Financial Officer	0	\$0	0	\$0	0	\$0
Accounting & Reporting	24	1,251	23	1,094	21	1,032
SR VP Finance	2	54	5	277	7	389
Risk Management	6	343	6	332	6	341
Treasury	13	612	12	637	12	689
Total	45	\$2,260	46	\$2,340	46	\$2,451
CUSTOMER ACTIVITIES						
VP Customer Affairs	15	\$723	37	\$2,014	39	\$2,536
Collections	125	6,566	118	5,863	92	4,745
Bonus Awards	0	91	0	100	0	100
Commercial Resource Center	1	75	4	217	7	421
Account Management	46	2,311	42	2,131	38	2,070
Customer Review Unit	14	702	13	704	13	714
Customer Service	176	9,140	166	8,452	194	10,043
PMO	6	396	3	161	0	0
Total	383	\$20,004	383	\$19,642	383	\$20,629
MARKETING & PLANNING						
VP Marketing	1	\$49	2	\$48	2	\$50
Marketing	29	1,586	28	1,603	28	1,664
Strategic Planning	4	187	5	281	5	291
VP Regulatory & External Affairs*	4	169	2	80	2	49
Gas Control & Acquisitions	21	1,313	21	1,311	20	1,277
Rates & Gas Planning	6	346	6	387	6	399
Total	65	\$3,750	64	\$3,710	63	\$3,730
OPERATIONS						
Chief Operating Officer	5	\$281	5	\$357	7	\$522
Senior VP Operations	9	592	3	173	0	0
VP Gas Management	2	39	2	40	2	41
Field Services	352	20,258	346	19,950	342	21,163
Distribution	474	26,881	469	26,630	470	28,056
Gas Processing	137	9,112	134	9,067	133	9,043
Operations Systems Support	4	203	4	242	4	249
Total	983	\$57,366	963	\$56,459	958	\$59,074
SYSTEMS & SERVICES						
Information Services	57	\$3,289	65	\$3,821	65	\$3,969
VP Compliance, Technical & Transformation*	5	288	9	549	10	635
VP Support Services	3	210	3	118	3	120
Procurement	7	387	6	351	6	359
Engineering Services	9	579	8	510	8	535
Facilities Management	53	2,645	50	2,473	49	2,405
Telecommunications	4	177	4	222	4	228
Security	3	168	2	118	2	122
Materials Management	59	3,486	59	3,444	59	3,574
Chemical Services	4	223	4	243	4	251
Field Operations	42	2,597	43	2,462	43	2,651
Total	246	\$14,049	253	\$14,311	253	\$14,849
SUB-TOTAL	1,772	\$102,479	1,759	\$102,067	1,753	\$106,320
Labor Savings			(19)	(\$1,105)	(13)	(\$798)
SUB-TOTAL	1,772	\$102,479	1,740	\$100,962	1,740	105,522
Philadelphia Gas Commission	5	342	5	315	5	365
GRAND TOTAL PAYROLL	1,777	\$102,821	1,745	\$101,277	1,745	\$105,887
Capitalized Full Time Equivalents	383	22,187	369	21,429	375	22,733

* Restated due to Organizational Changes

SD-4

**PHILADELPHIA GAS WORKS
REMAINING NORMALIZED EXPENSES**

<u>Line No.</u>	<u>Description</u>	<u>Department</u>	<u>Estimate 2005-06</u>	<u>Budget 2006-07</u>	<u>Forecast 2007-08</u>
1.	Management Audit	PUC	\$ 111,134	\$ -	\$ -
2.	Restructuring	Amortization of Restructuring Costs	1,086,695	-	-
3.	HRIS - Payroll	Human Resources	20,925	20,925	10,463
4.	HRIS - Payroll	VP Labor, Safety, & Preparedness	20,925	20,925	10,463
5.	HRIS - Payroll	Treasury	84,969	84,969	42,484
6.	Oracle 11i Upgrade	Accounting & Reporting	64,029	64,029	64,029
7.	Oracle 11i Upgrade	Treasury	42,335	42,335	42,335
8.	Oracle 11i Upgrade	Material Management	21,168	21,168	21,168
9.	Oracle 11i Upgrade	Procurement	21,168	21,168	21,168
10.	Oracle 11i Upgrade	Information Services	42,335	42,335	42,335
11.	Noetix	Accounting & Reporting	4,214	4,214	4,214
12.	Business Continuity	Policies & Compliance	<u>30,104</u>	<u>30,933</u>	<u>30,342</u>
13.	Total		<u>\$ 1,550,000</u>	<u>\$ 353,000</u>	<u>\$ 289,000</u>

**PHILADELPHIA GAS WORKS
ENVIRONMENTAL EXPENSES FY 2005 THROUGH FY 2012**

<u>Environmental</u>	<u>Actual FY 2005</u>	<u>Estimate FY 2006</u>	<u>Budget FY 2007</u>	<u>Forecast FY 2008</u>	<u>Forecast FY 2009</u>	<u>Forecast FY 2010</u>	<u>Forecast FY 2011</u>	<u>Forecast FY 2012</u>					
Cost of Removal (Net)	\$ -	\$ 1,547,000	\$ 400,000	\$ 455,000	\$ -	\$ -	\$ -	\$ -	\$ 2,402,000				
Labor													
Technical Support	\$ -	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000				
Total	\$ -	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000				\$ 700,000
Purchased Service													
Purchased Service	\$ -	\$ 92,588	\$ 666,000	\$ 435,000	\$ 364,000	\$ 180,000	\$ 218,000	\$ 127,000					
Assessment Study	-	430,000	75,000	-	-	-	-	-					
Total	\$ -	\$ 522,588	\$ 741,000	\$ 435,000	\$ 364,000	\$ 180,000	\$ 218,000	\$ 127,000	\$ 2,587,588				
Maint. Contractors													
Misc. Contractors	\$ -	\$ 1,392,000	\$ 1,426,500	\$ 2,433,477	\$ 1,451,067	\$ 341,067	\$ 341,067	\$ 341,067					
Total	\$ -	\$ 1,392,000	\$ 1,426,500	\$ 2,433,477	\$ 1,451,067	\$ 341,067	\$ 341,067	\$ 341,067	\$ 7,728,245				
Total Cumulative	\$ -	\$ 2,014,588	\$ 2,267,500	\$ 2,968,477	\$ 1,915,067	\$ 621,067	\$ 659,067	\$ 568,067	\$ 11,013,833				
	\$ -	\$ 2,014,588	\$ 4,282,088	\$ 7,250,565	\$ 9,165,632	\$ 9,788,699	\$ 10,445,766	\$ 11,013,833	Total	\$ 13,415,833			
Expense	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	
Labor	\$ -	\$ -	\$ -	\$ -	\$ 20,000	\$ 20,000	\$ 20,000	\$ 20,000					
Purchased Serv.	-	-	-	-	72,800	36,000	43,600	25,400					
Maint. Contractors	-	-	-	-	290,213	68,213	68,213	68,213					
Amortization	-	-	-	-	-	383,013	507,227	639,040	752,654	369,640	245,427	113,613	
Total	\$ -	\$ -	\$ -	\$ -	\$ 383,013	\$ 507,227	\$ 639,040	\$ 752,654	\$ 752,654	\$ 369,640	\$ 245,427	\$ 113,613	
Cumulative	\$ -	\$ -	\$ -	\$ -	\$ 383,013	\$ 890,240	\$ 1,529,280	\$ 2,281,934	\$ 3,034,588	\$ 3,404,228	\$ 3,649,655	\$ 3,763,268	
5 Year Amortization	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	
Cash	\$ -	\$ -	\$ -	\$ -	\$ 1,915,067	\$ 621,067	\$ 659,067	\$ 568,067					
Expense	-	-	-	-	383,013	124,213	131,813	113,613					
Deferred	-	-	-	-	1,532,054	496,854	527,254	454,454					
Cumulative L-T Deferred	-	-	-	-	1,532,054	2,028,907	2,173,147	2,120,374	1,481,334	728,680	359,040	113,613	
Less Current Amortiz.	-	-	-	-	-	(383,013)	(507,227)	(639,040)	(752,654)	(369,640)	(245,427)	(113,613)	
Remaining L-T Deferred	\$ -	\$ -	\$ -	\$ -	\$ 1,532,054	\$ 1,645,894	\$ 1,665,921	\$ 1,481,334	\$ 728,680	\$ 359,040	\$ 113,613	\$ -	
Deferred Costs	-	-	-	-	\$ 1,532,054	\$ 496,854	\$ 527,254	\$ 454,454					
Current Costs	-	2,014,588	2,267,500	2,968,477	383,013	507,227	639,040	752,654	752,654	369,640	245,427	113,613	\$ 3,763,268
Cost of Removal	-	1,547,000	400,000	455,000	-	-	-	-					
Total	\$ -	\$ 3,561,588	\$ 2,667,500	\$ 3,423,477	\$ 1,915,067	\$ 621,067	\$ 659,067	\$ 568,067					
Cumulative		<u>\$ 3,561,588</u>	<u>\$ 6,229,088</u>	<u>\$ 9,652,565</u>	<u>\$ 11,567,632</u>	<u>\$ 12,188,699</u>	<u>\$ 12,847,766</u>	<u>\$ 13,415,833</u>					
Settlement Proceeds	08/31/2005	08/31/2006	08/31/2007	08/31/2008	08/31/2009	08/31/2010	08/31/2011	08/31/2012					
Expenses / Amortization	\$ 9,513,000	\$ 2,544,000	\$ 1,621,585										
Settlement Balance	\$ (4,026,000)	\$ (3,561,588)	\$ (2,667,500)	\$ (3,423,477)	\$ (1,915,067)	\$ (621,067)	\$ (659,067)	\$ (568,067)					
	\$ 5,487,000	\$ 4,469,412	\$ 3,423,477	\$ 0									

**PHILADELPHIA GAS WORKS
DEFERRED RESTRUCTURING EXPENSES**

	<u>Actual</u> FY 2002	<u>Actual</u> FY 2003	<u>Estimate</u> FY 2004	<u>Budget</u> FY 2005	<u>Forecast</u> FY 2006	<u>Original</u> <u>Total</u>
<u>Legal Fees</u>	\$ 131,543	\$ 250,627	\$ -	\$ -	\$ -	\$ 382,170
<u>Consultants/Information Services</u>	890,480	1,624,270	-	-	-	2,514,750
<u>PGW Training Labor</u>	126,654	44,464				171,118
<u>Customer Education/ Duplicating Postage/Advertising</u>	8,193	187,723	-	-	-	195,916
<u>Other Expenses</u>	218	6,157	251	-	-	6,626
Total Cash Impact	\$ 1,157,088	\$ 2,113,241	\$ 251	\$ -	\$ -	\$ 3,270,580
Cumulative Cash Impact	\$ 1,157,088	\$ 3,270,329	\$ 3,270,580	\$ 3,270,580	\$ 3,270,580	
Outstanding Balance			\$ 2,180,387	\$ 1,090,193	\$ (1)	
Amortization Recovery						
Period Three Years		Original				
FY 2004	\$	1,090,193				
FY 2005		1,090,193				
FY 2006		1,090,194				
Total	\$	3,270,580				

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PHILADELPHIA GAS WORKS
ACCOUNTS RECEIVABLE & BAD DEBT EXPENSE

<u>Accounts Receivable</u>	Actual 2004-05	Estimate 2005-06	Budget 2006-07
Beginning Receivable Balance	\$ 313,750	\$ 286,327	\$ 265,039
Billed Gas Revenues	846,729	940,256	958,921
Other Operating Revenues/Adjustments	45,710	42,638	43,135
Total Revenues	892,439	982,894	1,002,056
	94.86%	93.09%	94.00%
Collections Current Revenues	(846,592)	(915,000)	(941,933)
Adjustments	19,890	(11,570)	
Net Write-Offs	(93,160)	(77,612)	(65,400)
Total Credit / Reductions	(919,862)	(1,004,182)	(1,007,333)
Ending Receivable Balance	286,327	265,039	259,762
 <u>Bad Debt Expense</u>			
Current Year Net Receivable	286,327	265,039	259,762
Adjusted Net Receivable	286,327	265,039	259,762
Reserve Factor	24.60%	23.25%	23.25%
Total Bad Debt Expense	70,424	61,519	60,737
<u>Write Off Gas Accounts</u>	92,979	77,500	65,000
<u>Write Off Other</u>	181	112	400
 <u>Reserve Balance</u>			
Beginning Reserve Balance - Gas	228,842	206,287	190,306
Net Write-Off - Gas	(92,979)	(77,500)	(65,000)
Appropriation to Reserve - Gas	70,424	61,519	60,737
Ending Reserve Balance Gas	206,287	190,306	186,043
OAR Reserve	1,412	1,300	900
M & J Reserve	(219)	25	25
Total Reserve Balance	207,480	191,631	186,968
	0.7246	0.7230	0.7198
Net Accounts Receivable	78,847	73,408	72,794
 <u>OTHER OPERATING REVENUES</u>			
	Actual 2004-05	Estimate 2005-06	Budget 2006-07
Billed Revenue	846,729	940,256	958,921
New Billed Revenues	846,729	940,256	958,921
Other Operating Rev.	21,912	17,865	18,219
Sales Tax	12,902	14,104	14,384
Appliance Repair & Other Revenues	10,896	10,669	10,532
	45,710	42,638	43,135
	892,439	982,894	1,002,056
Sales Tax %	0.0152	0.0150	0.0150
Other Oper Rev %	0.0259	0.0190	0.0190

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**PHILADELPHIA GAS WORKS
COLLECTIBILITY STUDY - APRIL 2006**

Classification	Balance Per Study		Reserve % Uncollectible	\$ Uncollectible
	Receivable	Collectible		
Active Non-budget Agreement				
Commercial	845,166.79	598,320.34	29.21%	246,846.45
Residential	<u>19,049,674.86</u>	<u>14,467,847.23</u>	24.05%	<u>4,581,827.63</u>
Total	19,894,841.65	15,066,167.57	24.27%	4,828,674.08
Off - Curb & Dig				
Commercial	325,610.16	-	100.00%	325,610.16
Residential	<u>3,697,145.08</u>	<u>718,566.23</u>	80.56%	<u>2,978,578.85</u>
Total	4,022,755.24	718,566.23	82.14%	3,304,189.01
Finals				
Commercial	4,622,013.07	1,064,505.48	76.97%	3,557,507.59
Residential	<u>73,439,249.24</u>	<u>6,672,950.23</u>	90.91%	<u>66,766,299.01</u>
Total	78,061,262.31	7,737,455.71	90.09%	70,323,806.60
Non-Budget Non-Agreement				
Commercial	46,562,537.09	39,611,652.55	14.93%	6,950,884.54
Residential	<u>142,076,254.20</u>	<u>86,196,320.46</u>	39.33%	<u>55,879,933.74</u>
Total	188,638,791.29	125,807,973.01	33.31%	62,830,818.28
Sub-Total Before CRP	<u>\$ 290,617,650.49</u>	<u>\$ 149,330,162.52</u>	<u>48.62%</u>	<u>\$ 141,287,487.97</u>
CRP AGREEMENTS				
CRP Current Program	9,339,903.44	5,490,224.60	41.22%	3,849,678.84
CRP Program ****	640,693.94	293,315.72	54.22%	347,378.22
CRP Arrears	70,241,643.64	32,157,285.94	54.22%	38,084,357.70
CRP Regulatory Asset	-	-	-	-
Total CRP	<u>\$ 80,222,241.02</u>	<u>\$ 37,940,826.26</u>	<u>52.71%</u>	<u>42,281,414.76</u>
Inactive Accounts Credit Balances	\$ 8,718,282.01 \$ (10,620,160.42)	\$ 2,899,566.77	66.74%	5,818,715.24
Grand Total	<u>\$ 368,938,013.10</u>	<u>\$ 190,170,555.55</u>		<u>\$ 189,387,617.97</u>
Cycle 22, 23 GTS & Unfrozen Pay.	<u>\$ 2,218.94</u>			
Total AR	<u>\$ 368,940,232.04</u>			

****CRP Program includes CRP Liheap Make-Up (CRP-LL), CRP Relief Loan (CRP-RL), Non-Gas Charges Billed (CRP-LN) and Non-Gas Charges from Current year not billed (CRP-LD)

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**NATURAL GAS
PRICE - VOLUME ANALYSIS**

	<u>Budget</u> <u>2006-07</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>Over(Under)</u> <u>Estimate</u>
N.G. Utilization (Mcf)	58,518,925	55,375,359	3,143,566
COMMODITY	\$563,454,415	\$576,117,816	(\$12,663,401)
Average Price	9.6286	10.4039	(0.7753)
DEMAND	<u>\$67,381,823</u>	<u>\$63,298,737</u>	<u>\$4,083,086</u>
Total Demand & Commodity	\$630,836,238	\$639,416,553	(\$8,580,315)
Average Price	10.7800	11.5470	(0.7669)
REFUNDS	-	(236,876)	236,876
TOTAL	<u><u>\$630,836,238</u></u>	<u><u>\$639,179,677</u></u>	<u><u>(\$8,343,439)</u></u>
 <u>CHANGE DUE TO:</u>			
Commodity Price	(\$45,368,640)	(0.7753)	(7.45%)
Volume	32,705,239	3,143,566	5.68%
Demand	<u>4,083,086</u>		
Total Demand & Commodity	(8,580,315)	(0.7669)	(6.64%)
Refunds	<u>236,876</u>		
TOTAL CHANGE	<u><u>\$ (8,343,439)</u></u>		

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PHILADELPHIA GAS WORKS
DETAIL OF OTHER OPERATING REVENUES
(Dollars in Thousands)

	<u>Actual</u> <u>2004-05</u>	<u>Estimate</u> <u>2005-06</u>	<u>Budget</u> <u>2006-07</u>
Finance Charges	\$ 21,594	\$ 17,580	\$ 17,933
Returned Check Charges	296	260	260
Credit Card Charge Back Fees	16	19	20
Suspended Service Revenues	<u>6</u>	<u>6</u>	<u>6</u>
Total	<u>\$ 21,912</u>	<u>\$ 17,865</u>	<u>\$ 18,219</u>

Estimated Weather 3,825 degree days
 City Loan \$45.0 M Fully Outstanding @ 8/31/06
 TXCP \$150.0 M with \$70.0 MM Outstanding @ 8/31/06
 Collection Factor 83.0%
 \$18.0 M City Payment Made and Granted Back to PGW
 Deferred gas payments \$22.0 M paid in FY 2006
 Debt Service reduced by \$12.0M refunding @ 1/28/06
 05/23/06

BUDGET OF CASH RECEIPTS AND DISBURSEMENTS
 FISCAL YEAR ENDING AUGUST 31, 2006
 (Millions of Dollars)

	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	TOTAL
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	
OPENING BALANCE - CASH INCLUDES \$49.9 TXCP RECEIPTS	15.2	12.8	59.0	31.7	26.3	36.9	49.3	88.3	98.0	134.6	143.9	101.7	15.2
Gas	40.2	47.2	54.2	67.3	106.5	109.5	132.3	98.8	79.0	65.0	55.0	51.0	906.0
Other	17.1	0.5	0.6	0.7	1.2	0.3	4.2	1.3	6.2	3.5	0.5	1.9	38.0
Drawn from Capital Funds - Principal (\$100.0MM)	0.0	0.0	0.0	34.7	0.0	20.0	0.0	0.0	6.2	0.0	0.0	(0.7)	60.2
Drawn from Capital Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.8	0.0	0.0	(1.0)	2.8
Drawn from Lease Funds - Principal (\$0.0MM)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drawn from Lease Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Advance (Repayment) of Capital Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pension Draw	0.0	0.0	0.0	5.7	1.4	1.4	1.4	1.4	1.4	1.8	0.0	0.0	14.5
City Loan	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
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.0	0.0	0.0	18.0
	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL RECEIPTS	57.3	47.7	54.8	108.4	109.1	131.2	137.9	101.5	96.6	88.3	55.5	51.2	1,039.5
TOTAL	72.5	60.5	113.8	140.1	135.4	168.1	187.2	189.8	194.6	222.9	199.4	152.9	1,054.7
DISBURSEMENTS													
Labor	12.8	10.7	11.3	12.3	11.0	10.6	12.8	11.0	12.0	11.5	11.4	12.0	139.4
Natural Gas	26.5	30.5	58.6	94.0	108.9	84.4	69.2	69.6	30.6	36.5	35.0	32.0	675.8
Debt Service	3.1	0.0	0.1	0.1	14.9	6.3	4.0	0.0	5.7	1.0	39.3	7.0	81.5
TXCP: Interest	0.1	0.0	0.0	0.4	1.0	0.1	0.0	0.0	1.5	0.5	0.5	0.4	4.7
Repayment of City Loan	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
	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
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.0	0.0	0.0	18.0
Other Disbursements	17.2	9.6	12.1	6.9	13.4	16.1	12.9	11.2	11.5	11.5	11.5	10.8	144.7
TOTAL DISBURSEMENTS	59.7	50.8	82.1	113.7	149.2	117.5	98.9	91.8	61.3	79.0	87.7	62.3	1,064.0
MONTHLY CASH FLOW	(2.4)	(3.1)	(27.3)	(5.3)	(40.1)	13.7	39.0	9.7	35.3	9.3	(42.2)	(11.1)	(24.5)
CUMULATIVE CASH FLOW	(2.4)	(5.5)	(32.8)	(38.2)	(78.3)	(64.6)	(25.6)	(15.9)	19.4	28.7	(13.5)	(24.5)	
OPENING TXCP	49.9	49.9	49.9	99.2	99.2	99.2	149.9	148.6	148.6	148.6	149.9	149.9	149.9
TXCP ISSUED DURING MONTH	0.0	49.3	0.0	0.0	50.7	0.0	0.0	0.0	149.9	0.0	0.0	0.0	249.9
TXCP PAID DOWN DURING MONTH	0.0	0.0	0.0	0.0	0.0	1.3	0.0	0.0	148.6	0.0	0.0	79.9	229.8
ENDING TXCP	49.9	99.2	99.2	99.2	149.9	148.6	148.6	148.6	149.9	149.9	149.9	70.0	70.0
OPENING BALANCE - CASH	15.2	12.8	59.0	31.7	26.3	36.9	49.3	88.3	98.0	134.6	143.9	101.7	15.2
MONTHLY CASH FLOW	(2.4)	(3.1)	(27.3)	(5.3)	(40.1)	13.7	39.0	9.7	35.3	9.3	(42.2)	(11.1)	(24.5)
NET TXCP ACTIVITY MONTHLY	0.0	49.3	0.0	0.0	50.7	(1.3)	0.0	0.0	1.3	0.0	0.0	(79.9)	20.1
ENDING BALANCE - CASH	12.8	59.0	31.7	26.3	38.9	49.3	88.3	98.0	134.6	143.9	101.7	10.8	10.8
CITY LOAN AVAILABLE - END OF 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
CITY LOAN UTILIZED - END OF MONTH	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0
CASH POSITION NET OF TXCP AND CITY LOAN	(82.1)	(85.2)	(112.5)	(117.9)	(158.0)	(144.3)	(105.3)	(95.6)	(60.3)	(51.0)	(93.2)	(104.2)	

Budgeted Weather 4,525 degree days
 City Loan \$43.0 MM Outstanding @ 8/31/07
 TXCP \$150.0 MM with \$70.0 MM Outstanding @ 8/31/07
 Collection Factor 94.0%
 \$18.0 MM City Payment Made and Granted Back to PGW

BUDGET OF CASH RECEIPTS AND DISBURSEMENTS
 FISCAL YEAR ENDING AUGUST 31, 2007
 (Millions of Dollars)

	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	TOTAL	
05/23/06	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug		
OPENING BALANCE - CASH INCLUDES \$70.0 TXCP RECEIPTS	10.8	70.7	71.4	64.7	73.1	67.3	65.1	95.2	119.8	126.3	115.5	56.8	10.8	
Gas	46.7	52.2	53.8	72.5	96.6	114.2	126.1	111.8	92.4	68.4	55.1	52.2	941.8	
Other	0.8	0.8	2.4	0.8	0.8	0.8	0.8	0.9	0.9	0.8	0.8	2.6	13.2	
Drawn from Capital Funds - Principal	0.0	0.0	0.0	0.0	4.1	0.0	0.0	0.0	0.0	0.0	0.0	67.9	72.0	
Drawn from Capital Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.1	3.1	
Drawn from Lease Funds - Principal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Drawn from Lease Funds - Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Advance (Repayment) of Capital Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Pension Draw	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.5	1.5	1.5	1.5	1.5	17.3	
City Loan	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	
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.0	0.0	0.0	18.0	
	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
TOTAL RECEIPTS	48.9	54.4	57.6	74.7	102.9	116.4	128.3	114.2	94.8	88.7	57.4	127.3	1,065.4	
TOTAL	59.7	125.1	129.1	139.4	176.0	183.7	193.3	209.4	214.6	214.9	172.9	184.1	1,076.2	
DISBURSEMENTS														
Labor	11.4	12.2	12.8	12.2	13.0	12.0	12.1	11.6	12.3	11.4	12.1	13.1	146.2	
Natural Gas	32.5	26.4	35.5	42.2	68.2	81.1	65.1	62.2	60.0	54.0	44.3	43.7	615.2	
Debt Service	4.0	1.0	1.0	1.0	10.6	6.3	4.0	1.0	1.0	1.0	44.6	15.5	91.0	
TXCP: Interest & Variable Rate Debt Fees	0.6	1.3	0.8	0.8	1.3	0.8	0.8	1.3	0.8	0.8	1.3	0.6	10.9	
Repayment of City Loan	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.0	2.0	
	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
City Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.0	0.0	0.0	18.0	
Other Disbursements	20.4	12.8	14.3	10.2	15.6	18.5	16.2	13.5	14.2	14.3	13.8	13.2	176.9	
TOTAL DISBURSEMENTS	68.9	53.7	64.3	66.3	108.7	118.7	98.1	89.6	88.3	99.4	116.1	88.1	1,060.2	
MONTHLY CASH FLOW	(20.0)	0.7	(6.7)	8.4	(5.8)	(2.2)	30.1	24.6	6.4	(10.8)	(58.7)	39.1	5.2	
CUMULATIVE CASH FLOW	(20.0)	(19.3)	(26.0)	(17.6)	(23.4)	(25.6)	4.5	29.1	35.6	24.8	(33.9)	5.2		
OPENING TXCP	70.0	70.0	149.9	149.9	149.9	149.9	149.9	149.9	149.9	149.9	149.9	149.9	149.9	70.0
TXCP ISSUED DURING MONTH	79.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	79.9	
TXCP 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	79.9	79.9	
ENDING TXCP	149.9	149.9	149.9	149.9	149.9	149.9	149.9	149.9	149.9	149.9	149.9	70.0	70.0	
OPENING BALANCE - CASH	10.8	70.7	71.4	64.7	73.1	67.3	65.1	95.2	119.8	126.3	115.5	56.8	10.8	
MONTHLY CASH FLOW	(20.0)	0.7	(6.7)	8.4	(5.8)	(2.2)	30.1	24.6	6.4	(10.8)	(58.7)	39.1	5.2	
NET TXCP ACTIVITY MONTHLY	79.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(79.9)	0.0	
ENDING BALANCE - CASH	70.7	71.4	64.7	73.1	67.3	65.1	95.2	119.8	126.3	115.5	56.8	16.0	16.0	
CITY LOAN AVAILABLE - END OF MONTH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.0	2.0	
CITY LOAN UTILIZED - END OF MONTH	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	43.0	43.0	
CASH POSITION NET OF TXCP AND CITY LOAN	(124.2)	(123.5)	(130.2)	(121.8)	(127.6)	(129.8)	(99.7)	(75.1)	(68.6)	(79.4)	(138.1)	(97.0)		

1 **Q. Have you previously presented testimony before the Philadelphia Gas**
2 **Commission?**

3 A. Yes, on numerous occasions. I have most recently presented testimony
4 before this Commission on matters associated with PGW's 2005-2006
5 Operating Budget proceedings and Five Year Forecast. Prior to the above
6 occasion, I presented testimony on PGW's proposed annual Operating &
7 Capital Budgets and multiple base rate increase requests.

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

10 A. I am responsible for the overall development and preparation of the
11 financial documentation, exhibits and part of the supporting
12 documentation included in PGW's proposed 2006-2007 Operating Budget
13 filing.

14 **Q. Please describe the factors that impacted the current 2005-2006 Estimate**
15 **and also went into the development of the 2006-2007 Operating Budget**
16 **and your involvement.**

17 A. My direct involvement has been to facilitate the departmental interaction
18 associated with PGW's Operating Budget process. This includes the
19 review of all Operating Budgets prepared by the individual departments,
20 updates to that information and the coordination, analysis, control and
21 issuance of the complete 2006-2007 Operating Budget document. I have
22 interacted with the City Finance Director, PGW's Senior Team, and, in
23 particular, Mr. Joseph F. Golden, Jr., PGW's Controller, in developing
24 PGW's financial plan. PGW developed a financial plan for the 2006-2007
25 Operating Budget which takes into account the corporate goal of
26 reducing operating and maintenance expenses and certain corporate
27 initiatives, including the continuing Collection effort and to maintain a safe
28 and reliable distribution system, while keeping PGW in a position of
29 financial stability and competitiveness. During the 2005-2006 fiscal period,

1 PGW's bond rating remained above investment grade with a negative
2 outlook by Standard & Poor's and Fitch Ratings', Moody's Investor's
3 Services assigned a stable outlook. Fitch Ratings' assigned a negative
4 watch to the rating, which usually entails a six month period to ascertain
5 whether the factors that resulted in the change have been addressed in a
6 positive manner. The negative outlook and watch result from on-going
7 liquidity issues and the collection risks presented by the significantly higher
8 natural gas prices. The City of Philadelphia, in conjunction with City
9 Council, assisted PGW in improving its liquidity by foregoing the \$18.0
10 million annual payment for five years starting in fiscal year 2004 and
11 delaying the final repayment date of the \$45.0 million City loan until
12 August 2008. Also, in January 2006 PGW increased the size of its
13 Commercial Paper program to \$150.0 million, an increase of \$50.0 million,
14 through negotiations with its lending banks to provide additional
15 borrowing capacity for working capital requirements, mainly higher
16 natural gas costs. These actions were some of the necessary steps taken
17 to bolster PGW's overall cash flow, and combined with stable collection
18 rates, PGW anticipates that it will be able to demonstrate improved
19 sustainable financial performance to the financial community. The
20 company realized a substantial rise in its overall collection rate from 91.4%
21 for fiscal year 2004 to 94.9% during the fiscal period ended August 2005.
22 Currently, the collection rate stands at 92.0% through April 2006, with an
23 expected August 2006 year end level of 93.0%. This level is expected to
24 be achieved in spite of the substantially higher customer billings during the
25 most recent winter period. PGW completed the \$313.4 million 6th Series
26 (1998 Ordinance) refunding bond issue in January 2006, which was
27 comprised of all variable rate bonds. This transaction resulted in over
28 \$14.6 million in overall debt service savings (5.14% present value savings)
29 with nearly \$10.5 million applicable to the 2006 fiscal period.

1 The 2005-2006 heating season reflects an approximately 16.0% warmer
2 than normal winter and heating customers are expected to be charged
3 \$12.5 million through the Weather Normalization adjustment (WNA). The
4 2005-2006 fiscal period reflected significantly higher natural gas prices and
5 higher customer accounts receivable balances. The impact of higher
6 customer accounts receivable balances on bad debt expense,
7 additional maintenance costs for the LNG cascade plant; additional
8 actuarial funding costs for PGW's employee pension plan and higher
9 depreciable utility plant expense were some of the main reasons for the
10 \$12.5 million or 4.7% increase in overall operating and maintenance costs
11 in the 2005-2006 Estimate compared to the 2005-2006 Budget Year as
12 detailed on Exhibit A-1, Line 18. The higher natural gas prices for storage
13 injections continue to put a strain on PGW's already thin cash liquidity
14 position as the Company heads into next year's winter operating season, a
15 period of PGW's largest working capital requirements. One of the
16 underlying assumptions that present a risk in the 2006-2007 Operating
17 Budget is PGW's ability to sustain or improve upon its historic collection
18 factor of 92.0%. In the 2006-2007 fiscal period PGW expects to bill nearly
19 \$1.0 billion to customers while collecting over \$940.0 million, which would
20 be the highest levels in PGW's history. PGW will continue to utilize the \$45.0
21 million City Loan for working capital purposes and is committed to
22 reducing expenses and increasing collections in an effort to minimize the
23 level of required short term borrowing needs. PGW anticipates that a
24 \$150.0 million new money bond issue will be required in December 2006 to
25 provide funds for its capital expenditures during the 2006-2007 and 2007-
26 2008 fiscal periods.

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

28 A. The purpose of my testimony is to provide the documentation and
29 supporting methodology for the schedules and exhibits, provide detailed

1 information regarding certain income and expense items and, where
2 necessary, explain the reasons for variations between the fiscal periods.

3 **Q. Please describe the financial statements which support the 2006-2007**
4 **Operating Budget submission.**

5 A. The Operating Budget for the 2006-2007 fiscal year has been summarized
6 to indicate the functional expenses similar to previous Gas Commission
7 presentations for comparative purposes. To facilitate an understanding
8 and to illustrate the trend and level of operating expenditures by key
9 functionality, data is provided on the Statement of Income, Exhibit A-1, of
10 the Operating Budget presentation for the 2004-2005 Actual, the 2005-
11 2006 Budget and Estimate and the proposed 2006-2007 Budget periods.
12 The Cash Flow Statement, Exhibit A-2, reflects the sources and uses of cash
13 and is one of the basic documents for financial planning at PGW. The
14 Revenue Bond Debt Service Coverage Statement is prepared in
15 accordance with the Rate Covenant of the 1975 General Ordinance, as
16 amended, and the 1998 General Ordinance, authorizing the issuance of
17 revenue bonds. In compliance with the provisions of the Ordinances,
18 PGW prepares and forwards a report to the Director of Finance of the City
19 of Philadelphia within 120 days of the conclusion of each fiscal year
20 detailing compliance with the revenue bond debt service requirements
21 for such fiscal year. A calculation for the 2005-2006 and 2006-2007 fiscal
22 periods is included with the Company's filing on Exhibit A-3.

23 **Q. Who will explain the details of these documents?**

24 A. I will present a financial summary of the impacts of the revenue and fuel
25 cost data, which were filed and subsequently revised as part of the on-
26 going Gas Cost Rate ("GCR") filings with the PaPUC, and will continue
27 through the Statement of Income to explain the impacts of financing and
28 other financial considerations on the Cash Flow Statement and Revenue
29 Bond Debt Service Coverage schedule.

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

2 A. The Statement of Income, presented as Exhibit A-1, includes projected
3 operating revenues for fiscal year 2006-2007 of \$980.7 million.

4 **Total Operating Revenues** (Line 10) are forecasted to decrease by \$4.4
5 million to \$980.7 million less than 1.0% when compared to the 2005-2006
6 Estimate of \$985.1 million. The major portion of the change in revenues
7 reflects the return to a normal heating season with the commensurate
8 increase in sales to firm heating customers. The 2006-2007 Budget Year
9 represents 4,525 degree days which is PGW's new 30 year average level,
10 while the 2005-2006 fiscal period reflects 3,825 degree days, 700 degree
11 days or approximately 15.5% less than the normal level. However, based
12 on recent customer utilization data the 2006-2007 Budget Year assumes
13 that firm heating sales are expected to be approximately 5.0 Bcf less than
14 the 2005-2006 forecasted Budget Year reflecting added conservation. This
15 will result in a substantial decline in the projected margin to cover fixed
16 costs. A reduction in the 2006-2007 Gas Cost Rate of \$1.62 per Mcf from
17 the current level of \$12.56 per Mcf to \$10.94 per Mcf further contributed to
18 the lower revenue projections, while added revenues from gas
19 transportation customers are anticipated reflecting increased sales
20 volumes.

21 **Non-Heating Revenues** (Line 1) for the 2006-2007 Budget Year are
22 projected at \$115.6 million, an increase of \$1.4 million or 1.0% over the
23 \$114.2 million expected during the 2005-2006 period. Additional sales to
24 interruptible customers totaling .8 Bcf more than offset the 7.5% decline in
25 the average price per Mcf resulting in a \$7.7 million rise in revenues. A
26 decrease in firm non-heating billed revenues of \$4.8 million is mainly due
27 to a lower GCR in effect. The GCR, the Universal Service Charge ("USC")
28 and the Restructuring Charges for fiscal year 2005-2006 are anticipated to
29 be under recovered by \$6.2 million with \$.5 million applicable to non-

1 heating revenues. The impact on firm non-heating revenues of the
2 applicable charges for the fiscal periods 2004-2005 and 2005-2006 is
3 anticipated to lower reported revenues by \$1.6 million.

4 **Gas Transportation Service Revenues** (Line 2) are anticipated to rise by
5 \$1.1 million or 18.0% to \$7.3 million from the prior year's level of \$6.2 million
6 due primarily to additional volumes of gas being transported for
7 customers of 2.2 Bcf.

8 **Heating Revenues** (Line 3) during the 2006-2007 fiscal year are projected
9 to total \$829.9 million, \$3.8 million, or less than a 1% decrease from the
10 \$833.7 million expected in the 2005-2006 period. The major factors for the
11 \$14.6 million increase in billed revenues in the 2006-2007 Budget Year
12 reflect a 4.2 Bcf increase in usage due to the return to a normal 4,525
13 degree day heating season. A lower GCR in effect during the 2006-2007
14 Budget Year is expected to partially offset the above increase. The GCR,
15 USC and the Restructuring charges are expected be under recovered by
16 \$6.2 million with \$5.7 million applicable to heating revenues. The impact
17 on firm heating revenues of the applicable charges for the fiscal periods
18 2004-2005 and 2005-2006 is anticipated to lower reported revenues by
19 \$18.4 million.

20 The **Weather Normalization Adjustment** (Line 4) is expected to result in a
21 \$12.5 million charge to heating customers during the 2005-2006 fiscal
22 period as a result of the warm winter heating season. The 2006-2007
23 Budget Year anticipates a normal winter heating season which would not
24 result in a WNA adjustment.

25 The **Unbilled Gas Adjustment** (Line 5) is anticipated to decline by \$.7
26 million to a total of \$10.6 million due mainly to a lower average price per
27 Mcf of gas used but not yet billed at August 2007. At August 2006,
28 unbilled gas revenues of \$11.3 million are expected to be \$2.5 million
29 above the level of the prior period reflecting a higher average price per

1 Mcf.

2 **Q. What are the major components of Appliance Repair & Other Service**
 3 **Revenues?**

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

6 **Appliance Repair and Other Service Revenues** (Line 7) totaling \$10.5 million in
 7 the 2006-2007 Budget Year are associated with the parts and labor plan
 8 contracts for house heaters, automatic water heaters and other appliances,
 9 and for appliance repairs and service calls. Also included in this category
 10 are reconnection charges generated by customer bill paid turn-ons. The
 11 reduced revenues forecasted in the 2006-2007 Budget Year totaling \$.1
 12 million mainly result from slightly lower collection related activities associated
 13 with customer service restorations. The 2006-2007 Budget Year projects 72,100
 14 Parts & Labor Plans to be in force the same level as the previous year, with no
 15 planned change in price.

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

18 **Appliance Repair and Other Service Revenues**

19 **(Dollars in Thousands)**

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
20 Parts & Labor Plans	\$7,793	\$7,538	\$7,538
21 Paid & Charge-for-Service	561	237	237
22 Reconnection, Turn on Charges	<u>2,541</u>	<u>2,894</u>	<u>2,757</u>
23 TOTAL	<u>\$10.895</u>	<u>\$10.669</u>	<u>\$10.532</u>

24 **Other Operating Revenues** (Line 8) principally reflect finance charges on
 25 delinquent customer account balances. The 2006-2007 Budget projects
 26 an increase of \$.3 million to \$18.2 million due to higher customer gas
 27 billings and commensurate delinquent balances.
 28
 29

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

2 A. The Statement of Income includes projected **Total Operating Expenses**
3 (Line 19) for the 2006-2007 Budget Year of \$912.0 million, a \$5.4 million or
4 less than a 1.0% decrease from the prior year. The major reasons for the
5 variation in costs are explained below.

6 **Natural Gas** (Line 11) - Natural gas costs are forecasted to total \$630.8
7 million in the 2006-2007 Budget Year, \$8.4 million or 1.3% below the \$639.2
8 million level projected for the 2005-2006 fiscal period. The decline from
9 the 2005-2006 Estimate of natural gas costs primarily reflects reduced
10 commodity pipeline prices of 77.5 cents per Mcf totaling \$45.4 million,
11 while additional supply requirements of 3.1 Bcf are expected to result in a
12 \$32.7 million increase. Demand charges are forecasted to rise by \$4.1
13 million. The 2005-2006 fiscal period reflected the receipt of natural gas
14 refunds totaling \$.2 million. No natural gas refunds are projected to be
15 received in the 2006-2007 Budget Year.

16 **Contribution Margins** (Line 14) - PGW forecasts that the margins to cover
17 fixed overhead and other costs and interest expense are expected to
18 total \$349.9 million in the 2006-2007 Budget Year, a rise of \$4.0 million from
19 the \$345.9 million level projected in the 2005-2006 Estimate. This margin
20 represents the funds (total operating revenues less the cost of fuel)
21 available to meet PGW's operational and financial requirements

22 **Labor and Fringe Benefits** (Line 15) - This expense item, the second largest
23 expense that PGW incurs, is budgeted to increase by \$7.6 million or 5.4% to
24 \$147.3 million. The main factors that contribute to the added labor and
25 benefits costs of \$7.6 million are as follows: (1) Operating labor costs in the
26 2006-2007 Budget Year are anticipated to increase by \$3.3 million to \$83.1
27 million from the current year level of \$79.8 million. The 2006-2007 Budget
28 Year reflects an average PGW personnel level of 1,740 employees
29 approximating the level anticipated in the 2005-2006 period as detailed

1 on Exhibit C-3-1, Line 11. Currently, PGW has approximately 1,767
2 employees as of April 2006. As shown on Exhibit A-1-1 (Line 30), PGW has
3 projected cost reductions totaling \$5.8 million of which the labor cost
4 component in the 2006-2007 fiscal period is \$.8 million, the remaining \$5.0
5 million will be detailed in the discussion of other expenses. This decrease
6 can be attributed, in part, to the consolidation of overall workforce
7 resources that can then be utilized in the most cost effective and
8 productive way. During the 2005-2006 fiscal period the unionized
9 workforce received a 1% general wage increase. The 2006-2007 Budget
10 provides funding for a 3% general wage increase effective September 1,
11 2006 and 2½ % effective May 15, 2007 for all unionized employees and
12 when combined with normal merit and progression increases adds nearly
13 \$3.3 million to costs when comparing the 2005-2006 and 2006-2007 fiscal
14 periods. The 2006-2007 Budget provides funding for a 3% wage increase
15 for union exempt employees in September 2006. A rise in capitalized
16 labor charges is anticipated for the 2006-2007 Budget Year lowering
17 operating labor by \$1.3 million, while overtime costs are projected to rise
18 by \$.4 million. (2) Pension expenses are anticipated to rise by \$.3 million to
19 \$17.6 million in the 2006-2007 Budget Year reflecting the most recent
20 information from its actuarial consultant to update the current pension
21 funding requirements. (3) The \$3.1 million rise in health insurance reflects
22 premium increases for prescription drug and medical coverage for both
23 active and retired employees. (4) Payroll taxes are expected to total \$6.6
24 million in the 2006-2007 Budget Year, an increase of \$.9 million from the
25 prior year. The 2005-2006 fiscal period included a non-recurring refund
26 settlement associated with Pennsylvania sales tax liability. A more
27 detailed explanation of labor and fringe benefits (Exhibit C-3) will be
28 provided later in my testimony.

29 **Bad Debt Expense** (Line 16) - PGW has provided separate supporting

1 documentation for the Accounts Receivable and Bad Debt expense
2 calculations (SD-5) and the most recent collectibility study as of April 2006
3 identifying the bad debt reserve requirement (SD-6). PGW anticipates a
4 \$60.7 million expense related to bad debt for the 2006-2007 Budget Year
5 and \$61.5 million for the current 2005-2006 fiscal period. The forecasted
6 decrease in this expense reflects an improvement in PGW's overall
7 collection rate currently 92.0% as of April 2006. PGW expects to attain a
8 93.0% collection rate for the 2005-2006 fiscal period, while a 94.0%
9 collection rate target is reflected in the 2006-2007 Budget Year. PGW's
10 collection initiative remains at the forefront of all company activities as
11 improvement in overall customer collections is paramount to improving
12 cash flow and liquidity.

13 **Other Expenses and Depreciation** (Line 17) - The principal reasons for the
14 \$3.8 million decline in these expense categories for the 2006-2007 Budget
15 Year of \$73.1 million resulted from reductions in the appropriation for
16 reserves and losses, lower material and \$5.0 million in projected overall
17 cost savings throughout PGW's operations. Also, an increase in the
18 allocation of fringe benefits and administrative and general charges to
19 capital projects reflecting higher capital spending further contributed to
20 the reduced costs. These decreases were partially offset by higher
21 renewal premiums for public liability insurance, additional costs for
22 contracted maintenance, outside purchased services, advertising,
23 promotion and depreciation costs. A more detailed explanation of other
24 expenses and depreciation (Exhibit C-4) will be presented later in my
25 testimony.

26 **Other Income** (Line 21) - PGW expects a \$1.4 million rise in other income
27 during the 2006-2007 Budget Year primarily as a result of earnings on
28 restricted funds and short term investments reflecting higher projected
29 investable balances and rising interest rates.

1 **Interest Expense** (Line 27) - Total interest expense of \$74.0 million in the
2 2006-2007 Budget Year represents an increase of \$8.5 million from the
3 2005-2006 fiscal period. Long-term debt (Line 23) interest costs are
4 budgeted to increase by \$4.7 million due mainly to the effect of the
5 proposed 7th Series 1998 Ordinance \$150.0 million new money bond issue
6 offset by scheduled long-term debt maturities. Other interest (Line 24)
7 expense is anticipated to rise by \$3.6 million in the 2006-2007 Budget Year
8 primarily as a result of interest costs associated with PGW's Tax-Exempt
9 Commercial Paper Program which is anticipated to be maintained at the
10 \$150.0 million level in the 2006-2007 fiscal period. Also, fees associated
11 with PGW's variable rate debt and higher bond discount and issuance
12 expenses are anticipated to further increase interest expense. The Loss
13 from the Extinguishment of Debt (Line 26) of \$5.5 million in the 2006-2007
14 Budget Year is expected to be \$.2 million greater than the prior period
15 reflecting the continued expense amortization of prior bond refundings.

16 **Net Earnings** (Line 28) - The net earnings from Operations are forecasted at
17 \$4.4 million for the 2006-2007 Budget Year. This reflects a \$6.0 million
18 decrease from the 2005-2006 fiscal period projected earnings of \$10.4
19 million.

20 **Q. Proceeding to Exhibit A-2, the Cash Flow Statement, would you please**
21 **identify the individual items which account for the total sources of \$141.3**
22 **million for the 2006-2007 Budget Year shown on Line 13?**

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

29 **Net Income** (Line 1) totaling \$4.4 million is a transfer from Line 28, Exhibit A-

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

4 **Depreciation and Amortization** (Line 2) are sources of funds, as these items
5 represent those (non-cash) costs chargeable to expense in the current
6 period, although the actual cash payments were made primarily in prior
7 periods. In the 2006-2007 Budget Year, this category is projected to
8 increase by \$2.1 million to \$46.0 million as a result of higher depreciation
9 expense on depreciable utility plant, bond discount, issuance and
10 premium charges and higher extinguishment of debt costs.

11 **Earnings on Restricted Funds** (Line 3) represent cash withdrawals from
12 restricted funds, principally the revenue bond sinking and capital
13 improvement funds. In the 2005-2006 and 2006-2007 fiscal periods, interest
14 withdrawn from these funds is expected to be \$3.9 million and \$.1 million
15 greater than the interest earned, respectively. This resulted from earnings
16 in prior periods not being withdrawn or restricted in use during the fiscal
17 period in which the earnings occurred.

18 **Elimination of Accrued Interest on Refunded Debt** (Line 4) the \$3.2 million
19 represents accrued interest payable eliminated by the 6TH Series refunding
20 bond issue.

21 **Increased/(Decreased) Other Assets/Liabilities** (Line 5) reflects a change
22 between the 2005-2006 and 2006-2007 fiscal years of \$2.0 million. The
23 main components that are reflected in this source of cash are deferred
24 operating expenses and payments and interest accruals that continue to
25 be made on the long term debt portion of tax-exempt capital
26 appreciation ("TECA") bonds. These payments account for a portion of
27 the change between the fiscal years.

28 The sum of net income and the previously mentioned adjustments is
29 reported on (Exhibit A-2, Line 6) as available from Operations and totals

1 \$51.3 million in the 2006-2007 Budget Year, \$9.1 million lower than
2 forecasted in the 2005-2006 fiscal year.

3 **Funds Required for Capital** (Line 7) represents one of the components of
4 PGW's cash management process. The funds withdrawn from the Capital
5 Improvement Fund are utilized to fund PGW's capital expenditures. The
6 2005-2006 fiscal period anticipates \$60.2 million being withdrawn from the
7 Capital Improvement Fund to support capital spending for the period.
8 The 2006-2007 Budget Year projects that \$72.0 million will be withdrawn
9 from the capital fund to provide the necessary funding for capital
10 spending. No internally generated funds will be generated during the
11 2005-2006 and 2006-2007 fiscal periods. PGW's \$75.2 million capital
12 expenditure program in the 2006-2007 Budget Year is expected to be
13 financed entirely by debt financing.

14 **Grant Income** (Line 8) – The \$18.0 million represents the grant back of the
15 City Payment to PGW to be used as project revenues available to cover
16 debt service in the coverage calculation.

17 **Capitalized Interest** (Line 10) - PGW will utilize capitalized interest fund
18 proceeds to make the debt service payments on the 5th Series A-1 bonds
19 totaling \$5.9 million in the 2005-2006 fiscal year. This restricted fund was set
20 up at the time of the October 2004 bond sale.

21 **Release of Sinking Fund Proceeds** (Line 11) – Since the highest principal
22 and interest payments associated with 1975 Ordinance Bonds has been
23 made, PGW expects that \$3.7 million will be released from this restricted
24 account during the 2005-2006 year.

25 **Temporary Financing** (Line 12) - In the current 2005-2006 fiscal period,
26 PGW's outstanding level of tax-exempt commercial paper notes is
27 anticipated to be \$70.0 million at August 31, 2006. The full amount of
28 commercial paper notes was first repaid on May 17, 2006. PGW, for the
29 remaining portion of the fiscal year, anticipates reissuing notes, as

1 needed, to assist in meeting projected working capital requirements and
2 available arbitrage opportunities. The level of outstanding notes between
3 August 2005 (\$49.9 million) and August 2006 (\$70.0 million) (Line 29)
4 increased by \$20.1 million. The 2006-2007 Budget Year anticipates that
5 during the major part of the fiscal year, the maximum level of notes \$149.8
6 million will be outstanding and required to assist in meeting working
7 capital requirements and arbitrage opportunities. The outstanding level of
8 notes at August 2007 is forecasted at \$70.0 million. PGW, during the 2000-
9 2001 fiscal period, received a \$45.0 million interest free loan from the City
10 of Philadelphia to assist in meeting working capital requirements. It is
11 anticipated that this loan will be fully utilized at August 2006 and \$43.0
12 million is expected to be outstanding at August 2007. The loan was
13 restructured and full repayment is now anticipated in August 2008. The
14 overall impact of PGW's operations including collection improvements,
15 the forgiveness of the \$18.0 million City payment and the continued
16 utilization of the \$45.0 million City loan during the 2006-2007 Budget Year is
17 projected to leave PGW with a cash balance of \$16.0 million, compared
18 to the \$10.8 million anticipated at the close of the 2005-2006 fiscal period.
19 The **Total Sources** (Line 13) of \$141.3 million in the 2006-2007 fiscal year are
20 expected to be \$27.0 million less than the level projected in fiscal year
21 2005-2006 mainly reflecting reduced earnings from Operations and
22 restricted accounts.

23 **Q. How are these Total Sources applied within PGW?**

24 A. The Total Sources are utilized as detailed on the lower part of Exhibit A-2
25 under the category **Total Uses** (Line 24) of \$141.3 million. The primary areas
26 of expenditures are as follows:

27 **Net Capital Expenditures** (Line 14) represent expenses for approved
28 capital budget projects. These costs totaling \$75.2 million in the 2006-2007
29 Budget Year are projected to increase by \$7.1 million from the 2005-2006

1 fiscal period level of \$68.1 million. These expenditures include: (1) direct
2 charges for labor, material, equipment, contractors and transportation
3 services; (2) allocated expenses for fringe benefits, and administrative and
4 general expenses; and (3) an Allowance for Funds Used During
5 Construction ("AFUDC"). The total costs are reported net of contributions,
6 reimbursements and salvage.

7 **Funded Debt Reduction** (Lines 15 & 16) - This expense represents the
8 payment of the principal portion of PGW's long-term debt under pre-
9 determined debt amortization schedules. These payments include
10 revenue bond debt service principal repayments. In the 2006-2007
11 Budget Year, these payments are expected to total \$38.0 million, a rise of
12 \$6.8 million from the \$31.2 million paid in the 2005-2006 fiscal period.

13 **Temporary Financing/City Loan Repayments** (Lines 18 & 19) - The 2006-
14 2007 Budget Period anticipates a \$2.0 million repayment of the \$45.0
15 million City loan resulting in an outstanding balance at August 31, 2007 of
16 \$43.0 million.

17 **Distribution of Earnings** (Line 20) - This represents the annual \$18.0 million
18 payment made to the City of Philadelphia under the Philadelphia
19 Facilities Management Corporation Agreement/Ordinance. This payment
20 will be made to the City of Philadelphia and it will then be granted back
21 to PGW to be utilized as project revenues.

22 **Additions to (Reductions of) Non-Cash Working Capital** (Line 21) - This
23 category represents PGW's continuing effort to shift from the accrual
24 method of accounting to a cash basis. The detail of Working Capital is
25 presented on Exhibit H-1, and the annual changes in working capital,
26 which specifically support Line 21 of Exhibit A-2 are detailed on Exhibit H-2.

27 **Q. Would you please explain the major factors that resulted in the working**
28 **capital requirements for the 2005-2006 fiscal year and the continuing**
29 **impact on the proposed 2006-2007 Budget Year.**

1 A. The \$55.4 million net increase in working capital requirements during the
2 2005-2006 Period (Exhibit H-2, Line 13) reflects changes in both assets and
3 liabilities. The 2005-2006 fiscal period anticipates a decrease in accounts
4 receivable (Exhibit H-2, Line 1) of \$21.3 million and a commensurate
5 reduction in the reserve for bad debts (Exhibit H-2, Line 3) of \$15.8 million
6 resulting in a net gas accounts receivable decline (Line 4) of \$10.1 million.
7 Unbilled gas revenues (Line 2) of \$11.3 million at August 2006 are
8 projected to rise by \$2.5 million reflecting a higher average price per Mcf
9 for gas used but not yet billed. The reduction in accounts receivable was
10 mainly the result of the receipt of \$11.5 million in environmental related
11 insurance proceeds during the 2005-2006 fiscal period. PGW will be
12 consulting with its outside auditors to ascertain the required reserve for
13 uncollectible accounts and has presented separate supporting
14 documentation, which details the accounts receivable balance, reserve
15 for uncollectible accounts and bad debt expense. Materials and Supplies
16 (Exhibit H-2, Line 5) increased by \$53.8 million principally due to a
17 substantially higher price for natural gas and the volume in storage
18 inventories, while Other Current Assets (Exhibit H-2, Line 6) rose by \$8.8
19 million due mainly to a projected under recovery for the 2005-2006 GCR,
20 USC and restructuring charges of \$6.2 million. Liabilities, namely accounts
21 payables (Exhibit H-2, Line 10), are expected to rise by \$8.4 million
22 principally due to higher prices for natural gas purchases totaling \$7.3
23 million, while general trade payables are projected to rise by \$1.1 million.
24 In addition, Other Current Liabilities (Exhibit H-2, Line 11) are expected to
25 decline by \$4.1 million mainly as a result of the of the return to customers
26 of the \$7.6 million over recovery of the 2004-2005 GCR, USC and
27 restructuring charges, while higher accrued interest of \$2.6 million on long
28 term debt reflects the January 2006 6th Series bond refunding issue. The net
29 impact of these working capital changes resulted in an increased

1 requirement in the 2005-2006 fiscal year.

2 The 2006-2007 Budget Year projects overall working capital requirements
3 of \$2.9 million (Exhibit H-2, Line 13). The \$1.3 million net decrease in
4 Accounts Receivable (Exhibit H-2, Line 4) reflects the targeted goal of a
5 94.0% collection rate which is expected to lower outstanding customer
6 receivables, while providing the necessary requirement in the reserve for
7 bad debt. Materials and Supplies (Exhibit H-2, Line 5) are forecasted to
8 decline by \$3.4 million mainly reflecting a 2.3 Bcf decline in the volume of
9 natural gas in storage offset by higher average prices of nearly 91.0 cents
10 per Mcf or 10.6%. Other Current Assets (Exhibit H-2, Line 6) are expected
11 to decline by \$6.1 million reflecting the charge to customers of the \$6.2
12 million 2005-2006 under recovery associated with GCR, USC and
13 restructuring costs. Accounts Payable (Exhibit H-2, line 10) are expected
14 to decrease by \$12.8 million reflecting lower year end natural gas costs.
15 Other Current Liabilities (Exhibit H-2, Line 11) are anticipated to decrease
16 by \$.9 million reflecting lower accrued wages and the reserve for Injuries
17 and Damages, offset by higher accrued interest associated with the
18 proposed 7th Series \$150.0 million bond issue. These asset and liability
19 changes result in the additional net working capital requirement of \$2.9
20 million for the 2006-2007 Budget Year (Exhibit H-2, Line 13).

21 PGW's ending Cash Balance (Exhibit A-2, Line 28) at August 2006 is
22 expected to total \$10.8 million, \$104.2 million less than the combined
23 outstanding level of \$70.0 million of commercial paper notes and the
24 \$45.0 million City Loan. This year end cash balance is lower than the \$15.2
25 million actual cash balance in 2004-2005 which was \$79.7 million below
26 the combined outstanding level of \$49.9 million in commercial paper
27 notes and the \$45.0 million City Loan. The 2006-2007 Budget Year projects
28 a cash balance at year end of \$16.0 million, \$97.0 million less than the
29 combined outstanding commercial paper level of \$70.0 million and the

1 \$43.0 million City Loan. The ultimate goal for PGW in the future is to
2 continue to improve upon its historic collection rate so that much needed
3 liquidity can be generated to reduce short term borrowings and partially
4 support the financing of its capital programs with internally generated
5 funds.

6 **Q. Could you explain the income and expense components that are utilized**
7 **when computing the Revenue Bond Debt Service Coverage Ratio for the**
8 **2006-2007 Budget Year on Exhibit A-3?**

9 A. The coverage ratio is calculated based on the 1975 Ordinance and the
10 1998 Ordinance which sets the priority of payments of outstanding long-
11 term debt. In deriving data for the coverage calculation, several non-
12 cash adjustments are made to both revenue and expense items:

13 **Total Funds Provided** (Exhibit A-3, Line 7) - The funds provided in the
14 proposed 2006-2007 Operating Budget total \$1,009.6 billion and are
15 comprised of: (1) total gas and other operating revenues, (2) other
16 income adjusted to include actual cash withdrawals from both the
17 Capital Improvement and Revenue Bond Sinking funds (rather than only
18 the interest earned in the fiscal period), the \$18.0 million in Grant Income,
19 and (3) AFUDC on borrowed funds for capital expenditures.

20 **Total Funds Applied** (Line 12) - The funds applied reflect operating
21 expenses from Exhibit A-1, Line 19, totaling \$912.0 million, less certain non-
22 cash and subordinate expenses (Exhibit A-3, Line 11) totaling \$41.9 million.
23 The components of the non-cash expenses include: (1) depreciation
24 expense included in operating expenses, (2) payments to the City of
25 Philadelphia for miscellaneous services rendered, including Philadelphia
26 Gas Commission expenses.

27 **Funds Available to Cover Revenue Bond Debt** (Line 13) are projected to
28 be \$139.5 million in the 2006-2007 Budget Year.

29 **Revenue Bond Debt Service** (Line 14) - The total funds applied to 1975

1 Revenue Bond Debt Service are \$35.7 million, representing the scheduled
2 cash payments of principal which are due annually with interest paid
3 semi-annually.

4 **Debt Service Coverage Ratio 1975 Revenue Bonds** (Line 15) - The debt
5 service coverage ratio for 1975 Ordinance Revenue Bonds is obtained by
6 dividing Funds Available to cover 1975 Debt Service (\$139.5 million) by
7 Funds Applied to 1975 Debt Service Revenue Bonds (\$35.7 million). The
8 result produces a coverage ratio of 3.90 times. The mandatory coverage
9 ratio for 1975 Senior Debt Service is 1.5 times. The remaining coverage
10 ratios, as set forth in the 1998 Ordinance, are now calculated. Net
11 available after 1975 Debt Service (Line 16) totaling \$103.7 million is utilized
12 to calculate the coverage ratio on 1998 Ordinance Senior Debt Service
13 (Line 19) of \$53.3 million at a mandatory 1.5 times. The projected
14 calculation for this ratio is shown at 1.95 times (Line 20). The final
15 component of the coverage calculation under the 1998 Ordinance is
16 shown on (Lines 21 through 23). Net available after the 1998 Debt Service
17 (Line 21) of \$50.4 million is used to calculate coverage on 1998
18 Subordinate Debt Service (Line 22) of \$2.0 million. The result is shown on
19 (Line 23) as Debt Service Coverage Subordinate Bonds of 25.37 times. The
20 mandatory requirement is 1.0 times on subordinate debt service. The
21 projected coverage ratios for the current 2005-2006 fiscal period are
22 expected to be 3.33 times on 1975 Ordinance debt service and 3.01 times
23 on 1998 Ordinance debt service, while the coverage ratio on 1998
24 Subordinate debt service is expected to be 32.79 times.

25 **Q. Returning to the Statement of Income (Exhibit A-1), could you explain in**
26 **detail the items that are included under the category Labor and Fringe**
27 **Benefits on Exhibit A-1, Line 15.**

28 **A.** This category includes payroll costs (excluding that portion chargeable to
29 capital activities), payments made to beneficiaries of PGW's employee

1 pension plan and corresponding withdrawals from the pension fund. This
2 category also includes the cost of premiums paid for employees' (both
3 active and retired) health and group life insurance coverage, payroll
4 taxes associated with FICA and Medicare and state unemployment taxes
5 (exclusive of those taxes chargeable to capital activities) as detailed on
6 Exhibit C-3.

7 **Q. Are contractual labor escalations included in the periods covered on**
8 **Exhibit A-1?**

9 A. Yes, a three year contract is in effect with the Gas Works Employees' Union
10 for the period from May 16, 2005 to May 15, 2008. A 1% general wage
11 increase was effective for unionized employees on September 1, 2005.
12 The remaining general wage increases over the covered period are 3%
13 effective September 1, 2006 and 2½% on May 15, 2007. The 2006-2007
14 Budget provides funding for a 3% increase for non-union employees.

15 **Q. Could you explain the difference in labor and fringe benefit expenses**
16 **between the 2005-2006 and 2006-2007 fiscal periods?**

17 A. The 2006-2007 Budget Year reflects payroll costs of \$105.9 million, an
18 increase from the 2005-2006 fiscal year level of \$101.3 million (Exhibit C-3,
19 Line 1). Operating labor costs (Exhibit C-3, Line 3) also rose by \$3.3 million
20 to \$83.1 million, while labor charged to capital projects and other
21 activities rose by \$1.3 million.

22 The 2006-2007 Budget Year projects pension beneficiary payments (Line 4)
23 to total \$32.5 million, with a \$14.9 million (Line 5) withdrawal from the
24 pension fund to meet the anticipated payments. This will result in an
25 actuarial pension expense of \$17.6 million. The 2005-2006 Estimate for
26 pension beneficiary payments is expected to be \$31.5 million, with a \$14.2
27 million withdrawal from the pension fund to meet the scheduled
28 payments. The actuarial pension expense for PGW in the 2005-2006 fiscal
29 year is forecasted to total \$17.3 million. The actuarially computed pension

1 expense for the 2005-2006 and 2006-2007 fiscal periods was based on
 2 updated information based on PGW's most recent pension study
 3 prepared by its actuarial consultant.

4 Health insurance costs (Exhibit C-3, Line 8) are anticipated to be \$34.8
 5 million in the 2005-2006 fiscal period, while the 2006-2007 Budget Year
 6 expects a \$3.1 million increase to \$37.9 million. PGW is continually
 7 exploring ways to reduce costs for all employees' health coverage with its
 8 primary health care providers.

9 Payroll taxes (Exhibit C-3, Line 16) are anticipated to be \$6.6 million in the
 10 2006-2007 Budget Year an increase of \$.9 million. The 2005-2006 fiscal year
 11 reflected a non recurring refund of \$.6 million associated with sales tax
 12 liability. The following schedule details the major components of the Labor
 13 and Fringe Benefits expense:

14 **Labor and Fringe Benefits**

15 **(Dollars in Thousands)**

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
18 Operating Labor	\$80,634	\$79,848	\$83,154
19 Pension Payments	31,204	31,478	32,454
20 Pension Fund Withdrawals	(16,502)	(14,181)	(14,861)
21 Group Life Insurance	1,594	2,100	2,100
22 Health Insurance	33,571	34,804	37,884
23 Payroll Taxes	<u>6,218</u>	<u>5,678</u>	<u>6,574</u>
24 TOTAL	<u>\$136.719</u>	<u>\$139.727</u>	<u>\$147.305</u>

25 **Q. Could you explain the personnel levels included on Exhibit C-3-1, Line 11**
 26 **and why PGW feels that the 2006-2007 Budget Year level is reasonable?**

27 **A.** PGW, in the 2006-2007 Budget Year, expects to attain an average level of
 28 1,740 employees, currently PGW has approximately 1,767 employees and
 29 although the company targeted an average of 1,740 employees as its

1 goal in 2005-2006 it most likely will not attain that level. The main reason
2 for this situation is that the expected outsourcing of certain functions did
3 not occur as planned with a resultant higher level of employees.
4 However, PGW did not spend the related purchased service expenditures.
5 PGW recognizes that certain areas of the company due to the on-going
6 field operations initiative and other critical functions need additional
7 staffing and continued training; the 2006-2007 Budget provides the
8 necessary funding. PGW is committed to adhering to the highest level
9 of safety in the work place, while at the same time reducing overall
10 workers' compensation claims through continued training.

11 **Q. Please detail the items included in Other Expenses and Depreciation on**
12 **Exhibit A-1, Line 17.**

13 A. The expenses shown on Exhibit A-1, Line 17, totaling \$73.1 million for the
14 2006-2007 Budget Year captioned "Other Expenses and Depreciation"
15 include an appropriation for reserves and other losses (excluding the
16 appropriation for uncollectible gas accounts), advertising, general
17 material, property and liability insurance, contracted maintenance,
18 utilities, rentals, purchased services, postage, promotion, depreciation and
19 miscellaneous expenses.

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

26 **Exhibit C-4, Detail of Other Operating Expenses**

27 **Q. Have any adjustments been made to the expense categories detailed on**
28 **Exhibit C-4 to reflect past Regulatory Commission orders?**

29 A. Yes, PGW has complied with Regulatory Commissions' past orders which

1 amortized certain non-recurring costs and normalized other expense items
2 for ratemaking and budgeting purposes. The purchased services
3 category mainly reflects these adjustments. Schedule (SD-4) provides
4 documentation of the accounting for the remaining non-recurring
5 expenses, and has been included as part of PGW's Operating Budget
6 filing.

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

9 A. This expense category includes appropriations to the Injuries and
10 Damages Reserve for PGW's estimate of outstanding suits and claims and
11 workers' compensation settlements, corporate loss settlements, and a
12 provision for employees' compensated absences. As stated previously,
13 this item excludes the appropriation for uncollectible accounts.

14 **Q. What factors contributed to the increase in settlements during the 2005-**
15 **2006 Estimate compared to the 2004-05 actual, and the slightly higher**
16 **projected level of settlements for the 2006-2007 Budget Year?**

17 A. PGW's settlements for suits and claims and costs for workers'
18 compensation were \$2.7 million during the 2004-2005 actual period and
19 combined with the appropriation of \$3.0 million resulted in a year-end
20 reserve balance of \$3.5 million at August 2005. PGW's current projection
21 of total reserves for outstanding suits and claims and workers'
22 compensation settlements is expected to total nearly \$5.1 million at
23 August 2006, a decrease compared to the \$8.5 million that was projected
24 at August 2005. The 2005-2006 fiscal year primarily reflects the settlement
25 of several workers' compensation claims. The appropriation to the Reserve
26 for Injuries and Damages is expected to total \$3.1 million during the 2005-
27 2006 fiscal period resulting in an ending reserve balance of \$3.2 million.
28 Settlements for the 2005-2006 fiscal period are anticipated to total \$3.4
29 million. The reserve balance at August 2006 is expected to provide

1 coverage for suits and claims and workers' compensation settlements
2 during the 2006-2007 Budget Year.

3 The 2006-2007 Budget Year projects settlements totaling \$3.6 million with a
4 major claim case anticipated to be settled during the upcoming period,
5 while the appropriation of \$2.3 million represents the required level
6 necessary to provide a year-end reserve balance of \$1.8 million. This
7 forecasted reserve balance at August 2007 is expected to provide
8 coverage for outstanding suits and claims and workers' compensation
9 settlements anticipated during the 2007-2008 fiscal year.

10 PGW continues, through the Human Resources, Risk Management and
11 Legal departments, and the use of a third party provider to handle its
12 workers' compensation program to identify all potential savings that can
13 be achieved through an effective coordination of these activities.

14 The following schedule details the Injuries and Damages Reserve:

15 **Injuries and Damages Reserve**

16 **(Dollars in Thousands)**

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
17 Beginning Balance	\$3,235	\$3,520	\$3,172
18 Settlements	(2,715)	(3,411)	(3,584)
19 Appropriation	<u>3,000</u>	<u>3,063</u>	<u>2,257</u>
20 Ending Balance	<u>\$3.520*</u>	<u>\$3.172*</u>	<u>\$1.845*</u>

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

23
24
25 **Q. Would you explain the items included in the Advertising expenses shown**
26 **on Exhibit C-4, Line 2, and the increase of 13% comparing the 2006-2007**
27 **Budget Year to the 2005-2006 Estimate?**

28 A. The major components of the advertising expenditures in the 2006-2007
29 Budget Year are related to corporate campaigns to inform eligible

1 customers of the availability of Low Income Heating Assistance Programs,
2 collection activities related to customer bill payment, PGW's Parts and
3 Labor Repair Plans and customer appliance safety and corporate
4 customer informational and educational advertising. The major portion of
5 the added spending reflects advertising costs in the 2006-2007 Period
6 related to customer conservation activities. In addition, advertising is
7 associated with Regulatory activities related to rate and tariff changes,
8 meeting notices and hearings.

9 **Q. What are the main components of the General Material costs included on**
10 **Exhibit C-4, Line 3 for the 2006-2007 Budget Year and the 2005-2006 fiscal**
11 **period?**

12 A. In the 2006-2007 Budget Year, the three major operating departments are
13 anticipated to utilize \$7.0 million in material in their operations (pipe,
14 valves, appliance and replacement parts, etc.) approximately \$.2 million
15 or 2.3% more than in the current period. PGW remains committed to an
16 overall cost containment initiative to lower the overall departmental
17 material utilization.

18 **Q. What type of Insurance Premiums are included in the Insurance costs**
19 **reported on Exhibit C-4, Line 4, and what is the reason for the \$.3 million or**
20 **nearly 10% increase projected in the 2006-2007 Budget Year?**

21 A. Insurance expense includes premiums for property, public liability, and
22 workers' compensation coverage. Public liability coverage for the 2005-
23 2006 and 2006-2007 fiscal years is expected to be maintained at the
24 current \$200.0 million level with a self-retention level of \$500,000 per
25 occurrence. The renewal premiums for public liability insurance are
26 anticipated to rise by nearly \$.3 million or 14% to \$2.7 million in the 2006-
27 2007 Budget Year up from the \$2.4 million level experienced in the 2005-
28 2006 fiscal period. In the 2004-2005 through 2006-2007 fiscal years, the cost
29 of providing insurance coverage is reflected as follows:

Insurance Expense
(Dollars in Thousands)

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Property Insurance	\$827	\$1,067	\$1,067
Public Liability & Workers' Comp.	2,608	2,351	2,690
Miscellaneous	<u>50</u>	<u>60</u>	<u>70</u>
TOTAL	<u>\$3,485</u>	<u>\$3,478</u>	<u>\$3,827</u>

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

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

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

Q. Costs associated with Contracted Maintenance on Exhibit C-4, Line 5, are projected to rise by nearly \$.4 million or 6% in the 2006-2007 Budget Year. Please explain the reason for the increased expense.

A. The primary reason for the additional contracted maintenance costs reflects added regulatory requirements for transmission line inspections and higher costs for adjusting existing PGW infrastructure facilities associated street repaving activities. Also, maintenance of PGW software applications is anticipated to increase by \$.1 million. PGW expects

1 contracted maintenance expenses overall to total \$5.6 and \$6.0 million in
2 the 2005-2006 and 2006-2007 fiscal periods, respectively.

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

5 A. Utilities include the cost of electric, telephone and water service. In the
6 2004-2005 through 2006-2007 fiscal years, the actual or projected costs for
7 these services are:

	<u>Utility Expense</u>		
	<u>(Dollars in Thousands)</u>		
	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
12 Electric	\$2,052	\$2,108	\$2,093
13 Telephone	1,306	1,177	1,127
14 Water	<u>443</u>	<u>384</u>	<u>396</u>
15 TOTAL	<u>\$3,801</u>	<u>\$3,669</u>	<u>\$3,616</u>

16 The 1% decline in utility expenditures projected for the 2006-2007 Budget
17 Year mainly reflects lower costs for purchased telephone services
18 reflecting a scaling back of overall Company usage. Electric costs were
19 relatively unchanged in a year to year comparison. The utility expenses
20 included above exclude the cost of gas used by the company. This gas
21 expense, in accordance with the prescribed FERC accounting
22 methodology, is included in Natural Gas expense on Exhibit A-1, Line 11.

23 **Q. What costs are included in Rental expenses, as presented on Exhibit C-4,**
24 **line 7?**

25 A. Rental expenses include the rental and leasing of such items as computer
26 related and telephone equipment, hand held microprocessors,
27 transportation and construction equipment and PGW's customer service
28 centers. This expense category in the 2006-2007 Budget Year is expected
29 to remain relatively constant at \$.8 million.

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

3 A. This expense category primarily includes professional and technical
4 services such as: legal, engineering, auditing, consulting and computer
5 related services, as well as, certain specialized services, e.g., advertising,
6 production, collection agencies, armored car services, weather
7 forecasting, banking and financial services and home weatherization
8 services, etc., which are not normally available within the company's
9 internal organization. The 2006-2007 Budget Year anticipates that
10 purchased service costs will total \$23.7 million, an increase of \$2.8 million
11 or 13.7% above the 2005-2006 Estimate of \$20.9 million. The major
12 increases in the 2006-2007 Budget Year result from \$1.0 million to provide
13 funding for possible outsourced company operations. In addition, higher
14 costs for security services, internal audit services and costs for a possible
15 base rate filing further contributed to the added expenses. These
16 increases were offset by decreased expenditures related to customer bill
17 payment credit card fees and non recurring costs attributable to the LNG
18 project and the proposed Exelon utility merger. The 2006-2007 Budget
19 anticipates that weatherization and conservation expenditures will total
20 \$2.2 million, approximating the 2005-2006 Estimate. These costs are part of
21 the non-fuel charges that are currently recoverable through the Universal
22 Service Charge.

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

25 A. Yes. PGW mails all of its monthly customer gas bills. In addition, this
26 expense includes the cost for the mailing of collection notices, parts and
27 labor plan contracts and general business correspondence. The 2006-
28 2007 Budget Year total of \$2.6 million is \$.2 million greater than the \$2.4
29 million expected to be incurred in the current fiscal period.

1 **Q. Please describe the items included in the category Promotion on Exhibit**
2 **C-4, Line 10.**

3 A. The promotional expenses are associated with the Marketing
4 department's initiatives to expand the use of natural gas in all market
5 segments. The Marketing department included \$.5 million for customer
6 incentives in the 2006-2007 Budget Year, no promotional expenditures are
7 anticipated in the 2005-2006 fiscal period.

8 **Q. What are the components of Non-Utility Revenues presented on Exhibit C-**
9 **4, Line 11?**

10 A. This category formerly included repair and other service revenues, which
11 are now reported as part of other operating revenues. The components
12 of these revenues are associated with the 1% commission paid by the
13 Commonwealth of Pennsylvania for sales tax collection and
14 reimbursement for non-business related phone calls.

15 **On Exhibit C-4, Line 12, what expenses are charged to capital and what is**
16 **the basis for the allocated charges to capital and corresponding credits to**
17 **Operations?**

18 A. Certain labor-related fringe benefit expenses, such as employee group life
19 and health insurance, pensions and payroll taxes are charged initially to
20 PGW's operating accounts on the Statement of Income, Exhibit A-1. In
21 order to assign a proportional share of these costs to capital projects that
22 utilize PGW personnel, a percentage of the total cost of the labor and
23 fringe benefit expenses to the total direct payroll is calculated. On the
24 basis of this calculation, these expenses are allocated to capital projects
25 and operating expenses are reduced on the basis of the direct labor
26 charges to capital. Also, administrative costs are allocated to capital
27 based on the percentage of administrative and general expenses to total
28 expenditures, excluding fuel costs. Capital projects are charged and
29 operating expenses lowered on the basis of the total charges on a

1 monthly basis to capital projects. The 2006-2007 Budget Year anticipates
2 an allocation of \$19.2 million in labor related fringe benefits and
3 administrative and general costs to capital projects, an increase of \$2.5
4 million from the 2005-2006 fiscal period level of \$16.7 million reflecting a
5 higher capitalization factor for labor related costs and the additional
6 capital spending in the upcoming 2006-2007 Budget Year.

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

9 A. PGW currently depreciates plant-in-service based on a 2004 depreciation
10 study performed by the firm of Black & Veatch. The 2006-2007 Budget
11 Year projects the utilization of a 2.4% composite depreciation rate and
12 when applied to the projected plant-in-service balances, mainly
13 accounts for the \$1.3 million rise in depreciation expense.

14 **Q. Miscellaneous expenses included on Exhibit C-4, Line 15, are forecasted**
15 **to decrease by \$6.2 million in the 2006-2007 Budget Year. Please explain**
16 **the reasons for the lower costs and the main components of this**
17 **category?**

18 A. Miscellaneous expenses are forecasted to decline in the 2006-2007
19 Budget Year primarily due to the previously mentioned corporate goal of
20 \$5.0 million or 2% in across the board cost reductions and the final year of
21 the amortization of restructuring costs during the 2005-2006 period. These
22 decreases were offset somewhat by additional costs reflecting employee
23 training programs and an expansion of PGW's employee tuition refund
24 program during the 2006-2007 Budget Year. A detail of the components
25 of the miscellaneous expense category is listed below:
26
27
28
29

Miscellaneous Expenses**(Dollars in Thousands)**

	<u>Actual</u>	<u>Estimate</u>	<u>Budget</u>
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Expense of Employees	\$453	\$840	\$954
Dues & Subscriptions	2,881	3,294	3,676
Taxes	24	24	28
PFMC Management Fee	325	371	372
Amortization Restructuring Costs	1,087	1,087	-
Cost Savings	-	-	(5,000)
Amortization Non-Recurring Expense	432	439	327
Deferred Compensation	334	343	355
(Additions)/Reductions LNG Inventory	<u>(290)</u>	<u>(1,083)</u>	<u>(1,568)</u>
TOTAL	<u>\$5,246</u>	<u>\$5,315</u>	<u>\$(856)</u>

15 **Q. Does this conclude your testimony in this proceeding?**

16 **A. Yes, it does. Thank you.**

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CITY OF PHILADELPHIA

OFFICE OF THE DIRECTOR OF FINANCE

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VINCENT J. JANNETTI
Acting Secretary of Financial
Oversight and
Director of Finance

May 17, 2006

The Honorable Marian B. Tasco
Chairwoman
PHILADELPHIA GAS COMMISSION
One Parkway Building
1515 Arch Street
Philadelphia, PA 19102

Dear Chairwoman Tasco:

Please be informed that pursuant to Section IV - 2 (a) of the Agreement between the City of Philadelphia and the Philadelphia Facilities Management Corporation ("Management Agreement"), I have reviewed the Fiscal Year 2007 Philadelphia Gas Works Operating Budget, and have determined that same is consistent with the accounting methods prescribed in Section IV - 1 of the Management Agreement and is otherwise in form and extent satisfactory to me.

Please feel free to contact this office should you require any assistance.

Sincerely,

A handwritten signature in black ink, appearing to read 'Vincent J. Jannetti'.

Vincent J. Jannetti
Acting Secretary of Financial Oversight &
Director of Finance

RESOLUTION

**FOR AUTHORIZATION TO SUBMIT THE
PGW FISCAL YEAR 2007 OPERATING BUDGET TO THE
PHILADELPHIA GAS COMMISSION FOR REVIEW AND APPROVAL**

I, **ABBY L. POZEFSKY**, Assistant Secretary of **PHILADELPHIA FACILITIES MANAGEMENT CORPORATION**, do hereby certify that the following is a true and correct copy of action taken by the Board of Directors of said corporation by unanimous consent to the adoption of this resolution dated May 22, 2006, pursuant to provisions of Section 5727(b) of the Non-Profit Corporation Law of the Commonwealth of Pennsylvania.

**RESOLUTION FOR AUTHORIZATION TO SUBMIT THE
PGW FISCAL YEAR 2007 OPERATING BUDGET TO THE
PHILADELPHIA GAS COMMISSION FOR REVIEW AND APPROVAL**

WHEREAS, according to the Agreement between the City of Philadelphia and the Philadelphia Facilities Management Corporation ("PFMC") for the management and operation of the Philadelphia Gas Works ("PGW") dated December 29, 1972, as amended (the "Management Agreement"), §IV.2(a), PGW's operating budget is subject to the approval of the Philadelphia Gas Commission;

WHEREAS, according to the Management Agreement §IV.2(a), PGW's operating budget must be prepared with the aid of the Director of Finance and be consistent with the accounting methods described in the Management Agreement §IV.1, in a form and extent that is satisfactory to the Director of Finance and the Philadelphia Gas Commission;

WHEREAS, pursuant to that certain resolution passed October 29, 2002, the Board may approve and authorize certain expenditures set forth in the operating budget in excess of Five Hundred Thousand Dollars (\$500,000) annually without the necessity for further resolution, including: (1) certain fixed non-discretionary expenditures; (2) certain payroll and benefits expenditures; and (3) gas supply purchases with contracts of varying terms which are not subject to Gas Commission review and City Council approval but reviewed for prudence as a part of PGW's Gas Cost Rate proceedings before the Public Utilities Commission, subject to the authority to the Chief Executive Officer to make intra-year modification of up to ten percent in each of the preceding three categories;

WHEREAS, PGW has prepared its Fiscal Year 2007 Operating Budget and is currently developing the Forecast Fiscal Years 2008

through 2012 through the evaluation of the current needs and outlook of the municipally owned utility;

WHEREAS, PFMC has conducted a review of PGW's Fiscal Year 2007 Operating Budget and finds it in satisfactory form and content, and will review the Forecast Fiscal Years 2008 through 2012 when they are fully developed;

NOW THEREFORE, BE IT RESOLVED, that PFMC approves PGW's Fiscal Year 2007 Operating Budget, subject to further refinement by PGW management, should that become necessary or desirable; and that PGW is authorized to file with the Philadelphia Gas Commission for its approval and with the Director of Finance for his approval, as to form and content, the PGW Fiscal Year 2007 Operating Budget, in accordance with the Management Agreement §IV.2(a).

AND FURTHER RESOLVED that pursuant to that certain resolution passed October 19, 2002 the Board hereby approves and authorizes certain expenditures as set forth in the operating budget in excess of Five Hundred Thousand Dollars (\$500,000) annually without the necessity for further resolution, including: (1) certain fixed non-discretionary expenditures, including but not limited to: state and local taxes; interest and principal payments to bondholders; commercial paper payments; postage; electric; and the annual fixed fee payment to the PUC; (2) certain payroll and benefits expenditures including but not limited to: payments to fund payroll obligations; payroll taxes; payments to the pension sinking fund; retirement benefit payments; health care payments; and life insurance payments; and (3) gas supply purchases with contracts of varying terms which are not subject to Gas Commission review and City Council approval but reviewed for prudence as a part of PGW's Gas Cost Rate proceedings before the Public Utilities Commission; subject to the authority to the Chief Executive Officer to make intra-year modification of up to ten percent in each of the preceding three categories.

IN WITNESS WHEREOF, I have hereunto set my hand and have caused the corporate seal of said Corporation to be hereunto affixed this 23rd day of May, 2006.

PHILADELPHIA FACILITIES
MANAGEMENT CORPORATION

By: _____

Abby L. Pozefsky

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME - BRINGDOWN
(Dollars in Thousands)

	<u>2001</u> <u>+ \$36M</u>	<u>2007</u>	<u>Diff</u>
Operating Revenues			
1	Total Gas Revenues	766,280	942,090
2	Total Other Operating Revenues	28,026	28,564
3	Total Operating Revenues	<u>794,306</u>	<u>970,654</u>
4			
Operating Expenses			
6	Fuel	415,065	630,841
7			
8	Contribution Margin (lines 3 minus 6)	379,241	339,813
9			(39,428)
10	Other Oper. & Maintenance	206,766	229,932
11	Depreciation/Cost of Removal	32,537	38,196
12	Sub Total Other Oper. & Maint. & Depreciation	<u>239,303</u>	<u>268,128</u>
13			28,825
14	Total Operating Expenses (lines 6 + 12)	<u>654,368</u>	<u>898,969</u>
15			
16	Operating Income (lines 3 minus 14)	139,938	71,685
17			
18	Other Income	6,106	11,212
19			5,106
20	Income Before Interest	146,044	82,897
21			
22	Total Interest	57,789	73,978
23			16,189
24	Net Income	<u>88,255</u>	<u>8,919</u>
25			(79,336)

\$50M Rate Case Scenario @ 5.0% NPV

\$50.0M from rates at NPV of 5.0%

	Year 1 FY2007-08	Year 2 FY2008-09	Year 3 FY2009-10
September	1,388,889	1,388,889	1,388,889
October	1,388,889	1,388,889	1,388,889
November	1,388,889	1,388,889	1,388,889
December	1,388,889	1,388,889	1,388,889
January	1,388,889	1,388,889	1,388,889
February	1,388,889	1,388,889	1,388,889
March	1,388,889	1,388,889	1,388,889
April	1,388,889	1,388,889	1,388,889
May	1,388,889	1,388,889	1,388,889
June	1,388,889	1,388,889	1,388,889
July	1,388,889	1,388,889	1,388,889
August	1,388,889	1,388,889	1,388,889
	\$16,666,667	\$16,666,667	\$16,666,667
Net Discounted Cash Flow - Annual	\$16,223,919	\$15,434,273	\$14,683,060
Net Discounted Cash Flow - Cumulative	\$16,223,919	\$31,658,192	\$46,341,252

	Debt Service	NPV Factor	NPV of Debt Service	NPV of Interest Income Capital Balance	NPV of Interest Income Sinking Fund	NPV of Interest Income Sinking Fund	Total
1	5,263,000	0.941905	4,957,248	2,064,012	297,650	297,650	2,595,586
2	5,149,000	0.887186	4,568,119	1,191,887	280,358	280,358	3,095,874
3	5,035,000	0.835645	4,207,472	399,769	264,070	264,070	3,543,633
4	4,921,000	0.787098	3,873,311	0	248,729	248,729	3,624,582
5	4,807,000	0.741372	3,563,776	0	234,280	234,280	3,329,497
6	4,693,000	0.698302	3,277,133	0	220,669	220,669	3,056,464
7	4,579,000	0.657735	3,011,768	0	207,849	207,849	2,803,918
8	4,465,000	0.619524	2,766,174	0	195,775	195,775	2,570,400
9	4,351,000	0.583533	2,538,952	0	184,401	184,401	2,354,550
10	4,237,000	0.549633	2,328,794	0	173,688	173,688	2,155,106
11	4,123,000	0.517702	2,134,485	0	163,598	163,598	1,970,887
12	4,009,000	0.487626	1,954,894	0	154,094	154,094	1,800,800
13	3,895,000	0.459298	1,788,965	0	145,142	145,142	1,643,823
14	3,781,000	0.432615	1,635,718	0	136,710	136,710	1,499,008
15	3,667,000	0.407482	1,494,238	0	128,768	128,768	1,365,470
16	3,553,000	0.383810	1,363,676	0	121,287	121,287	1,242,389
17	3,439,000	0.361513	1,243,242	0	114,241	114,241	1,129,001
18	3,325,000	0.340511	1,132,198	0	107,604	107,604	1,024,594
19	3,211,000	0.320729	1,029,860	0	101,353	101,353	928,507
20	3,097,000	0.302096	935,592	0	95,465	95,465	840,127
21	2,983,000	0.284546	848,801	0	89,919	89,919	758,882
22	2,869,000	0.268015	768,936	0	84,695	84,695	684,241
23	2,755,000	0.252445	695,486	0	79,775	79,775	615,712
24	2,641,000	0.237779	627,975	0	75,140	75,140	552,835
25	2,527,000	0.223966	565,961	0	70,775	70,775	495,186
26	2,413,000	0.210954	509,033	0	66,663	66,663	442,370
27	2,299,000	0.198699	456,809	0	62,791	62,791	394,019
28	0	0.187156	0	0	34,607	34,607	(34,607)
29	0	0.176283	0	0	33,802	33,802	(33,802)
30	0	0.166042	0	0	32,974	32,974	(32,974)
Total	102,087,000		54,278,617	3,655,668	4,206,870	4,206,870	46,416,078

Assumptions:

1. Gross Bond Proceeds - \$57.0M
2. Net Bond Proceeds - \$50.0M
3. NPV Rate - 5.0%
4. Investment Rate - 5.0%
5. Coverage 1.0x

	Debt Service	Debt Service Coverage 1.5	NPV Factor	NPV of Debt Service	NPV of Interest Income Capital Balance	NPV of Interest Income Sinking Fund	NPV of Interest Income Sinking Fund	Total
1	5,263,000	7,894,500	0.941905	7,435,872	2,064,012	297,650	5,074,210	
2	5,149,000	7,723,500	0.887186	6,852,179	1,191,887	280,358	5,379,933	
3	5,035,000	7,552,500	0.835645	6,311,208	399,769	264,070	5,647,369	
4	4,921,000	7,381,500	0.787098	5,809,967	0	248,729	5,561,238	
5	4,807,000	7,210,500	0.741372	5,345,664	0	234,280	5,111,385	
6	4,693,000	7,039,500	0.698302	4,915,700	0	220,669	4,695,031	
7	4,579,000	6,868,500	0.657735	4,517,651	0	207,849	4,309,802	
8	4,465,000	6,697,500	0.619524	4,149,261	0	195,775	3,953,487	
9	4,351,000	6,526,500	0.583533	3,808,427	0	184,401	3,624,026	
10	4,237,000	6,355,500	0.549633	3,493,191	0	173,688	3,319,502	
11	4,123,000	6,184,500	0.517702	3,201,728	0	163,598	3,038,130	
12	4,009,000	6,013,500	0.487626	2,932,341	0	154,094	2,778,247	
13	3,895,000	5,842,500	0.459298	2,683,447	0	145,142	2,538,306	
14	3,781,000	5,671,500	0.432615	2,453,576	0	136,710	2,316,866	
15	3,667,000	5,500,500	0.407482	2,241,357	0	128,768	2,112,589	
16	3,553,000	5,329,500	0.383810	2,045,515	0	121,287	1,924,228	
17	3,439,000	5,158,500	0.361513	1,864,863	0	114,241	1,750,622	
18	3,325,000	4,987,500	0.340511	1,698,297	0	107,604	1,590,693	
19	3,211,000	4,816,500	0.320729	1,544,790	0	101,353	1,443,437	
20	3,097,000	4,645,500	0.302096	1,403,388	0	95,465	1,307,923	
21	2,983,000	4,474,500	0.284546	1,273,201	0	89,919	1,183,282	
22	2,869,000	4,303,500	0.268015	1,153,404	0	84,695	1,068,709	
23	2,755,000	4,132,500	0.252445	1,043,229	0	79,775	963,455	
24	2,641,000	3,961,500	0.237779	941,963	0	75,140	866,823	
25	2,527,000	3,790,500	0.223966	848,942	0	70,775	778,167	
26	2,413,000	3,619,500	0.210954	763,550	0	66,663	696,886	
27	2,299,000	3,448,500	0.198699	685,214	0	62,791	622,423	
28	0	0	0.187156	0	0	34,607	(34,607)	
29	0	0	0.176283	0	0	33,802	(33,802)	
30	0	0	0.166042	0	0	32,974	(32,974)	
Total	102,087,000	153,130,500		81,417,925	3,655,668	4,206,870	73,555,387	

Assumptions:

1. Gross Bond Proceeds - \$57.0M
2. Net Bond Proceeds - \$50.0M
3. NPV Rate - 5.0%
4. Investment Rate - 5.0%
5. Coverage 1.5x

\$50M Rate Case Scenario @ 6.0% NPV

\$50.0M from rates at NPV of 6.0%

	Year 1 FY2007-08	Year 2 FY2008-09	Year 3 FY2009-10
September	1,388,889	1,388,889	1,388,889
October	1,388,889	1,388,889	1,388,889
November	1,388,889	1,388,889	1,388,889
December	1,388,889	1,388,889	1,388,889
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May	1,388,889	1,388,889	1,388,889
June	1,388,889	1,388,889	1,388,889
July	1,388,889	1,388,889	1,388,889
August	1,388,889	1,388,889	1,388,889
	\$16,666,667	\$16,666,667	\$16,666,667
Net Discounted Cash Flow - Annual	\$16,137,406	\$15,199,909	\$14,316,875
Net Discounted Cash Flow - Cumulative	\$16,137,406	\$31,337,314	\$45,654,189

	Debt Service	NPV Factor	NPV of Debt Service	NPV of Interest Income Capital Balance	NPV of Interest Income Sinking Fund	NPV of Interest Income Sinking Fund	Total
1	5,263,000	0.941905	4,957,248	2,464,379	297,650		2,195,219
2	5,149,000	0.887186	4,568,119	1,409,285	280,358		2,878,476
3	5,035,000	0.835645	4,207,472	468,464	264,070		3,474,937
4	4,921,000	0.787098	3,873,311	0	248,729		3,624,582
5	4,807,000	0.741372	3,563,776	0	234,280		3,329,497
6	4,693,000	0.698302	3,277,133	0	220,669		3,056,464
7	4,579,000	0.657735	3,011,768	0	207,849		2,803,918
8	4,465,000	0.619524	2,766,174	0	195,775		2,570,400
9	4,351,000	0.583533	2,538,952	0	184,401		2,354,550
10	4,237,000	0.549633	2,328,794	0	173,688		2,155,106
11	4,123,000	0.517702	2,134,485	0	163,598		1,970,887
12	4,009,000	0.487626	1,954,894	0	154,094		1,800,800
13	3,895,000	0.459298	1,788,965	0	145,142		1,643,823
14	3,781,000	0.432615	1,635,718	0	136,710		1,499,008
15	3,667,000	0.407482	1,494,238	0	128,768		1,365,470
16	3,553,000	0.383810	1,363,676	0	121,287		1,242,389
17	3,439,000	0.361513	1,243,242	0	114,241		1,129,001
18	3,325,000	0.340511	1,132,198	0	107,604		1,024,594
19	3,211,000	0.320729	1,029,860	0	101,353		928,507
20	3,097,000	0.302096	935,592	0	95,465		840,127
21	2,983,000	0.284546	848,801	0	89,919		758,882
22	2,869,000	0.268015	768,936	0	84,695		684,241
23	2,755,000	0.252445	695,486	0	79,775		615,712
24	2,641,000	0.237779	627,975	0	75,140		552,835
25	2,527,000	0.223966	565,961	0	70,775		495,186
26	2,413,000	0.210954	509,033	0	66,663		442,370
27	2,299,000	0.198699	456,809	0	62,791		394,019
28	0	0.187156	0	0	34,607		(34,607)
29	0	0.176283	0	0	33,802		(33,802)
30	0	0.166042	0	0	32,974		(32,974)
Total	102,087,000		54,278,617	4,342,129	4,206,870		45,729,618

Assumptions:

1. Gross Bond Proceeds - \$57.0M
2. Net Bond Proceeds - \$50.0M
3. NPV Rate - 6.0%
4. Investment Rate - 6.0%
5. Coverage 1.0x

	Debt Service	Debt Service 1.5 Coverage	NPV Factor	NPV of Debt Service	NPV of Interest Income Capital Balance	NPV of Interest Income Sinking Fund	NPV of Interest Income Sinking Fund	Total
1	5,263,000	7,894,500	0.941905	7,435,872	2,464,379	297,650	4,673,843	
2	5,149,000	7,723,500	0.887186	6,852,179	1,409,285	280,358	5,162,536	
3	5,035,000	7,552,500	0.835645	6,311,208	468,464	264,070	5,578,673	
4	4,921,000	7,381,500	0.787098	5,809,967	0	248,729	5,561,238	
5	4,807,000	7,210,500	0.741372	5,345,664	0	234,280	5,111,385	
6	4,693,000	7,039,500	0.698302	4,915,700	0	220,669	4,695,031	
7	4,579,000	6,868,500	0.657735	4,517,651	0	207,849	4,309,802	
8	4,465,000	6,697,500	0.619524	4,149,261	0	195,775	3,953,487	
9	4,351,000	6,526,500	0.583533	3,808,427	0	184,401	3,624,026	
10	4,237,000	6,355,500	0.549633	3,493,191	0	173,688	3,319,502	
11	4,123,000	6,184,500	0.517702	3,201,728	0	163,598	3,038,130	
12	4,009,000	6,013,500	0.487626	2,932,341	0	154,094	2,778,247	
13	3,895,000	5,842,500	0.459298	2,683,447	0	145,142	2,538,306	
14	3,781,000	5,671,500	0.432615	2,453,576	0	136,710	2,316,866	
15	3,667,000	5,500,500	0.407482	2,241,357	0	128,768	2,112,589	
16	3,553,000	5,329,500	0.383810	2,045,515	0	121,287	1,924,228	
17	3,439,000	5,158,500	0.361513	1,864,863	0	114,241	1,750,622	
18	3,325,000	4,987,500	0.340511	1,698,297	0	107,604	1,590,693	
19	3,211,000	4,816,500	0.320729	1,544,790	0	101,353	1,443,437	
20	3,097,000	4,645,500	0.302096	1,403,388	0	95,465	1,307,923	
21	2,983,000	4,474,500	0.284546	1,273,201	0	89,919	1,183,282	
22	2,869,000	4,303,500	0.268015	1,153,404	0	84,695	1,068,709	
23	2,755,000	4,132,500	0.252445	1,043,229	0	79,775	963,455	
24	2,641,000	3,961,500	0.237779	941,963	0	75,140	866,823	
25	2,527,000	3,790,500	0.223966	848,942	0	70,775	778,167	
26	2,413,000	3,619,500	0.210954	763,550	0	66,663	696,886	
27	2,299,000	3,448,500	0.198699	685,214	0	62,791	622,423	
28	0	0	0.187156	0	0	34,607	(34,607)	
29	0	0	0.176283	0	0	33,802	(33,802)	
30	0	0	0.166042	0	0	32,974	(32,974)	
Total	102,087,000	153,130,500		81,417,925	4,342,129	4,206,870	72,868,926	

Assumptions:

1. Gross Bond Proceeds - \$57.0M
2. Net Bond Proceeds - \$50.0M
3. NPV Rate - 6.0%
4. Investment Rate - 6.0%
5. Coverage 1.5x

PHILADELPHIA GAS WORKS
OPERATING & MAINTENANCE COSTS
(Millions of Dollars)

CATEGORY	ACTUAL FY2000		ACTUAL FY2001		ACTUAL FY2002*		ACTUAL FY2003		ACTUAL FY2004		ACTUAL FY2005		ESTIMATE FY2006		BUDGET FY2007	
	Dollars	%	Dollars	%	Dollars	%	Dollars	%	Dollars	%	Dollars	%	Dollars	%	Dollars	%
Fuel Costs	\$ 266	45%	\$ 431	57%	\$ 304	49%	\$ 427	54%	\$ 451	57%	\$ 510	60%	\$ 639	65%	\$ 631	64%
Depreciation	31	51%	32	61%	31	54%	31	58%	34	61%	35	64%	37	69%	38	68%
Interest	59	61%	58	68%	59	63%	57	65%	59	68%	64	71%	65	75%	74	75%
City Payment	18	64%	18	71%	18	66%	18	67%	-	68%	-	72%	-	75%	-	75%
Sub-Total	<u>374</u>		<u>539</u>		<u>412</u>		<u>533</u>		<u>544</u>		<u>609</u>		<u>741</u>		<u>743</u>	
Bad Debt	55	73%	68	80%	52	74%	85	78%	71	77%	70	79%	61	82%	61	82%
Operating Labor	79	87%	81	90%	73	86%	79	88%	81	87%	81	89%	81	90%	84	90%
Pensions	1	87%	2	91%	8	87%	13	89%	15	89%	15	90%	17	91%	17	92%
Health & Life Insurance	26	91%	29	94%	31	92%	32	93%	36	94%	35	95%	37	95%	40	96%
Taxes	7	92%	6	95%	6	93%	6	94%	6	94%	6	95%	6	96%	6	96%
Labor & Benefits	<u>113</u>		<u>118</u>		<u>118</u>		<u>130</u>		<u>138</u>		<u>137</u>		<u>141</u>		<u>147</u>	
Other:																
Losses/ Insurance/																
Utilities/Postage	11	94%	10	97%	13	95%	11	95%	11	96%	12	97%	13	97%	12	98%
General Material/																
Purchased Services	23	98%	22	99%	22	99%	27	99%	26	99%	26	99%	27	100%	29	101%
Miscellaneous	10	100%	4	100%	7	100%	10	100%	8	100%	3	100%	-	100%	(6)	100%
Sub-Total	<u>44</u>		<u>36</u>		<u>42</u>		<u>48</u>		<u>45</u>		<u>41</u>		<u>40</u>		<u>35</u>	
Total	<u><u>586</u></u>		<u><u>761</u></u>		<u><u>624</u></u>		<u><u>796</u></u>		<u><u>798</u></u>		<u><u>857</u></u>		<u><u>983</u></u>		<u><u>986</u></u>	
* (Overtime reduced reflecting weather)																
Controllable Costs																
Operating Labor & Taxes	86		87		79		85		87		87		87		90	
Losses/ Insurance/																
Utilities/Postage	11		10		13		11		11		12		13		12	
General Material/																
Purchased Services	23		22		22		27		26		26		27		29	
Miscellaneous	10		4		7		10		8		3		-		(6)	
Total	<u>130</u>		<u>123</u>		<u>121</u>		<u>133</u>		<u>132</u>		<u>128</u>		<u>127</u>		<u>125</u>	
Percentage of 2000 Costs			95%		93%		102%		102%		98%		98%		96%	

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	FORECAST 2007-08	FORECAST 2008-09	FORECAST 2009-10	FORECAST 2010-11	FORECAST 2011-12
OPERATING REVENUES								
Non-Heating	\$ 114,880	\$ 114,212	\$ 114,834	\$ 116,734	\$ 112,487	\$ 106,113	\$ 105,845	\$ 105,471
Gas Transport Service	4,679	6,147	7,256	7,889	8,461	8,983	9,465	9,908
Heating	713,159	821,190	820,732	845,817	816,568	762,697	757,378	749,166
Proposed Base Rate	-	-	80,000	80,000	80,000	80,000	80,000	80,000
Weather Normalization Adjustment	(1,365)	12,500	-	-	-	-	-	-
Unbilled Adjustment	(803)	2,513	219	522	(376)	(714)	(57)	(90)
Total Gas Revenues	830,550	956,562	1,023,041	1,050,962	1,017,140	957,079	952,631	944,455
Appliance Repair & Other Revenues	10,895	10,669	10,532	10,743	10,957	11,177	11,400	11,628
Other Operating Revenues	21,912	17,865	19,552	19,958	19,333	18,198	18,101	17,946
Total Other Operating Revenues	32,807	28,534	30,084	30,701	30,290	29,375	29,501	29,574
Total Operating Revenues	863,357	985,096	1,053,125	1,081,663	1,047,430	986,454	982,132	974,029
OPERATING EXPENSES								
Natural Gas	509,700	639,180	630,836	658,487	623,363	562,396	558,243	550,889
Other Raw Material	4	5	5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	658,492	623,368	562,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	422,284	423,171	424,062	424,053	423,884	423,135
Gas Processing	18,584	16,206	15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,465	27,377	34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125	14,168	14,398	14,657	14,863	15,152
Account Management	7,695	7,928	7,625	7,690	7,787	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	59,250	58,337	55,291	51,291	47,025	44,850
Marketing	2,592	2,470	2,992	3,088	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	41,944	45,904	49,654	53,719	58,126
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)	(7,258)	(7,529)	(7,379)	(7,220)	(7,008)
Amortization of Restructuring Costs	1,087	1,087	-	-	-	-	-	-
Pensions	14,702	17,297	15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-	-	383	507	639	753
Pro Forma Adjustments	-	-	217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	236,924	249,305	250,986	252,276	253,644	257,896
Depreciation	35,904	36,928	38,213	39,565	40,825	42,091	43,531	43,515
Cost of Removal	3,643	3,200	3,200	3,200	3,200	3,200	3,200	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
	35,045	37,066	38,196	39,454	40,848	42,064	43,520	43,483
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	275,120	288,759	291,834	294,340	297,164	301,379
TOTAL OPERATING EXPENSES	793,012	917,374	905,961	947,251	915,202	856,741	855,412	852,273
OPERATING INCOME	70,345	67,722	147,164	134,412	132,228	129,713	126,720	121,756
Other Income	4,778	8,198	11,428	12,272	9,938	9,634	9,681	9,655
INCOME BEFORE INTEREST	75,123	75,920	158,592	146,684	142,166	139,347	136,401	131,411
INTEREST								
Long-Term Debt	53,856	51,778	56,437	56,698	54,265	51,809	48,884	46,024
Other	6,123	9,561	13,186	13,229	13,134	13,028	12,941	12,805
AFUDC	(907)	(1,168)	(1,202)	(1,002)	(1,036)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	74,131	71,214	68,347	65,013	61,798
NET INCOME	11,272	10,417	84,614	72,553	70,952	71,000	71,388	69,613
City Payment	-	-	-	-	-	-	-	-
Net Earnings	\$11,272	\$10,417	\$84,614	\$72,553	\$70,952	\$71,000	\$71,388	\$69,613

PHILADELPHIA GAS WORKS
CASHFLOW STATEMENT
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	FORECAST 2007-08	FORECAST 2008-09	FORECAST 2009-10	FORECAST 2010-11	FORECAST 2011-12
SOURCES								
Net Income	\$11,272	\$10,417	\$84,614	\$72,553	\$70,952	\$71,000	\$71,388	\$69,613
Depreciation & Amortization	42,281	43,928	46,007	47,128	47,959	48,821	49,864	49,501
Earnings on Restricted Funds	(3,265)	3,899	(178)	(929)	(971)	(1,016)	(1,063)	4,195
Elimination of Accrued Interest on Refunded Debt	-	3,186	-	-	-	-	-	-
Increased/(Decreased) Other Assets/Liabilities	(6,917)	(1,024)	911	716	808	915	(8,203)	(11,639)
Available From Operations	43,371	60,408	131,354	119,468	118,748	119,720	111,986	111,670
Funds Required for Capital	68,000	60,195	72,000	60,000	39,843	-	-	-
Grant Income	18,000	18,000	18,000	18,000	18,000	18,000	-	-
Capital Leasing Funds Debt Service	2,005	-	-	-	-	-	-	-
Capitalized Interest Debt Service	2,283	5,924	-	-	-	-	-	-
Release of Sinking Fund Asset	6,038	3,680	-	-	-	-	-	-
Temporary Financing	-	20,100	-	-	-	-	-	-
TOTAL SOURCES	139,697	168,305	221,354	197,468	176,591	137,720	111,986	111,670
USES								
Net Construction Expenditures	66,910	68,057	75,152	62,597	64,755	63,018	61,587	59,920
LNG & BCCS	-	-	-	16,000	23,000	7,800	-	-
Funded Debt Reduction:								
Revenue Bonds	35,387	29,906	36,675	47,010	46,530	47,920	39,479	36,020
PMA Lease/Subordinate Debt	1,255	1,310	1,370	1,430	1,500	1,565	1,640	1,715
Capital Lease	1,947	-	-	-	-	-	-	-
Debt Reduction Funding	-	-	20,000	-	-	-	-	-
Post Retirement Benefit Funding	-	-	-	-	-	-	-	-
Temporary Financing Repayment	850	-	25,000	10,000	35,000	-	-	-
City Loan Repayment/Status	-	-	2,000	43,000	-	-	-	-
Distribution of Earnings	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000
Additions To (Reductions of)								
Non-Cash Working Capital	3,793	55,433	(73)	(1,502)	(11,870)	(5,078)	464	3,659
Cash Needs	128,142	172,706	178,124	196,535	176,915	133,225	121,170	119,314
Cash Surplus (Shortfall)	11,555	(4,401)	43,230	933	(324)	4,495	(9,184)	(7,644)
TOTAL USES	139,697	168,305	221,354	197,468	176,591	137,720	111,986	111,670
Cash - Beginning of Period	3,666	15,221	10,820	54,050	54,983	54,659	59,154	49,970
Cash - Surplus (Shortfall)	11,555	(4,401)	43,230	933	(324)	4,495	(9,184)	(7,644)
ENDING CASH	15,221	10,820	54,050	54,983	54,659	59,154	49,970	42,326
Outstanding Commercial Paper	49,900	70,000	45,000	35,000	-	-	-	-
City Loan Outstanding	45,000	45,000	43,000	-	-	-	-	-
Internally Generated Funds	-	-	-	-	-	63,018	61,587	59,920

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	FORECAST 2007-08	FORECAST 2008-09	FORECAST 2009-10	FORECAST 2010-11	FORECAST 2011-12
FUNDS PROVIDED								
Total Gas Revenues	\$830,550	\$956,562	\$1,023,041	\$1,050,962	\$1,017,140	\$957,079	\$952,631	\$944,455
Other Operating Revenues	32,807	28,534	30,084	30,701	30,290	29,375	29,501	29,574
Total Operating Revenues	863,357	985,096	1,053,125	1,081,663	1,047,430	986,454	982,132	974,029
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,097	11,250	11,343	8,967	8,618	8,618	13,850
City Grant	18,000	18,000	18,000	18,000	18,000	18,000		
AFUDC (Interest)	907	1,168	1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,083,577	1,112,008	1,075,433	1,014,080	991,735	988,838
FUNDS APPLIED								
Fuel Costs	509,704	639,185	630,841	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	275,120	288,759	291,834	294,340	297,164	301,379
Total Operating Expenses	793,012	917,374	905,961	947,251	915,202	856,741	855,412	852,273
Less: Non-Cash Expenses	39,338	40,554	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	864,074	903,951	870,590	810,834	808,027	804,889
Funds Available to Cover Debt Service	130,103	139,541	219,503	208,057	204,843	203,246	183,708	183,969
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	6.14	6.05	6.33	6.74	5.98	5.72
Net Available after Prior Debt Service	91,297	97,592	183,755	173,689	172,475	173,091	152,963	151,805
Other Capital Leases	1,998	-	-	-	-	-	-	-
Net Available after Prior Capital Leases	89,299	97,592	183,755	173,689	172,475	173,091	152,963	151,805
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	67,813	66,852	67,966	65,143	60,885
New Proposed Bond Debt Service	-	-	-	-	-	-	-	-
Total New Debt Service	45,999	32,467	53,313	67,813	66,852	67,966	65,143	60,885
Debt Service Coverage 1998 Bonds	1.94	3.01	3.45	2.56	2.58	2.55	2.35	2.49
Net Available after 1998 Debt Service	43,300	65,125	130,442	105,876	105,623	105,125	87,820	90,920
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	65.65	53.31	53.08	52.93	44.18	45.83
Net Available To Service Aggregate Debt Serv	111,075	114,154	197,990	187,140	184,050	182,419	180,906	175,853
Aggregate Debt Service	88,790	76,402	91,048	104,167	101,210	100,107	97,876	95,033
Fixed Coverage Charge	1.25	1.49	2.17	1.80	1.82	1.82	1.85	1.85
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	1.82	1.53	1.54	1.54	1.56	1.56

PHILADELPHIA GAS WORKS
BALANCE SHEET
(Dollars in Thousands)

	Actual 8/31/05	Estimate 8/31/06	Budget 8/31/07	Forecast 8/31/08	Forecast 8/31/09	Forecast 8/31/10	Forecast 8/31/11	Forecast 8/31/12	
ASSETS									
Utility Plant Net	981,722	1,012,851	1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	
Sinking Fund Reserve	104,530	93,800	102,050	102,050	102,050	102,050	102,050	102,050	
Capital Improvement Fund	102,701	39,732	99,843	39,843	-	-	-	-	
Debt Reduction Funding	-	-	20,216	21,145	22,116	23,133	24,195	-	
Cash	15,221	10,820	54,050	54,983	54,659	59,154	49,970	42,326	
Gas	273,805	264,254	252,901	237,840	220,936	200,954	180,719	160,073	
Other	12,522	785	506	352	350	350	350	350	
Accrued Gas Revenues	8,787	11,300	11,519	12,041	11,665	10,951	10,894	10,804	
Reserve for Uncollectible	(207,480)	(191,631)	(185,490)	(173,747)	(158,969)	(140,202)	(117,180)	(92,099)	
Accounts Receivable:	87,634	84,708	79,436	76,486	73,982	72,053	74,783	79,128	
Materials & Supplies	129,984	183,784	180,389	176,809	162,083	159,236	155,999	152,694	
Other Current Assets	(164)	2,986	3,056	3,236	3,441	3,596	3,751	3,906	
Deferred Debits	2,796	8,448	3,228	2,487	2,362	2,262	2,337	2,387	
Unamortized Bond Issuance Expense	39,094	42,089	46,912	43,166	39,574	36,138	32,868	29,740	
Unamortized Extraordinary Loss	38,494	55,859	50,301	45,095	40,244	35,726	31,552	27,624	
Deferred Environmental	9,513	9,513	9,513	8,000	6,500	5,000	3,500	2,000	
Other Assets	8,297	3,411	2,881	2,925	3,030	3,138	3,250	3,365	
TOTAL ASSETS	1,519,822	1,548,001	1,701,665	1,665,047	1,645,793	1,665,965	1,666,790	1,644,160	
EQUITY & LIABILITIES									
City Equity	222,646	233,063	317,677	390,230	461,182	532,182	585,570	637,183	637,183
Revenue Bonds	1,045,371	1,042,430	1,154,385	1,105,945	1,057,915	1,008,430	967,311	909,576	929,576
TECA Accretions	14,313	12,608	13,913	15,314	16,818	18,434	10,933		
Unamortized Discount	(9,484)	(5,113)	(5,683)	(5,201)	(4,738)	(4,295)	(3,885)	(3,509)	(3,509)
Unamortized Premium	22,901	20,797	18,826	16,956	15,183	13,516	11,996	10,550	10,550
Capital Equipment Leasing	-	-	-	-	-	-	-	-	-
Long Term Debt:	1,073,101	1,070,722	1,181,441	1,133,014	1,085,178	1,036,085	986,355	916,617	936,617
Notes Payable	49,900	70,000	45,000	35,000	-	-	-	-	
City Loan	45,000	45,000	43,000	-	-	-	-	-	
Accounts Payable	63,918	72,285	59,468	57,930	52,987	53,688	53,234	52,826	
Customer Deposits	6,280	8,250	9,000	8,750	8,500	8,000	7,500	7,000	
Other Current Liabilities	3,734	3,431	2,129	2,137	2,195	2,254	2,313	2,372	
Deferred Credits	14,608	5,814	4,724	1,323	1,326	1,331	1,336	1,341	
Accrued Interest	9,591	12,224	14,374	13,945	13,526	13,097	12,725	12,385	
Accrued Taxes & Wages	3,861	4,231	2,796	2,817	3,088	3,609	4,130	2,900	
Accrued Distribution to City	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	
Other Liabilities	24,183	19,981	19,056	16,901	14,811	12,719	10,627	8,536	
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,701,665	1,665,047	1,645,793	1,665,965	1,666,790	1,644,160	Normal

<u>Capitalization</u>	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	<u>Normal</u> <u>Amortiz.</u> <u>FY2012</u>
Total Capitalization	1,295,747	1,303,785	1,499,118	1,523,244	1,546,360	1,568,267	1,571,925	1,553,800	1,573,800
Total Long Term Debt	1,073,101	1,070,722	1,181,441	1,133,014	1,085,178	1,036,085	986,355	916,617	936,617
Debt to Equity Ratio	0.83	0.82	0.79	0.74	0.70	0.66	0.63	0.59	0.60
Capitalization Ratio	4.82	4.59	3.72	2.90	2.35	1.95	1.68	1.44	1.47
Plant in Service	1,517,046	1,573,346	1,641,403	1,716,555	1,795,152	1,882,907	1,953,725	2,015,312	2,015,312
Regulatory Asset Securitization Capital - 106&107	56,300	68,057	75,152	78,597	87,755	70,818	61,587	59,920	59,920
Total Plant	1,573,346	1,641,403	1,716,555	1,795,152	1,882,907	1,953,725	2,015,312	2,075,232	2,075,232
Accumulated Depreciation	(591,624)	(628,552)	(666,765)	(706,330)	(747,155)	(789,246)	(832,777)	(876,292)	(876,292)
Net Utility Plant	981,722	1,012,851	1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	1,198,940

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

TESTIMONY OF

BARBARA BISGAIER

ON BEHALF OF
PHILADELPHIA GAS WORKS
DOCKET No. R-00061931

December 2006

1 **I. QUALIFICATIONS AND PURPOSE OF TESTIMONY**

2 **Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

3 A. Barbara C. Bisgaier, Managing Director, Public Financial Management, Inc., 2
4 Logan Square, Suite 1600, Philadelphia, Pennsylvania 19103-2770, (215) 567-
5 6100. I am a Financial Advisor to state an local governments and authorities.

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

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

9 **Q. SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS.**

10 A. I have been employed by Public Financial Management, Inc. for more than 24
11 years. For approximately 22 of those years, I have had the title of managing
12 director and have managed the firm's municipal utility practice. During my
13 career at Public Financial Management, Inc., I have served as a Financial Advisor
14 to a broad range of state and local government and authorities. In particular, my
15 experience has been concentrated in the area of publicly-owned utility systems.
16 In addition to the Philadelphia Gas Works, my utility clients have included,
17 among others, the Water Department of the City of Philadelphia, the Pittsburgh
18 Water and Sewer Authority, the Harrisburg Water and Sewer Authority, the New
19 Jersey Water Supply Authority, the North Jersey District Water Commissioners,
20 the Passiac Valley Sewerage Commissioners, the Middlesex County (NJ)
21 Utilities Authority, the Ocean County (NJ) Utilities Authority, the Atlantic
22 County (NJ) Utilities Authority, the Southeast Morris County Water Authority,
23 the Atlantic City Sewerage Authority, the Louisville Water Company, the District

1 of Columbia Water and Sewer Authority and the Bluegrass Water Commission.
2 In addition, I have served as the Financial Advisor to the City of Philadelphia. In
3 that capacity, I have served as the City's advisor for debt issued by the City and
4 by its authorities and enterprises (the Water Department, the Division of Aviation,
5 the Philadelphia Municipal Authority and PGW). This has included serving as
6 the advisor for two bond issues that were each in excess of one billion dollars.
7 Over the course of my career, I have served as the advisor for the issuance of
8 long-term debt having a par value in excess of \$25 billion. In the course of these
9 various engagements, my responsibilities include general financial planning and
10 the management of the debt issuance process. With regard to the financial
11 planning aspect of my work, I assist clients with their development of capital
12 financing strategies, debt policies, budgets and rate setting issues. With regard to
13 the debt issuance process, I frequently serve as the liaison between my clients and
14 the bond rating agencies, the municipal bond insurers and other credit providers
15 (such as letter of credit banks). I also advise my clients throughout the debt
16 issuance process as to the costs and benefits of various alternative approaches to
17 business and financial issues under consideration. I am also frequently
18 responsible for working with my clients to prepare disclosure documents, offering
19 circulars and presentations to the bond rating agencies and credit enhancers.

20 **Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

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

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

1 A. Prior to my employment by Public Financial Management, Inc., I was employed
2 by Strouse, Greenberg & Co. from 1980-1982 as a financial analyst. From 1974-
3 1980, I was employed by the City of Philadelphia, concluding my employment
4 with the title Deputy Director of the Office of Housing and Community
5 Development.

6 **Q. EXPLAIN THE BASIS OF YOUR EXPERIENCE WITH AND**
7 **KNOWLEDGE OF PGW.**
8

9 A. Public Financial Management, Inc. was engaged in 1992 by the City of
10 Philadelphia to serve as its Financial Advisor. That engagement included,
11 broadly, responsibility for the preparation of the Five-Year Financial Plans
12 mandated by the Pennsylvania Intergovernmental Cooperation Authority, general
13 financial planning for the City and traditional financial advisory work for the City
14 and its enterprises in connection with the issuance of long-term and short-term
15 debt. At the commencement of this engagement, the City's below-investment-
16 grade bond rating and general fiscal distress essentially barred it and its
17 enterprises from the public debt markets. In 1993, with the beginning of a return
18 to fiscal stability, the City began its return to the capital markets. I began serving
19 specifically as the Financial Advisor to PGW with the issuance of its 14th Series
20 Bonds. I have subsequently served as the Financial Advisor for each of PGW's
21 bond transactions. I have assisted PGW in the implementation of certain asset
22 management transactions, most notably the competitive acquisition of a Forward
23 Rate Agreement for its debt service reserve fund and the implementation and
24 subsequent unwind of a "knock-in" swap with Morgan Guaranty Trust Company.
25 I have also assisted PGW with the issuance of its commercial paper; that

1 assistance has included the annual preparation of the offering/disclosure
2 document, procurement of the various letters of credit that have provided program
3 liquidity and management of the process of obtaining and maintaining a credit
4 rating for PGW's commercial paper program. I also managed the competitive
5 implementation of PGW's equipment leasing financing program. In the course of
6 each of these specific engagements, I have made various presentations on PGW's
7 behalf to the Philadelphia City Council, the Philadelphia Gas Commission and the
8 Philadelphia Facilities Management Corporation. I have had extensive contact
9 with each of the three municipal bond rating agencies on behalf of PGW, both
10 with regard to specific bond transactions and to the general credit of PGW. I have
11 had similar contacts with six municipal bond issuers on PGW's behalf and have
12 been responsible for the procurement of letters of credit from several different
13 commercial banks for the commercial paper program. This work has permitted
14 me to become familiar with the financial structure, condition, and issues of PGW,
15 and to have obtained a substantial institutional knowledge of PGW.

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

18
19 A. Yes, I have testified before the Philadelphia Gas Commission and testimony to
20 the Public Utility Commission in PGW's interim rate proceeding, and in
21 connection with PGW's last base rate filing.

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

23 A. My testimony is divided into two parts. The first part addresses the implications
24 for PGW of the continuation of its struggle to achieve and sustain an adequate
25 level of liquidity. The second part of my testimony, much of which has been

1 presented to the PUC in previous testimony regarding PGW, provides further
2 detail of the consequences of: (1) PGW's failure to meet the debt service coverage
3 requirements mandated by its ordinances; (2) PGW's failure to sustain its tax-
4 exempt commercial paper program; and (3) the downgrading to non-investment
5 grade of PGW's bonds.

6 **Q. WHAT DO YOU CONSIDER TO BE THE GREATEST FINANCIAL**
7 **ISSUES FACING PGW?**

8
9 A. PGW faces two very significant financial threats: a lack of basic liquidity and,
10 given its complete reliance upon the issuance of debt to fund its capital
11 requirements, the potential loss of access to the long-term capital markets (that is,
12 the ability to issue bonds to fund required improvements to the System).

13 **Q. DISCUSS THE PARAMETERS OF PGW'S LIQUIDITY ISSUE.**

14
15 A. Since the late 1990s, PGW has struggled to generate sufficient revenues to cover
16 the cost of its operations. Despite substantially improved collection levels, major
17 improvements to the entire billing and collection systems (including the
18 successful implementation of the Automatic Meter Reading program which has
19 resulted in accurate and timely billing), staffing level reductions, the ability to
20 adjust the GCR monthly (with Commission approval) and the implementation of
21 the Weather Normalization Clause, PGW has been forced to rely upon a number
22 of costly techniques and/or "one time fixes" to insure that it can meet its cash
23 requirements.

24 PGW's lack of liquidity is perhaps its most severe problem and the one
25 that, if unresolved, is likely to drive PGW into a freefall financial crisis. PGW
26 relies upon four principal sources of liquidity. First and foremost, it relies upon

1 its \$150 million tax-exempt commercial paper program (this program was
2 increased from \$100 million to the current level in January 2006). The
3 commercial paper program was originally established in the early 1980s to
4 provide liquidity to meet seasonal cash flow requirements. While the program is
5 still nominally designed for that purpose, the fact that the total amount of this line
6 of credit remains fully extended for significant periods of the year has effectively
7 converted the commercial paper into a permanent part of PGW's capital structure
8 and substantially, if not completely, eliminated its utility in providing true
9 financial flexibility. Typically, PGW used to have commercial paper outstanding
10 during the gas-purchase and heating seasons and then retired it fully in May or
11 June of each year as the revenues from the heating season were received. PGW
12 still follows this schedule, however, it is often forced to use one of its other
13 sources of borrowed cash (see below) in order to effectuate the full retirement of
14 the commercial paper each year. Then, PGW must immediately reissue
15 commercial paper so that there is always a substantial balance outstanding by the
16 end of August at the end of PGW's fiscal year. This is my reason for stating that
17 the commercial paper is no longer really a cash-flow management tool but rather
18 a permanent capital borrowing.

19 The letter of credit (provided by a consortium of commercial banks led by
20 JPMorgan, Chase & Company) that supports the commercial paper program
21 expires in May 2007. While it is anticipated that it will be renewed at the \$150
22 million level, because there is no term-out connected with a draw on the letter of

1 credit, a failure of the bank consortium to renew all or a major portion of the
2 facility would create an immediate and staggering cash crisis for PGW.

3 The second element of liquidity available to PGW is the \$45 million line
4 of credit authorized by the City of Philadelphia to assist PGW in meeting its cash
5 requirements. Like the commercial paper program, this credit facility is often
6 fully extended and so too has become an almost permanent part of PGW's capital
7 structure. The term of this facility expires in 2008 when PGW will be required to
8 repay the City in full and this liquidity element will be eliminated from PGW's
9 capital structure. The imminence of this event is obviously a significant threat to
10 PGW's liquidity position, particularly since the zero rate of interest imposed by
11 the City makes this PGW's lowest cost financing option.

12 Despite the availability of these two lines of credit, PGW is often required
13 to meet seasonal cash requirements by internal borrowing from its bond-funded
14 capital account (these borrowings must be replenished before the end of each
15 fiscal year in which they are made). These borrowing are, of course, only
16 available if and to the extent that capital funds are available at any given time.
17 For example, in the spring of 2002, PGW's petition to the PUC for emergency
18 rate relief could potentially have been avoided had bond-funded cash been
19 available. Because the proceeds of previous bond issues had already been
20 expended for capital purposes, this source of cash was not available to meet
21 liquidity requirements. This source of cash is, therefore, limited both as to timing
22 and availability and should not and cannot be relied upon to provide seasonal

1 liquidity to PGW. Any loss of access to the long-term capital markets (see below)
2 would eliminate the ability of PGW to use bond proceeds for liquidity purposes.

3 Finally, PGW has in recent years relied up gas-storage deferral contracts
4 with a variety of natural gas providers to delay cash outlays during cash-strapped
5 periods of time. This technique is expensive (it essentially makes PGW a
6 borrower in the taxable market) and is dependent upon PGW's continued
7 creditworthiness. To the extent that PGW were to lose its investment grade credit
8 rating, the potential gas-storage deferral lenders would be unwilling to advance
9 cash to PGW.

10 Despite the fact that it has available to it this potential menu of liquidity
11 options, PGW often finds itself in the position of having almost no cash on hand.
12 For example, during the 2005/2006 heating season, had the commercial paper
13 program not been increased from \$100 million to \$150 million, PGW would
14 literally not have had sufficient cash to make its January 1 and February 1 debt
15 service payments.

16 PGW lurches from one cash crisis to another. In the past five years, it has
17 been bailed out of each crisis by emergency rate relief (2002), the implementation
18 of the City loan in 2002, extensions of the term of the City loan in 2002 and 2006,
19 extensive gas-storage deferral borrowings in 2003, 2004 and 2005, the City's
20 agreement to forgo the requirement that PGW make the annual City payment of
21 \$18 million, initially in 2004 and continuing, per the City's most recent Five-Year
22 Plan, through 2010 and the increase in the commercial paper program (2006).
23 Along the way, it has also relied upon its ability to access the capital fund for

1 peak cash requirement periods. It is impossible to conclude that this incredible
2 balancing act can continue or, in a properly financed utility, should continue. It is
3 clear that PGW's essential lack of liquidity is the single greatest threat to it
4 financial viability.

5 This financial threat has been continually noted by the bond rating
6 agencies. For example, in its August 30, 2005 report (Exhibit BB-1), Standard &
7 Poor's which rates PGW's long-term credit rating as BBB- with a Negative
8 Outlook noted "PGW's liquidity remains marginal despite annual transfer-
9 payment forgiveness from the city of Philadelphia" (Exhibit BB-1, p.2). In its
10 January 20, 2006 report (Exhibit BB-2), S&P comments upon PGW's practice of
11 using unexpended bond proceeds to meet ongoing working capital and debt
12 service requirements: "This practice points to the general insufficiency of cash
13 flows to meet ongoing operational and debt obligations" (Exhibit BB-2, p.2).

14 In considering the list of liquidity options currently available to it, one is
15 struck by the fact that each of the options is external to PGW and is not intrinsic
16 to its basic operations. In other words, liquidity, to the extent that it exists, does
17 not flow from implemented rates but rather from dependence on a series of
18 external circumstances or providers, none of which may be absolutely relied upon
19 to continue to meet the needs of PGW and its customers.

20 **Q. HOW DO OTHER GOVERNMENTAL UTILITIES MEET AND**
21 **MEASURE LIQUIDITY?**

22
23 A. In the public sector, a utility's liquidity is typically measured by the availability of
24 "days of cash" on hand. It is not unusual for utilities in the A-rated category to
25 have in excess of 200 days of unrestricted cash on hand. Over the past several

1 years, PGW has had periods of time when it has actually had less than 15 days of
2 its cash requirements on hand. In January 2006, PGW reached the point at which
3 it had only \$4 million in cash on hand (this actually represented less than two
4 days of cash on hand). Had its commercial paper program capacity not been
5 increased by \$50 million, PGW would have defaulted upon either or both of its
6 debt service and gas purchase payment obligations. Because PGW has so
7 stretched its available lines of credit, the scarcity of cash is even more threatening
8 than it would be to a utility that had not exhausted all of its credit options.

9 *Well-financed municipal utilities achieve fiscal well being and rating*
10 *agency and capital market acknowledgement by demonstrating both the ability*
11 *and willingness to implement a series of steady, timely, adequate and pre-*
12 *determined rate increases. These rate increases are planned and publicly*
13 *acknowledged to insure their transparency. They demonstrate a utility's control*
14 *over its own financial future and a lack of dependence upon outside factors. They*
15 *also demonstrate the financial flexibility of a utility to manage unforeseen*
16 *situations. For example, the spike in natural gas prices that occurred during the*
17 *2004/2005 heating season, although it could ultimately be recovered by PGW*
18 *through the GCR, placed immediate enormous demands upon PGW's cash. A*
19 *utility with a comfortable cushion of cash on hand could have much more easily*
20 *(and cost effectively) managed this crisis without having to resort to a series of*
21 *one-time moves that in themselves threaten future flexibility.*

22 **Q. IF PGW IS GRANTED A RATE INCREASE OF \$100 MILLION PLUS \$10**
23 **MILLION IN PROCEEDS FROM OFF-SYSTEM SALES AND CAPACITY**
24 **RELEASE, WHAT WILL BE THE EFFECT ON PGW'S CASH OR**
25 **LIQUIDITY POSITION?**

1
2 A. If it is granted a total of \$110 million of funding as forecast in JRB-1 PGW will
3 end fiscal year 2011-12 with cash available of \$53.8 million. This represents
4 approximately 23 days of cash on hand which is a modest figure. While this may
5 appear to represent an improvement in PGW's cash position when compared to
6 year end 2005-2006 projected levels of \$10.8 million or 4 days of cash on hand,
7 the real increase in the level of liquidity must also be measured by the substantial
8 improvement to the balance sheet (i.e. the absolute reduction in long term
9 indebtedness and the retirement of all short-term debt) and by the fact that the
10 commercial paper program will once again be completely available for its original
11 purpose (the management of seasonal cash flow requirements). Indeed, I
12 understand that all of the 2005-2006 cash on hand was generated externally from
13 the issuance of commercial paper. A comprehensive improvement to liquidity
14 levels will permit internal generation of cash to manage unexpected events and/or
15 unanticipated financial requirements without once again beginning the downward
16 spiral that can only be slowed by increased borrowing and the loss of internally
17 generated capital funding. Having that ability substantially reduces PGW's risk
18 and materially enhances its creditworthiness.

19 **Q. HOW DOES THIS COMPARE TO THE IMPACT OF AN OF \$80**
20 **MILLION RATE INCREASE.**

21
22 A. An \$80 million rate increase will see PGW end fiscal year 2011-12 with a cash
23 surplus of \$42.3 million or 18 days of cash on hand. While this may appear to be
24 a relatively modest differential when compared to balances from \$110 million of
25 funding, a comparison of the respective balance sheets is actually much more

1 telling. In the \$110 million scenario, PGW would end fiscal year 2011-2012 with
2 long term debt (principal amount of revenue bonds outstanding) of \$659 million.
3 In the \$80 million scenario, PGW would not have had sufficient funds to have
4 substantially accelerated the repayment of its outstanding debt and would end
5 fiscal year 2011-2012 with \$909 million of outstanding long term debt. The
6 annual debt service payment requirement associated with a 38% greater level of
7 outstanding debt would place considerably more stress on PGW's true liquidity
8 level and thus place PGW potentially closer to the start of another downward
9 financial spiral, greater risk, and reduced creditworthiness.

10 **Q. ARE THEIR OTHER FINANCIAL THREATS TO PGW IMPLICIT IN ITS**
11 **CURRENT CAPITAL STRUCTURE?**

12
13 **A.** Yes. PGW is currently totally dependent upon the sale of bonds to finance its
14 capital improvement program. Since 1993, it has had virtually no internally
15 generated funds from which to fund its capital program. Given that it has no other
16 source of equity available to it, this has resulted in substantial and steadily
17 increasing debt levels that, together with the associated coverage requirements,
18 place a significant burden on rates and liquidity. Without a change in this capital
19 structure, PGW will be in a perpetually risky position with no means of altering
20 the situation. Unless and until PGW reduces its reliance on debt financing for all
21 capital requirements, it faces continual downward financial pressures.

22 The only means potentially available to PGW to effectuate such a change
23 is to reduce PGW's debt-to-equity ratio from its current level through a return to a
24 rate structure that produces sufficient internally generated funds so that debt
25 levels may be reduced while capital spending levels are maintained.

1 Q. **IS THERE AN IMMEDIATE FINANCIAL THREAT ON THE HORIZON**
2 **FOR PGW?**

3
4 A. Exhibit JRB-1 indicates clearly that, absent rate relief, PGW will be in default of
5 its bond covenants in Fiscal Year 2009. PGW is required pursuant to both its
6 1975 and 1998 Bond Ordinances to produce revenue sufficient to cover debt
7 service (after the payment of operating expenses) by 1.5 times. According to the
8 projections reflected in JRB-1, that covenant will be violated in FY 2009. Such a
9 violation will result in a technical (i.e. non-monetary) default and the immediate
10 loss of PGW's investment grade credit rating.

11 Q. **YOU HAVE PREVIOUSLY TESTIFIED THAT PGW IS ON THE BRINK**
12 **OF LOSING ITS INVESTMENT GRADE CREDIT RATING. WHY DID**
13 **THAT NOT HAPPEN AND WHY DO YOU REMAIN CONCERNED**
14 **ABOUT A DOWNGRADE?**

15
16 A. For the past five years, PGW has been on the brink of losing its investment grade
17 credit ratings. It has not done so because minimum rating agency requirements
18 related to debt service coverage, cost controls and cash collections have been met.
19 While the management improvements that resulted in cost controls and
20 substantially improved cash collections have been important in the maintenance
21 of the investment grade credit rating, the availability of a variety of one-time
22 funding sources have, in my opinion, masked the systemic fiscal condition of
23 PGW and, from the perspective of the rating agencies, bought PGW more time.
24 The rating agencies are sensitive to the fact that their action in making a utility
25 non-investment grade will have grave and spiraling consequences. Therefore,
26 without compromising their own standards, they are willing to acknowledge the
27 benefits of one-time fixes, especially if those one-time fixes buy time in which to

1 make planned systemic improvements. I believe they are now anticipating that
2 systemic improvements will be immediately forthcoming. In the case of PGW,
3 major "fixes" such as the support of the City of Philadelphia with the \$45 million
4 loan and the annual payment deferral were given enormous weight by the rating
5 agencies since these benefits were viewed as tax-based support by PGW's owner.
6 However, these one-time strategies have been substantially exhausted. In the
7 immediate future, PGW will, therefore, be judged by the rating agencies based
8 both on its own systemic ability to provide internal liquidity and on a capital
9 structure that is indicative of fiscal health.

10 **Q. WHAT CAPITAL STRUCTURE SHOULD PGW BE SEEKING TO**
11 **ACHIEVE?**

12
13 A. In order to remain a viable entity, PGW must achieve and maintain a capital
14 structure which is much less heavily weighted with debt. Absent the balance and
15 implicit financial health from an improved debt to equity structure, PGW will
16 continue to lurch from fiscal crisis to fiscal crisis. I fully support PGW's goal of a
17 debt to equity (fund balance) ratio of 50%/50%. I reach this conclusion not
18 because this goal is implicitly or objectively correct, but because that is the
19 condition PGW will be in 2013 if requested rate relief is granted (see JRB-1). A
20 50%/50% debt to equity ratio will be indicative of a successfully implemented
21 financial strategy, an achievement I believe the rating agencies are anticipating.
22 Such a financial strategy involves a multi-year strategy pursuant to which PGW is
23 able both to eliminate short-term borrowing (except for seasonal cash flow
24 purposes) from its permanent capital structure, materially reduce its reliance upon
25 debt-funded capital and produce internally generated cash on hand.

1 **Q. WHAT ARE THE IMPLICATIONS OF THE POTENTIAL LOSS OF**
2 **PGW'S INVESTMENT GRADE CREDIT RATING?**
3

4 A. First, a loss of the investment-grade credit rating will essentially preclude PGW
5 from continuing to access the public markets to fund its capital requirements.
6 Since this is PGW's only source of capital funding, it would be faced with an
7 inability to fund even the most minimal safety improvements to its System.

8 Additionally, the loss of the investment-grade credit rating will have a
9 material negative impact on PGW's overall liquidity position for a number of
10 reasons. Most critically, the willingness of the consortium of banks that provide
11 the letter of credit that supports the commercial paper program will be threatened.
12 The withdrawal of that support or the reduction in the level of that support will
13 create an immediate cash crisis for PGW. At best, there will be a material
14 increase to the cost of maintaining the letter of credit and with it, the commercial
15 paper program. If PGW were to drop to a below-investment grade status, it is
16 also probable that it would not have access to the financing available through its
17 gas-storage deferral transactions. Rather, gas providers would not extend credit to
18 PGW and gas purchases would have to be financed with immediately available
19 funds. Finally, the repayment of the City's \$45 million loan could not be
20 achieved.

21 Obviously any one of these outcomes would imperil PGW. It should also
22 be noted, that were PGW to be deemed non-investment grade, it is probable that
23 that categorization would be sustained over a significant time period. Having
24 once acted, the rating agencies would not reverse themselves without a

1 demonstration that material and systemic improvements had occurred that would
2 mitigate against the development of a new financial crisis.

3 **Q. WHAT DO YOU SEE AS THE BENEFITS TO PGW OF THE CREATION**
4 **OF A LESS RISKY CAPITAL STRUCTURE?**

5
6 A. With its present financial position and capital structure, PGW and its stakeholders
7 have virtually no hope that it can avoid the perpetual cycle of crisis in which it
8 currently operates. This cycle of crisis is a threat to the ratepayers, it is a threat to
9 the City and, ultimately, it is a threat to PGW's ability to survive.

10 A rate structure that creates systemic and self-generated liquidity together
11 with the meaningful ability to rely upon internally generated capital funding will
12 produce an absolute reduction in debt service and greater cash flexibility. This
13 will substantially eliminate the risks to PGW's owner and ratepayers while
14 enhancing the value of the PGW franchise, whether PGW remains a municipal
15 utility or is ultimately sold to an investor-owned utility.

16 **Q. WHAT POSITIVE BENEFITS WOULD ACCRUE TO THE COMPANY IF**
17 **IT WERE ABLE TO ACHIEVE A BALANCED AND AFFORDABLE**
18 **CAPITAL STRUCTURE?**

19
20 A. The Company will finally be in a "going concern" mode and be stable enough so
21 that it would be able to weather short term crises without having to contemplate
22 drastic steps that could threaten its ability to continue to provide safe and
23 adequate service. A "going concern" state would also allow the City to seriously
24 consider whether other ownership options would be better for it, PGW itself and
25 its customers.

26 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

27
28 A. Yes it does.

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& POOR'S**
RATINGS DIRECT
RESEARCH
Philadelphia; Utility, Gas

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Credit Profile
AFFIRMED

\$46.815 mil. Philadelphia gas wks rev bnds (ASSURED GTY)	AAA/BBB-(SPUR)
\$160.660 mil. Philadelphia gas wks rev bnds (1998 Gen Ordinance) ser A dtd 06/01/1998 due 07/01/1999-2014 2018 2026	AAA/BBB-(SPUR)
\$103.550 mil. Philadelphia gas wks rev bnds (1998 Gen Ordinance) ser B dtd 06/01/1998 due 07/01/2014 2018 2028	AAA/BBB-(SPUR)
\$20.010 mil. Philadelphia gas wks rev bnds (Sub1998 Gen Ordinance) ser C dtd 06/01/1998 due 07/01/1999-2014	AAA/BB+(SPUR)
\$61.960 mil. Philadelphia gas wks rev bnds 16th ser dtd 05/07/1999 due 07/01/2000-2009 2013-2015	AAA/BBB-(SPUR)
\$112.245 mil. Philadelphia gas wks rev bnds 2nd ser dtd 05/07/1999 due 07/01/2000-2029	AAA/BBB-(SPUR)
\$120.225 mil. Philadelphia gas works rev bnds (1998 Gen Ordinance) third ser dtd 06/01/2001 due 08/01/2003-2019 2021 2031	AAA/BBB-(SPUR)
\$186.705 mil. Philadelphia gas works rev bnds seventeenth series (1975 Gen Ordinance) due 07/01/2005-2022 2026	AAA/BBB-(SPUR)
\$125.000 mil. Philadelphia gasworks rev bnds fourth series (1998 Gen Ordinance) due 08/01/2004-2022 2032	AAA/BBB-(SPUR)
\$102.530 mil. Philadelphia gas wks rev (1998 General Ordinance) (FSA)	AAA/BBB-(SPUR)
\$355.825 mil. Philadelphia gas wks	BBB-

OUTLOOK: NEGATIVE

Rationale

On Aug. 30, 2005, Standard & Poor's affirmed its ratings on Philadelphia Gas Works' (PGW) revenue bonds. The ratings reflect the weak service territory, historically poor collections, high debt levels, and thin coverage of aggregate debt service. These weaknesses are partially offset by a lack of competitors and modest levels of support from the City of Philadelphia, Pa.

PGW is the nation's largest municipally owned gas utility, serving about 499,000 customers in Philadelphia. As of July 2005, the utility had about \$1.2 billion in total debt outstanding.

A weak service territory has contributed to low collection rates that have plagued the company for several years. Undercollection of billed accounts becomes acute in years with colder-than-normal winter months and high gas prices. In 2003 (5% colder-than-normal), PGW's collection rates fell to an historically low 87%. In the past two years, collection rates have improved, thanks in part to two consecutive years with warmer-than-normal winter months and various management initiatives. Year-to-date, the company has collected about 95% of billed gas revenues—a marked improvement from previous years. However, as the

heating season approaches and with gas prices at record highs, it remains to be seen if the company will be able to maintain its current 95% collection rate. The newly enacted Responsible Utility Customer Protection Act (Act 201) should provide PGW with the means for some lasting improvement. The law has allowed PGW to implement new rules regarding shut-offs, deposits, and customer tracking.

PGW's debt burden is high, with debt per customer at about \$2,400. Moreover, debt is expected to continue to increase as PGW depends entirely on external long-term financing to fund its capital-improvement program. The company spends about \$70 million in capital expenditures per year. It issues debt to fund its capital program on a two-year cycle. It is PGW's practice to use its capital improvement fund to meet ongoing working capital and debt-service requirements. The practice points to the general insufficiency of cash flows to meet ongoing operational and debt obligations.

Coverage of aggregate debt service has benefited from better collections and the suspension of PGW's annual \$18 million transfer payment to Philadelphia. For the fiscal year ended 2004, PGW's coverage of aggregate debt service was about 1.18x. Coverage in previous years had been at or below 1.0x. The company should end fiscal 2005 with coverage of about 1.25x. Coverages could decline if collection rates decline. All other things constant, new Act 201 rules and policies should enable PGW to collect a higher percentage of billed revenues than in previous years. However, if the winter is colder than normal and gas prices rise, delinquencies could increase and coverages decline, despite the new rules.

Competitive pressures are few, which reduces PGW's business risk. Although PGW's customers have had retail choice since September 2003, the absence of alternate providers has effectively secured the system's position as a regulated monopoly in Philadelphia. The utility's relationship to the city of Philadelphia also helps to reduce financial risk. Standard & Poor's assumes that the city will continue to provide modest levels of financial support to PGW. This support includes a suspension of PGW's annual payment to the city through PGW's fiscal 2008 and a deferral of PGW's \$45 million City loan bullet maturity until 2008.

Liquidity

PGW's liquidity remains marginal despite annual transfer-payment forgiveness from the city of Philadelphia. Alternative sources of liquidity include a \$100 million commercial paper program, access to capital improvement program funds, and the ability to enter into gas-storage deferral contracts.

As of July 2005, PGW's unrestricted cash balances were \$32 million, or roughly 15 days of operating expenses. With \$79.8 million in commercial paper outstanding, PGW had no availability under its *commercial paper program*. PGW's *commercial paper* is backed by a letter of credit (LOC) from JP Morgan Chase & Co. Commercial paper capacity was increased to \$100 million in August 2005. This enhanced capacity will boost end-of-fiscal-year cash and available liquidity to about 31 days of operating expenses. The LOC does not contain a term-out provision. The current ratings assume that the company will renew its LOC shortly before it expires in May 2007. An inability to renew the facility at the current amount could lower ratings. PGW regularly makes interfund loans among its various consolidated accounts (including its capital improvement fund) to pay ongoing obligations, including debt service. PGW should have \$100 million in its capital fund at the end of the fiscal year. *Gas-storage deferral contracts* enhance PGW's short-term liquidity by delaying cash outlays in summer months, when liquidity is tight. The deferred payments involve a cost of carry, which makes them potentially less cost-effective than a traditional purchase-and-store strategy.

The company's gas supply contracts contain adequate assurance provisions, which provide counterparties with the right to demand prepayment if a supplier has reasonable grounds for insecurity regarding PGW's performance under the contract, including due to a material change in PGW's creditworthiness. Cash reserves and available commercial paper are inadequate to cover PGW's peak winter prepayment exposure.

Outlook

The outlook is negative. Ratings could be lowered if current collection rates and coverage levels decline. The current high gas price environment could negatively affect both measures in the next heating season. Furthermore, current ratings assume that the city will providing annual payment forgiveness to PGW

through (PGW's) fiscal year 2008. They also assume that the city will allow PGW to defer its \$45 million loan payable until 2008. Without such support, ratings would be lowered. The outlook may be revised to stable if the upcoming heating season does not result in lower collection rates and coverage levels.

Business Description

PGW is a municipally owned utility that purchases, sells, and distributes gas within the city limits of Philadelphia, Pa. The utility is managed by the Philadelphia Facilities Management Corp. All utility property is owned by the City of Philadelphia. PGW maintains a distribution system with about 3,000 miles of gas mains and 500,000 service lines serving about 499,000 customers. Nearly 95% of PGW's customers are residential users.

Business Profile

PGW's business profile score is characterized as satisfactory-to-weak, or a '6' on Standard & Poor's 10-point scale, where '1' is the highest score. Business profile scores for most (gas) local distribution companies (LDC) range from '1' (excellent) to '4' (strong).

Regulation

PGW's customers have had retail choice since September 2003. Given the unfavorable demographics and collection characteristics of PGW's service territory, as well as the absence of an alternative supplier, we assume that in the near-to-intermediate term PGW will likely remain a regulated monopoly.

The Pennsylvania Public Utility Commission (PUC) has regulated PGW base and gas cost recovery rates and other charges since July 1, 2000. We view PGW's regulatory environment as generally supportive of credit quality. For example, the utility has access to automatic gas cost recovery and weather normalization adjustment (WNA).

Automatic gas cost recovery enables PGW to reflect the rise or fall in actual and projected gas costs in customer rates on a real-time, quarterly basis. The recovery mechanism includes an end-of-year true-up provision whereby any overrecovery or underrecovery of gas costs incurred are passed through to customers in the following fiscal year. In 2001, the Pennsylvania Public Utility Commission (PUC) allowed PGW to retain an \$11 million overrecovery to meet obligations due through January 2002.

Weather normalization enables PGW to smooth out fluctuations in distribution revenues due to abnormal weather. PGW's WNA had an initial three-year period, beginning in August 2002. The company is reviewing its WNA and will submit a filing to the PUC shortly. In response to the filing, the PUC will decide whether to continue, continue with modifications, or eliminate the WNA. The current rating assumes that the company will continue to have access to its WNA. Although poor collections exacerbate liquidity problems in colder-than-normal years (as total customer bills increase), the WNA keeps distribution revenues from dropping precipitously in years with warmer-than-normal winters.

In February 2005, the PGW won a major victory with the passage of Act 201. Because of the new law, PGW may now shut off service to delinquent customers during the winter and on Fridays under certain conditions. To shut off service to non-low-income customers during winter months, PGW is no longer required to get PUC permission. As per the new law, PGW may now require customers whose service has been shut off to pay past-due bills in full, arrange for a payment agreement, pay a reconnect fee, and/or pay a deposit before it restores service. The new law also permits PGW to make any adult living in a home where service has been shut off accountable for all or part of an overdue balance before the adult can obtain service in his or her name. While opposition to Act 201 persists, the current ratings assume that the company will not be forced to roll back any of its new collection-related rules and policies.

Markets

PGW serves about 499,000 customers in the city limits of Philadelphia. Residential customers (95% of customers) should provide for a stable and predictable revenue stream. However, unlike the surrounding metro area, the City of Philadelphia is characterized by a declining population, below-average wealth levels, and higher-than-average unemployment levels that contribute to poor collections. Philadelphia's population declined 1.2% per year on a compound annual basis between 1994 and 1998. Median household effective buying income is only 74% of the national average. Also, the average unemployment

rate for 2004 was 7.43% for Philadelphia, compared with 5.49% for the U.S. as a whole.

Low collection rates have plagued the company for several years. The company has written-off about 20% of receivables annually since 2001. As of July 2005, about 78% of PGW's gross receivables were more than 90 days old. That said, after falling to a historic low in 2003 (87%), collection rates appear to be improving. Collection rates have benefitted from two consecutive years with warmer-than-normal winters and various management initiatives. Year-to-date, the company has collected about 95% of billed gas revenues—a marked improvement from previous years. The collection rate could decline again in the event of a colder-than-normal winter and natural gas prices rise to record highs.

Operations

PGW manages its gas supply through a mix of flowing supplies, off-system underground storage, and city-owned and PGW-operated liquefied natural gas (LNG) facilities. PGW purchases about 40% of its gas requirements through four firm supply contracts. Purchases are first-of-the-month index. PGW's access to an automatic purchased gas adjustment clause tempers its exposure to the volatile natural gas market. However, the gas cost pass-through mechanism assumes that PGW has a 100% collection rate. With collection rates typically in the low 90% area, PGW is not insulated from commodity risk.

PGW receives gas from two pipeline transmission companies that own most of the facilities and land at eight of the nine city gas stations—Texas Eastern Transmission Corp. and Transcontinental Gas Pipe Line Corp. As such, PGW draws gas primarily from the U.S. Gulf Coast and Canada. PGW's reliance on only two pipeline interconnections exposes it to moderate event risk and negative supply shocks.

During periods when PGW's load is less than contracted transportation service, it may use available capacity on the aforementioned pipelines to deliver gas to its off-system storage facilities or to liquefy and store gas in its LNG facilities. Purchasing gas during lower-cost summer months, storing it, and then redelivering it during the winter reduces the company's gas supply costs, which when high, tend to exacerbate its collection problems. However, the company's deferred gas storage transactions tend to cut into some of the cost savings. The transactions allow PGW to delay cash outlays for gas obtained in liquidity-tight summer to the winter. The deferred payments involve a cost of carry, which makes them potentially less cost-effective than a traditional purchase and store strategy.

About 45% of peak day demand can be met with vaporized gas from two city-owned and PGW-operated LNG facilities. The LNG facilities enhance supply security.

About 56% (by length) of PGW's gas mains are cast iron, 33% are steel, 5% are ductile iron, and 5% are plastic. PGW's capital spending budget reflects the extensive maintenance and capital expenditures generally associated with older cast iron systems. Over the past three years, about 62% of PGW's capital expenditures were related to maintaining distribution facilities, including its mains and small diameter services.

Competitiveness

Retail customers in Pennsylvania can choose among natural gas suppliers as per the Pennsylvania Gas Choice Act of 1999. However, below-average demographics in PGW's service territory and the utility's high risk for uncollectible accounts keep would-be competitors at bay. Currently, there are no competitive natural gas suppliers offering service to residential customers in PGW's service territory. Residential customers account for 95% of all customers and about 70% of total gas sales.

Management

The current management team, in place since July 2000, has had some success in tackling certain regulatory, operational, and other issues, such as obtaining an immediate interim rate increase of \$36 million from the PUC in April 2002, addressing billing system functionality problems also in 2002, and working with the city to defer or eliminate its \$18 million annual payment.

Management will likely confront significant financial and operational challenges. High gas prices—especially if coupled with a colder-than-normal winter—could stretch the company's customers and add to the company's uncollectible account, thereby reducing cash flows. Also, opposition to Act 201, whether at the local level or in the state legislature, could thwart management's ability to implement rules and policies designed to further improve collections. In the past year, management has implemented several collection

strategies that are likely to improve collections. These include requiring deposits from previously delinquent customers, making landlords partially responsible for overdue tenant accounts, proceeding with winter and Friday shut-offs, and tracking customers for new gas service.

Financial Profile

PGW's below-average financial profile is characterized by high debt levels, thin coverage of aggregate debt service, and low collection rates that pressure liquidity.

PGW's debt burden is high with debt per customer at about \$2,400. Moreover, debt is expected to continue to increase as PGW depends entirely on external long-term financing to fund its capital improvement program. The company's capital expenditures total about \$70 million per year. It issues debt to fund its capital program on a two-year cycle. It is PGW's practice to use its capital improvement fund to meet ongoing working capital and debt-service requirements. The practice points to the general insufficiency of cash flows to meet ongoing operational and debt obligations.

Coverage of aggregate debt service has benefited from better collections and the suspension of PGW's annual \$18 million transfer payment to the city. For the fiscal year ended 2004, PGW's coverage of aggregate debt service was about 1.18x. Coverage in previous years had been at or below 1.0x. The company should end fiscal 2005 with coverage of about 1.25x. Coverages could decline if collection rates decrease. All other things constant, new Act 201 rules and policies should enable PGW to collect a higher percentage of billed revenues than in previous years. However, in the event of a colder-than-normal winter and elevated gas prices, delinquencies could increase and coverages decline, despite the new rules.

Legal provisions/covenants

The gas system's net revenues secure the bonds. Series 1998 1C bonds are subordinate to all other 1975 and 1998 ordinance bonds. Aside from Series 1998 1C, all bonds share equally in the pledge of revenues. The lien created by the 1975 ordinance was closed, except for refunding bonds. There are no additional bonds tests. To issue bonds under either ordinance, the chief financial officer for the city must file a financial report that determines that estimated net revenues will be sufficient to meet the covenants of the respective ordinance.

Under the 1998 ordinance, the rate covenant requires 1.5x coverage of maximum annual debt service on the senior bonds, but only 1x coverage of the debt remaining under the 1975 ordinance and the subordinate bonds. The rate covenant for the 1975 ordinance bonds still requires 1.5x coverage on all outstanding 1975 ordinance debt. Therefore, rates must be set to satisfy both ordinances, or at the higher rate required by the two ordinances. As the debt under the 1975 ordinance matures and the amount of debt under the 1998 ordinance increases, the revenue required to satisfy the rate covenants will decrease. The company is currently in compliance with its covenants.

PGW does not have a debt-service reserve fund. However, bondholders benefit from the existence of two sinking fund reserve accounts. Under both ordinances, PGW is required to maintain sinking funds with deposits sufficient to meet 100% of debt service (relating to all bonds) due in the following year. The sinking funds were funded from bond proceeds.

Under its management agreement, the Philadelphia Facilities Management Corp. is required to make an annual \$18 million payment to the city on behalf of PGW. The city has waived this requirement through 2009. Authorizing legislation must be passed at the city level annually to permit and formalize the suspension.

Philadelphia Gas Works Financial Statistics

	12 months ended July 2005 (unaudited)	--Fiscal year ended Aug. 31--				
		2004 (audited)	2003 (audited)	2002 (audited)	2001 (audited)	2000 (audited)
Debt-service coverage (incl. capital leases; no comm. paper) (x)	1.38	1.18	1.28	1.16	1.21	1.12
Coverage of debt service & city payment	1.38	1.18	1.07	0.99	1	0.93

(excluding comm. paper) (x)

Days cash on hand (incl. available comm. paper)	15.4	16.9	0.2	3.7	0.3	6.4
Amount of debt/customer (\$)	2,419	2,106	2,245	2,024	2,063	1,864
% of billings received	94.8	91.4	86.6	97.6	88.1	92.9

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**STANDARD
& POORS****RATINGS DIRECT****RESEARCH****Summary: Philadelphia, Pennsylvania; Gas**

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Credit Profile

US\$313.39 mil gas works rev bnds (1998 General Ordinance)
 ser SIXTH dtd 01/26/2006 due 08/01/2031 AAA/A-1+
 Sale date: 24-JAN-2006

AFFIRMED

\$61.960 mil. Philadelphia gas wks 16th ser (FSA) AAA/BBB-(SPUR)

OUTLOOK:

NEGATIVE

Rationale

Standard & Poor's Rating Services assigned its 'AAA/A-1+' rating to Philadelphia, Pa.'s Philadelphia Gas Works (PGW) revenue bonds, sixth series. The long-term component of the rating is based on a bond insurance policy provided by Financial Security Assurance Inc. ('AAA/Stable'). The long-term component of the rating represents the likelihood that debt service will be paid over the life of the issue. The short-term component of the rating is based on a standby purchase agreement provided severally by JP Morgan Chase Bank N.A. ('A-1+'), Wachovia Bank N.A. ('A-1+'), and The Bank of Nova Scotia ('A-1+') where they are each obligated to pay 33.5% of each drawing. The short-term component of the rating represents the likelihood of payment of tenders.

The liquidity facility shall provide coverage for principal and 34 days of interest at the maximum rate of 10% for the purchase price of bonds that are not successfully remarketed. The SBPA is scheduled to expire on Jan. 26, 2009, unless earlier extended or terminated according to its terms.

For the complete rationale on the 'BBB-' Standard & Poor's underlying rating (SPUR) on the bonds, see "Philadelphia, Pa.", RatingsDirect Jan. 20, 2006.

The bonds will initially bear interest in a weekly variable interest rate mode but, upon mandatory tender, may be converted to bear interest in other modes, which include term-rate mode or fixed-rate modes. Bondholders may tender their bonds during the weekly mode upon delivering appropriate notice. The bonds are further subject to mandatory tender due to the occurrence of various events, including upon conversion to a mode other than the weekly mode, expiration, or substitution of the liquidity facility and due to certain events of default under the SBPA, which lead to a timed termination event. The bonds may be called due to optional redemptions and are subject to mandatory sinking fund payments.

Outlook

The negative outlook on Standard & Poor's underlying rating (SPUR) on PGW reflects the presence of several challenges that have the potential to erode the utility's credit quality. Despite the benefits of stronger collection enforcement tools, the utility needs to demonstrate an ability to sustain recent improvements in collection rates in the face of higher commodity costs and the system's customers' weak demographic profile. Furthermore, additional debt needed to support a sizable capital program will likely pressure rates and possibly also collections and financial margins. Moreover, PGW needs to formulate a

concrete credit-protective strategy for addressing the 2008 expiration of the city's current annual refund of PGW's transfer payment and the city's \$45 million loan to PGW. Higher ratings are not likely in the absence of improved and sustained collection rates and financial margins.

Complete ratings information is available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

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**STANDARD
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RATINGS DIRECT
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Philadelphia; Gas

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Credit Profile
AFFIRMED

\$355.825 mil. Philadelphia gas wks	BBB-
\$17.040 mil. Philadelphia gas works rev (1975 Gen Ordinance) (AMBAC)	AAA/BBB-(SPUR)
\$11.435 mil. Philadelphia gas works rev bnds Eighteenth ser (1975 Gen Ordinance) (CIFGNA)	AAA/BBB-(SPUR)
\$20.010 mil. Philadelphia gas wks (Sub1998 Gen Ordinance) ser C (FSA)	AAA/BB+(SPUR)
\$103.550 mil. Philadelphia gas wks (1998 Gen Ordinance) ser B (FSA)	AAA/BBB-(SPUR)
\$160.660 mil. Philadelphia gas wks (1998 Gen Ordinance) ser A (FSA)	AAA/BBB-(SPUR)
\$112.245 mil. Philadelphia gas wks 2nd ser (FSA)	AAA/BBB-(SPUR)
\$120.225 mil. Philadelphia gas wks (1998 Gen Ordinance) THIRD ser (FSA)	AAA/BBB-(SPUR)
\$125.000 mil. Philadelphia gas wks 4th series (1998 Gen Ordinance) (FSA)	AAA/BBB-(SPUR)
\$186.705 mil. Philadelphia gas wks (1975 Gen Ordinance) Seventeenth ser (FSA)	AAA/BBB-(SPUR)
\$46.815 mil. Philadelphia gas wks (ASSURED GTY)	AAA/BBB-(SPUR)
\$102.530 mil. Philadelphia gas wks (1998 General Ordinance) (FSA)	AAA/BBB-(SPUR)
\$313.390 mil. Philadelphia gas wks VRDB (1998 General Ordinance) ser SIXTH (FSA)	AAA/A-1+/BBB-(SPUR)

OUTLOOK: NEGATIVE

Rationale

Standard & Poor's Ratings Services assigned its 'BBB-' underlying rating to municipal gas utility Philadelphia Gas Works' (PGW) \$320 million sixth series refunding bonds. PGW is issuing these bonds to refund previously issued bonds under the 1998 senior ordinance.

Standard & Poor's also affirmed its 'BBB-' ratings on PGW's series 1975 and series 1998 senior lien revenue bonds and its 'BB+' ratings on PGW's series 1998 subordinate lien bonds.

The outlook is negative. As of Aug. 31, 2005, the utility had \$1.16 billion of outstanding debt.

The ratings on PGW reflect the service territory's weak demographics, resulting poor collections of billed revenues that have recently shown improvement following the legislative enactment of more stringent collection tools, the utility's high leverage, and thin debt service coverage of total fixed obligations.

Weaknesses are tempered by the modest benefits that flow from the City of Philadelphia's extension of the maturity of its loan to the utility as well as the city's willingness to rebate transfer payments over the near term.

PGW is the nation's largest municipally owned gas utility, serving about 497,000 customers in Philadelphia. As of Aug. 31, 2005, the utility's \$1.16 billion of outstanding debt obligations consisted of \$326 million senior closed-lien 1975 ordinance bonds, \$719 million senior 1998 ordinance bonds, \$14 million subordinate 1998 series bonds, a \$45 million loan from the city, and \$51 million CP notes. In connection with the disclosure published for the issuance of the sixth series bonds, the utility reported that, following the Aug. 31 close of its fiscal year, it had exhausted the balance of its \$100 million of CP capacity and is presently issuing additional CP following the utility's 50% upsizing of the CP program to \$150 million in December 2005. In addition, unspent proceeds of bonds previously issued to fund capital projects represent a liquidity tool.

PGW has been plagued by low collection rates for several years. The collection rates are a function of the service territory's demographics. Historically, undercollections of billed revenues have become acute in years with colder-than-normal winter months and high gas prices. In 2003 (which was 5% colder than normal), PGW's collection rates fell to an historically low 87%. In the past two years, collection rates showed improvement due to warmer-than-normal winter months and the recent implementation of more stringent enforcement tools to address delinquent accounts. Although rolling average 12-month collections were in the vicinity of 95% of billed gas revenues throughout much of 2005, it remains too early to determine the effects of the current heating season's record gas prices on collections. The recently enacted Responsible Utility Customer Protection Act (Act 201) should provide PGW with tools for sustaining higher-than-historical collection rates because of its more liberal shut-off policies and stricter deposit requirements.

PGW has a high debt burden. Debt represents about 85% of the utility's capitalization and average debt per customer is about \$2,100. Moreover, debt levels are expected to continue to increase because PGW plans to rely exclusively on additional long-term debt financing to fund its capital-improvement program, which will likely place additional pressures on financial margins, rates, and possibly collections. In the past five years, PGW spent an average of \$59 million per year on capital projects, an amount that is projected to increase nearly 13% to an average of \$65 million per year in each of the coming five years. PGW issues debt to fund its capital program on approximately a two-year cycle.

It is PGW's practice to use unexpended bond proceeds in its capital improvement fund to meet ongoing working capital and debt-service requirements to compensate for seasonal cash flow issues. This practice points to the general insufficiency of cash flows to meet ongoing operational and debt obligations.

Coverage of combined debt service and fixed obligations has benefited in the past two fiscal years from improved collections and rebates of PGW's annual \$18 million transfer payment to the City of Philadelphia. For fiscal 2004, PGW's coverage of aggregate debt service was about 1.18x, but declined slightly to 1.13x in the most recent fiscal year indicating that against a backdrop of improving collections, revenues have not fully kept pace with rising costs. Prior to 2004, coverage levels had been of particular concern because coverage had been at or below 1.0x for a number of years.

Competitive pressures are few, but this does not necessarily reduce business risk, given the collection issues associated with the customers that must be served by the utility as a provider of last resort. Nevertheless, an absence of alternate providers has effectively secured the system's position as a regulated monopoly in Philadelphia even though PGW's customers have had the legal right to choose alternative commodity providers since September 2003. Customer migration to alternative commodity providers would not impair PGW's financial performance. PGW's delivery network is essentially immune from competition.

The utility's relationship to the city of Philadelphia could help reduce financial risk. Evidence of the city's financial support for the utility includes the current multiyear suspension of PGW's annual payment to the city through PGW's fiscal 2008 and a deferral of PGW's repayment of \$45 million bullet maturity on the city's loan until 2008.

Liquidity

PGW exhibits nominal financial flexibility despite the city's recent decision to rebate the utility's \$18 million annual transfer payments. As noted, the \$100 million CP program has been fully tapped and PGW has exhausted all sources of liquidity other than unspent bond proceeds for capital projects. The city up-sized its CP program by 50% in January and is issuing additional CP. Also available for now are \$100 million of unexpended bond proceeds, which PGW may use to cover short-term operating needs. PGW regularly makes interfund loans among its various consolidated accounts (including its capital improvement fund) to pay ongoing obligations, including debt service.

Gas-storage deferral contracts enhance PGW's short-term liquidity by delaying cash outlays in summer months, when liquidity is tight. The deferred payments involve a cost of carry, which makes them potentially less cost effective than a traditional purchase-and-store strategy.

PGW's CP is backed by an LOC from JP Morgan Chase & Co. The LOC does not contain a term-out provision, which could pressure the city's ability to meet financial obligations if the city needs to reimburse the LOC provider.

The company's gas supply contracts contain adequate assurance provisions, which provide counterparties with the right to demand prepayment if a supplier has reasonable grounds for citing insecurity regarding PGW's ability to perform financial obligations created under the contract, including a material change in PGW's creditworthiness. The noted dearth of liquidity means that cash reserves and available CP are inadequate to cover PGW's potential peak winter prepayment exposure.

Outlook

The negative outlook on PGW reflects the presence of several challenges that have the potential to erode the utility's credit quality. Despite the benefits of stronger collection enforcement tools, the utility needs to demonstrate an ability to sustain recent improvements in collection rates in the face of higher commodity costs and the system's customers' weak demographic profile. Furthermore, additional debt needed to support a sizable capital program will likely pressure rates and possibly also collections and financial margins. Moreover, PGW needs to formulate a concrete credit-protective strategy for addressing the 2008 expiration of the city's current annual refund of PGW's transfer payment and the city's \$45 million loan to PGW. Higher ratings are not likely in the absence of improved and sustained collection rates and financial margins.

Debt Derivative Profile (DDP)

PGW has been assigned a debt derivative profile of '2' on Standard & Poor's five-point DDP scale with '1' representing the lowest risk and '5' the highest risk. The overall score of '2' reflects our view that PGW's single swap represents a neutral credit risk at this time. PGW is entering into a floating-to-fixed swap in connection with the issuance of the variable rate demand refunding bonds. The utility is entering the swap under the guidelines established by the City of Philadelphia's adopted derivative policy. The swap counterparty is JP Morgan Chase Bank N.A. (AA-/Stable/A-1+). The risk of swap termination and the exposure to a termination payment are remote because of the swap counterparty's high rating relative to the termination triggering rating of 'BBB+', and the presence of bond insurance that removes the risk that the sixth series bonds' enhanced rating will fall to its termination trigger rating of 'BBB+'. PGW is not exposed to collateral requirements while the bond insurance is in effect.

While a change in the mode of the variable rate bonds from a weekly rate to a fixed or term mode would terminate the swap, such a mode change is unlikely because the issuer would only change modes if it were economical to do so and would have to factor any potential termination payment into the calculation of the economics of a mode change.

Under the swap, PGW will tender fixed payments and receive variable payments. The variable payments are not directly tied to actual variable rate debt service on the bonds. Rather, the swap counterparty's variable payments to PGW will equal the Bond Market Association Municipal Swap Index (BMA) to and including Aug. 1, 2011, and thereafter a floating rate payment equal to 70% of one-month LIBOR times the notional amount thereafter. The swap's duration is for the life of the bonds. PGW has assumed basis risk for any difference between the bonds' actual interest rate and the interest received from the swap counterparty. However, there is strong empirical evidence to suggest that BMA and, thereafter, 70% of

LIBOR, should be closely correlated with the interest expense on these weekly rate bonds.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

TESTIMONY OF

GARY KRELLENSTEIN

ON BEHALF OF
PHILADELPHIA GAS WORKS

DOCKET No. R-00061931

December 2006

1 **I. QUALIFICATIONS AND PURPOSE OF TESTIMONY**

2 **Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

3 A. My name is Gary Krellenstein. My business address is JPMorgan Chase, 270 Park Ave,
4 48th Floor, New York, NY 10017

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

6 A. I am Investment Banker and Managing Director in JPMorgan's Energy Group. My areas
7 of focus are municipal utilities, rural electric cooperatives, alternative energy
8 technologies and project financing. I also specialize in issuer relations, preparation, and
9 presentations to the rating agencies, bond insurers, and institutional investors

10 **Q. SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS.**

11 A. I have worked in the utility industry for over 25 years. I spent 5 years working as an
12 engineer and systems analyst, 17 years as a utility analyst for various financial firms on
13 Wall Street and for the past four years I have worked in the capacity as an investment
14 banker in the municipal utility industry. During my 17 years experience as a research
15 analyst, I became intimately familiar with the operations, financing and credit risk and
16 rating analysis of municipal utilities. I received national recognition in this field and for
17 12 consecutive years took top honors in the annual polls conducted by *Institutional*
18 *Investor Magazine* (1st team 1991-2002) in the municipal utility category. I have been
19 elected to All-American Research Teams (first place in the Utilities, Industrial
20 Development and Pollution Control categories) by the *Bond Buyer*, *Global Guaranty*, and
21 *Smith's Research and Rating Review*. In addition, the National Federation of Municipal
22 Analysts (NFMA) presented me with the "1998 Award for Excellence."

23 I am the former chairman of The Bond Marketing Association's (TBMA)
24 Municipal Credit Committee and the current co-chairman of the NFMA's "Best

1 Practices” committee for municipal utilities. I also sat for 5 years on the Advisory
2 Committee for *Public Utilities Fortnightly* magazine. I am a member of the Institute of
3 Electrical and Electronics Engineers, the American Nuclear Society, the Natural
4 Resource Defense Council (NRDC), the National Federation of Municipal Analysts
5 (NFMA), the IEEE Power Engineering Society, the NYC Partnership Energy Task Force,
6 and the American Association for the Advancement of Science.

7 I frequently speak at national conferences and symposiums on energy issues,
8 credit analysis and financing and have given presentations at Harvard University,
9 Carnegie Mellon University, the American Public Power Association (APPA), and the
10 National Federation of Municipal Analysts’ Annual Meeting. I am a co-author of “The
11 Handbook of Municipal Bonds” (Edited by Heide, Klein & Lederman, Probus Books,
12 Chicago and Cambridge England, 1994, ISBN 1-55738-577-7), am currently working on
13 the 2007 update to that book, and I will author chapters on analyzing “Tax Exempt
14 Utilities” and “PCR, IDR and Conduit Financing Bonds.”

15 **Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

16 A. I have a B.S. in Nuclear Engineering from the University of Wisconsin – Madison, an
17 M.B.A. in Operations and Finance from Cornell University, and an A.P.C. in Computer
18 Science from New York University. I have also studied Computer Science at the
19 University of California – Berkeley and Biology at Harvard University.

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

21 A. Prior to rejoining JPMorgan in 2000, I was the Director of Municipal Research at First
22 Albany Corporation. I have also worked as a utility analyst at Lehman Brothers, Merrill
23 Lynch and Morgan Guaranty, and as a nuclear engineer and systems analyst for Ebasco

1 Services (Envirosphere Company), the U.S. Department of Energy and the U.S. Nuclear
2 Regulatory Commission.

3 **Q. PLEASE EXPLAIN THE BASIS OF YOUR EXPERIENCE WITH AND**
4 **KNOWLEDGE OF PGW.**

5 A. My coverage of PGW and its outstanding bonds began in the mid-1980s as a junior
6 analyst at Morgan Guaranty and has been ongoing since. I have also worked on PGW at
7 JPMorgan Chase regarding bank credit facilities to the utility and as an investment
8 banker on several of PGW's recent bond issuances and swap transactions.

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

10 A. The purpose of this testimony is to advise the Commission about the risks that PGW
11 faces. As a result of my prior experiences, I am very familiar with PGW's current
12 financial operations and credit position. It should be noted that I am speaking solely from
13 personal experience as a former research analyst and not as a representative of JPMorgan
14 Chase Bank; nor do I make any representation that my views are shared by JPMorgan
15 Chase or any other organization.

16 **II. INVESTMENT COMMUNITY PERSPECTIVE ON PGW**

17 **Q. WHAT IS THE INVESTMENT COMMUNITY'S OPINION OF PGW?**

18 A. PGW is viewed as one of the weakest (from a financial and credit risk perspective) large
19 municipal utilities in the nation. Its current underlying credit ratings (excluding credit
20 enhancement and bond insurance) from Moody's, Standard & Poor's and Fitch places it
21 in the bottom 10 percent of all rated municipal utilities. To the best of my knowledge, it
22 is the lowest rated municipal utility in the nation that has debt outstanding in excess of \$1
23 billion (most low rated municipal utilities are relatively small and serve communities
24 with a limited economic base).

1 Q. HAVE YOU READ MS. BISGAIER'S TESTIMONY?

2 A. Yes.

3 Q. MS. BISGAIER TESTIFIES THAT IT IS IMPORTANT FOR PGW TO REDUCE
4 ITS RELIANCE ON EXTERNAL FINANCING AND PRODUCE A MORE
5 BALANCED CAPITAL STRUCTURE OVER THE NEXT FIVE YEARS. DO
6 YOU AGREE?

7 A. Yes. Under the current financial and analytic models used by the bond insurers and
8 banks, if PGW continues to rely on external financing for the majority of its future capital
9 needs, it will exceed the "high quality" enhancement capacity available in the market. In
10 turn, this would force the utility to seek lower quality enhancement options and/or issue
11 unenhanced securities in the market, which would be significantly more expensive. These
12 higher costs would result in deteriorating financial ratios and a probable downgrade
13 unless PGW was willing and able to pass all of its higher financing costs on to its
14 customers. In either case, the long-term costs to its customers would most likely be far
15 higher than those costs incurred by allowing PGW to implement a rate increase in the
16 amount requested now which would be sufficient to stabilize or improve its financial
17 position and reduce its external financing needs.

18 Q. ARE YOU FAMILIAR WITH THE REQUIREMENTS OF INVESTORS WHO
19 WOULD INVEST IN PGW?

20 A. Yes.

21 Q. PLEASE EXPLAIN.

22 A. Most investors in the tax-exempt market, including holders of PGW's insured bonds, are
23 looking for low risk investments that generate tax-exempt income. These investors are
24 primarily comprised of corporations and wealthy individuals in high tax brackets,
25 although several "hedge funds" have recently become players in the municipal market.
26 Tax-exempt bonds are not traditionally used by investors looking for growth or high

1 returns (preservation of capital is a key consideration for most tax-exempt investors).
2 Consequently, the market for low or sub-investment grade municipal bonds is very
3 shallow and often requires the participation of “cross-over” buyers (investors from the
4 high yield taxable markets who will only minimally factor in the bond’s tax-exempt
5 status and require significantly higher rates-of-return). If PGW had to access the capital
6 markets with below investment grade ratings, the yield penalty it would most likely incur
7 in the current financial environment would be excessive (the premium could easily be
8 35% to 100% over investment grade rates depending of structure, maturity, calls features,
9 size, etc.) and it would have a severe negative impact on the utility’s financial operations
10 and its cost of service to customers.

11 **Q. WHAT DO YOU BELIEVE WILL BE THE IMPACT ON PGW IF PGW IS**
12 **UNABLE TO REDUCE ITS RELIANCE ON EXTERNAL FINANCING AND**
13 **PRODUCE A MORE BALANCED CAPITAL STRUCTURE OVER THE NEXT**
14 **SEVERAL YEARS?**

15 **A.** The continued reliance on external financing for all of its capital requirements will put
16 pressure on PGW’s financial operations and ratios and will probably result in the loss of
17 additional bond insurance capacity, the reduction or loss of its current bank facilities and
18 the probable downgrade of its ratings.

19 The loss of additional bond insurance capacity and bank facilities will make it
20 difficult for PGW to access the capital markets in a timely and efficient manner. To
21 successfully access the capital markets without high quality enhancement, the utility
22 would have to pay significantly higher interest rates and fees to compensate investors and
23 counterparties for their greater risk exposure. This will result in higher financing costs,
24 which will lead to higher costs for PGW’s customers.

25 Worse, should the utility’s ratings drop below investment grade, its ability to

1 access the capital markets would be severely compromised and it could be forced to pay
2 excessive fees to obtain any sizeable amount of funding. Should this downgrade coincide
3 with increased volatility in the gas markets (such as a dramatic increase in natural gas
4 prices), PGW could lose its access to the capital markets for a period of time, resulting in
5 dire consequences to its operations and ability to serve its customers.

6 **Q. YOU DESCRIBE THE RISKS AND CHALLENGES FACING PGW, BUT IS IT**
7 **YOUR VIEW THAT PGW HAS MADE ANY PROGRESS SINCE ITS LAST**
8 **RATE CASE?**

9 A. PGW has made substantial progress. That progress is reflected in the data presented by
10 Mr. Bogdonavage and Ms. Bisgaier, such as the substantially improved collection levels,
11 major improvements to the entire billing and collection systems (including the successful
12 implementation of the Automatic Meter Reading program which has resulted in accurate
13 and timely billing), staffing level reductions, the ability to adjust the GCR periodically
14 and the implementation of the Weather Normalization Clause. It is also demonstrated by
15 the willingness of lenders, such as JPMorgan, to increase PGW's ability to borrow under
16 the commercial paper program and the action taken by Fitch Rating Services in
17 September of this year when they removed PGW from credit watch and changed the
18 outlook to "stable."

19 **Q. DOES STABLE OUTLOOK MEAN THAT PGW IS NOW IN GOOD FINANCIAL**
20 **CONDITION?**

21 A. No. The Baa2 (Moody's)/ BBB- (S&P) /BBB- (Fitch) ratings, in addition to the
22 "negative" outlook still in place by S&P, imply that PGW has minimal ability to
23 withstand any significant adverse event without the potential for dropping below
24 investment grade by one or more of the rating agencies. The shift to stable outlook by
25 Fitch earlier this year reflects that agency's perception (with which I agree) that

1 management has stopped the further erosion of the company's financial position and
2 begun a turn-around. But, it is also premised on the belief that the utility must and will
3 receive adequate rate relief from regulators. Should a rate decision be made that is
4 considered to be adverse to the utility's financial operations and expectations for
5 improved liquidity, it would be reasonable to assume that all three rating agencies might
6 put PGW on "credit-watch" and/or downgrade them shortly thereafter, resulting in
7 significantly higher costs for both the utility and its customers or additional adverse
8 consequences.

9 Conversely, a favorable regulatory decision could lead to a rating upgrade by one
10 or more of the rating agencies, which should allow PGW to reduce its cost of capital and
11 generate savings that will ultimately be passed on the customers since there are no
12 shareholders that would reap the benefits.

13 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

14 **A. Yes.**