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June 12, 2007

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2007 JUN 12 PM 4:05

Re: Pennsylvania Public Utility Commission v. Philadelphia
Gas Works, Docket No. R-00061931

Dear Secretary McNulty:

On behalf of Philadelphia Gas Works, enclosed for filing please find an original and nine copies of its Main Brief with regard to the above referenced matter. A copy has been served in accordance with the attached Certificate of Service. Also enclosed is a disk with the Main Brief in Word Format.

Very truly yours,

Daniel Clearfield

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

DC/lww
Enclosure

cc: Hon. Cynthia Fordham w/enc.
Hon. Angela Jones w/enc.
Cert of Service w/enc.

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document upon the participants listed below in accordance with the requirements of § 1.54 (relating to service by a participant).

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :

v. :

Philadelphia Gas Works :

Docket No. R-00061931

ORIGINAL

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MAIN BRIEF
of
PHILADELPHIA GAS WORKS

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STATEMENT OF THE CASE

On December 22, 2006, Philadelphia Gas Works ("PGW" or "Company") filed Supplement No. 16 to Tariff Gas - Pa. P.U.C. No.2 to become effective February 20, 2007. The Supplement proposes changes in rules, regulations and rates calculated to produce \$100 million, or 9.6 %, in additional annual revenues.¹

Pursuant to Section 1308 (d) of the Public Utility Code, Supplement No. 16 was suspended by operation of law until September 20, 2007, and on March 5, 2007 the suspension was extended by the Company until September 28, 2007. By Order entered February 8, 2007, the Pennsylvania Public Utility Commission ("PUC" or "Commission") instituted an investigation into the lawfulness, justness and reasonableness of the proposed rate increase, as well as the lawfulness, justness and reasonableness of PGW's existing rates.

The matter was assigned to the Office of Administrative Law Judge ("ALJ"), and to ALJs Cynthia Williams Fordham and Angela T. Jones, for resolution by hearings and for issuance of a Recommended Decision. Active parties are: Office of Trial Staff ("OTS"); Office of Consumer Advocate ("OCA"); Office of Small Business Advocate ("OSBA"); Action Alliance of Senior Citizens of Greater Philadelphia ("AASCGP"); Tenant Union Representative Network ("TURN"); Philadelphia Industrial and Commercial Gas Users Group ("PICGUG"); School District of Philadelphia ("SDP"); Philadelphia Housing Authority ("PHA"); Interstate Gas Supply, Inc. ("IGS"); and Hess Corporation ("Hess").

After a second prehearing conference on March 2, 2007, Prehearing Order No. 3 was issued establishing the procedural schedule. The ALJs issued briefing instructions to the active

¹ The PUC's Suspension Order (Feb. 8, 2007) incorrectly states the level of base rate increase as \$107 million. The Proposed Tariff Supplement No. 16 produces \$99,999,000. PGW Exh. HSG-7C (revised), p. 2, line 11 which is included in App. F hereto. *Accord*, App. A, hereto, p. 6.

parties in a separate order, including the "Special Instructions for Briefs and Exceptions in Major General Rate Increase Proceedings." The ALJs noted that some items in the Special Instructions are not applicable because this is not an investor owned utility case involving rate base and rate of return.

Four public input hearings were held: March 26, 2007 (Dorothy Emanuel Recreation Center); March 28, 2007 (George Washington High School); and April 9, 2007 (Community College of Philadelphia; 1:00 p.m. and 9:00 p.m.).² Evidentiary hearings were held May 21-24, 2007 in Philadelphia. Prepared written testimony of witnesses for the following parties was entered into the record pursuant to various stipulations: PGW; OTS; OCA; OSBA; AASCGP; PICGUG; SDP; PHA; IGS; and Hess. Additional testimony and exhibits were admitted into the record and cross examination was conducted at the hearings.

The record closed on May 25, 2007. This Main Brief supports PGW's request for base rate relief.

Attached as appendices "G" and "H" to this brief are "Statement of Questions Presented" and "Proposed Ordering Paragraphs," as requested by the ALJs' Briefing Order.

²

A total of 62 people testified at the public input hearings. A majority complained that they did not want to pay higher rates, which is not surprising. However, such complaints that people do not want to pay does not provide a basis for rejecting any portion of the Company's requested base rate relief. In contrast, a number of people – including State Representatives Cherelle Parker (200th District) (Tr. 103) and Babette Josephs (182nd District), (Tr. 262-65) State Senator Anthony Hardy Williams (8th Senatorial District), (Tr. 380) and consumer activist Lance Haver – commended PGW for increasing its collection rate and customer enrollment in CRP. Tr. 303-04 (One person testified that the Company is not aggressive enough in collecting bills, and could be more aggressive. Tr. 279.) Mr. Haver also observed that higher gas bills are not the Company's fault, and noted the following additional positive steps the Company has taken to keep bills reasonable: (1) loan from the City; (2) free workshops showing customers how to conserve gas; (3) weatherization of thousands of homes; (4) assistance to customers for LIHEAP and crisis grants; and (5) more professional management at PGW. Tr. 303-04. City Councilman Frank Rizzo, Jr. described the Company's efforts to deal with its financial crisis as "valiant." Tr. 107, 259, 384.

ARGUMENT

I. INTRODUCTION

The inadequacy of PGW's current rates has forced PGW to rely so extensively on borrowed funds – long term and short term – that the Company is being driven deeper and deeper into a hole that creates both risk and substantial cost for customers. The evidence in this case demonstrates that, without the relief requested, the current marginal financial situation will deteriorate quickly and very predictably. The deterioration will not hurt stockholders because there are none. Customers will bear the burden, both in cost and in quality of service.

Unfortunately PGW's very conservative proposal to provide financial and operating stability by increasing base rates by 9.6% overall, along with its proposal to revise the way in which PGW customers obtain the benefits from off-system sales and capacity release credits, has not been endorsed by the opposing parties. Looking very narrowly at the situation through the prism of test year results, they have opined that PGW is not violating its debt service coverage covenant in the test year and therefore does not need more than a minimal (\$22.5-\$25 million) rate increase (to take account of a \$45 million loan payback next year). With respect to the Company's lack of cash working capital and its over reliance on long term debt to finance construction, the parties apparently either do not share PGW's concerns or assume that such borrowing can and should continue to be the exclusive source of support for the capital program, the apparent presumption being that so long as PGW has any capacity to borrow it should do so to that limit, regardless of consequence or cost. If borrowing is not possible, they appear to conclude, then the Company can and should rely on such "quick fixes" as borrowing from restricted construction funds or selling gas inventories, again regardless of consequence or cost. Or, if all else fails, they suggest, PGW should simply call on the General Fund of the City of Philadelphia as it requires, regardless of law, consequence or cost. These suggestions are simply

not realistic or legal, and they certainly would not be acceptable answers to an otherwise justified revenue requirement presented by an investor owned utility. Such one-time fixes are, by their very nature, not predictable or on-going and cannot be relied on to stabilize the Company and are highly disfavored by the investment community as signs of a company at the edge. They certainly do not provide the basis for recovery that both the Company and its potential bondholders need.

Municipal ownership of PGW rather than investor ownership does not mean that the Commission, as apparently suggested by some of the parties, can pick and choose in applying regulatory principles by which rate setting is guided. In fact, PGW's rates are required to be set using the "Cash Flow Method," which, as the name implies, must include an allowance for "cash" from rates – cash working capital to supplement its other source of liquidity – its tax exempt commercial paper program which has at this point become a permanent part of PGW's outstanding indebtedness, rather than as a backup in times of temporary cash shortfalls. Certainly, this methodology can not be interpreted as requiring PGW to borrow to obtain its cash to fund its operations, until it can operate no more.

At bottom, the Commission must focus on the real world need for and effect of any rate determination for PGW and consider both the short term and longer term effects. PGW is one of the most important issues facing Philadelphia. In this proceeding, the Commission must take the requested action to put PGW on the path to financial stability so as to ensure the continued provisioning of safe adequate and reasonable service for the residents of the City of Philadelphia.

II. REVENUE REQUIREMENT

A. Overview

As described in summary by PGW witness Steven Hershey, PGW's requested base rate increase request of \$100 million, together with its proposal to retain the proceeds from natural

gas off-system sales and capacity release credits (projected at an average level of \$10 million annually), was necessary for three distinct reasons. That testimony continues to provide a useful summary of the Company's needs:

First, . . . , PGW has experienced a significant increase in non-gas operating expenses and interest expense since its last fully litigated case. PGW seeks rates that appropriately reflect those increased expenses.

Second, . . . without a substantial rate increase, PGW will have inadequate earnings in FY 2009 to meet its debt service obligations and will fall below "investment grade" coverage levels in FY 2008.

The third reason for seeking a rate increase is to ensure that, in the long term, PGW has adequate liquidity when needed without having to resort continually to borrowing. PGW must break the ever-more expensive cycle of cash deficits which require one-time fixes and even more borrowing. PGW is billing just under \$1 billion in revenues and yet, for fourteen years, has had no internally generated funds. The company has limped from one crisis to the next, never having the resources to address its structural financial problems. In the last few years, PGW has found itself with only the slimmest of cash balances – in one instance just \$4 million – and all of it from borrowed funds. PGW cannot survive unless it is able to borrow, but, borrowing has only pushed PGW and its customers deeper into the hole.³

Mr. Hershey then described how these financial circumstances have adversely affected

PGW:

PGW has come to resemble the customer of a pay day lender who is unable to sustain a cash flow sufficient to pay expenses and meet financial needs and is compelled to borrow to make it to his next paycheck, piling on the cost of borrowing, and making the situation worse. PGW is requesting sufficient funds so that, for the first time in a generation, it can be a self-sustaining, viable gas distribution enterprise. Indeed, as Ms. Bisgaier and Mr. Krellenstein testify, unless this downward spiral is meaningfully addressed, PGW is in real danger of collapsing from the weight of

³ PGW St. 1 at 2-3.

its debt burden and the enormous risk this situation imposes upon the Company and its customers.⁴

PGW will demonstrate below that its current level of rates is not only insufficient to produce crucially necessary cash working capital and liquidity and to reduce its crushing debt burden, but as soon as FY 2008, the Company will be in real danger of not being able to meet its debt service coverage requirements. PGW's requested \$100 million rate increase will address these deficiencies by allowing it to cover all of its expenses and other costs; to assure that it will be able to meet its debt service coverage requirements both in the test year and in the next several years; to provide sufficient cash working capital from rates so that, along with its tax exempt commercial paper program, it will have adequate liquidity to meet all of its needs throughout the year; and to permit PGW to begin to reduce its dependence on expensive long term debt to fund capital improvements before the weight of that debt crushes the Company.

While granting the Company's entire request is the only way to fully meet all of these key financial needs, it is important to understand that even setting the Company's rates so that the allowed earnings level would equal that established by the PUC in PGW's last two rate cases would require a minimum increase of some \$70-71 million.⁵ Plainly, the recommendations of the OCA and the OTS – for just a \$22.5 to \$25 million rate increase – fail to deal realistically and fairly with the financial issues facing the Company today; would return it to the extremely precarious financial position that it found itself in 2000; and likely place the Company, and its customers in a position where even PGW's continued ability to provide safe, reliable and adequate service could be threatened.

⁴ *Id.* at 2 - 3 .

⁵ App. B, hereto.

Before discussing the evidence justifying PGW's base rate request, PGW will review its present financial status. It will then discuss the legal requirements applicable to establishing PGW's base rates – the Cash Flow Method – the specific elements of which are set forth in an Ordinance of the City of Philadelphia and which section 2212(e) of the Public Utility Code makes applicable here. Next, PGW will explain the development of the base line *pro forma* test year on which its revenue requirement claim is based, the results of which are shown on final summary schedules attached to this brief as Appendix "A." There is relatively little disagreement about the test year revenues and expenses and the resulting financial data that comprise PGW's *pro forma* test year claim at present rates; OCA, the OTS and PGW disagree as to just \$2-3 million of expense adjustments. (The Company will support its position on each of these remaining contested areas at the end of the "Revenue Requirement" section of this brief.) PGW will then discuss the deficiencies in its *pro forma* test year financial statistics in three key areas: debt service coverage; cash working capital; and debt-to-equity ratio. It will then demonstrate how its \$100 million rate increase request (along with its proposal to retain the proceeds of off-system sales and capacity release credits for a construction fund) appropriately addresses each of these elements.

Both the evidence and the applicable law demonstrate that strict adherence to the test year construct alone, while justifying a substantial portion of the increase requested, is not in the public interest. In order to adequately address the need, the Commission must look to the data from the test year and the Company's five year planning period. Failure to do so jeopardizes PGW's ability to continue to provide safe and reliable service.

What the analysis demonstrates is that to fully address each of these financial needs, PGW could have justified a significantly greater rate increase. However, because of their

understanding of the impact of increases in energy prices on the service territory, and especially the effects on the poor and working poor, PGW's Board of Directors specifically directed the Company to hold the rate increase to the \$100 million level and to seek out alternative ways to achieve its financial needs for any additional requirements.⁶

1. The Current Financial Status of PGW

The most dramatic testimony in the entire proceeding was the frank assessment of the Company by Gary Krellenstein, an investment banker and expert in municipal utility finances:

PGW is viewed as one of the *weakest* (from a financial and credit risk perspective) *large municipal utilities in the nation*. Its current underlying credit ratings (excluding credit enhancement and bond insurance) from Moody's, Standard & Poor's and Fitch places it in the *bottom 10 percent* of all rated municipal utilities. To the best of my knowledge, it is the *lowest rated municipal utility in the nation that has debt outstanding in excess of \$1 billion* (most low rated municipal utilities are relatively small and serve communities with a limited economic base).⁷

Why is PGW still on such precarious financial footing after almost seven years of regulation by the PUC, which, after a bumpy start, has been supportive of the Company in past decisions? Like a patient with multiple critical illnesses, PGW can be described as having taken one step forward and two steps back on the road to cure since its last base rate case. While it has made significant progress on some fronts – including improved operating efficiency collections

⁶ PGW St. 2 at 15. PGW also delayed the filing as long as possible until the need for a base rate increase could no longer be avoided. PGW St. 1 at 4. This is not to say, however, that suggestions by some (i.e., OCA St. at 18-20) that a rate increase will create bill payment difficulties for PGW customers is a basis for rejecting an increase that is otherwise just and reasonable. Moreover, denying a needed rate increase clearly could result in increased costs of borrowing or the resort to very expensive "quick fixes" in the future as well as reduced service adequacy and reliability, ultimately imposing more costs on customers. The proper response to this concern is to continue to support PGW's leading efforts to provide energy assistance and other support to low income customers who have a legitimate need for such help. PGW St. 1R at 5-7.

⁷ PGW St. 4 at 3 (emphasis supplied).

and its level of uncollectibles, for example – it continues to struggle on others that are effectively beyond the control of management. Unfortunately, achieving that progress will not prevent the remaining problems from plunging the Company into financial crisis – if left untreated.

PGW last increased its base rates in April, 2002, when the Commission granted its request for a \$36 million extraordinary rate increase.⁸ That same \$36 million increase was made permanent when, in August, 2002, the Commission approved a settlement of PGW's \$60 million base rate request.⁹

The 2002 rate increase followed a \$33.6 million base rate hike, that had been authorized by the Commission in the Fall of 2001, after a fully litigated proceeding. The subsequent extraordinary rate increase rescued the Company from a likely downgrade to junk bond status that would have created a financial crisis of significant proportions.

After the 2002 case, PGW hoped that the two base rate increases and the implementation of a Weather Normalization Clause would stabilize PGW's earnings and cash flow and permit it to reduce its outstanding short and long-term debt by financing a portion of its capital construction program from internal sources. Unfortunately, this did not occur. Even before the increase was finalized, in August, 2002, historically high natural gas prices and higher than anticipated costs in several other areas quickly reduced PGW's revenues and cash flow while

⁸ *Petition of PGW For Extraordinary Rate Relief Pursuant to 66 Pa. C. S. § 1308(e)*, R-00017034F0002, April 12, 2002 (hereinafter, "*PGW Extraordinary Rate Order*").

⁹ *Pa. PUC v. PGW*, R-00017034, August 8, 2002 (hereinafter, "*PGW 2002 Base Rate Order*"); PGW St. 2 at 2-3. The settlement was a "black box" settlement in which there was agreement only on the overall increase. See, *Joint Petition for Settlement of PGW Base Rate Proceeding*, R-00017034, June 28, 2002, ¶ III(2). The settlement also permitted PGW to implement a "Weather Normalization Clause" which protects the Company from losses caused by warmer than normal weather, and protects the customer from additional payments when the weather is colder than normal, but does not address lost sales from conservation or load loss.

increasing its uncollectibles.¹⁰ For example, in FY 2003, the Company's collections dropped to a historically low 86.60% (compared to its longer-term historic rate of approximately 92%); this translated into more than \$40 million in lost revenues and the drop put the Company in danger of losing its barely investment grade bond rating. The Company responded immediately by stepping up an internal Collections Initiative that was already in progress and taking other steps. These various efforts were successful and in FY 2004 PGW realized a 91.41% collections rate which improved to 96.01% in and 96.57% in FY 2005 and 2006, respectively, thus dramatically improving the collection rate and doing so at a time of record high commodity costs.¹¹

However, the drop in collections combined with the over \$200 million increase in natural gas expense since the FY 2001 period (the test year used in PGW's last, fully litigated base rate proceeding) eliminated virtually all of the cash working capital generated by the base rate increases, significantly increased bad debt expense¹² and contributed to a significant reduction in sales; the losses in sales were worsened by reduced population and slowing industrial growth in Philadelphia and improved customer energy efficiency.¹³ As a result, PGW's current test year sales margin – the difference between the total customer charges and the cost of natural gas included in the rate – is some \$39-40 million less than the margins authorized in the 2001 and

¹⁰ PGW St. 2 at 3.

¹¹ PGW St. 6 at 2; PGW Exh. RG-1.

¹² See PGW Exh. JRB-16. PGW's allowance for Bad Debt expense in the 2001 rate proceeding was \$55.6 million. *Pa PUC v. PGW*, R-00006042, October 4, 2001 (hereinafter, "*PGW 2001 Base Rate Order*"), Order on Reconsideration, Schedule 1 (Income Statement). Since that time, its actual Bad Debt Expense ranged from \$51.5 million to \$85 million, \$71 million and \$80 million. FY 2006 Bad Debt Expense, reflecting the significant improvement in collections, was \$40.1 million. PGW Exh. JRB-16.

¹³ PGW St. 2 at 4-6.

2002 rate cases.¹⁴ Sales margin is the portion of PGW's charge from which PGW must recover all non-gas expenses and obtain debt service coverage, cash working capital and internally generated funds. Additionally, PGW has suffered a continued material increase in several expenses, including debt service costs (an increase of \$16 million) and health and pension costs (\$11.5 and \$13.7 million increases, respectively).¹⁵ Overall, PGW's operating and maintenance expenses and depreciation have increased approximately \$29 million since its last fully litigated case in 2001.¹⁶

These factors have led to two very troubling facts. First, PGW's current rates produce no cash working capital. All of its liquidity – the dollars needed to pay its bills when due prior to receipt of revenues – is being generated by borrowing, by the almost continual issuance of tax-exempt commercial paper. Indeed, because of the dramatic increase in its cash flow needs caused by the hikes in natural gas prices¹⁷ PGW was not only unable to reduce its commercial paper borrowing limit, as it had hoped to do at the conclusion of its 2002 rate case,¹⁸ but had to increase the limit in order to meet its day-to-day obligations. In fact, the last increase in the commercial paper borrowing limit (from \$100 to \$150 million) in January, 2006 came days

¹⁴ See PGW Exh. JRB-3; PGW Exh. JRB-11.

¹⁵ PGW St. 2 at 4; PGW Exh. JRB-3.

¹⁶ *Id.*

¹⁷ While PGW receives a "dollar for dollar" recovery of its natural gas costs through its Gas Cost Rate (GCR), it receives these payments on a rolling 12 month basis. As a result, PGW is continually required to find the funds from other sources to pay its gas bills – obligations which are immediately payable – when they come due. In addition, PGW does not directly recover the natural gas costs that customers do not pay but only receives compensation for them through its allowance for bad debt expense in base rates. Tr. at 519.

¹⁸ *PGW 2002 Base Rate Order*, ¶ 6.

before PGW would have otherwise defaulted on a natural gas supply bill.¹⁹ Reliance on such borrowing is not only risky but expensive – one must wonder whether it will always be available when needed and, if so, at what price?

The second serious result of the combined effects of record high gas prices and increased expenses was the inability to finance any portion of PGW's capital program from internally generated funds. PGW must spend at least \$60-70 million annually simply to maintain the safety and reliability of its gas distribution and storage systems and to meet customer load growth requests.²⁰ While PGW has cut back its construction budget to only the essentials needed to *maintain safe and adequate service*,²¹ PGW needs to rely exclusively upon the issuance of long-term debt to fund these necessary construction costs, which, unfortunately, results in increased costs for ratepayers. When all such work is paid for with long term debt, every dollar used for safety, reliability, or adequacy of service in the capital program costs the customer, excluding transaction costs associated with the bond sale, one dollar and fifty cents because of the multiplier effect of the bond covenant.²² In addition, of course, PGW's debt-to-equity ratio is extremely high – 83% in the test year, where it has been since FY 2005, and without rate relief, the percentage of PGW's plant-in-service funded by debt will reach 89% by FY 2012.²³ This level of debt not only imposes enormous costs on customers in the form of additional debt service and coverage requirements, but also creates risk that needed improvements will not be

¹⁹ PGW St. 3 at 9; Tr. at 549-51.

²⁰ PGW St. 2 at 5.

²¹ PGW St. 5 at 11-14.

²² PGW St. 2 at 12-13.

²³ *Id.* at 5.

possible if the Company is denied access to the capital markets.²⁴ At those levels of debt to equity, the willingness of lenders to provide the funds required when needed and in the amount needed becomes more and more questionable.

These dual ailments – the lack of adequate cash working capital and the overdependence on long term debt – have caused the rating agencies to continue to view the Company with serious concern, even while there have been some positive statements.²⁵ Whether the Company will be faced, once again, with a financial crisis of the kind that required the grant of extraordinary rate relief in 2002 will turn largely on the outcome of this proceeding.

Mr. Krellenstein explained:

The Baa2 (Moody's)/ BBB- (S&P) /BBB- (Fitch) ratings, in addition to the "negative" outlook still in place by S&P, imply that PGW has minimal ability to withstand any significant adverse event without the potential for dropping below investment grade by one or more of the rating agencies. The shift to stable outlook by Fitch earlier this year reflects that agency's perception (with which I agree) that management has stopped the further erosion of the company's financial position and begun a turn-around. *But, it is also premised on the belief that the utility must and will receive adequate rate relief from regulators.* Should a rate decision be made that is considered to be adverse to the utility's financial operations and expectations for improved liquidity, it would be reasonable to assume that all three rating agencies might put PGW on "credit-watch" and/or downgrade them shortly thereafter,

²⁴ PGW St. 3 at 13-14, 16-17; PGW St. 3R at 12.

²⁵ "For example, in its August 30, 2005 report (Exhibit BB-1), Standard & Poor's, which rates PGW's long-term credit rating as BBB- with a Negative Outlook, noted 'PGW's liquidity remains marginal despite annual transfer-payment forgiveness from the city of Philadelphia'(Exhibit BB-1, p.2). In its January 20, 2006 report (Exhibit BB-2), S&P comments upon PGW's practice of using unexpended bond proceeds to meet ongoing working capital and debt service requirements: 'This practice points to the general insufficiency of cash flows to meet ongoing operational and debt obligations' (Exhibit BB-2, p.2)." PGW St. 3 at 10. PGW was recently upgraded by one half (*i.e.*, from BBB- to BBB) by Fitch but that was on PGW's 1975 bonds and essentially represented a correction of a misimpression concerning the status of those bonds. Tr. at 575.

resulting in significantly higher costs for both the utility and its customers or additional adverse consequences.²⁶

Barbara Bisgaier, the Company's financial advisor who interacts with the investment community and the rating agencies on behalf of PGW on a continuous basis,²⁷ described the current view of the Company by the investment community and the rating agencies in similar terms:

For the past five years, PGW has been on the brink of losing its investment grade credit ratings. It has not done so because minimum rating agency requirements related to debt service coverage, cost controls and cash collections have been met. While the management improvements that resulted in cost controls and substantially improved cash collections have been important in the maintenance of the investment grade credit rating, the availability of a variety of one-time funding sources have, in my opinion, masked the systemic fiscal condition of PGW and, from the perspective of the rating agencies, bought PGW more time. The rating agencies are sensitive to the fact that their action in making a utility non-investment grade will have grave and spiraling consequences. Therefore, without compromising their own standards, they are willing to acknowledge the benefits of one-time fixes, especially if those one-time fixes buy time in which to make planned systemic improvements. *I believe they are now anticipating that systemic improvements will be immediately forthcoming.* In the case of PGW, major "fixes" such as the support of the City of Philadelphia with the \$45 million loan and the annual payment deferral were given enormous weight by the rating agencies since these benefits were viewed as tax-based support by PGW's owner. However, *these one-time strategies have been substantially exhausted.* In the immediate future, PGW will, therefore, be judged by the rating agencies based both on its own systemic ability to provide internal liquidity and on a capital structure that is indicative of fiscal health.²⁸

²⁶ PGW St. 4 at 6-7 (emphasis supplied).

²⁷ PGW St. 3 at 2-4; Tr. at 771.

²⁸ PGW St. 3 at 14-15 (emphasis supplied).

In summary, while the Company has made significant strides in the last several years, and has reduced certain costs and improved collections, external forces have put it at a point where it must receive substantial rate relief in order not merely to continue that progress, but to prevent an erosion of that progress and a more serious financial crisis that will be painful and costly for the Company, its customers, and the Philadelphia region in general.

B. The Public Utility Code Dictates That PGW's Rates Be Set Using The Cash Flow Method, As Defined In The Management Agreement Ordinance, And That Its Rates Be Set At Levels That Guarantee The Satisfaction Of All Of Its Bond Covenants.

At this point in PGW's history with the Commission, nearly seven years since the Company first became subject to the PUC's jurisdiction and after multiple rate orders, the ratemaking standards applicable to PGW should be abundantly clear to all. Section 2212(e) of the Public Utility Code clearly provides that, "notwithstanding any other provision of the Code to the contrary", the PUC must use PGW's pre-PUC ratemaking methodology and requirements to establish PGW's rates.²⁹ As the Supreme and Commonwealth Courts have repeatedly explained, and the Commission has acknowledged, that required methodology is the Cash Flow Method as

²⁹ 66 Pa. C.S. § 2212(e).

outlined in the City of Philadelphia's Management Agreement Ordinance.³⁰ Succinctly, the Cash Flow Method sets rates "by tailoring them to [the Company's] anticipated need for cash."³¹

There is no disagreement (nor could there be) that the Cash Flow Method is PGW's prior ratemaking method. This method is defined in or "established" by Section VII of the Management Agreement Ordinance.³² At the time of the enactment of § 2212(e) (as well as today),³³ Section VII required, in pertinent part, as follows:

(1) The Gas Commission shall fix and regulate rates and charges for supplying gas to customers . . . which . . . will, in each fiscal year produce revenues, at a minimum:

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

...

³⁰ *Public Advocate v. Philadelphia Gas Com'n*, 674 A.2d 1056, 1058-59, 1061 (Pa. 1996); *City of Philadelphia v. Pa. Public Utility Com'n*, 829 A.2d 1241, 1245 (Pa. Cmwlth. 2003); *Action Alliance of Senior Citizens of Greater Philadelphia v. Philadelphia Gas Com'n*, 406 A.2d 1155, 1156-57 (Pa. Cmwlth. 1979); *Pa. P.U.C. v. PGW*, Docket No. R-00006042, Opinion and Order (October 4, 2001) ("2001 Order") at 14-15. *The Management Agreement Ordinance*, including all amendments through 1995, is set forth in PGW Rejoinder Exhibit 1 (Bogdonavage). This is the same version of the Management Agreement that was introduced into the record in 2001. See, Testimony of Thomas E. Knudsen, Exh. TEK-2 (R-00006042). A complete copy of the Management Agreement Ordinance, with a complete legislative history, and all amendments through June 30, 2000 (the effective date of section 2212 of the Gas Choice Act) is attached as Appendix "D" to this Brief.

³¹ *Action Alliance*, 406 A.2d at 1156.

³² *Action Alliance*, 406 A.2d at 1158; *Public Advocate*, 674 A.2d at 1058; *City of Philadelphia*, 829 A.2d at 1245 ("PGW's revenue requirements are identified in the Management Agreement Ordinance referenced above. Specifically, Section VII(1) . . . The PUC acknowledged the significance of the Management Agreement Ordinance . . .")

³³ As noted during the hearings (Tr. at 526-27) the PUC's 2001 rate order quoted from Section VII of the Management Agreement Ordinance but utilized the original, 1972 version which had been since amended. As also noted, the amended version of the Management Agreement (with amendments through 1995) had been placed into the record in that prior case. PGW's Rejoinder Exhibit 1 reflects the Management Agreement as amended through 1995 because no subsequent amendments have dealt with section VII. PGW has attached copies of the amendments that were made to the Management Agreement Ordinance from 1995 through June, 2000 in Appendix D.

(b) Sufficient also . . . :

(i) To make base payments to the City in the aggregate annual principal amount of . . . ;

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

(iii) To provide cash, or equivalent, for working capital in such reasonable amounts as may be determined by the Company to be necessary and as shall be approved by the Gas Commission.³⁴

The OTS suggests that the Commission's Order in PGW's 2001 base rate case offered less than a full endorsement or acknowledgement of the mandatory ratemaking formula in Section VII of the Management Agreement.³⁵ Further, the OTS contends that the Commission's consideration of the revenue requirements enumerated in Section VII is permissive, not mandatory.³⁶ The 2001 Order supports neither of these propositions, and, more importantly, both are wholly inconsistent with § 2212(e), the Cash Flow Method, and the applicable case law. The Order states:

We note that PGW's Management Agreement sets forth specific categories of expenses and revenues that *are to be included* in PGW's rate setting process. The Commonwealth Court has determined that this Agreement specifies the Cash Flow Method as the ratemaking formula for establishing PGW's rates. The Commonwealth Court in *Action Alliance* ...has deemed the above process of fixing rates as the Cash Flow Method.

...

³⁴ PGW Rejoinder Exh. 1 (Bogdonavage); App. D, hereto.

³⁵ OTS St. 1-SR at 4.

³⁶ OTS St. 1-SR at 5 ("Because working capital is contained in the Management Agreement Ordinance, the Commission *may* consider a reasonable level . . .") (emphasis added).

For the purposes of this ratemaking issue, the General Assembly clearly directs the Commission, in Section 2212(e) of the Act, to set rates in a base rate proceeding for PGW in accordance with its previous ratemaking methodology and requirements In this instance, the previous ratemaking methodology, *as contained in PGW's Management Agreement* and affirmed by the Pennsylvania courts, is the Cash Flow Method.³⁷

As this excerpt reflects, the Commission plainly: (1) recognized the Cash Flow Method as the prior ratemaking method; (2) acknowledged that the Cash Flow Method is comprised of the formula of the specific revenue requirements identified in the Management Agreement Ordinance; and (3) declared that all of those revenue requirement items specified in the Agreement must be included in PGW's rate setting process. These are not revenue needs that "may" be considered by the Commission but revenue need that "are to be included" and must be accounted for in setting the Company's rates³⁸ – at just and reasonable levels.³⁹

Recently, Commonwealth Court acknowledged the Commission's proper recognition and consideration of the Management Agreement and its revenue requirements in its review of the

³⁷ *PGW 2001 Base Rate Order* at 14-15 (emphasis added).

³⁸ *Id.* at 14. Notably, both Section VII(1) of the Management Agreement and § 2212(e) state the respective agencies' ratemaking obligations in mandatory directives, using "shall." The distinction between "shall" and "may" was famously detailed in *Lane v. Hartford Accident and Indemnity Co.*, 6 D.&C. 4th 537, 538 (Dauphin 1990), :

While many words in our wonderful language are ambiguous, it is difficult to . . . construe "shall" into "may." It is worth remembering that this seemingly small, modest word "shall" has, at times in the past, been the pivot upon which the hopes and dreams of whole empires have turned. Whether one considers MacArthur's ringingly famous promise of eventual triumph after the fall of the Philippines, "I shall return!" . . . this word has universally been regarded as a statement of the positive and the unequivocal, not the conditional or the variable.

³⁹ The Commission has never held – nor could it – that it may simply refuse to award a rate increase proven to be justified due to some vague notion that the result would not be "just and reasonable," anymore than it could do so for an investor-owned utility.

2001 Order in *City of Philadelphia v. Pa. Public Utility Com'n*, 829 A.2d 1241 (Pa. Cmwlth. 2003). The Court explained:

PGW's revenue requirements are identified in the Management Agreement Ordinance referenced above. Specifically, Section VII(1) of the Management Agreement Ordinance provides that non-municipal service gas rates shall be fixed so that project revenues will be at least sufficient to cover enumerated expenses for each fiscal year. The enumerated expenses include all operating and maintenance costs, interest and amortization of debt, general expenses, payments to the City, debt reductions and capital additions, working capital, and non-cash expenses included in estimates of revenue requirements. The PUC acknowledged the significance of the Management Agreement Ordinance and analyzed its relevant provisions.⁴⁰

Here again, the Commonwealth Court's decision plainly holds that the Cash Flow Method entails a mandatory consideration, and reasonable allowance for in rates, of all of the revenue items enumerated in Section VII(1) of the Management Agreement. While addressed in greater detail below, one of the requirements that PGW's rates "shall" be fixed so as to ensure revenue "at least sufficient to cover"⁴¹ is the need "to provide cash, or equivalent, for working capital in reasonable amounts."⁴²

Equally flawed is the suggestion, made by the OTS and others, that the Cash Flow Method only requires the Commission to set rates to meet only one criteria: the Company's minimum debt service coverages.⁴³ The Commission has never taken this position, nor could it

⁴⁰ *City of Philadelphia*, 829 A.2d at 1245 (emphasis supplied).

⁴¹ *Id.*

⁴² *Public Advocate*, 674 A.2d at 1059 (quoting Section VII(1)(b)(iii)); PGW Rejoinder Exh. 1 (same); App. D, hereto.

⁴³ *See, e.g.*, OTS St. 1-SR at 3, 5 ("The Commission has determined that the Cash Flow Method is to enable PGW to meet its minimum debt service coverage and operating and maintenance expenses . . . The Commission has indicated that this methodology allows for the use of minimum debt service coverage in establishing just and reasonable rates"); Tr. at 916.

lawfully. As indicated in the PUC and Commonwealth Court decisions cited above, all of the revenue requirement items identified in Section VII(1) of the Management Agreement must be provided for in rates. Ensuring that PGW has sufficient revenues to pay its debt service for each fiscal year is just one of these requirements. Moreover, as the requirement is that PGW must be assured that it will meet its debt service coverages, the level of revenues permitted must provide sufficient cushion to make sure of that result.

This conclusion is also consistent with the past application of PGW's prior ratemaking methodology by the Philadelphia Gas Commission ("PGC"). The PGC consistently rejected contentions that it should abandon or ignore particular requirements of the Cash Flow Method, most particularly an allowance for cash for working capital. For example, in a 1983 PGC proceeding, the PGC indicated that

Public Counsel witnesses . . . set rates by determining PGW's revenue requirement based on a debt service coverage recommendation . . . and, then, test whether those earnings provide adequate cash-flow to PGW, to cover all requirements of the Management Agreement . . . utilizing an accrual method of accounting."⁴⁴

The PGC rejected this debt service approach in recognition of its obligation to set rates sufficient to cover all items contained in Section VII of the Ordinance/Agreement, including an allowance for cash working capital.⁴⁵ Section 2212(c) compels that this clear explication of PGW's prior ratemaking methodology be adhered to by the Commission.

1. The PUC Must Permit PGW To Impose Rates And Charges That Will Enable It To Meet All Of Its Bond Covenants.

⁴⁴ *Philadelphia Gas Com'n*, Adjudication and Order (Sept. 3, 1982) at 8 (*see* App. E, hereto).

⁴⁵ *Id.* at 9.

Separate and distinct from the Commission's application of the Cash Flow Method, Section 2212(e) also directs the PUC to ensure that PGW, through the collection of rates and charges, will satisfy its bond covenants. No party has suggested that the Commission set PGW's rates at a level which will require it to breach its bond covenant regarding its minimum debt service coverage obligations. However, PGW has three relevant bond covenants, not just one. As the Commission recognized in its February 22, 2001, Interim Rate Case Opinion and Order (adopting a settlement between PGW and the PUC Law Bureau),⁴⁶ PGW must comply with the following bond covenants:

- (1) a covenant that requires PGW to maintain funds that are 150% of its annual debt service obligation [debt service coverage covenant];
- (2) a covenant that requires PGW and its owner, the City of Philadelphia, to charge rates that permit PGW to have sufficient cash to pay all of its obligations, including its debt service obligation, during each fiscal year in full when they are due [rate covenant];⁴⁷ and
- (3) a covenant that requires PGW and the City to continuously maintain and operate the Gas Works.

Accordingly, as a matter of law, the Commission must set rates to provide sufficient revenues to satisfy all of PGW's covenants – including the covenant to have sufficient cash to pay all of its obligations during each fiscal year in full when they are due.

C. Baseline standard – *Pro Forma* Revenues and Expenses at Present Rates

1. Baseline Test Year – FY 2007 Budget

⁴⁶ See *Pa. PUC v. PGW*, R-00005654, Opinion and Order of February 22, 2001 at ¶ 1; Joint Petition for Full Settlement at ¶ 10. *Accord*, PGW Rejoinder Exhibit 2 (Bogdonavage).

⁴⁷ Significantly, this covenant requires the necessary cash to be derived from rates. The reference to the City of Philadelphia, when read in context, was to its role as the entity, through the PGC, that set PGW's rates, and not as a potential source of the cash necessary to meet PGW's obligations.

PGW's proposed baseline standard was its FYE ("Fiscal Year Ending") 2007 Budget adjusted for ratemaking purposes.⁴⁸ The starting point for the test year was PGW's "fully forecasted" FYE 2007 Budget, as approved by the PGC.⁴⁹ The "fully forecasted" budget/test year supporting data are displayed in an exhibit to Mr. Bogdonavage's testimony⁵⁰ and is equivalent to the "fully forecasted" future test year typically used by the PUC to calculate a revenue requirement for an investor-owned utility.

2. Pro Forma Revenues

The FY 2007 Budget included a forecast of "normalized revenues" which were supported by the testimony of PGW acting Chief Operating Officer Craig White.⁵¹ Only one adjustment was proposed to PGW's proposed *pro forma* test year revenues, by OTS witness Kubas, to increase the *pro forma* level of the average residential heating customer usage projected for the test year.⁵² PGW accepted this adjustment with one modification,⁵³ to which the OTS subsequently agreed.⁵⁴

⁴⁸ PGW's original baseline *pro forma* Test Year Income Statement was shown on PGW Exhibit JRB-1. A revised baseline calculation at present rates was submitted in rebuttal on PGW Exhibit JRB-13A. Exhibit JRB-13B shows the *pro forma* test year assuming the proposed rate increase (and PGW's proposed retention of off-system sales/capacity release proceeds). Exhibits JRB-13A and 13B reflect a series of adjustments (described in the footnotes "A" through "G" attached to Exhibit 13A and 13B). These adjustments are explained in Mr. Bogdonavage's rebuttal testimony (PGW St. 2R at 39-40) and reflect acceptance of certain adjustments proposed by OCA or OTS to PGW's *pro forma* revenues and expenses (adjustments A, C, E & F), the inclusion of certain adjustments that were inadvertently omitted from PGW's original filing (Adjustments "B", "D") and the inclusion of the *pro forma* effect on PGW's recent, \$200 million bond issuance (Adjustments G & H). The adjustments are explained in Mr. Bogdonavage's Rebuttal testimony, PGW St. 2R at 39-40. Modified versions of these schedules, to reflect the effect of a stipulation on bad debt expense, are attached hereto as Appendix "A".

⁴⁹ PGW St. 2 at 18; OCA St. 2 at 18-19.

⁵⁰ PGW Exh. JRB-2.

⁵¹ PGW St. 5 at 2-9.

⁵² OTS St. 3 at 4-10.

3. Pro Forma Expenses

1. All of the budgeted expenses for the fully forecasted test year were fully detailed in the record.⁵⁵ Except for a limited number of issues discussed below, no party took issue with the use of PGW's approved budget as the starting point for the calculation of PGW's *pro forma* Test Year expenses.⁵⁶ PGW then adjusted the Budget data both to reflect accounting adjustments that became known after the PGC approved its Budget, to normalize certain test year data in accordance with standard PUC practice, or to adjust data to reflect claims that, while denied by the PGC for Budget purposes, were nonetheless considered appropriate by the Company for inclusion in calculating PGW's PUC-approved revenue requirement.⁵⁷

⁵³ PGW St. 5R at 13-15.

⁵⁴ OTS St. 3SR at 2. The agreed to calculation of Mr. Kubas' adjustment is included in PGW Exhibit 13 as well in the final summary schedules presented in App. A, hereto.

⁵⁵ PGW Exh. JRB-2 "Prepared Direct Testimony of Joseph R Bogdonavage (Before the Philadelphia Gas Commission)."

⁵⁶ *See, e.g.*, OCA St. 2 at 18.

⁵⁷ The adjustments made were as follows:

1. Revision to Revenues and Expenses to reflect modified "Soft Off" accounting. PGW St. 2 at 18-19. PGW modified its billing and accounting treatment for natural gas usage recorded at premises where service has been terminated or discontinued but where actual physical shut-off of the potential flow of gas would be prohibitive.
2. PGW adjusted its test year revenues and expenses at present rates to reflect a 96% collection factor as opposed to the 94% rate it had used in preparing its original PGC budget submission. *Id.* This adjustment had the effect of increasing *pro forma* revenues and to decrease *pro forma* bad debt expense at present rates. No one challenged the propriety of this adjustment.
3. PGW also adjusted its PGC-authorized budget to reflect lower pension expense due to revised actuarial expenses. PGW St. 2 at 19-20.

PGW then adjusted its PGC-approved budget to reflect *pro forma* adjustments to account for PUC ratemaking conventions or to "normalize" budget data, to wit:

Of the scores of projections and calculations that make up PGW's *pro forma* Test Year at present rates, only a handful were challenged in any way. Of those, PGW elected to accept several of the adjustments or was able to arrive at a stipulation with the party that proposed it.⁵⁸

The only adjustments to *pro forma* income still at issue have a relatively small impact:

OTS:

Application of Stipulated	
Bad Debt Expense %	\$ 1.2 million
Management Incentive Plan:	\$ 500 thousand
Marketing	\$ 475 thousand
Lobbying	\$ 245.2 thousand
Injuries & Damages	\$ 725 thousand
Advertising	\$ 35 thousand
Regulatory Fines	<u>\$ 50 thousand</u>

TOTAL: \$ 3.2 million

PGW will set forth its position on each of these adjustments, as well as an issue raised by the School District, in the final section of the Revenue Requirement portion of this Brief. As will be shown below, PGW's need for rate increase is amply demonstrated and will not be affected in any material respect even if all of the contested OCA/OTS adjustments to its *pro forma* test year results were adopted by the PUC. However, PGW submits that its revenue requirement should not viewed solely by reference to its future test year, its financial projections should be examined both for the Test Year as well as its five year planning period.

-
1. Rate Case Expense. PGW's estimated rate case expense was included on a 3-year amortized basis, in accordance with PUC policy. *Id.*
 2. Certain prior period, one-time expenses (\$353,000) were removed from the test year because they are not reflective of normal, on-going conditions. *Id.*
 3. Annualized Union Wage Increase. Two union wage increases that will take effect in the test year were annualized to reflect their full, 12-month impact. *Id.*

⁵⁸ The adjustments that were accepted were as follows: 1. Bad Debt Expense (PGW Hearing Exhibit 4); Authority Expense (PGW St. 2R at 36); Merger Expense (PGW St. 2R at 34-35); and Prescription Drug Plan Costs (PGW St. 12 at 9).

4. Examining PGW's Financial Results in both the Test Year and the 5-year planning period is prudent and necessary for a Cash Flow Method regulated company.

All of PGW's financial presentations in this case include the financial results for FYE 2007 – its "test year" in the proceeding – but also for the five-year period FY 2008 through FY 2012. It did this because, while its key revenue requirement needs and standards (i.e., debt service coverage, inadequate cash working capital and unreasonable debt level) are test year based⁵⁹ the appropriate level of rate relief needed to effectively and fairly address these issues is best determined by an examination of PGW's projected financial results over a reasonable planning period. In fact, it will be impossible for the Commission to fully resolve these issues if it looks exclusively at the test year period without consideration of the full five year period.⁶⁰

Determining a utility's revenue requirement needs by examining both test year results and projected future financial or operational performance outside the test year is clearly not prohibited in any way. Indeed, the Commission regularly exercises its discretion to consider "known and measurable" changes projected to occur outside the test year and has never decreed a hard and fast "cut-off" for such changes.⁶¹ In this instance, PGW's five year projections have

⁵⁹ E.g., Tr. at 743-747.

⁶⁰ PGW St. IR at 9.

⁶¹ See, e.g., *Pennsylvania Electric Company, v. PUC*, 467 A.2d 1367, 1373 (Pa. Cmwlth. 1983), affirm'd, 509 Pa. 324, 502 A.2d 130 (1985), ("Commission has a wide area of discretion with respect to the extent and type of adjustments which it [can] make to test year data providing there is substantial evidence in the record warranting its action."); *Bell Telephone Co. of PA v. Pa. PUC*, 105 P. Comwlth. 286, 524 A.2d 1009 (1987) (utility estimates of effect of AT&T Divestiture beyond the end of the test year sufficiently "known and definite"); *PUC v. Citizens Utilities Water Company of PA*, 1996 Pa. PUC LEXIS 164 ("[t]here is, however, an exception to the general rule against rate recovery of out of period expenses. When an expense is found to be 'extraordinary, substantial and nonrecurring', recovery has been permitted."); *PUC v. Philadelphia Electric Company*, 1982 Pa. PUC LEXIS 81; 56 Pa. PUC 191 (Commission allowed the company's claim for post test-year pollution control projects.); *PUC v. Pennsylvania Power & Light Co.*, 1995 Pa. PUC LEXIS 189; 85 Pa. PUC 306 (SFAS 106 change extraordinary, one time event, which occurred outside the test year).

several indices of reliability. The projections are part of a rigorous strategic planning process that the Company undertakes annually and which is reviewed and approved by PGW's Board of Directors as well as the PGC.⁶² The rigor of this process has produced a degree of reliability that is no less than in the various cases, cited herein, in which this Commission has allowed expenditures beyond the test year. It is not produced solely for this rate case and the methodology has been used for years for the purposes of assessing the strategic direction and projected financial status of the Company. Moreover, the forecasted data are based on the fully forecasted test year –as to which the parties have no material issue.

Moreover establishing rates or allowances based upon projections extending beyond the test year is by no means unprecedented; the Commission has granted rate allowances based upon financial and operational projections that have extended 20 years or more into the future. For example electric utilities were permitted by the Electric Choice Act to collect stranded costs based upon a long term (20 years in many cases), net present value analysis of the "known and definite" projected reduced economic value of the utility's generating facilities that was assumed to occur as a result of the allowance of competition.⁶³ In allowing such recovery, the Commission accepted a significantly higher degree of uncertainty with regard to a broader market array of issues than are present here. Even before that, and based upon the Commission's general "used and useful" standard whether an electric utility's new generating facilities were

⁶² PGW St. 2 at 14.

⁶³ *See, e.g., Application of Duquesne Light Company for Approval of Its Restructuring Plan Under Section 2806 of the Public Utility Code, 1998 Pa. PUC LEXIS 196 (August 13, 1998).* (The definition of stranded costs in section 2803 of the Code requires that the costs are: 1) in fact stranded, meaning not recoverable in a competitive market; 2) stranded as a result of the transition to competitive markets; 3) generation related, not transmission or distribution costs; 4) known and measurable; 5) determined over the life of the asset; 6) only a "net" amount; 7) unmitigated; and 8) determined on a net present value as of January 1, 1999).

"used and useful" was analyzed on the basis of the need for the plant both in the test year and in the years in which the rates would be in effect.⁶⁴

Utilizing test year data along with projected planning period data is even more appropriate for a Cash Flow Method-regulated company. As a Cash Flow Method regulated company, PGW's year-to-year revenue requirement needs are related. An increase in an annual cash working capital allowance in one year will have a concomitant and salutary effect in future years – and vice versa.⁶⁵ As explained above, dramatically increased natural gas prices starting in 2002 began to have a negative effect on the Company's cash flow, collections and contribution margins, and continued reliance on debt, culminating in its present severe deficiency. A failure to consider the longer term effects of a particular rate award could result in a decision that will quickly become inadequate – forcing an almost immediate return to the PUC for additional relief. Such regulation with blinders cannot be in the public interest.

However, for one of the most pressing of PGW's financial difficulties – its over reliance on long term debt to fund its capital program, a refusal to consider the Company's financial projections for the next several years could doom the Company to never being able to remedy this fundamental deficiency because the potential harm – the enormous future cost to be imposed on ratepayers and the potential that the Company will be eventually barred from the capital market – will always be an "out of test year" event – until it is too late.⁶⁶ Mr. Hershey explained this in his rebuttal testimony:

⁶⁴ See, e.g., *Pa. P.U.C. v. Pennsylvania Power and Light Co.*, R-842651, 67 PUR4th 30, 1985 Pa. PUC LEXIS 56 [*24].

⁶⁵ See, e.g., Tr. at 743-747.

⁶⁶ *Id.*; PGW St. 1R at 7-10; Tr. at 746.

If, as argued by these witnesses, rate relief could be granted only for a problem that occurred during the test year, most problems could not be resolved when the utility uses the Cash Flow Method of rate making that is mandated for PGW. The Public Utility Code prescribes a nine-month ratemaking process. Using that process and assuming that PGW were to file on the first day of its test year – September 1st is the beginning of PGW's fiscal year – PGW could not expect a decision from the Commission until May of the following calendar year. PGW would then have to collect any allowed increased revenue sufficient to solve the problem in the remaining months of the fiscal year/test year, but those would be the months with the lowest level of sales. There would be no substantial contribution to earnings or cash until well into the late fall or early winter of the following year. By then the fate of the utility would have been sealed. . . .

The Commission should treat PGW's liquidity and debt burden, as well as the forecasted violation of the debt service covenant as known and measurable events and provide the rates now to solve the problem.⁶⁷

The parties dismissed PGW's five-year forecast analysis essentially on two grounds: 1) that the projections were merely estimates and therefore unreliable⁶⁸ and 2) that the standard PUC rate making approach prohibits calculation of a revenue requirement based upon data outside the test year.⁶⁹ First, the parties have mischaracterized PGW's financial presentation; several of the most serious problems are present in the test year.⁷⁰ But suggesting that the Commission should not look beyond the test year to see the projected effects of its action here because the results are merely "projections," is inconsistent with the Commission's established practice of permitting "known and definite" events to be incorporated into the test year. As Mr. Hershey pointed out, both the OCA and the OTS recognized the fact that PGW was scheduled to

⁶⁷ PGW St. 1R at 9-10.

⁶⁸ OCA St. 2SR at 2-4.

⁶⁹ OTS St. 1 at 11.

⁷⁰ PGW St. 2R at 3-4; Tr. at 744-45.

repay the \$45 million City Loan in FY 2008 – and made provisions for that in the rate increase recommendation. PGW's projected debt service coverage deficiency and future long-term debt costs are all just as "known and definite" as the projections of natural gas revenues and expenses in the fully forecasted test year itself.⁷¹

PGW is not arguing that examining test year results should be abandoned – only that those results should be supplemented by the projected results for a reasonable future period⁷² and any solution authorized by the Commission should take account of the effects of the PUC's actions on the Company's financial results over the next several years, starting with the test year. Indeed, PGW submits that it would be unfair to customers if the five-year projections were not part of the analyses of PGW's revenue requirement needs.

D. PGW Has Demonstrated That Its Entire \$100 Million Base-Rate Relief Request is Required Under the Cash Flow Method of Rate Making and Requires a \$70 Million Rate Increase Just to Put the Company in the Same Position That it Was After the PUC Prior Two Base Rate Proceedings.

1. Introduction

As set forth above, the PUC is required to utilize PGW's prior rate making methodology – the Cash Flow Method – in calculating the revenue requirement for PGW's base rates. In contrast to the revenue requirement calculation method used by investor-owned utilities, that sets a utility's revenue requirement to cover expenses and produce a target return on a Commission-determined rate base, the Cash Flow Method is required to set rates to produce revenues to cover all of the Company's operational and financial needs at levels determined by the evidence to be just and reasonable. As noted above, PGW's Management Agreement Ordinance requires that

⁷¹ PGW St. 1R at 7-8.

⁷² Tr. at 576; Tr. at 609-11.

rates be set to produce revenues sufficient to cover expenses, debt service, cash working capital and amounts to fund construction and retire debt.⁷³

PGW has justified its need for a rate increase to cover all of these requirements in two different ways. It has meticulously set forth financial data, supported by expert financial analysts, which show PGW's serious need for additional rate relief to cover all of its expenses, to produce debt service coverage levels that satisfy its bond ordinances, to produce adequate cash working capital and to produce a reasonable debt-to-equity ratio – both in the test year and over the five-year planning period. That analysis shows unequivocally that PGW's \$100 million base rate request is in fact well below the level that it could justify if rates were to be set to fully meet all of PGW's financial needs and requirements. But PGW has also presented another analysis which shows the level of rate increase that is minimally necessary simply to put the Company in the same position that it was in after the PUC's prior two base rate orders, the last being issued of August, 2002. PGW submits that this "prior rate case comparison" analysis provides the minimum level of rate increase that can be justified under the Cash Flow Method. While a rate increase based on this "prior rate case comparison" analysis would not permit PGW to address all of its pressing financial needs, it will provide some improvement to the Company from falling further backwards.

2. An Analysis Comparing PGW's Prior Rate Case Shows that a \$70.2 - \$71.5 Million Minimum Rate Increase Is Justified to Maintain the Company at the Same Position that it was in after the PUC's Prior Two Base Rate Proceedings.

Even though there is relatively unanimity on PGW's *pro forma* Test Year financial presentation, with just \$2-\$3 million separating the parties, (depending upon how the Bad Debt

⁷³ Management Agreement Section VII(a)(i)-(v); (b)(ii)(iii). PGW Rejoinder Exh. 1 (Bogdonavage); Appendix D to this Brief.

Expense stipulation is applied), the OCA and the OTS nonetheless have opposed any substantial increase for the Company and have recommended that it receive just a fraction of its claim – \$22-\$25 million. They reach that conclusion by ignoring test year data and looking at just one issue beyond the test year – repayment of the \$45 million City loan. However, even if one were to include all of the adjustments to PGW's *pro forma* FY 2007 fully forecasted test year which have either been agreed to by the parties or proposed by OCA or OTS, PGW nonetheless would still require a substantial rate increase – \$70-71 million – merely to put the Company in the same financial position as it was in at the conclusion of its last base rate position in 2002. Such an award would essentially just permit PGW to cover all of its increases in expenses since the last case and realize the same amount of previously authorized "contribution margin," which is the source of the income to provide adequate debt service coverages, to provide for cash working capital and, if possible, fund some of its construction program without having to issue long term debt. In essence it is analogous to permitting an investor owned utility to receive a rate increase that gives it the opportunity to earn a cost of equity or overall cost of capital at the same level that was determined reasonable by the PUC in a prior proceeding. While it does nothing to resolve any new problems, or the serious issues just beyond the test year period, thus leaving PGW and its customers still at risk, such an award would at least maintain the status quo. A seemingly irrefutable fact is that, absent some material event or evidence of gross imprudence or mismanagement – not present here – a utility's revenue requirement determination should at the very least maintain the status quo.

Such a comparison approach also brings some regulatory consistency to the process of establishing rates for the Company. Admittedly, there are few well-established "benchmarks" or guidelines to determine definitively the level of reasonableness for items such as "cash working

capital for PGW." However, now that the Commission has made at least two final determinations of revenue requirement for PGW's base rates, the Commission's prior actions, properly analyzed, may serve as a basis for comparison of the adequacy of PGW's present base rates, and can both logically and legally be viewed as the minimum level of rate increase that should be considered in this case.

In its direct case, PGW first presented evidence that calculated that level of increase mandated by examining the results of its prior two base rate proceedings.⁷⁴ In PGW's last fully litigated rate case in 2001 all elements of *pro forma* revenues and expenses were determined, leading the PUC to award PGW a net increase of \$33.6 million in contrast to its request for a \$65 million rate increase.⁷⁵ The level of operating and maintenance expenses, depreciation and interest expense authorized in the 2001 case provides a direct comparison to the levels claimed – and, for the most part, agreed to – by the parties in this case. PGW's comparative exhibit shows that since the 2001 proceeding, PGW's total operating and maintenance expenses and depreciation increased by \$29 million⁷⁶ and its total interest expense increased by \$16.2 million.⁷⁷ These two components, which total \$45 million, are produced entirely from an examination of the 2001 proceeding.

In addition to covering its expenses, and as noted above, PGW's rates must also be sufficient to satisfy its debt service coverage requirements, to produce cash working capital and to finance its construction program. Those dollars come from its allowed "contribution margin,"

⁷⁴ PGW Exh. JRB-3.

⁷⁵ *PGW 2001 Base Rate Order*; PGW St. 2 at 4,11.

⁷⁶ PGW Exh. JRB-3, line 12.

⁷⁷ *Id.*, line 22.

which are the dollars produced from retail rates less the cost of natural gas. In order to fairly represent the level of contribution margin authorized by the Commission in the last two cases, Mr. Bogdonavage combined the contribution margins permitted in the fully litigated 2001 base rate case with the additional amount authorized by the Commission as a result of its subsequent extraordinary rate relief determination in April 2002.⁷⁸ The Extraordinary Rate Decision awarded PGW an additional \$36 million of rate relief specifically to give PGW additional income in order to meet the S&P "fixed charge coverage" requirements, without which PGW would have been downgraded to junk bond status.⁷⁹ Significantly, the extraordinary rate proceeding made no findings concerning any of PGW's test year revenue or expense claims because, by law, the extraordinary rate proceeding is in an interim determination that must be filed as part of a full general rate case.⁸⁰ Accordingly, to avoid understating the level of margin allowed by the Commission in the two cases, Mr. Bogdonavage added the \$36 million to the level of margin authorized in the 2001 proceeding. The result is that when the contribution margins allowed in the 2001 and 2002 rate case are compared to the margins in the 2007 test year, based upon PGW's original filing, those margins decreased by some \$38 million.⁸¹ PGW did not utilize the net income or other revenue or expense items from the final resolution of the 2002 rate case to make its comparison because the final determination in the case was achieved by a "black box" settlement that did not include any specific authorizations for revenues, expenses, appropriate levels of debt service coverage, cash working capital or the like. In fact,

⁷⁸ PGW St. 2R at 17-19; Tr. at 562.

⁷⁹ *PGW Extraordinary Rate Order* at 28-29.

⁸⁰ 66 Pa C.S. § 1308(e).

⁸¹ PGW Exh. JRB-3.

the settlement prohibited the parties from suggesting that any such individual determinations were made.⁸²

The results of comparing the 2001/2002 results with PGW's initial *pro forma* claim in this proceeding was that PGW's rates need to be increase by almost \$80 million⁸³ simply to put he Company in the position it was in after those prior two cases.⁸⁴

In order to update that presentation and to reflect the stipulation that has been entered into between the OTS and PGW regarding the appropriate level of bad debt expense (the largest dollar adjustment made by the OTS or the OCA), PGW has attached Appendix B to this Brief that shows an updated version of JRB-11. This updated version incorporates all of the adjustments to *pro forma* results that are incorporated in Appendix A and makes only one change from JRB-11 – to adjust the bad debt expense included in total operating and maintenance and depreciation to reflect the new (lower) stipulated level.⁸⁵ In addition, and similar to JRB-11, Appendix B reflects all of the adjustments made by OTS and OCA to *pro forma* expenses and revenues, even those that PGW has not accepted, to eliminate controversy and to show the

⁸² Joint Petition for Settlement of Philadelphia Gas Works Base Rate Proceeding, R-00017034, Section III(2) ("the \$36 million settlement award is the result of a compromise and does not reflect or constitute the recovery of any individual expense claim or revenue assumption contained in PGW's *pro forma* test year filing.")

⁸³ PGW Exh. JRB-3.

⁸⁴ PGW updated its JRB-3 analysis in its rebuttal testimony (JRB-11) in order to reflect its revised *pro forma* test year at present rates (reflected in its Schedules JRB-13A) as well as to take account of various adjustments that the parties had made to PGW's *pro forma* claims. PGW Exh. JRB-11.

⁸⁵ App. B, pg. 1. App. B, Page 2 also shows the same analysis calculating the bad debt expense on total gas revenues in order to show the sensitivity of that issue to the ultimate results.

absolute minimum base line level of rate increase that could be considered as just and reasonable in this case even if all of the opposing Parties' adjustments were accepted as valid.⁸⁶

As can be seen, even if every single adjustment to the Company's *pro forma* operating expenses were accepted and all stipulated adjustments were included, PGW's base line minimum rate increase to put the Company in the position it was in 2001 - 2002 is \$70.2 - \$71.5 million.⁸⁷

The OTS did not agree with PGW's "bringdown" approach claiming among other thing that each case "must stand on its own merits" and alleging that it was not appropriate to compare PGW's claims here with those from the previous cases.⁸⁸ But the Commission regularly considers its prior determinations in deciding a case before it.⁸⁹ Indeed, in certain cases it is legally required to follow its prior rulings.⁹⁰ Certainly, if the Commission is going to change its position it must have a good explanation for its change in position.⁹¹ The key point missed by Mr. Plonski is that the "bringdown" is the appropriate standard unless evidence demonstrates that something has changed to make it inappropriate. There is no such evidence in this record.

Mr. Plonski also insisted –without explaining why – that it would be inappropriate to combine net income determinations and instead looked to PGW's projected income statement that was included in the PUC's 2002 Extraordinary Rate Order in order to conclude that a \$25

⁸⁶ PGW St. 2R at 18.

⁸⁷ *Id.*

⁸⁸ OTS St. ISR at 10-11.

⁸⁹ As one example, OTS witness Markovich based her rejection of PGW's preferred method of calculating Bad Debt expense on the Commission's ruling in PGW's last fully litigated base rate case.⁸⁹ OTS St. 2 at 13-14.

⁹⁰ *See, e.g., Philadelphia Electric Co. v. Pa PUC*, 61 Pa. Cmwlth. 3425, 433 A.2d 620 (1981).

⁹¹ *See, e.g. Scott Paper Company v. Pa PUC*, 126 Pa. Cmwlth. 111, 558 A.2d 914 (1987); *Westinghouse Electric Corp. v. PaPUC*, 44 Pa. Cmwlth. 407, 404 A.2d 212 (1979).

million rate hike would provide a greater level of net income to PGW than the Commission authorized in that case.⁹² First, this comment completely fails to address how it could be fair and reasonable to permit PGW only a \$25 million rate increase when its expenses, including interest expense, have gone up by as much as \$45 million and its contribution margins have decreased by \$38 - \$40 million. The only logical conclusion is that Mr. Plonski's recommendation does not provide the same level of debt service coverage, cash working capital and ability to finance construction and debt pay down that the Commission implicitly considered reasonable as a result of the last two cases – yet he has provided no explanation or justification as to how his position could be reasonable.⁹³ Second, Mr. Bogdonavage explained why the allowed income from the 2001 case was properly combined with the extraordinary rate allowance in 2002,⁹⁴ record evidence which is supported by the language in the *PGW Extraordinary Rate Order* itself.

Thus, the \$70-\$71 million result of PGW's prior rate case analysis represents the minimum reasonable result in this case. While it will not fully address all of PGW's needs, it will provide some positive movement in the right direction. For example, a \$70 million rate

⁹² OTS St. 1SR at 11.

⁹³ PGW St. 2R at 19-20. Moreover, Mr. Plonski's reference to the net income levels displayed in the PUC's Order in the extraordinary rate relief petition (OTS St. 1SR at 14) is both legally and factually incorrect. First, as already explained, the final settlement in that case specifically directed that no party had agreed to any specific levels of revenues, expenses (and thus net income) as part of that case. Thus, to cite to any of those levels would appear to be inappropriate. Moreover, Mr. Plonski actually cites the wrong figure in his testimony, referencing net income after City Payment (which is inapplicable) rather than the actual net income figure of \$61.9 million on the schedule. *See, PGW Extraordinary Rate Order*, Sch. 1. But, since the Commission did not make any determinations that that level of income was authorized, saving that determination for the underlying base rate case, which was then resolved by settlement, PGW submits that the only appropriate way to consider the results of the two cases is by combining the contribution margin allowance from both and comparing the specifically allowed expense and interest calculation.

⁹⁴ PGW St. 2R at 17-20; Tr. at 561-562.

increase is projected to permit PGW to reduce its debt-to-equity ratio to 64% by FY 2012.⁹⁵

Accordingly, this minimally acceptable rate increase will begin to address – but not solve – PGW's most serious financial problems.

3. An Item-By-Item Application Of The Cash Flow Method Shows That PGW Has Demonstrated A Need For The Entire \$100 Million Rate Increase Request.

In order to deal reasonably with all of PGW's financial needs, and to put the Company on the right track financially, the PUC needs to set rates to fully address three key issues,

- Provide sufficient revenues to produce debt service coverages that at least meet PGW Bond Ordinance requirements both now and over the next several years;
- Provide sufficient revenues to produce cash working capital from rates which, when combined with other sources of liquidity (such as its commercial paper program) will provide assurances that the Company will be able to pay all of its obligations when due; and
- Provide sufficient revenues to permit PGW to begin to finance its capital improvement program from internally produced cash rather than from long term borrowing.

The Company's proposed \$100 million rate increase (along with the ability to retain the proceeds from off-system sales and capacity release credits) will positively address each of these crucial financial indicators and is thus required under a reasonable application of the Cash Flow Method. In contrast, a \$25 million rate increase does not even give lip service to the requirements of the Cash Flow Method and will do no more than permit the Company to barely cover its expenses and just meet its debt service coverage requirements in the Test Year. By the OCA/OTS's own admission an increase at this inadequate level will simply force PGW to continually file for a series of base rate increases just to survive without dealing with any of the

⁹⁵ PGW Exh. JRB-10. (\$60.M+\$10.0M Scenario.) While the Company would still have no non-borrowed cash working capital in the test year, at \$70 million it would begin to produce internally generated funds from operations in FY 2009. If a \$70 million rate increase were combined with authorization to utilize off-system sales/capacity release proceeds the Company would have 3 days of non-borrowed cash on hand by FY 2009.

systemic financial troubles that have been clearly demonstrated on the record. The problem remains, however, that even a quick succession of rate filings will not completely address the problem so long as this Commission accepts the concept that the test year data and only that data can be examined.

a. Results At Present Rates

(1) Debt Service and Fixed Charge Coverage

While PGW's present rates are projected to permit it to cover its expenses in the test year without unexpected changes, the Company will quickly end up in a financial crisis if it does not here receive substantial rate relief. By Fiscal Year 2008 it will barely be meeting its debt service coverage requirements; in fact the margin of error is so slim – just 1.52x – that without sufficient rate relief from this case PGW would be forced to seek emergency rate relief prior to the end of FY 2008 just to assure that it will finish the year without violating its bond ordinance debt service coverage covenants and suffer a downgrade to junk bond status in FY 2008.⁹⁶ All parties appear to recognize the need to assure that PGW satisfies its bond ordinance debt service coverage requirements.⁹⁷ Without rate relief here, PGW would, in FY 2008, also fall well below the minimum "fixed coverage charge" (1.2x) required by the bond rating agencies in order to maintain an investment grade bond rating.⁹⁸ Again, the parties appear to recognize that it would be extremely bad and costly for the Company and its rate payers if PGW did not meet its bond

⁹⁶ App. A, pg. 3 ("Debt Service Coverage 1998 Bonds"); PGW St. 2R at 7-8; St. 3 at 14-16; (Tr. at 541-42).

⁹⁷ PGW Cross Exam Exhs. 1,2; OTS St. 1 at 7.

⁹⁸ App. A, pg. 3 ("Fixed Coverage Charge"); PGW St. 2 at 6.

covenants and lost its investment grade bond rating.⁹⁹ Yet, in the face of this data the OTS and OCA inexplicably insisted that PGW had not justified any rate increase.¹⁰⁰

(2) Cash Working Capital

Like any operating utility, PGW has a need for cash working capital - a cash allowance to permit the Company to pay its expenses and debt service when they come due in advance of receiving the revenues from customers.¹⁰¹ Unlike other companies that have investors who loan the utility cash working capital – and accordingly pay investors a return on the "loan" by having a cash working capital amount added to utility's rate base (on which they earn a rate of return) PGW has no investors and is not regulated using a rate base. Thus, it must receive its cash working capital from the rates it charges to customers.

To be sure, PGW is NOT looking to ratepayers as the sole source of necessary cash flow. PGW's cash flow statements¹⁰² show that PGW already accounts for and utilizes all sources of cash flow, including depreciation, bond proceeds to finance construction, earnings from investments and the like.¹⁰³ Moreover, to provide supplemental liquidity PGW has a tax exempt commercial paper program, backed by a Letter of Credit that has a \$150 million limit.¹⁰⁴ The Commercial Paper program is designed to help finance the purchase of gas inventories and

⁹⁹ See, e.g., PGW Cross Exam Exh. 3; Tr. at 807-08.

¹⁰⁰ OTS St. 1 at 15; OCA St. 2 at 13. Recall that Appendix A incorporates all agreed upon adjustments to *pro forma* results leaving just a handful of issues – worth \$3 million – to be decided. Accordingly, only by looking solely at the results in the test year and refusing to look at the projected results for any of the following years, could such a conclusion be reached.

¹⁰¹ PGW St. 2 at 7-8; PGW St. 2R at 8-9; PGW St. 3 at 7; St. 3R at 5-6; PGW Cross Exam. Exh. 1, Answer to Question 1(a)-(c).

¹⁰² See e.g., PGW Exh. JRB-13A pg. 2; App. A, pg. 2.

¹⁰³ Tr. at 532.

¹⁰⁴ PGW St. 3 at 6-8; PGW St. 3R at 5-7.

accounts receivables during periods of low collections in the year, and needs to be fully available for that purpose to be effective at the end of each year.¹⁰⁵ Unfortunately, at present rates PGW's liquidity (cash plus commercial paper)¹⁰⁶ is almost fully utilized both at the end of and throughout the year, because PGW has been forced to use its letter of credit as a substitute for cash working capital by "maxing out" its credit card,¹⁰⁷ *i.e.*, having its commercial paper continually utilized almost at maximum levels.¹⁰⁸ The testimony of PGW's financial advisor, Ms. Barbara Bisgaier, explains PGW's precarious financial circumstances as a result:

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

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

PGW's lack of liquidity is perhaps its most severe problem and the one that, if unresolved, is likely to drive PGW into a freefall financial crisis. PGW relies upon four principal sources of liquidity. First and foremost, it relies upon its \$150 million tax-exempt commercial paper program (this program was increased from \$100 million to the current level in January 2006). The commercial paper program was originally established in the early 1980s to provide liquidity to meet seasonal cash flow requirements. While the program is still nominally designed for that purpose, the fact that the total amount of this line of credit remains fully extended for significant periods of the year has

¹⁰⁵ *Id.* Tr. at 554-55; Tr. at 530-31; Tr. at 748.

¹⁰⁶ *See* Tr. at 533; Tr. at 771.

¹⁰⁷ PGW St. 1R at 2-4.

¹⁰⁸ PGW St. 3 at 7; PGW St. 3R at 6; Tr. at 554-55; PGW's average cash balance throughout the year in 2006 and to date for 2007 is negative \$40 - \$57 million, demonstrating that for all but about 30 days during the year it is utilizing its commercial paper program not to address seasonal cash flow needs but also to fund day-to-day operations. PGW Rejoinder Exh. 3 (Bogdonavage); Tr. at 547.

effectively converted the commercial paper into a permanent part of PGW's capital structure and substantially, if not completely, eliminated its utility in providing true financial flexibility. Typically, PGW used to have commercial paper outstanding during the gas-purchase and heating seasons and then retired it fully in May or June of each year as the revenues from the heating season were received. PGW still follows this schedule, however, it is often forced to use one of its other sources of borrowed cash (see below) in order to effectuate the full retirement of the commercial paper each year. Then, PGW must immediately reissue commercial paper so that there is always a substantial balance outstanding by the end of August at the end of PGW's fiscal year. This is my reason for stating that the commercial paper is no longer really a cash-flow management tool but rather a permanent capital borrowing.¹⁰⁹

No single fact could better demonstrate PGW's acute cash and liquidity shortfall than the fact that in January, 2006, PGW - a Company with almost \$1 billion in annual expenses - had on one day just \$4 million dollars of cash available and had reached its available commercial paper issuance limit.¹¹⁰ If it had not been able to convince the consortium of banks that support the commercial paper program to increase the limit on its letter of credit by another \$50 million, PGW would not have been able to make its January debt service payments or to pay a natural gas supply bill.¹¹¹

Illustrating its complete lack of cash working capital, PGW's test year cash flow statement shows that, while it projects it will end the year currently with some \$51.6 million in "Cash" (and just \$40 million of commercial paper available) that cash amount is completely borrowed both by issuing the commercial paper and by utilization of the City loan.¹¹² If both of these obligations were to be paid back, PGW would produce negative \$101.4 million in cash working capital. The \$91.6 million of liquidity (\$51.6 million cash plus \$40 million available

¹⁰⁹ PGW St. 3 at 6-7.

¹¹⁰ PGW St. 3 at 9; PGW St. 3R at 6-7; Tr. at 549-51.

¹¹¹ PGW St. 3R at 7.

¹¹² App. A, pg. 2.

commercial paper) represents just 39 days of cash operating expense obligations.¹¹³ The 5-year forecasted data shows that without rate relief, PGW's cash flow situation will become even worse until, in FY 2011, PGW will not even be in a position to cover all of its expenses for the year, let alone have sufficient cash working capital.¹¹⁴

(3) Pay down of Debt in Capital Structure

A final critical issue looming over the Company is the level of debt in the capital structure. At present rates, PGW is projecting a test year debt-to-equity ratio of 83%, with this level increase to 89% by FY 2012.¹¹⁵

Again, Ms. Bisgaier initially described the problem:

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

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

The only means potentially available to PGW to effectuate such a change is to reduce PGW's debt-to-equity ratio from its current level through a return to a rate structure that produces sufficient internally generated funds so that debt levels may be reduced while capital spending levels are maintained.¹¹⁶

¹¹³ Cash Operating Expenses: (App. A, p. 1 Total Operating Expenses (\$894 million) less depreciation (\$38.2 million) equals \$856 million divided by 365 equals \$2,345 thousand per day).

¹¹⁴ App. A, pg. 2.

¹¹⁵ App. A, pg. 5.

¹¹⁶ PGW St. 3 at 13-14.

The 83% debt level is not only wildly out of synch with municipal gas companies and investor owned utilities,¹¹⁷ it is also imposing enormous long term costs on rate payers – some \$59 million a year, which is expected to grow to \$65 million even if the Company does not issue any more long term debt in the planning period.¹¹⁸ This is far higher than if PGW were able to pay for some or all of its construction internally, given the need to charge customers both for the cost of the debt but also for the debt service (interest plus principal payment) coverage. As a result, customers must pay \$1.50 for the cost of every dollar borrowed to pay for the capital program.

But the biggest concern is that PGW's ability to make capital improvements – which historically amount to some \$70 million a year, and which is crucially necessary to maintain safe, adequate and reliable service – is entirely dependent upon PGW's continued ability to issue long term debt.¹¹⁹ If PGW were not allowed access to the capital markets – because of a downgrade or because the cost of the financing it was able to secure was unreasonably high – the Company's ability to assure safe and adequate service would be severely compromised.¹²⁰

b. PGW's \$100 Million Proposed Rate Increase would address the Company's financial needs in a reasonable manner.

PGW's proposed \$100 million rate increase would address in a reasonable manner all of the elements that must be included in the Company's revenue requirement.

(1) Debt Service and Fixed Charge Coverage

¹¹⁷ PGW St. 3 at 15; PGW St. 3R at 8-12; Exhs. BB-3, 4, 5.

¹¹⁸ App A., pg 1, comparison of 2007 and 2011 Long Term Debt Interest.

¹¹⁹ PGW St. 2 at 5.

¹²⁰ PGW St. 3R at 12; PGW St. 4 at 5-6.

PGW's Bond Ordinance coverage requirements would be 2.75x or above for test year and the 5-year planning period; its fixed coverage charges would exceed 2x, giving the Company the potential that its 1998 bonds – the key financial indicator insofar as coverage is concerned – could be upgraded from the lowest investment grade levels.¹²¹

(2) Cash Working Capital and Liquidity

A \$100 million rate increase will put PGW on the path towards adequacy in this area, but would still leave it far short of any comparable company. PGW financial expert Barbara Bisgaier who advises hundreds of municipal utilities, testified that a minimum standard of liquidity for municipal utilities (cash working capital and short term borrowing) is 200 days.¹²² Even with the entire \$110 million increase in place, PGW would have just 72 days of liquidity available in the test year.¹²³ Indeed, Ms. Bisgaier provided data that showed that of the hundreds of water and multiple service utilities for which she was able to obtain data, including some that provide natural gas service, the days of liquidity reported were far greater.¹²⁴

Moreover, looking at cash working capital only, a \$100 million rate increase would provide PGW with negative \$22.1 million in non-borrowed cash in the test year, becoming positive only in FY 2008 and ranging from \$42 million to \$53.7 of positive cash working capital

¹²¹ App. A, page 8 ("Debt Service, 1998 Bonds").

¹²² PGW St. 3 at 10-11; PGW St. 3R at 8-10.

¹²³ App. A, pg. 7 (total liquidity: \$170.8 [\$50.8M Cash and \$120M available commercial paper] divided by \$2,358 (total operating expenses less depreciation: \$860.8 divided by 365)). In FY 2012 PGW would have 92 days of liquidity even if its full request was granted. App. A, pg. 7 (total liquidity: \$203.8M [\$53.8M + \$150M] Commercial paper available divided by \$2,222 (total operating expenses less depreciation: \$810.9M divided by 365)).

¹²⁴ PGW St. 3R, Exh. BB-3; Exh. BB-4. The latter schedule shows that the average days of liquidity for municipals that provide energy as one of their utility services – including two that provide natural gas – is 691 days. The average days of liquidity for the three municipals that sell natural gas in addition to other services is 653 days. PGW Exh. BB-4A.

thereafter. PGW's Mr. Bogdonavage testified that the Company should have \$55-60 million of non-borrowed cash.¹²⁵ Granting the Company's entire increase will only permit it to come close to that standard.

Both the OCA and the OTS protested the use of days of liquidity, claiming that such a standard is not typically utilized by public utility commissions. Instead, they argued, utilities usually are provided a cash working capital allowance in rates. An allowance that reflects 45 days, or 1/12th of a utility's total operating expenses, they claim, is usually deemed minimally reasonable.¹²⁶ Neither party ever provided any real evidence to rebut Ms. Bisgaier's expert opinion and supporting schedules showing that 200 days was a minimum allowance, but even if the Commission were to use the OTS/OCA suggested standard, PGW still is far from meeting that – when properly calculated. Such a cash working capital allowance is just that – cash produced in rates. As noted, even with the \$100 million rate increase, PGW would nonetheless not produce ANY cash working capital from rates in the test year. If PGW's rates were to be set to permit a cash working capital allowance of 1/12 of total operating expenses – \$110.2 million in FY 2007 using PGW's final summary position, PGW would have to raise its rates by over \$230 million.¹²⁷

(3) Reducing Debt in Capital Structure.

¹²⁵ PGW St. 2 at 7.

¹²⁶ OTS St. 1SR at 26; OCA St. 1S at 10. The PUC has utilized the "1/8th" or 12.5% method to calculate a cash working capital allowance. *See, Pa PUC v. Sunshine Hills Water Co.*, R-912023, 1992 Pa. LEXIS 85[*57] (1992).

¹²⁷ The only way that PGW's cash working capital could be deemed adequate is by counting cash from operations plus cash that the company has or could borrow - but in providing for a cash working capital allowance the PUC has never, to PGW's knowledge, offset a utility's otherwise justified cash working capital allowance by the amount the Company can borrow from some other source. *See e.g., Sunshine Hills Water Co.* supra.

Finally, PGW demonstrated that a \$100 million rate increase would make reasonable strides towards reducing its dependence on long term debt and the percentage of debt in its capital structure. A \$100 million rate increase (plus \$10 million off-system proceeds) will permit PGW to not only avoid additional long term borrowing costs by over \$18 million annually, a reduction that will continue to grow over the next 20 years,¹²⁸ but also to save additional millions by avoiding the 1.5x debt service coverage requirements that ratepayers must remit on such bond debt service. The \$100 million increase is projected to produce a 47% level of debt by Fiscal Year 2012, with the assumption that PGW received the increase for all of FY 2007 (which cannot occur). On a realistic basis, PGW's debt level in FY 2012 is projected to be 54%.¹²⁹ Such an achievement would finally put the Company on solid financial footing. Ms. Bisgaier described this goal:

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

A. In order to remain a viable entity, PGW must achieve and maintain a capital structure which is much less heavily weighted with debt. Absent the balance and implicit financial health from an improved debt to equity structure, PGW will continue to lurch from fiscal crisis to fiscal crisis. I fully support PGW's goal of a debt to equity (fund balance) ratio of 50%/50%. I reach this conclusion not because this goal is implicitly or objectively correct, but because that is the condition PGW will be in 2013 if requested rate relief is granted (see JRB-1). A 50%/50% debt to equity ratio will be indicative of a successfully implemented financial strategy, an achievement I believe the rating agencies are anticipating. Such a financial strategy involves a multi-year strategy pursuant to which PGW is able both to eliminate short-term borrowing (except for seasonal cash flow purposes) from its permanent capital structure, materially reduce its reliance upon debt-funded capital and produce internally generated cash on hand.¹³⁰

¹²⁸ Compare, App. A, pg. 1 (Interest-Long-Term debt – FY2012) with pg. 6.

¹²⁹ PGW Exh. JRB-10.

¹³⁰ PGW St. 3 at 15-16.

c. *Conclusion*

Looking individually at the key elements of PGW's Cash Flow Method calculation, such an increase would finally put the Company on firm financial footing, as explained by Ms.

Bisgaier:

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

A. The Company will finally be in a "going concern" mode and be stable enough so that it would be able to weather short term crises without having to contemplate drastic steps that could threaten its ability to continue to provide safe and adequate service. A "going concern" state would also allow the City to seriously consider whether other ownership options would be better for it, PGW itself and its customers.¹³¹

Importantly, the Company voluntarily proposed a regulatory control to give the Commission assurance that, if it granted PGW the tools to extricate itself from its financial difficulties, it would not collect any more in rates than it needed to achieve its targets. Mr. Bogdonavage testified that PGW would agree to a provision in the Commission's order that would require it to voluntarily file a rate review when it achieved a 50% debt to equity ratio. At that time the Commission could determine the rate level that was needed to maintain PGW's level of debt at that level and make rate adjustments as appropriate.¹³²

4. The Recommended \$25 Million Rate Increase Proposed by OTS and OCA Is Demonstrably Inadequate, Not Consistent With the Requirements of the Cash Flow Method and Would Lead to Immediate Additional Rate Requests and Negative Reactions From the Investment Community

Both the OCA and the OTS recommended that PGW be permitted to implement just a \$22.5 - \$25 million rate increase, even claiming that the Company's test year data did not justify

¹³¹ PGW St. 3 at 17.

¹³² PGW St. 2 at 18.

any increase and that only if the payoff of the \$45 million loan in Fiscal Year 2008 were considered as an out-of-period adjustment could even this minimal amount be justified.¹³³ But both of these positions utterly fail to actually apply the PGW Cash Flow Method, or simply ignores key items. Adopting these recommendations would create enormous financial risk for the Company and its customers, force PGW to have to file another base rate case almost immediately and would likely subject it to a reevaluation of its bond rating, which could lead to a disastrous downgrading to non-investment level.

Both OCA and OTS focused on only one of the several requirements of the Cash Flow Method – setting rates to meet its minimum bond indenture debt service coverage requirements.¹³⁴ Even then, these parties apparently concluded that if PGW just met the required debt service coverage levels in the test year – no matter how marginally – and if PGW had any cash at the end of the year, the Cash Flow Method and PGW's bond covenants were satisfied. But PGW demonstrated that the OCA/OTS recommendation only satisfies even these bare minimum debt service coverage requirements for a limited time. If it only receives a \$25 million rate increase, PGW will fall below the 1.5x debt service coverage requirement by FY 2009-2010, and will fail to earn the 1.2x minimum for an investment grade utility at that time.¹³⁵ Indeed, the coverages produced by this level of increase will be so close to the minimum floor in FY 2008-

¹³³ OCA St. 1 at 27; OTS St. 1 at 16-17; OTS St. 1R at 28-31.

¹³⁴ OTS St. 1 at 15-16; OCA St. 2 at 12-14.

¹³⁵ PGW Exh. JRB-8. App. C, hereto. PGW has included as Appendix "C" an updated version of Exhibits JRB-8, which modifies the JRB-8 presentation only to take account of the OTS/PGW bad debt expense stipulation. While this schedule calculates bad debt expense on a "total revenue basis" for simplicity, none of the results would be changed materially if the schedule calculated bad debt expense on a "gas revenue" basis only.

2009 (1.79x)¹³⁶ that the Company would have to file for a rate increase in FY 2007-2008 in order to be completely assured that it would have sufficient revenue to meet its bond requirements in that year. *This level of risk is not one that investors tolerate, not one that the Commission should endorse, and not one that PGW's customers should have to endure.*

But the recommended \$25 million increase is even more unreasonable when one considers the amount of cash working capital and liquidity such an increase would produce (or, more accurately, not produce). At a \$25 million rate increase, PGW projects that it would have \$50.3 million of cash outstanding at the end of the FY 2007 test year¹³⁷ all of which will have been borrowed, meaning that the only way PGW could produce cash working capital would be by sacrificing a significant portion of its short term borrowing capacity.¹³⁸ The \$50 million of "cash" therefore is an illusion. If the Company paid off all sources of short term borrowing, its cash balance at the end of the fiscal year would be negative \$57.7 million and this would only get worse with the passage of time.¹³⁹ The conclusion: 100% of PGW's cash from operations is borrowed; PGW's rates, even with a \$25 million rate increase would not include any cash working capital allowance and would, by FY 2012, leave the Company worse off than today.

As explained above, no utility company – or, indeed no company of any kind – can successfully operate if its operations do not contain an internally generated cash working

¹³⁶ See, App. C, pg. 3.

¹³⁷ *Id.* at pg. 2.

¹³⁸ *Id.*

¹³⁹ PGW Exh. JRB-8, App. C, pg. 2 (Cash Flow Statement). At a \$25 million rate increase, PGW's cash working capital position would improve only marginally moving forward: FY 2008: negative \$49.2 million; FY 2009: negative \$24.1 million; FY 2010: negative \$20.3 million; FY 2011: negative \$39.1 million. In FY 2012 it would plunge to negative \$76.2 million. *Id.*

capital.¹⁴⁰ When a company must borrow 100% of its cash working capital needs, it not only imposes costs upon ratepayers (who must pay the interest and bank fees on the perpetually outstanding commercial paper) but also robs the Company of crucial liquidity, putting the company in an extremely perilous position. Essentially PGW is "robbing Peter to pay Paul," in Mr. Hershey's allusion, pay-day lending exemplified on the corporate level and, as a result, PGW's total liquidity position is significantly below what is necessary.¹⁴¹ Using a monthly cash flow analysis, Mr. Bogdonavage showed this by modeling what would happen if natural gas prices returned to Hurricane Katrina/Rita levels. A \$25 million rate increase would leave PGW \$2 million short of the necessary liquidity it needs (i.e., cash plus commercial paper) to pay its obligations in January 2007 and \$13.1 million short in January 2008.¹⁴² Importantly, this cash deficiency at the end of January is after PGW has utilized all its available short term borrowing; in other words, in these scenarios PGW would have no source of cash working capital available to pay its bills, other than the "last ditch" alternatives, which amount to selling one's car to pay the rent. How can this result be prudent or reasonable?

The OCA and OTS seemed to dismiss this evidence primarily by denying that PGW has any right to cash working capital in the first place. OTS witness Plonski first testified that a cash working capital allowance was not even part of a revenue requirement established using the Cash Flow Method.¹⁴³ When PGW's rebuttal testimony explained that, unlike the Cash Flow Method employed for some other companies, its Cash Flow Method included a specific allowance for

¹⁴⁰ See, e.g., PGW St. 3 at 10; PGW St. 3R at 5.

¹⁴¹ PGW St. 2 at 14-15; Tr. at 602; 744-45.

¹⁴² PGW Exh. JRB-9B; PGW St. 2R at 9.

¹⁴³ OTS St. 1 at 6.

cash working capital, he continued to claim that such an allowance was "discretionary" and that, in any event PGW would have plenty of "working capital" under his recommendation if it simply took steps such as selling gas assets or accounts receivable, or utilizing the proceeds from its capital fund.¹⁴⁴

But PGW showed that Mr. Plonski had interpreted an out of date version of the Management Agreement Ordinance (the City Ordinance that, according to the Public Utility Code Section 2212(e), mandated the elements of the Cash Flow Method) and misunderstood that, for PGW, a specific allowance for cash working capital is mandated.¹⁴⁵ Moreover, PGW's witnesses showed that forcing the Company to do things like selling natural gas inventories or accounts receivable frankly makes no sense- such action would force PGW to sell its source of revenue, only to require repurchasing that source¹⁴⁶ and that its bond fund can not, except in limited, short term circumstances be used for cash working capital needs and must be repaid before the end of the fiscal year.¹⁴⁷ In any event, resorting to such devices (and especially after this Commission refused to recognize PGW's legitimate needs) would send a disastrous signal to the investment community that PGW was a company "lurching from crisis to crisis and... always at risk [of failure]."¹⁴⁸

The OCA, on the other hand, simply pointed to the \$50 million in "cash" that PGW projected it will have at year end Fiscal Year 2007, and declared this level adequate without

¹⁴⁴ OTS St. 1-SR at 5.

¹⁴⁵ Tr. at 526-28.

¹⁴⁶ Tr. at 534-40 (Bogdonavage).

¹⁴⁷ Tr. at 539; (Accord) Tr. at 750.

¹⁴⁸ Tr. at 751-52.

referring to any quantifiable standard.¹⁴⁹ In fact, as explained above 100% of this year end cash, as well as its net cash balances throughout the year, except for a few days, would be borrowed. As noted, borrowed cash working capital does not meet the Management Agreement requirement for an allowance in rates of revenues sufficient to produce a reasonable amount of cash (or equivalent, i.e., short term investments) for working capital. It simply means that PGW has less available short term borrowing, resulting in an inadequate overall level of liquidity.

Even if one were to put this fatal deficiency aside, the OCA never explained how its recommendations met even the 45 day cash working capital allowance that its own witness posited was a minimally reasonable standard.¹⁵⁰ As Mr. Bogdonavage testified, the 45 days (or 1/12th) of total operating expense method would mean that PGW should have \$112 million of cash from operations at year end.¹⁵¹ Even counting the \$50 million of borrowed cash, the rate increase would have to be greater by \$60 million to meet the standard suggested by the OCA's own witness! None of these discrepancies were ever explained or reconciled.

Finally, and perhaps most important, the OCA/OTS recommendation would do nothing to address PGW's crushing debt burden. The OTS witness refused to even consider this issue, claiming that capital structure was irrelevant when setting rates using PGW's Cash Flow

¹⁴⁹ OCA St. 1R at 9. OCA witness Lelash admitted that he had not performed his own cash flow analysis. PGW Cross Exam Exh. 3; Tr. at 811-12. He also claimed that if PGW needed more cash working capital it should get it from the City of Philadelphia. This argument is addressed in the following section of this brief.

¹⁵⁰ OCA St. 1SR at 10.

¹⁵¹ Tr. 545, \$110 million under the updated schedules; App. A, p.1.

Method.¹⁵² Of course, this is demonstrably untrue; the PGW Cash Flow Method makes specific reference to an allowance in rates for revenues to fund capital projects or to pay down debt.¹⁵³

While the OCA witness frankly acknowledged that PGW's debt level is too high and needs to be reduced,¹⁵⁴ he never reconciled his opinion with the fact that a \$25 million rate increase would produce virtually the same level of capital structure debt – 81% – at the end of the planning period (FY 2012) as it now has.¹⁵⁵ Again, in light of this, how could the OCA's \$22.5 million recommendation be fair or reasonable? Mr. Lelash, for the OCA, did suggest that a 70% level of debt in its capital structure would be reasonable for the Company.¹⁵⁶ While that level, by all indications is still too high, it is interesting to note that PGW would need at least a \$60 million rate increase to achieve that level by FY 2011-12.¹⁵⁷ Mr. Lelash never explained this contradiction.

More troubling, because PGW would be forced to issue additional long term debt in 2009 and again in 2011, a \$25 million rate increase would mean that the Company and its customers would incur an additional \$50 - \$52 million in debt service and coverage requirements¹⁵⁸ by FY 2012 and ratepayers would be forced to pay that additional amount for the next 27 years.¹⁵⁹

¹⁵² PGW Cross-Exam Exh. 4; Tr. at 914-16.

¹⁵³ See Section II.B., *supra*. Mr. Plonski was apparently unaware of this provision when he prepared his testimony. Tr. at 914-15.

¹⁵⁴ PGW Cross Exh. 1, Answer to Question 20-22.

¹⁵⁵ App. C, pg. 5.

¹⁵⁶ PGW Cross Exam. Exh. 1, Answer to Question 23.

¹⁵⁷ PGW Exh. JRB-10.

¹⁵⁸ Tr. at 745-46. (\$50.4 million based on the revised schedules: App. C, pg. 3).

¹⁵⁹ *Id.*

Again, it is hard to understand how the ratepayers best interests are served by forcing them to incur rate increases of some \$1.4 billion (\$50- \$52 million over 27 years) in order to avoid some \$375 million in rate increases over the next five. The OCA/OTS recommendation is, therefore, not only dangerously deficient, it would be more costly to ratepayers and continue to put the Company at risk that its enormous debt burden will finally close off PGW's access to the long term capital markets, a disastrous result. It is useful to note that even if the Commission believed that a less aggressive goal than PGW's 50% level were more reasonable – for example 62%-64% – PGW's rates would nonetheless have to be increased by \$70 to \$80 million in total to reach that level by FY 2012 on a realistic basis.¹⁶⁰

5. The Parties Suggestion that a Rate Increase Could be Avoided if the City Would Make Additional Contributions Is Impractical, Inappropriate and Illegal.

Rather than deal with the fundamental inadequacy of their recommendation, both OCA and the OTS insist that if PGW needs more funds, rather than a greater rate increase PGW should get them from additional contributions by the City of Philadelphia, either by continuing to waive its \$18 million yearly fee, forgoing the \$45 million loan which must be repaid in FY 2008, or both.¹⁶¹ The implicit suggestion is that the City, as the direct owner of PGW has not done enough to support the Gas Works and has plenty of surplus available to provide additional amounts to avoid a rate increase and has the legal obligation to provide such support. In fact, none of these assumptions is true. Rather than simply respond with unsupported arguments, however, PGW presented the testimony of two leading experts in the financial resources of the City and its relationship with PGW: Joyce Wilkerson, the Chief of Staff to the Mayor and Vice

¹⁶⁰ PGW Exh. JRB-1.

¹⁶¹ OCA St. 1S at 2-3; OTS St. 1SR at 27.

Chair of the Philadelphia Facilities Management Corporation (PFMC), PGW's Board of Directors,¹⁶² and Rob Dubow, Executive Director of the Pennsylvania Intergovernmental Cooperation Authority (PICA) which exercises oversight of the City's financial affairs and reviews and approves 5-year plans prepared at least annually by the City.¹⁶³

Ms. Wilkerson refuted the suggestion that the City has not done enough to support PGW.

In fact, she testified, that since the year 2000:

- the City provided a \$45 million revolving loan in FY 2000 and has extended the repayment date on several occasions without charge. In addition to making such funds available, it has waived any fee or interest on the loan – which would have cost ratepayers \$2-3 million a year or as much as \$27 million by the time the loan is paid back in FY 2008.
- Since FY 2004 the City as "granted back the City Payment" which it has statutory right and obligation to receive.¹⁶⁴ This grant back as provided some \$72 million to PGW since FY 2004; by the time its grant back obligation terminates in FY 2010 (with the payment schedule to be reinstated in FY 2011), the City's total contribution will be \$126 million.¹⁶⁵

Thus, including the forgone interest on the \$45 million loan, the City's total commitment since 2000 and through FY 2011 will be close to \$200 million.

Without these funds, PGW would have required comparable rate increases – or simply collapsed in financial crisis.

Moreover, the suggestion that the City can or should make even more contributions to prop up the Company was effectively refuted by Ms. Wilkerson who testified without contradiction that the City simply cannot afford to make the kind of extensive contributions to PGW that the OCA and OTS are demanding:

¹⁶² PGW St. 9 at 2-3.

¹⁶³ PGW St. 10 at 1.

¹⁶⁴ 66 Pa. CS. § 2212(f).

¹⁶⁵ PGW St. 9 at 5 (emphasis supplied).

While in much better shape than it was several years ago, it should come as no surprise to anyone that the City's finances are very precarious. The City projects a FY 2008 fund balance of \$171 million which will enable it to finish the fiscal year with a balanced budget, as mandated by law, despite a projected operating deficit of \$89 million in FY 2008. Because of projected operating deficits in subsequent years, the fund balance dwindles to \$46 million—just \$1 million above the PICA required minimum—by the final year of the FY 2008-2012 Five Year Financial Plan. While the Five Year Plan does not include an assumption that PGW will resume paying the City Payment by FY 2012 – not because the City has agreed to forego the payment, only because the receipt of the payment is speculative at this point – the budget does not include adequate provision for a host of issues and problems that every Philadelphian understands: a severely underfunded pension fund, City Schools facing a projected \$1 billion five-year deficit, SEPTA's need for additional funding, combating blight and perhaps most importantly, making Philadelphia safe from crime, fire and other disasters.¹⁶⁶

Moreover, Ms. Wilkerson testified that, even if small amounts could be made available, it would be bad policy for the City or its citizens to continue to bailout the Company:

The second reason is that this administration firmly believes that PGW –like other City enterprise funds – should rise or fall on its own merit and not rely on subsidies from other parts of City government. By continually providing loans and foregoing payments, the City is essentially transferring public resources to the gas company. While gas customers are also citizens of Philadelphia, and, for the most part, taxpayers, forcing the City to subsidize gas customers means that PGW customers are insulated from the true cost of receiving gas service. At the same time, the City is deprived of crucial public services and projects, like increased law enforcement and fire protection.¹⁶⁷

Mr. Dubow the Executive Director of the City's budget oversight agency, PICA, confirmed Ms. Wilkerson's testimony:

The risk that PGW poses to the City's general fund is particularly serious because the City's five-year plan is narrowly balanced. It projects that the fund balance will drop to \$82 million next fiscal year and \$46 million by FY 2012 - barely one percent of revenues. PICA's concern about that slim fund balance is heightened because the five-year plan assumes no salary increases beyond its first year, no additional funding for the School District, \$90 million in additional state and federal funding for the Department of Human Services, no increased match for SEPTA in spite of SEPTA's own serious

¹⁶⁶ *Id.* at 6-7.

¹⁶⁷ *Id.* at 7-8.

difficulties, \$30 million in savings from health benefits initiatives that would have to be implemented by the next administration and more aggressive wage tax projections than any earlier five-year plan.

The risks are coupled with ever-increasing fixed costs to make it nearly impossible for the City to reduce its costs without making painful cuts. By 2012, one out of every four dollars the City spends will go to healthcare or pensions costs. The cost of City debt service and funding for prisons has each gone up by 50% since FY 2001.

Since by far the largest portion of the City's costs is for personnel, the only practical option the City has for meaningful reductions in its costs is to cut the number of employees and that is exactly what has happened over the last several years. While some of the cuts have come from support agencies (and those agencies have taken some big cuts), most employees are in key service agencies and those agencies have also taken a hit. From FY 2001 through December 31, 2006, the number of police officers dropped by almost 300 and the number of employees in the Health Department went down by 164. Not surprisingly there have been complaints about both public safety and services at the health centers.

In the FY08 budget, the City proposes cuts to almost every department, including Recreation, Streets, Fairmount Park, the Free Library, and Public Health. In addition, the budget proposes to slash funding to Community College by \$1 million and to the Art Museum by \$250,000

Providing the resources needed by PGW and demanded by other parties in this case would require the City to make even steeper cuts and would threaten to erode the provision of fundamental City services such as police, fire, sanitation and other basic municipal functions. Many of those services, in fact, are already underfunded.¹⁶⁸

Indeed, it would be inappropriate and illegal to set rates here with the assumption that an otherwise necessary rate increase could be avoided by trying to force the owner of the utility to make additional contributions instead. Such an action would be inconsistent with the mandate of the Management Agreement – which plainly requires that the revenues needed to operate the Company come from rates charged to ratepayers – not the City.¹⁶⁹ Indeed, any such required contribution from City revenues now dedicated for other purposes or the forgiveness of the City

¹⁶⁸ PGW St. 10 at 3-5.

¹⁶⁹ *PGW Extraordinary Rate Order* at 4 ("As this Commission has held in the past, we do not have statutory authority to direct the City to grant back the City Payment or defer or waive repayment of the \$45 million loan"); *Accord, PGW 2001 Base Rate Order* at 34.

Loan would run afoul of the Public Utility Code, Section 2212(1), because it would force the City to be out of compliance with its existing 5-year PICA plan.¹⁷⁰

Finally, even if the City had the wherewithal and the inclination to forgive the City Loan or make a similar contribution it would hardly make a dent in PGW's core financial problem – lack of sufficient cash working capital and liquidity and an unreasonable debt burden. PGW witness Mr. Bogdonavage provided an analysis of PGW's 5-year financial results if it received a \$25 million rate increase and the City loan was not required to be repaid.¹⁷¹ PGW would still find itself with an 80% debt-to-equity ratio in FY 2012, have no non-borrowed cash working capital in the test year, and just \$4 million of non-borrowed cash working capital in the following year – a far cry from the \$110 million that would be justified using the 45 day method of determining a cash working capital allowance.¹⁷² While such a an additional bailout would do no more than apply a band aid to a gaping wound, it would take away any remaining "hedge" that might be available to support PGW if a serious financial crisis developed due to some natural disaster or even higher natural gas prices. It would truly leave the Company with no where to turn in a serious crisis and make more likely the kind of financial melt down that could result in service interruptions and layoffs.

Considering the negative consequences that would follow from any reliance on the City to avoid a rate increase by providing what would clearly be a one-time bailout,¹⁷³ the OCA/OTS suggestions for a City contribution should be seen for what it is – an illegal and unwarranted

¹⁷⁰ 66 Pa. C.S. § 2212(1). An "assisted city" is Philadelphia.

¹⁷¹ PGW Rejoinder Exh. 4.

¹⁷² *Id.*

¹⁷³ PGW St. 3R at 13.

attempt to avoid dealing with the grim reality of PGW's present revenue requirement needs; it should be rejected.

E. Contested Revenue and Expense Issues

1. Introduction

As explained above, by the close of the record only a handful of expense issues continued to be contested between PGW, OCA and the OTS. Below, PGW presents its position on each of them.¹⁷⁴

2. Management Incentive Plan

PGW included in its FY 2007 *pro forma* test year expenses \$500 thousand to reflect the cost of an "at risk" incentive compensation program to provide annual increases to PGW's fifty-

¹⁷⁴ While not clear whether it intended to actually propose an adjustment, The School District asserted that PGW's retiree health care benefits are an unreasonable expense because PGW retirees do not contribute toward the cost of these benefits (SDP St. 1 at 9; St. 1SR at 4). But PGW demonstrated that these benefits were reasonable and eminently prudent in light of the salary levels that PGW's employees receive, compared to other comparable companies. Tr. at 779-80. Even more importantly, when the union has negotiated the collective bargaining agreements, they have conceded wage increases in order to retain this retirement benefit. Tr. at 789-90. This fact, when coupled with the history of non-union increases between 1999 to 2005, which was one increase of 2%, highlights the concessions PGW employees have made to retain this benefit. *Id.* Furthermore, a recent American Gas Association survey among gas utilities has shown that 93% of the gas utilities that participated in the survey offered post-retirement health care benefits. Tr. at 781. In light of the under market salaries, as established by an analysis by the international consulting firm Hay Group, PGW also needs this benefit to retain current staff and attract prospective employees. Tr. at 779-80. Another significant factor to consider with regard to this retiree benefit is that it is a vested right. PGW employees who have retired clearly have an expectation that their right to this benefit has vested. Tr. at 789-92. Additionally, continuation of this benefit has been provided as an inducement for PGW's early retirement programs. *Id.* While PGW has also done what it could to mitigate this expense since 2001 (Tr. at 790) a current expense it needs to attract and retain employees, that PGW cannot rid itself of unilaterally, and that is coupled with under-market salaries is not an unreasonable expense.

five top managers based upon performance. The program was first instituted in 2005 and it is the Company intends to make the program permanent.¹⁷⁵

In response to challenges from the OTS¹⁷⁶ and OCA,¹⁷⁷ PGW's Vice President of Human Resources, Albert D'Attilio demonstrated that the program was an eminently reasonable and well supported approach to providing salary increases to PGW's senior managers, especially in contrast to the usual practice of many other firms to simply provide an across-the-board increase to all management employees consistent with the wage increase awarded to union employees.¹⁷⁸

In summary, Mr. D'Attilio testified that the program:

- Was a prudent approach to rewarding performance in a way that encourages future performance.
- By providing the compensation on a "one time" basis the increase generally does not continue to be built into the base salary of the manager, thereby assuring that the manager will not receive a benefit in the future if performance lags.¹⁷⁹
- PGW's incentive compensation plan is vitally necessary to help the Company attract and retain competent management employees.¹⁸⁰

Notwithstanding Mr. D'Attilio's testimony, OTS witness Ms. Markovich alleged that the \$500,000 expense was "excessive without direct correlation to implementation of improvement in the operational service level and/or financial condition."¹⁸¹ Mr. Bleiweis claimed that the

¹⁷⁵ While the Program costs were not initially approved for inclusion in PGW FY 2007 Budget, PGW was given the opportunity to resubmit the Program to the PGC for reconsideration for the FY 2007 budget year. Tr. at 810.

¹⁷⁶ PGW St. 12 at 1.

¹⁷⁷ *Id.*

¹⁷⁸ PGW St. 12 at 1-9; PGW Exh. AD-2 (Answer to OCA III-35, OTS-RE-29).

¹⁷⁹ PGW St. 12 at 1-9; PGW Exh. AD-2 (Answer to OCA III-35, OTS-RE-29).

¹⁸⁰ PGW St. 12 at 1-9; PGW Exh. AD-2 (Answer to OCA III-35, OTS-RE-29).

¹⁸¹ OTS St. 2 at 6.

program was "insufficiently documented" and should be rejected because it had been rejected for inclusion in PGW's FY 2007 budget by the Philadelphia Gas Commission (PGC).¹⁸²

But the PUC's review of utility salary and wage claims start with the fact that the PUC is not a "super board of directors"¹⁸³ and the Commission may only deny employee compensation expenses for ratemaking if it finds that the program is not necessary to attract or retain qualified employees or is otherwise imprudent.¹⁸⁴

On the contrary, Mr. D'Attilio explained that the PGW plan was extremely reasonable when the PGW manager's overall compensation was considered. He showed that the Management Team is presently paid at the bottom 25th percentile of similarly situated managers for comparable companies.¹⁸⁵ Moreover, prior to the 2005 "at risk" one-time payment, PGW's managers had received just one across-the-board, 2% base wage increase since 1999.¹⁸⁶

Moreover, Mr. D'Attilio explained that PGW's Incentive Compensation Plan is less than one-half the level of salary incentives usually offered by comparable companies, and PGW has

¹⁸² OCA St. 2 at 15-19.

¹⁸³ *Northern Pa. Power Co. v. Pa. P.U.C.*, 5 A.2d 133 (Pa. 1939); *Meyers v. Pa. P.U.C.*, 65 A.2d 256 (Pa. Super 1949) (PUC properly dismissed complaint claiming mismanagement due to employee wage increase and requesting annulment of wage increase as PUC is not the financial manager of the utility); *Peoples Cab Co. v. Pa. P.U.C.*, 137 A.2d 873, 878 (Pa. Super. 1958) (PUC does not have authority to regulate or control management decisions of utility absent finding that management decision would adversely affect public.)

¹⁸⁴ *Bell Tel. Co. of Pennsylvania v. Pa. P.U.C.*, 408 A.2d 917, 924-25 (Pa. Cmwlth. 1979) (disallowance in rates of local telephone service discounts for Bell employees did not unreasonably interfere with Bell's management prerogative concerning personnel policy because no evidence demonstrated that the discounts were necessary to acquire or retain qualified employees or prudent for providing service to the public); *see also, Popowsky v. Pa. P.U.C.*, 674 A.2d 1149, 1153-54 (Pa. Cmwlth. 1996) (management service fees properly disallowed in rates because no evidence of actual expenses or services provided by management personnel).

¹⁸⁵ PGW St. 12 at 3-4; Tr. at 779-80.

¹⁸⁶ PGW St. 12 at 3.

none of the other compensation incentives (e.g., stock options, profit sharing) by which companies usually attempt to attract and retain its key employees.¹⁸⁷ It is frankly, hard to understand how this very modest program could be deemed unreasonable under these circumstances.¹⁸⁸

Finally, both the OTS and the OCA have alleged that PGW's Incentive Compensation Plan expenses should be denied because the costs of the program have not presently been approved by the Philadelphia Gas Commission for inclusion in PGW's FY 2007 Budget. But PGW approval or disapproval of an expense for budget purposes is not controlling from a rate making standpoint. Moreover, PGW explained that, while the Program costs had been denied because the PGC believed that the Company's documentation was not in its view sufficient, PGW was given the opportunity to submit a request for reconsideration.¹⁸⁹ The Company intends to include the costs of the Plan in its FY 2008 budget.

There is simply no basis for rejecting the costs of this Program under the standard PUC criteria for considering a utility's salary expense. Indeed, where, as here, the evidence

¹⁸⁷ *Id* at 2.5.

¹⁸⁸ The allegation that PGW's plan is not documented to the extent deemed sufficient by the OTS and the OCA (OTS St. 2 at 6-7; OTS St. 2SR at 2-4) is not a valid basis for rejecting it. Mr. D'Attilio adequately identified various documents and materials provided to the parties setting forth all aspects of the program and explained that all of the questions posed by Ms. Markovich had all been answered by PGW in those materials, or were answered by him on the record. (PGW St. 12 at 7-8; Tr. at 777.) PGW submits that, as adequate information about the Program was provided *in the record, and every issue and concern raised by the parties was addressed, there is no reasonable basis for rejecting this expense as imprudent or unreasonable.* The Commission could direct that the Company prepare more formal documentation after the rate case is completed, which it would be willing to share with the interested parties.

¹⁸⁹ Tr. at 809-10.

demonstrates that the Company's plan is reasonable, prudent and improves service to the public, the Company must be permitted to recover the costs of the plan in its rates.¹⁹⁰

a. Bad Debt Expense - PGW/OTS Stipulation -4.5%

PGW's original claim of \$52.3 million in Bad Debt Expense (subsequently adjusted to \$51.8 million)¹⁹¹ represented a projected level of Bad Debt Expense it will actually incur in FYE 2007 (at present rates). In response to OTS testimony that PGW's Bad Debt Expense should be set at 4% of total gas revenues, the Company and the OTS subsequently agreed to a 4.5% level.¹⁹² This represents a \$11-12 million (approximately 27%) reduction from the level PGW was authorized in its last fully litigated rate proceeding (\$55.6 million)¹⁹³ – a tremendous achievement.

The only issue that remains is whether the stipulated 4.5% figure should be applied to all operating revenues or merely to total gas revenues as the OTS apparently advocates.¹⁹⁴

In the Company's view, the stipulated 4.5% bad debt percentage must be applied to PGW's total operating revenues in order to fairly compensate the Company for all of the bad debt expense it incurs. Total operating revenues differ from total gas revenues in that the former includes revenues from appliance repair and other operating revenues which are almost entirely

¹⁹⁰ *Peoples Cab Co.*, 137 A.2d at 875-78 (PUC's discontinuance of utility's "single incentive plan" for cab drivers improper where evidence demonstrated that plan improved service to public in many ways).

¹⁹¹ PGW Exh. JRB-13A, pg. 1.

¹⁹² PGW Hearing Exh. 4.

¹⁹³ *See*, n. 10, *supra*. 2001. PGW's Collection Rate increased dramatically in the last several years – from a low of 87% in FY 2003 to 96.57% in Fiscal Year 2006.

¹⁹⁴ While the OTS witness in her testimony stated that she was applying her originally recommended 4.0% factor to "total revenues" (\$949,824 million; OTS St. 2 at 12) this amount reflects OTS's projected total gas revenues at proposed rates (i.e., with a \$25 million rate increase included).

finance charges.¹⁹⁵ PGW includes the revenues it bills to customers for appliance repair service and finance charges in its calculation of *pro forma* net income, and thus, gives customers the benefit of the net income produced from these service categories when calculating a revenue requirement. Further, like all revenues listed on the income statement, the level of revenues claimed are the amounts billed for these items. Of course PGW does not collect 100% of these billings. Accordingly, for PGW to be compensated the uncollectibles associated with these amounts the bad debt percentage must be applied to total operating revenues. Application of the bad debt expense percentage to total operating revenues at present rates produces a bad debt expense at present rates of \$43,722,000; applying the bad debt expense percentage only to gas revenues produces an expense of \$42,394,000, or a difference of \$1,285,000.¹⁹⁶

(1) Bad Debt Expense Tracker for Bad Debt Expense Changes Related to Incremental Additions to CRP Program.

Another Bad Debt Expense-related issue raised by OCA was OCA witness Colton's recommendation that the Commission direct PGW to include in its quarterly reconciliation of CRP costs a mechanism to identify and adjust CRP credits to reflect a reduction in bad debt expense, that Mr. Colton alleges will occur incrementally as CRP customers move into the program.¹⁹⁷ PGW showed that Mr. Colton's recommendation was totally inappropriate and should be rejected. While Mr. Colton attempted to characterize it differently, Mr. Bogdonavage explained that the adjustment was simply designed to track one of many factors that affect the Company's experienced level of bad debt expense. When a PGW customer makes a change to CRP it is likely to result in a change in the level of Bad Debt Expense the Company will

¹⁹⁵ PGW St. 2R at 27.

¹⁹⁶ App. A, pg. 1, 11.

¹⁹⁷ OCA St. 4 at 5-10; PGW St. 2R at 28.

experience for that particular customer. But PGW's Bad Debt expense can – and is likely to – change for a host of reasons, such as increased natural gas costs, reduced load, changes in customer income and others.¹⁹⁸ That is because the mix of customers or the amount of billed revenues is constantly changing from the amount that is assumed when base rates were calculated.¹⁹⁹ Even if there were a demonstrated reduction of bad debt expense if an additional CRP customer was added to the program, that effect could be short lived if that customer moves back from CRP to the regular rate or is terminated all together. Moreover such a reduction could be more than made up by incremental increases in bad debt caused by increases in other revenues. That phenomenon is graphically illustrated by the fact that, over the last several years, PGW's actual Bad Debt Expense has significantly exceeded its allowance in base rates, yet the number of CRP customers has steadily risen.²⁰⁰ Finally, Mr. Colton's proposal is to establish a mechanism to track bad debt expense.²⁰¹ Whether the Commission agrees that this is or is not a good idea, such a mechanism is prohibited by the Public Utility Code.²⁰²

b. Lobbying Expense

¹⁹⁸ PGW St. 2R at 27-31; Tr. at 562-64.

¹⁹⁹ PGW St. 2R at 27-31; Tr. at 562-64.

²⁰⁰ Compare, PGW Exh. JRB-14 with Exh. CC-1.

²⁰¹ OCA St. 4S at 4. ("The Company is double collecting part of a bad debt associated with the incremental increase in CRP participation. As indicated, his proposal is to track change in bad debt expense associated with customers moving from regular rates to CRP rates and to reduce the universal service on a quarterly basis to reflect his reduction in bad debt expense.")

²⁰² 66 Pa. C.S. § 1408 ("The Commission shall not grant or order for any public utility a cash receipts reconciliation clause or another automatic surcharge mechanism for uncollectible expenses."). This section which was designed to prevent a utility from seeking to include any kind of tracker for bad debt expense as its bad debt expense percentage or total amount increases applies equally to Mr. Colton's adjustment and renders it "null and void." *Id.*

PGW's *pro forma* operating expenses included \$100,000 for WolfBlock Government Relations, a lobbying firm, and some \$130,000 for a contract government relations firm with a designated person devoted exclusively to PGW.²⁰³ Both Ms. Markovich and Mr. Bleiweis claimed that these amounts represented "lobbying expenses" which allegedly were impermissibly included in the Company's *pro forma* expense claim.²⁰⁴ PGW continues to submit that these are reasonable expenses for two reasons. First, as part of its rebuttal testimony, PGW submitted information which showed that only 25% of the \$130,000 Mardi Enterprise contract related to "lobbying" with the other 75% to 80% associated with activities such as interacting with the PUC on various issues and concerns to the Commission regarding PGW, with the Energy Association of Pennsylvania, with other state and federal trade and industry groups and with public advocates such as the Office of Consumer Advocate and the Office of Small Business Advocate, as well as customers and community groups.²⁰⁵ Therefore, only 25%, or \$130,000, of the contract with Mardi Enterprises should be removed as "lobbying."²⁰⁶ Eliminating only the portion of government relations expense related directly to lobbying is consistent with present Commission policy.²⁰⁷

Despite this, Ms. Markovich refused to revise her adjustment, calling the testimony of Mr. Bogdonavage "vague and undocumented."²⁰⁸ Unfortunately, Ms. Markovich did not explain

²⁰³ PGW's St. 2R at 31.

²⁰⁴ OTS St. 2 at 17-19; OCA St. 2 at 19-21.

²⁰⁵ PGW St. 2R at 32-33.

²⁰⁶ *Id.*

²⁰⁷ *See, e.g., Pa. P.U.C. v. PPI, Gas Utilities Corp.*, R-00061398 (Feb. 8, 2007) at 33.

²⁰⁸ OTS St. 2SR at 20.

the PUC standard on which she was judging Mr. Bogdonavage's testimony or the basis for claiming that it was "undocumented." OTS did not attempt to seek more information or to audit PGW's claim after it was made in Mr. Bogdonavage's rebuttal testimony. If it had it would have been provided with sufficient documentation and support. Having made the assertion under oath, PGW met its burden of going forward to refute Ms. Markovich's challenge. Accordingly, PGW's position should be accepted.

Moreover, and with respect to the entire amount identified by Ms. Markovich, PGW submits that these expenses should nonetheless be included in its *pro forma* expense claim in recognition of PGW's very different status as a municipal utility. Contrary to Ms. Markovich's claim that these expenses should be "below the line"²⁰⁹ – there is no line. PGW has no shareholders and is owned by the City of Philadelphia – which has not been paid its City fee in years. In turn, the Company is "owned" by the citizens of that City who are essentially the same as PGW's ratepayers.²¹⁰ Therefore, any lobbying activities conducted by PGW must accrue to the benefit of its ratepayers. In fact, a key portion of PGW's lobbying activities is to encourage Congress and the Pennsylvania General Assembly to increase the funding of LIHEAP and other low income assistance programs, which obviously directly benefit PGW customers.²¹¹ Accordingly, all of PGW's government relation expense should be included in its *pro forma* expenses.²¹² As noted by Mr. Bogdonavage, the Public Utility Code, Section 2212(c) authorizes the PUC to "suspend or waive" the application [to PGW] of any provision of this title" To

²⁰⁹ *Id.*

²¹⁰ Tr. at 505 (Hershey).

²¹¹ PGW St. 1R at 6.

²¹² PGW St. 2R at 33.

the extent that including lobbying expenses in *pro forma* operating expenses for PGW is deemed generally prohibited by the Code,²¹³ PGW requests that the Commission waive its application for the reasons stated above.

c. Advertising Expense

Ms. Markovich initially recommended an adjustment to the Company's *pro forma* advertising expense of \$210,000 representing her view that the Company included advertising related to "marketing" (\$35,000) and improperly claimed amounts for advertising related to corporate awareness (\$175,000).²¹⁴ In PGW's rebuttal testimony Mr. Bogdonavage demonstrated that both amounts were reasonable operating expenses. The "corporate relations campaign" that Ms. Markovich took issue with, was actually advertising related to making customers aware of actions and activities they could take to conserve energy."²¹⁵ PGW included in Mr. Bogdonavage's rebuttal testimony samples of those ads. Upon review of those ads, Ms. Markovich rescinded her adjustment.²¹⁶

Second, Ms. Markovich took issue with the \$35,000 expense amount for what she characterized as marketing activities and claiming that the expense "is not related to providing safe and reliable service." She also claimed that activities incurred to encourage the promotion of one fuel over another "encourages all utilities to do this and therefore results in higher rates

²¹³ Lobbying expenses are generally prohibited from being included in rates pursuant to section 1316 of the Public Utility Code, 66 Pa. C. S. § 1316. Prohibition against charging ratepayers for "political advertising" which includes "lobbying but not money spent for appearances before regulatory or other governmental bodies in connection with a public utility's existing or proposed operations." Waiving or suspending the application of this section, to the extent that it even applies, would be in the public interest because, as noted, 100% of any positive benefits honored by PGW's lobbying activities accrued ultimately to PGW customers.

²¹⁴ OTS St. 2 at 22-24.

²¹⁵ PGW St. 2R at 34.

²¹⁶ OTS St. 2SR at 25.

for all ratepayers."²¹⁷ While the amount is relatively small, the principle is important. The Company firmly believes that actions that it takes to attempt to encourage customers to use natural gas – whether it is purchased from PGW or purchased from independent suppliers and simply delivered by PGW – clearly and demonstrably benefits all PGW customers because it produces increased revenues to cover fixed costs which otherwise would have to be recovered from existing ratepayers. Ms. Markovich's suggestion that this somehow would be unfair competition with other utilities is misplaced. In fact, the principle alternative fuel for both residential and business customers is heating oil,²¹⁸ which is not regulated and is not a utility; of course there is no other natural gas utility in Philadelphia with which PGW competes. The entire amount initially claimed by PGW (\$210,000) should be included in PGW's *pro forma* operating expenses.

d. Regulatory Fines and Penalties

PGW budgeted a small amount (\$50,000) for fines and penalties that may be assessed against the Company in the test year by the PUC for such things as violation of Chapter 56 regulations. OTS Witness Markovich and OCA Witness Bleiweis both took issue with the inclusion of the fines and penalties claiming that inclusion of such amounts in *pro forma* expenses was unjust and unreasonable.²¹⁹

While PGW acknowledges that the general policy of the PUC is to exclude such costs from *pro forma* operating expenses, PGW believes that it deserves individual consideration for its claim. As noted above in other contexts, PGW is a municipal utility with no shareholders.

²¹⁷ *Id.* at 24-25.

²¹⁸ *See* PGW St. 5R at 6-7.

²¹⁹ OTS St. 2 at 25-26; OCA St. 2 at 27-29.

All revenues produced ultimately accrue to the benefit of PGW customers. Similarly, all expenses incurred ultimately inure to the detriment of the PGW customers. Moreover, under the Cash Flow Method, any denial of an expense that is nonetheless required to be paid will simply reduce PGW's available amount of cash working capital and debt service coverage levels which ultimately will have to be made up by a rate increase at some point in the future. Or, PGW will be forced to borrow additional amount of long-term debt in order to finance the capital construction that otherwise could have been financed by the amount denied in rates for "regulatory fines and penalties." In any event, the costs are likely to be greater, while the risks imposed on the Company and its customers will be enhanced. For this reason, PGW respectfully suggests that applying the normal policy applicable to Pennsylvania public utilities for this item would not be in the public interest. Accordingly, PGW's *pro forma* operating expenses should not be reduced by \$50,000 to remove the amount of budgeted regulatory fines and penalties budgets for the Test Year.

e. Injuries and Damages Reserve and Associated Expenses

PGW included an amount in injuries and damages reserve to cover payments that PGW anticipates it will have to make as a result of class action lawsuits.²²⁰ Large class action lawsuits of this nature normally are experienced by companies and PGW is no exception. In rebuttal testimony, PGW updated its projection of the amount that is likely to be required to be paid out: at least \$1.8 million as well as \$2 million for injuries, damages and legal fees.²²¹ Despite this update, Ms. Markovich continued to object to this inclusion in PGW's *pro forma* expenses,

²²⁰ PGW St. 2R at 37.

²²¹ *Id.*

claiming that PGW had not proven that it experiences recurring class action suits as well as claiming the amount that PGW is now projecting for the suit is "speculative."²²²

The fact is that a Company such as PGW unfortunately is not immune to class action suits and is sued periodically. The suit that is pending is just one example. The present estimate of \$3.8 million is a legitimate projected operating expense and should be included in the Test Year. OTS had ample opportunity to test the updated claim – and made no attempt to do so. PGW would agree, however, that because class action suit payouts do not necessarily occur in each and every year, the cost of \$3.8 million would be more appropriately amortized over a reasonable period of time. If the current, updated projected liability and legal fees of \$3.8 million is amortized over five years PGW's annual operating expense claim would be \$760,000 a year, almost exactly the same amount that PGW had originally claimed as a *pro forma* test year expense (\$475,000 for injuries and damages and \$250,000 for legal expenses.) No adjustment to PGW's test year expenses should be made.

f. Marketing Promotion Expenses

PGW has an ongoing program to provide incentives to customers to assist them in converting from a different fuel source to natural gas, recognizing the initial investment required for such a conversion. PGW firmly believes that, in the long-term, ratepayers benefit from the additional throughput on PGW's system by assuring that PGW's facilities are more fully utilized and that operating costs are distributed among a greater number of customers. Incentives are provided in the form of discounts to the charges imposed upon the customer for the natural gas service or the delivery service it purchases and the benefits to PGW and its rate payers in the past

²²² OTS St. 2SR at 22.

have far exceeded the amount of the incentives used to induce the customer to install natural gas fueled facilities.²²³

Notwithstanding the obvious reasonableness of this program, Ms. Markovich opposed it, claiming initially that "payment for incentives only increase the overall cost of service for all utilities as each utility attempts to include these costs in rates."²²⁴ This is demonstrably false since incentives are principally directed at customers who are considering utilizing oil, propane or other non-regulated fuels as energy sources. Denial of the expenditure will only make it more difficult for PGW to increase sales. As noted previously, increased sales spread the Company's fixed operating costs over a larger base, helping existing customers.

Notwithstanding, even after Mr. Bogdonavage fully explained the benefits of this program to customers and to PGW in his rebuttal testimony, Ms. Markovich continued to oppose virtually all of the expense level on the new ground that two of the projects that had been initially contemplated for the Test Year had not as yet come to fruition.²²⁵ However, PGW fully expects that it will incur costs in the Test Year at around these levels and is budgeting a similar amount for FY 2008. Under the circumstances, the full amount of the expenditure should be included in its *pro forma* income.

g. *Authority*

²²³ PGW St. 2R at 37.

²²⁴ OTS St. 2 at 14-17.

²²⁵ OTS St. 2SR at 17-18.

PGW elected to accept the proposed adjustments made by OCA witness Bleiweis to remove expenses related to analyzing proposals to create an energy authority to operate PGW (\$190,000).²²⁶

h. Merger Costs

PGW elected to accept the proposed adjustment to remove \$50,000 from *pro forma* expenses to remove costs that it planned to spend on a potential merger with another utility.²²⁷

i. Prescription Drug Benefit

PGW elected to accept Ms. Markovich's proposal to reduce prescription drug benefit costs to reflect new estimates from PGW's benefits merger.²²⁸

F. PGW Should Be Permitted To Retain Off-System Sales And Capacity Release Credits For Use As Source Of Internally Generated Funds To Finance Construction.

PGW proposes to change the regulatory treatment of revenue derived from off-system sales and capacity release credits. Under the current regulatory treatment, PGW passes through to customers \$1 for every dollar of off-system sales or capacity release. As explained below, PGW now proposes to pass through to customers not \$1, but, in actual effect, \$1.50. Instead of flowing these proceeds through as a credit to the GCR, PGW proposes that the proceeds flow through to customers by making them available to fund necessary construction projects, which will result in avoiding the issuance of additional long term debt. PGW has relied exclusively on long term debt to fund its capital program since 1993.²²⁹ By funding construction projects from

²²⁶ PGW St. 2R at 36.

²²⁷ *Id.* at 34-35.

²²⁸ PGW St. 12 at 10. These three adjustments are all reflected in Appendices A-C hereto.

²²⁹ PGW St. 1 at 2. While the OCA insisted that when depreciation was considered the Company had produced funds from operations (OCA St. 1, Sch. 2); depreciation is not cash and in all those

this source, PGW will not have to use long term debt which means that ratepayers will not only avoid the cost of debt service interest but also the additional amount (50% of the annual interest and principal payment) that is necessary to be charged in order to comply with PGW's bond ordinance requirements.²³⁰ If permitted, PGW agrees to deposit any such proceeds in a construction fund and use them only to pay for construction items included in its approved capital budget. PGW projected that its off-system sales and capacity release credits will amount to \$10 million per year, on average.²³¹

PGW believes that this proposal is a much more reasonable and cost effective way to return the benefits of these transactions to customers. Lowering gas costs by applying revenue from these sales certainly helps customers in the short term, but it does nothing to change the underlying financial structure of the Company, which would provide more fundamental benefit to customers over the long term. PGW showed that funding its construction program and reducing its outstanding debt from these proceeds is cheaper to customers than the present value of the stream of payments associated with issuing additional long term debt.²³² One need only look at the multiplier effect of the debt service coverage requirements, the increasing costs of debt transactions, and the debt service required to carry the debt to recognize the problem.

PGW's capacity release credits and off-system sales margins retention proposal is fundamentally misunderstood by the parties. First and foremost, the parties ignore that for every \$10 million of cost PGW incurs in order to borrow long term to fund its capital program, the

years PGW's short term borrowing exceeded its funds from operations – so that no internally generated cash to fund construction were actually produced. PGW St. 2R at 19.

²³⁰ PGW St. 2 at 12-13; PGW St. 1 at 5; PGW St. 1R at 13-14.

²³¹ PGW St. 2 at 15-16.

²³² *Id.* at 12-13; PGW St. 1R at 13-14; PGW Exh. SPH-3.

related base rate impact is \$15 million because of the 1.5 times debt service coverage requirement. Regardless of any analysis of the opportunity costs of borrowing money, whether it be PGW's or OCA's, retention of the \$10 million annually in order to fund capital projects is cheaper for ratepayers if the \$10 million is utilized for capital budget projects and not credited to Purchased Gas Costs. As a result of the foregoing, it makes sense that PGW's proposal be viewed within a larger context than simply the "least cost fuel procurement policy consistent with [a utility's] obligation to provide safe, adequate and reliable service to its customers," as the OTS has insisted.²³³ However, this proposal does indeed provide least cost opportunities for PGW ratepayers overall and, at the same time, retention of the capacity release credits and off-system sales margins funds capital projects that support safe, adequate and reliable service. Additionally, it is important to note that Interstate Gas Supply, a potentially natural gas supplier on PGW's system, has stated that retention of these credits and margins supports gas competition.²³⁴ In turn, gas competition can result in lower gas prices, thereby promoting additional least cost fuel opportunities.

There is also a misperception that the assets that provide capacity release credits and off-system sales margin are used exclusively by firm sales customers thereby creating an unreasonable advantage for transportation customers.²³⁵ This is not so. The assets used to provide commodity service, such as pipeline transportation, storage contracts and PGW's LNG

²³³ OTS St. 4 at 6-7.

²³⁴ IGS St. 1 at 6.

²³⁵ OTS St. 4 at 8.

facilities, are also used to provide backup and balancing services to interruptible sales and transportation customers as well as to provide supply services to firm customers.²³⁶

A further misperception is that dedicating the retention of the \$10 million to capital projects will result in cost shifting.²³⁷ Such would be the case if the proposed capital projects like the second phase of the LNG Liquefaction Plant or the modernization of the Company's customer billing system, did not benefit the sales customer, but these projects do in fact not only benefit, but primarily benefit sales customers.²³⁸ Whatever incremental value these capital projects provide the interruptible and transportation customers, it is small when compared to the overall annual funding for capital projects which comes from transportation rates and the exclusion of the exponential debt service coverage impact on base rates with regard to the \$10 million as discussed above.

Finally, the concern that permitting PGW to retain \$10 million annually somehow violates the "least cost fuel procurement requirement"²³⁹ misperceives the requirements of that statutory standard. On its face, a gas utility's obligation to pursue a least cost fuel procurement strategy is just that – an obligation to take steps to insure that the cost it – the utility – incurs for natural gas are as low as reasonably possible, consistent with its obligation to provide safe, reliable and adequate service. PGW's proposal to treat the proceeds from these transactions differently for ratemaking purposes will have no negative impact whatever on PGW's vigorous pursuit of every opportunity to secure fuel at the least cost possible. In fact just the opposite is

²³⁶ PGW St. 1R at 12.

²³⁷ OTS St. 4 at 8-10.

²³⁸ PGW St. 1R at 12.

²³⁹ OTS St. 4 at 6-7.

likely to be the case, since the Company will have an important interest in seeking to reduce its dependence on the issuance of long term debt to finance necessary construction projects.²⁴⁰

The Commission should approve PGW's proposed change in regulatory treatment.

III. RATE STRUCTURE, COST OF SERVICE AND OTHER ISSUES

A. **The Company's Proposal To Allocate The Proposed Rate Increase Was Based On The Fully Allocated Cost Of Service And Was Designed To Move Rates For Each Class Closer To Unity With Cost.**

The Company's proposal to allocate the proposed rate increase is based upon a fully allocated class cost of service study ("CCOSS") and was designed to move the rates for each class closer to cost, keeping in mind the need for gradualism. PGW retained Howard Gorman of Black & Veatch Consulting to perform the CCOSS, which was performed using widely accepted practices and was based on the Fiscal Year 2007 Test Year.²⁴¹ As Mr. Gorman noted, one of the functions of the CCOSS is to assign the total cost incurred by the Company to provide service to each rate class, and to compare the costs assigned to each class to the revenue produced by the rates proposed by the utility in order to ensure that it recovers all of its cost of service.²⁴² Mr. Gorman did this, assigning the full Tariff Revenue Requirement on a cost causation basis to the rate classes, and the results are summarized in Exhibit HSG-1.

With the exception of the OCA and OTS, the Company's CCOSS was generally accepted. The criticisms of these parties focused primarily on PGW's allocation of the distribution mains plant investment and related costs.²⁴³ First, the OCA and OTS objected to the customer

²⁴⁰ PGW St. 1R at 11.

²⁴¹ PGW St. 8 at 1-41.

²⁴² *Id.* at 5-6.

²⁴³ OCA St. 3 at 6-20; OTS St. 3 at 10-14.

component of the distribution mains cost in PGW's CCOSS, claiming that mains are not sized based on the number of customers served therefrom. However, this position ignores the relationship between the number and location of customers served and the capital cost of the distribution mains. The cost of the mains is a function of both their length and diameter. As the evidence reflects, the more customers being served on the system, the greater the length of distribution mains that are required (and the higher the cost). Likewise, the more dispersed geographically the customers are, the greater the capital costs of the mains required to serve them in those locations.²⁴⁴ Moreover, respected authorities in the field of ratemaking and cost allocation find PGW's proposed inclusion of a customer cost component theoretically justified and can actually be viewed as supportive of its approach.²⁴⁵

Second, both the OCA and OTS assert that the classification and allocation of the distribution mains costs should include a commodity-related classification that is allocated on an average or annual demand factor.²⁴⁶ In contrast, PGW's CCOSS classifies the non-customer component of its distribution mains costs as demand-related with the allocation based on the Company's peak demands.²⁴⁷ The Commission should reject the parties' objection on this point as it is contrary to the principle of cost causation. The costs of mains are causally related only to peak demands, and not to annual demands. Annual demands are not a factor in the design of distribution mains, but rather the mains' length and diameter are the appropriate considerations, and those factors must be determined in reference to the Company's ability to meet its peak

²⁴⁴ PGW St. 8R at 8-10.

²⁴⁵ *Id.* at 11-12.

²⁴⁶ OCA St. 3 at 12-19; OTS St. 3 at 12-14.

²⁴⁷ PGW St. 8R at 14.

demand.²⁴⁸ Rather, the issues raised by OCA and OTS go to rate design, not cost of service.²⁴⁹ As such, their contentions are not a proper basis for modifying PGW's CCOSS.²⁵⁰ The Summary results of PGW's CCOSS are included in the first part of Appendix "F" attached hereto.

B. The Company's Revenue Allocation Is Fair And Appropriately Balances The Interests Of Its Various Rate Classes.

The Company seeks an increase of \$100 million above its present base rates, and has proposed to allocate this increase in a manner that moves each rate class toward unity between its relative rate of return and the system average rate of return (or unity with its cost of service).²⁵¹ The Company proposes no changes to the customer charges for firm sales customers.²⁵² In terms of progress toward unity, the Residential Heating class would move 32% toward cost, Commercial Heating would progress 17%, and Industrial Heating would progress 33%.²⁵³ This proposal was designed to implement a multi-step, gradual process of moving all classes to a system rate of return.²⁵⁴ In sum, considering the totality of the factors and need for gradualism,

²⁴⁸ *Id.* at 16-17.

²⁴⁹ *Id.* at 13, 17.

²⁵⁰ OTS also suggests that the average and excess demand method set forth in the American Gas Association's *Gas Rate Fundamentals* should be utilized to allocate PGW's distribution mains costs. OTS St. 3 at 13. However, as PGW's Mr. Gorman testified, when properly applied, this method actually supports PGW's CCOSS. PGW St. 8R at 20.

²⁵¹ PGW St. 8 at 36-39; PGW St. 8R at 4-5; PGW Exh. HSG-7C (revised), pg. 1 (included in the second part of App. F, hereto). PGW's proposal to retain the proceeds from off-system sales/capacity release will be handled through an adjustment to the GCR and thus will have no base rate impact.

²⁵² PGW St. 8 at 38.

²⁵³ PGW Exh. HSG-7C (Revised) attached as App. F, hereto.

²⁵⁴ PGW St. 5 at 9-11.

PGW's allocation is fair and clearly balances the interest of its various rate classes. Accordingly, its allocation should be accepted, whether based on a full or partial rate award.

The primary objections to the Company's proposed allocation come from the OSBA. OSBA contends that the relative rate of return measure is not appropriate because it implies that progress toward unity with cost is being realized when in fact, according to OSBA, progress is not being made. OSBA also objects to allocating PGW's universal service costs to any classes other than the residential class.²⁵⁵ Both of these complaints are unfounded and should be rejected. First, as PGW's expert Mr. Gorman explained, the Company's relative rate of return approach does in fact result in all of the rate classes moving closer to unity with the system average.²⁵⁶ Second, as to the Universal Service Charge cost allocation, OSBA both misapplies as to PGW the Commission's recent decisions on this issue and fails to recognize the evidence of record of the actual benefits realized by the commercial class from PGW's extensive and much-needed CRP program.²⁵⁷ Ironically, were the OSBA's theory applied to its logical end, only the actual participants in the CRP program would pay for the Company's universal service costs as, under the OSBA logic, an exemption from such costs would be just as warranted, if not more so, for the residential customers who are not participants in CRP as it would be for commercial customers.²⁵⁸

Finally, the School District and PHA offer a variety pack of complaints about the Company's rate increase allocation that are literally tantamount to a claim that no portion of the

²⁵⁵ OSBA St. 1 at 14-22, *Id.* at 28-33.

²⁵⁶ PGW St. 8R at 5.

²⁵⁷ PGW St. 1R at 15-20.

²⁵⁸ *Id.* at 17-18.

rate increase should be allocated to them.²⁵⁹ These arguments reflect a fundamental misunderstanding of ratemaking, the CCOSS and standard rate allocation.

For instance, the School District asserts that the proposed rate increase should not be applied to it because the increase is due to, and thus will penalize it for, "the residential customers' poor delinquent payments."²⁶⁰ Yet, as the CCOSS demonstrates, it is simply not true that the other classes are paying for the residential class's uncollectible accounts expense, as each class was allocated only its own uncollectible expense.²⁶¹ Moreover, despite these parties' repeated emphasis on their alleged good payment histories, the School District and PHA still must be treated as part of their respective classes for purposes of allocating costs and designing rates, and such functions cannot be performed on an individual customer by customer basis as is the apparent desire of the parties.²⁶²

Moreover, as the CCOSS demonstrates, while the Municipal and PHA revenues continue to exceed their costs at PGW's proposed rate allocation, their revenue/cost relationship is generally the same as that for the commercial and industrial classes.²⁶³ These parties presented no legitimate reason why they should be completely exempt from responsibility for the rate increase, a burden that would have to fall on the remaining classes. PGW's rate increase proposal generally moves these classes closer towards cost of service and is, thus, reasonable.

C. Other Tariff Rate Issues

²⁵⁹ PGW St. 8R at 21.

²⁶⁰ PSD St. 1 (Mondre) at 9.

²⁶¹ PGW St. 8R at 22.

²⁶² *Id.*

²⁶³ PGW Exh. HSG-7C (revised) pgs 1-2. (included in the second part of App. F, hereto).

1. The Commission Should Reject PICGUG's Demand For Dramatic Cuts In PGW's Interruptible Transportation Rates.

PICGUG's request that the Commission impose dramatic cuts in PGW's Interruptible Transportation ("IT") rates by requiring the Company to move from individually negotiated, margin based rates to cost-based rates,²⁶⁴ should be rejected for at least two reasons. First, the record is completely devoid of any evidence that such a change is needed to open PGW's system to interruptible transportation or that the Company is not negotiating reasonable rates based on its current margin-based maximum rates.²⁶⁵ Second, such a seismic change in PGW's IT rates, which currently provide a positive margin in relation to the cost of service, would violate the approved theory of gradualism and will have a significant negative impact on the rates paid by firm customers.²⁶⁶

PICGUG's position on this issue appears to have experienced a metamorphosis over the course of this proceeding. Restating the exact same claims it made during the Company's restructuring proceeding, PICGUG initially claimed that the only way IT customers will ever be able to obtain "reasonable" IT rates, and thus be able to transport, is if the Commission forces PGW to establish cost-based rates.²⁶⁷ However, PICGUG failed to back its assertions with any actual evidence. In contrast, PGW established in the record:

- that since its restructuring proceeding, there is a record of IT customers successfully transporting on PGW's system at reasonable IT rates negotiated with the Company;²⁶⁸

²⁶⁴ PICGUG St. 1 at 1-10.

²⁶⁵ PGW St. 5R at 2-5.

²⁶⁶ *Id.* at 9-10.

²⁶⁷ PICGUG St. 1 at 4-7.

²⁶⁸ PGW St. 5R at 2.

- that PGW has negotiated IT rates that are lower than its maximum IT rates with most of its IT customers;²⁶⁹
- that PGW seeks to arrive at a rate that takes into account the "opportunity cost" of utilizing natural gas as opposed to oil some other alternative fuel.²⁷⁰
- that one such customer, Jefferson Health System, a PICGUG member, negotiated multi-year agreements with PGW for Jefferson's facilities that have allowed it to successfully implement an economic transport program;²⁷¹
- that PGW is willing to negotiate fairly, responsibly and in good faith with any potential IT customer;²⁷²
- that PGW, in fact, has a financial incentive to negotiate reasonable IT rates with dual fuel customers as those rates currently provide a positive margin for the Company;²⁷³ and
- that, since 2002, the amount of throughput being delivered via interruptible transportation has increased tenfold.²⁷⁴

Confronted with this evidence, PICGUG moderated its position, claiming that its true objection was not the lack of cost-based rates but rather that its members had to negotiate with the Company over IT rates. For instance, PICGUG witness Lewis Cohen observed that the evidence presented by both PGW and OCA of the success of the IT rates "is based upon the Company's willingness to negotiate rates below the maximum rates."²⁷⁵ Decrying the fact that IT customers of other NGDCs allegedly do not have to engage in such negotiations, Dr. Cohen noted that "for customers on PGW's system, however, negotiating a lower IT rate may be the

²⁶⁹ *Id.* at 3.

²⁷⁰ *Id.*

²⁷¹ *Id.* at 2-4; PICGUG St. 1 at 4.

²⁷² Tr. at 622-624.

²⁷³ PGW St. 5R at 5.

²⁷⁴ *Id.*

²⁷⁵ PICGUG St. 1-S at 3.

only way in which these customers are able to transport natural gas on the Company's system."²⁷⁶
This is a far cry from cost-based rates being the *only* hope for potential IT customers.

Simply put, enabling PICGUG members to avoid having to negotiate IT rates with PGW is not nearly enough to warrant the severe negative impact that would be inflicted on the Company and its firm customers from a change to cost-based rates. PICGUG has supplied no evidence whatsoever that PGW will not or has refused to negotiate good faith IT rates – just the opposite. There is no evidence that PGW's current, PUC-approved margin-based rates are not working. PGW seeks to negotiate a "win-win" rate which saves the customer money in comparison to the amounts the customer would have to pay if it used an alternative fuel which benefits PGW by maximizing the contribution to fixed costs provided by the sale.²⁷⁷ There is no evidence that would warrant the Commission to change the status quo and mandate cost based rates at this time.

2. PGW Does Not Object To PHA's Request To Join The MS Rate, But Its Claims Of Past Overpayments Or A Failure To Charge The Lowest Applicable Rate Are Baseless.

PHA argues that it should be eligible for the Municipal Service ("MS") rate. PHA believes it is entitled to this rate treatment because it is "similar" to and has the "hallmarks" of a municipal entity.²⁷⁸ The Company has taken the position that it does not oppose PHA's request, if the Commission authorizes it, for PHA's *conventional* sites. The MS rate would not be applicable to PHA's scattered sites, which do not in any way resemble a qualifying municipal

²⁷⁶ *Id.*

²⁷⁷ PGW St. 5R at 5.

²⁷⁸ *See* PHA St. 2 at 13; PHA St. 2-SUR at 3.

entity, and any lost revenue from this reclassification must be recovered from the Company's remaining customers.²⁷⁹

Beyond seeking this reclassification, however, PHA suggested that its conventional sites could actually currently receive service under *three* rate classes – the PHA, MS and General Service-Residential classes – and that the Company has "picked the highest tariff rate possible to bill PHA."²⁸⁰ As a result, PHA appears to claim that it has overpaid PGW up to \$2.8 million.²⁸¹ This allegation, if true, would constitute violation of Section 1303 of the Code. But by the current text of the tariff, PHA is not in fact eligible for the MS rate – the tariff would have to be modified, of course, to make PHA eligible for this rate on a going-forward basis. Likewise, even the portion of the tariff quoted by PHA in relation to the GS-Residential rate – that it includes "residential and public housing authority customers"²⁸² – plainly does not cover PHA's conventional sites. As to those sites, PHA, not its customers, are the customer of record. The reference in the tariff is for PHA's scattered site customers, who reside in individually metered residences.²⁸³ These claims suffer from an utter lack of legal support and should be rejected by the Commission.

3. PHA's Claim of \$4 Million Overpayment Related To Scattered Sited Tenants Is Meritless.

The Philadelphia Housing Authority ("PHA"), in its supplemental testimony, makes several false claims about what PHA describes as "PHA's Scattered Sites and Housing Choice

²⁷⁹ PGW St. 5R at 27.

²⁸⁰ PHA St. 2-SUR at 3.

²⁸¹ PHA St. 2 at 12; PHA St. 2 at 3; PHA St. 2-SUR at 3.

²⁸² PHA St. 2-SUR at 2.

²⁸³ Tr. 624-626.

residents"²⁸⁴ and what PGW alternatively titles the "vendor program"²⁸⁵ These false assertions, which were not supported by evidence of record, are that:

- 1) PGW has over-billed PHA as much as \$4 million for the 800 scattered site tenant properties which are enrolled in the vendor program;
- 2) Some or all of the vendor program tenants whose gas service is directly billed to PHA at the General Service Rate are also enrolled in the Customer Responsibility Program ("CRP");
- 3) PHA pays the vendor program tenants' utility allowance directly to PGW regardless of the invoice amount; and
- 4) PGW's alleged over-billing is the result of PGW somehow recovering for vendor program billings by collecting the utility allowance from PHA directly at full residential rates, but actually billing the direct pay vendor participants at CRP rates. PHA admitted that the 4 million figure was a guess, or "estimate," since it had no actual evidence of the alleged number of vendor program participants who were on CRP and were direct pay by PHA.²⁸⁶

In order to respond to these false allegations, some background of the vendor program is necessary. The vendor program was established in the 1970's after PECO and PGW approached PHA about PHA tenants who were not paying their electric and gas bills.²⁸⁷ As a result, the vendor program was developed so that PGW billed PHA directly and PHA paid PGW directly for the gas service provided to the scattered site tenants who were enrolled in the vendor program.²⁸⁸ Since the vendor program pre-dates the existence of the Customer Responsibility Program ("CRP"), the vendor program is not designed to apply the CRP discount to the vendor

²⁸⁴ PHA St. 2S at 2.

²⁸⁵ Tr. at 627-628.

²⁸⁶ PHA St. 2-SUR at 4.

²⁸⁷ Tr. at 627.

²⁸⁸ Tr. at 627.

program billings.²⁸⁹ Additionally, the vendor program billings are calculated applying the General Service Rate and PHA remits the amount of the bill at the General Service Rate.²⁹⁰ Vendor program invoices are not paid simply by the direct issuance of the utility allowance to PGW.²⁹¹ As stated previously, PHA, by agreement with PGW, pays the amount billed at the General Service Rate – PGW has no information regarding the utility allowance amount for any scattered site property included in the vendor program.²⁹² Additionally, none of the properties are included in the CRP Program. As a result of the foregoing, PGW has not over-billed PHA \$4 million, none of the vendor program bills apply a CRP discount, PHA does not directly pay PGW the utility allowance amount for each vendor program enrollee and PGW does not pocket utility allowance payments that are in excess of the rate actually billed.

4. School District - Rule 10

The School District has misrepresented the circumstances under which PGW requires up front payments for all capital costs related to connecting School District buildings to PGW's distribution system (i.e. the cost of mains and services) and how these payments will eventually be credited to the School District in whole or in part. None of their allegations were supported by credible evidence. Among the School District's false assertions are that PGW is not complying with Section 10 of its Gas Service Tariff, the tariff does not support PGW's requirement for up front payments, and the School District has not received any credits to date for its up front capital payments.

²⁸⁹ Tr. at 627.

²⁹⁰ Tr. at 627-628.

²⁹¹ Tr. at 672-673.

²⁹² Tr. at 673.

The history of PGW requiring the School District to provide up front payments for capital costs began in the late 1990's.²⁹³ At that time, PGW discovered that the School District had not met its contractual obligations with respect to 80 schools.²⁹⁴ Specifically, the contracts set forth certain volumes to be used during the contract term in order for PGW to recover the capital costs related to connecting the schools to PGW's distribution system.²⁹⁵ Such a requirement is not only set forth contractually but also contained in PGW's tariff.²⁹⁶

Essentially, the "projected volumes" that the School District promised to use in its contracts for the 80 schools obviated the need for a customer contribution because the anticipated revenue would cover the capital costs. When the School District failed to live up to its contract and use the obligated volumes during the terms of the contracts, the actual revenues did not cover the capital costs.²⁹⁷ As a result, PGW's capital investment in the mains and services which were constructed specifically to connect the 80 schools to PGW's distribution system was lost, or, more specifically, shifted to firm customers.

PGW and the School District entered into negotiations in order to resolve this situation but the parties could not reach a consensus. Despite the failed negotiations, PGW did not believe

²⁹³ PGW St. 5R at 23.

²⁹⁴ *Id.*

²⁹⁵ *Id.*

²⁹⁶ "For permanent commercial and industrial Customers or developers making application for extensions or enlargements, where the Company in its sole judgment anticipates long-term, continuous usage at projected volumes of Gas: ... (b) where the combined estimated cost of delivery-main and service-delivery pipe installation is \$10,000 or more, the Customer or developer shall pay a customer contribution for the amount of the estimated cost in excess of the investment determined by the Company to be warranted by the anticipated revenue to be derived from the extension." *PGW Gas Service Tariff, Section 10.1.B.*

²⁹⁷ Tr. at 686.

that a lawsuit was the appropriate way to work things out.²⁹⁸ Instead, PGW decided that, on a going-forward basis, if the School District applied for new service for a school which required a capital investment that the School District must pay for the capital investment instead of PGW and that only when the School District actually met its contractual volumes would it credit any amounts due pursuant to section 10.B.1. of the Gas Service Tariff.²⁹⁹

The School District complains that the up front payments are non-compliant with and not supported by the Tariff. This is not so. Section 10.B.1. of the Gas Service Tariff cited above clearly states that this tariff section is applied to applications "where the Company in its sole judgment anticipates long-term, continuous usage at projected volumes of Gas." Given the School District's history of not meeting its contractual obligations, PGW cannot reasonably anticipate any type of usage from the School District even when the usage is contractually obligated. As a result, the tariff permits PGW to charge the School District up front for capital costs. Furthermore, the equities of this situation do not permit PGW ratepayers to bear the capital costs related to School District connections when the School District fails to provide promised revenues for the recovery of those capital costs.³⁰⁰

D. Customer Service Issues

1. Status of Collections Practices, Credit Scoring, Electronic Funds Transfer and Budget Billing

²⁹⁸ Tr. at 703.

²⁹⁹ Tr. at 687-688.

³⁰⁰ The School District further complains that it has yet to receive any credits for its up front payments. This is quite true but only because it has not yet successfully fulfilled the contractual criteria set forth qualifying the School District for credit. (PGW St. 5R at 23). PGW will reimburse the School District for its capital costs as outlined in each contract after its contractual obligations are fulfilled. *Id.*

In the Commission's October 27, 2004 Order in the Consolidated Proceeding, PGW was required to report on the following four issues in its next base rate case. First, PGW was directed to provide a progress report on the adequacy, cost-effectiveness and management of its collection practices.³⁰¹ Second, PGW was required to detail its current credit scoring process.³⁰²

Third, PGW was required to provide a cost/benefit analysis of implementing a mandatory Electronic Funds Transfer (EFT) program.³⁰³ Finally, PGW was asked to present a report with findings and recommendations regarding a program to educate the public about the benefits of PGW's budget billing plan.³⁰⁴

a. Collections

Regarding collections, PGW provided the testimony of Randall Gyory, Vice President for Customer Affairs, who explained that PGW's 12-month collection rate has improved from 91.42% in Fiscal Year 2004 to 96.01% in Fiscal Year 2005 to its best ever rate of 96.57% in Fiscal Year 2006.³⁰⁵ Because of these improved collections, PGW has collected \$36 million more than it would have collected under the collection rate that was experienced in FY 2004 and occurred even though PGW experienced a 7% increase in billings between FY 2005 and FY 2006.³⁰⁶ PGW continues to be very focused on improving its billings and collections systems

³⁰¹ *Investigation into Financial and Collections Issues Regarding the Philadelphia Gas Works (et. seq.)*, P-00042090 (hereinafter, "Consolidated Proceeding Order") October 27, 2004. Ordering Para. 11a.

³⁰² *Id.*, Para. 11c.

³⁰³ *Id.*, Para. 11d.

³⁰⁴ *Id.*, Para. 11e.

³⁰⁵ PGW St. 6 at 2.

³⁰⁶ *Id.*

and has devoted substantial time and effort toward achieving this goal.³⁰⁷ Such efforts include automation of processes, institution of tracking reports, full implementation of a Billing, Collections, and Customer Service ("BCCS") system, improvements in customer service, and implementation of the Collections Renewal Initiative ("CRI").³⁰⁸ In addition to these programs which have provided positive results for both PGW and its customers, PGW continues to work on new initiatives in FY 2007 which will provide additional collection tools to further improve its billing and collections systems.³⁰⁹

b. Credit Scoring

Regarding credit scoring, PGW witness Gyory testified that PGW has implemented a credit scoring process which it now utilizes to identify those applicants who will be asked to provide a deposit as a condition for receiving service.³¹⁰ This mechanism employs Experian's Telecommunications, Energy and Cable Risk Model to predict delinquent payment behavior on utility related accounts as well as a variety of other tools including account management and monitoring of subscriber payment patterns.³¹¹ Through utilization of this tool, PGW has implemented a highly successful deposit payment program which resulted in the collection of \$5.35 million in deposits in FY 2006 from those who were identified as higher credit risk.³¹²

c. EFT

³⁰⁷ *Id.* at 3.

³⁰⁸ *Id.* at 3.

³⁰⁹ *Id.* at 6.

³¹⁰ *Id.* at 7.

³¹¹ *Id.* at 7.

³¹² *Id.* at 8.

Regarding EFT, PGW Mr. Gyory testified that PGW has implemented various electronic bill payment options for consumers. These include "Pay Your Bill," "Express Bill," and "Auto-Pay."³¹³ "Auto-Pay" gives customers the option of utilizing EFT if so desired. In combination with all the other payment options available to customers, customers receive a range of choices from which to choose in accordance with their personal preferences.³¹⁴ This, along with other reasons (discussed below), has lead PGW to conclude that a mandatory EFT program would be cost prohibitive and not result in benefits enough to justify its implementation.

OCA witness Colton renewed his recommendation that PGW be required to implement mandatory EFT for delinquent customers with incomes above 250% of the federal poverty level and who enter into a payment agreement.³¹⁵ PGW does not support a mandatory EFT program for several reasons. First, PGW only has a very small number of customers on payment arrangements who are at or above 250% of the federal poverty level. Second, implementation of a mandatory EFT program will likely result in more problems, such as non-existent or closed checking accounts, failed EFT attempts due to insufficient funds that would make the EFT program too costly for PGW. Finally, the new state of the law regarding payment arrangements and the continuing legal interpretations of this law make less clear that PGW has the legal authority to deny a customer the right to enter into a payment agreement if the customer refuses to enroll in a mandatory EFT program.³¹⁶ While PGW does not support the imposition of an automatic EFT program, it is in the process of considering a late payer deposit program that

³¹³ *Id.* at 9.

³¹⁴ *Id.* at 10.

³¹⁵ OCA St. 4 at 16-21.

³¹⁶ PGW St. 6 at 10; PGW St. 6R at 15.

would waive deposit requirements for qualifying customers who agree to go on an EFT program where the customer would otherwise have to provide a deposit because he/she had been consistently late in paying his/her bill.³¹⁷ PGW suggests that it be permitted to implement and report back on this program before consideration is given to extending such an option to new applicants, as Mr. Colton suggested,³¹⁸ or imposing a more mandatory program.

d. Budget Billing

Regarding budget billing, PGW witness Gyory testified that in FY 2006, PGW undertook a multi-faceted program to educate customers about the availability and benefits of budget billing which included print ads, radio spots, cable ads, Spanish television ads, transit and billboard advertising, public relations and community outreach activities, street teams, energy assistance phone-a-thons, bill inserts, training social service agencies.³¹⁹ Currently an average of 48,000 residential customers are utilizing budget billing.³²⁰ While this education program has been successful, PGW does not support imposition of a mandatory budget billing program, as recommended by OCA witness Colton³²¹ for several reasons. First, automatic budget billing does not guarantee that a payment troubled customer will pay his/her bill more consistently.³²² Second, a program that automatically places someone on a mandatory payment plan because they miss one payment may result in an overly draconian and inappropriate response to one

³¹⁷ Tr. at 949-950.

³¹⁸ *Id.*

³¹⁹ PGW St. 6 at 11-12.

³²⁰ *Id.* at 12.

³²¹ OCA St. 4 at 21-27.

³²² PGW St. 6R at 15.

missed payment and result in a potential violation of Chapter 14.³²³ Third, implementing the program in November of each year would have an impact on PGW's cash flow because November and the winter period is the time of the year when PGW's highest gas bills become due to its suppliers; therefore, collecting as much as possible at this time of the year is very important to PGW.³²⁴ Finally, implementing a mandatory budget billing program would require modification to PGW's billing systems which would have a financial impact on PGW.³²⁵ As an alternative to being directed to implement a mandatory budget billing program, PGW is willing to study the implications of such a program as part of its customer segmentation study that it plans to undertake this year with data available probably by the second quarter of 2008.³²⁶

2. PGW's Universal Service Programs

PGW serves approximately 500,000 customers located exclusively in the City of Philadelphia.³²⁷ Based on census data, PGW estimates that there are approximately 152,500 customers at or below 150% of the FPL.³²⁸ PGW has been successful in keeping thousands of low-income residents and seniors on the system, with safe and affordable gas bills, while seeking to maximize individual contributions from those customers.³²⁹ PGW's current universal service programs include the Customer Responsibility Program ("CRP"), the Conservation Works Program ("CWP"), the Customer Assistance Referral Evaluation Program ("CARES"), LIHEAP

³²³ Tr. at 944.

³²⁴ Tr. at 945.

³²⁵ *Id.*

³²⁶ Tr. at 946; Tr. at 976-77.

³²⁷ PGW St. 7R at 10-17.

³²⁸ *Id.* at 4.

³²⁹ *Id.* at 2-3.

Outreach, Hardship Fund through the Utility Emergency Services Fund ("UESF"), and the Senior Citizen Discount Program.³³⁰ All together the costs of these benefits range from \$110 to \$210 million per year, costs that all other rate payers must subsidize.³³¹ Each of these programs are more extensively explained in the testimony of PGW witness Cristina Coltro.³³²

The current enrollment level in CRP, as reflected in the record is 75,093, which is the highest level of participation since the inception of the program and PGW expects that by the end of the future test year (FY 2007), there will be approximately 76,500 customers enrolled.³³³ This figure also represents approximately half of the 152,500 customers PGW estimates have incomes at or below 150% of the FPL.³³⁴ PGW has incentive to ensure the highest level of participation in CRP since it provides customers with the ability to timely pay their bills, and PGW has undertaken significant efforts to increase CRP enrollment over the last two years.³³⁵

The cost of the CRP program is recovered through PGW's Universal Service Charge ("USC"), a reconcilable charge that is adjusted quarterly.³³⁶ As directed by the Commission in PGW's restructuring proceeding,³³⁷ PGW has made an analysis of the additional costs that it incurs or avoids when a customer enrolls in CRP and any cost savings that might be realized as a

³³⁰ PGW St. 7 at 2; PGW St. 7R at 2.

³³¹ PGW St. 6R at 3.

³³² PGW St. 7 at 2-10; PGW St. 7R at 2-16.

³³³ PGW St. 7 at 4; PGW Exh. CC-1.

³³⁴ PGW St. 7R at 4.

³³⁵ *Id.* at 5.

³³⁶ PGW St. 7 at 4.

³³⁷ *Pennsylvania Public Utility Commission v. Philadelphia Gas Works, M-00021612 et al.*, March 31, 2003 at 52-53.

result of the projected test year level of CRP customers are already incorporated into PGW's projection of test year financial data.³³⁸ PGW is not proposing any cost offsets in its USC.³³⁹

In terms of the other discounts/programs available to PGW customers, approximately 46,000 senior citizens receive a monthly 20% discount on their bills.³⁴⁰ Gas allowances are also provided to approximately 7,000 Philadelphia Housing Authority tenant customers.³⁴¹ PGW also accepts medical certifications and offers regular payment arrangements and budget billing as a way to assist its customers in paying their bills.³⁴²

PGW's policies provide customers and applicants with a reasonable opportunity to maintain continuous service without unreasonable interruptions or delays.³⁴³ Through its programs and policies, PGW offers customers numerous opportunities to avoid termination.³⁴⁴ As stipulated between PGW and AASCGP, the Commission's regulations and policies impose an obligation on both the utility and the customer to deal in good faith. A utility is obligated to provide safe, adequate, and reasonable service in accordance with the law, Commission regulations and its legally approved tariff. The customer's concomitant obligation is to satisfy any applicable payment obligations including any payment arrangements entered into with the utility.³⁴⁵ PGW's reconnection policies are consistent with Chapter 14 restoration terms and

³³⁸ PGW St. 7 at 10-11; PGW Exh. CC-2.

³³⁹ PGW St. 7 at 11.

³⁴⁰ PGW St. 7R at 5.

³⁴¹ *Id.* at 6-8.

³⁴² PGW St. 7R at 2.

³⁴³ PGW St. 6R at 5.

³⁴⁴ PGW St. 6R at 5; Tr. at 935-936.

³⁴⁵ PGW Hearing Exh. No. 1.

regulations and are reasonable.³⁴⁶ All of PGW's policies are mindful of the need to balance the financial circumstances of its customers with the need of PGW to receive payment for services rendered.³⁴⁷

AASCGP is critical of PGW's termination and reconnection policies and relies solely on the claims of PGW customers without service during the time of the 2006 Cold Weather Survey to justify this criticism.³⁴⁸ However, this reliance is misplaced. The Cold Weather Survey is designed to identify those customers without service at a specific time and to provide information regarding possible restoration for customers without gas service. PGW's provision of utility service covers a whole range of issues, including the provisioning of safe, adequate and reliable service to its entire customer base.³⁴⁹ AASCGP does not accuse PGW of specific violations of the law.³⁵⁰ Relying solely on the number of customers without service pursuant to the Cold Weather Survey, AASCGP offers a panoply of suggestions from wholesale revision of customer notices to complete revisions of PGW's customer service systems to severe reductions in fees for various services, despite the costs of these services to PGW.³⁵¹ In making these suggestions, AASCGP did not estimate either the costs to PGW to implement the proposals or the effectiveness of the proposals.³⁵² PGW has a responsibility to its entire customer base and must balance a broad range of issues associated with service in its customer base to ensure that

³⁴⁶ PGW St. 6R at 5-6.

³⁴⁷ PGW St. 7R at 12.

³⁴⁸ AA St. 1 at 4.

³⁴⁹ PGW St. 6R at 4.

³⁵⁰ AASCGP St. N.1-SR at 2.

³⁵¹ AA St. 1 at 47-48.

³⁵² PGW Exh. RG-3.

all customers receive safe, adequate and reliable service. Implementing AASCGP's proposals would shift more costs to PGW's entire customer base which includes low income and working poor customers, even though there is no evidence that PGW is not complying with PUC regulations with regard to any of the issues raised by AASCGP and no evidence that implementation of the AASCGP recommendations would be effective or, for any reason, appropriate. Moreover, to the extent that there would be any delay in recovering the additional amounts needed to implement AASCGP's suggestions through rate increases, PGW would have to find some way to fund the projects which would thereby compounding PGW's current financial difficulties.³⁵³ In short, PGW is committed to appropriately balancing the needs of its customer base, its entire customer base, with the importance of remaining a viable company. While AASCGP does identify some issues of importance for PGW's low-income customers, its inaccurate picture of PGW's operating procedures and far-reaching, costly suggestions must be rejected. These issues would be more appropriately taken up with the State legislature.

3. Tariff Revisions

PGW's currently effective tariff contains detailed provisions which PGW utilized prior to becoming regulated by the Commission in 2000.³⁵⁴ While these detailed provisions were appropriate prior to the Commission's jurisdiction, they are no longer sustainable for several reasons. First, they may create confusion regarding the applicable standards.³⁵⁵ Second, there have been significant changes in the law as a result of Chapter 14 which have rendered many of these provisions inapplicable. Finally, PGW's proposed revisions will streamline the tariff in line

³⁵³ PGW St. 6R at 3.

³⁵⁴ PGW St. 6 at 12.

³⁵⁵ *Id.* at 13.

with the tariff format used by most other regulated utilities.³⁵⁶ Aside from amending its proposed tariff to be clear that PGW is now subject to 66 Pa. C.S. 1521, *et. seq.*, PGW's proposed revisions as presented accurately reflect the changes in law will provide less confusion for customers and must be accepted.³⁵⁷

AASCGP was the only party critical of PGW's suggested tariff revisions, claiming that they would deprive customers of notice and/or remove some of the customer protections AASCGP views as existing in PGW's current tariff.³⁵⁸ AASCGP is incorrect on both assertions. First, the "company policies" PGW proposes to reference in its revised tariff are reviewed extensively to ensure that they are consistent with the law and Commission regulations and PGW's intent in referencing them is to provide notice to the customers of their existence.³⁵⁹ The reference to these policies in PGW's tariff will provide customers with notice of their existence.

Second, none of the tariff revisions remove any rights currently held by PGW's customers and AASCGP has not provided evidence that rights would, in fact, be affected by these changes.³⁶⁰ AASCGP's focus on various tariff sections, such as the current Section 8.3.D, as proof that PGW's deletion of these sections is intended to remove customer rights is misplaced. Removing tariff sections which merely restate the law and existed in PGW's tariff prior to the Commission's jurisdiction is a reasonable position that will lead to a more streamlined, accurate and appropriate tariff for PGW and its customers. Similarly, removing practices which were

³⁵⁶ *Id.*

³⁵⁷ PGW St. 6R at 18.

³⁵⁸ AA St. 1 at 38.

³⁵⁹ PGW St. 6R at 16; Tr. at 942-943.

³⁶⁰ PGW St. 6 at 13; PGW St. 6R at 18.

never required and were provided as a matter of discretion – and which the Company has stated it intends to continue – merely confirms PGW's tariff to the approach used by every other utility.³⁶¹ Even AASCGP admits that some of the tariff provisions it advocates for PGW do not exist in any other utility's tariff.³⁶² Therefore, aside from permitting PGW to amend its proposed tariff to be clear that PGW is now subject to 66 Pa. C.S. 1521, *et. seq.*, PGW's proposed revisions as presented accurately reflect the changes in law and must be accepted.³⁶³

E. Competitive Issues

1. Hess/IGS revisions to supplier tariff/rules

Hess Corporation ("Hess") and Interstate Gas Supply, Inc. ("IGS") argue that various PGW supplier tariff provisions and operational rules are impeding the development of retail competition on the Company's system. Hess has proposed various revisions to the Company's supplier tariff and operational rules which Hess believes will promote competition, while IGS has expressed concern with some provisions of the Company's supplier tariff that IGS describes as "one-sided" or "potentially costly".

Hess's proposals concern: (1) NGS nominations of gas supply deliveries to PGW's system; (2) balancing and reconciliation of NGS deliveries compared to the consumption by NGS interruptible customers (imbalances); (3) cash outs and penalties associated with daily and monthly imbalances for interruptible customers, and treatment of annual imbalances for firm transportation customers; and (4) imbalance netting between a supplier's pools for interruptible and firm customers, as well as imbalance trading between suppliers and their pools for

³⁶¹ PGW St. GR at 18-19.

³⁶² PGW Exh. RG-5.

³⁶³ PGW St. GR at 18.

interruptible and firm customers. As PGW witness William Muntzer explained, the problem with Hess' proposals is that they would jeopardize the Company's ability to maintain control and reliability of its system, result in unnecessary and costly use of LNG and storage assets, and be very expensive to implement.³⁶⁴

The Company is committed to gas choice, and believes its tariff and operational rules are in compliance with the Gas Choice Act and PUC requirements and do not impede the development of retail competition on its system.³⁶⁵ Indeed, the Company stipulated with IGS that a competitive gas market in its service territory could provide benefits for consumers at all customer levels, that increased use of transportation by PGW customers may also reduce PGW costs, and that PGW welcomes NGSs on its system.³⁶⁶

However, PGW is not willing to further demonstrate its commitment to gas choice by implementing proposals that jeopardize the Company's ability to maintain the safety and reliability of its system or impose unnecessary and unreasonable costs on the Company or firm customers. Specifically, the Company is willing to: (1) extend the deadline for day-ahead nominations of gas supply deliveries to its system from 12 noon to 12:30 p.m. to accommodate upstream interstate pipeline contracts finalized after the noon deadline;³⁶⁷ (2) insert language into the supplier tariff stating the Company's use of the FERC interest rate to calculate the carrying

³⁶⁴ PGW St. 11 at 1-19; PGW St. 11-RJ at 1-7.

³⁶⁵ PGW St. 11 at 15.

³⁶⁶ PGW Hearing Exh. 2.

³⁶⁷ PGW St. 11 at 3. The Company's current practice of permitting intra day nominations on a best efforts basis as well as the Company's current practice of permitting corrections of nomination errors on a case-by-case basis, also provide ways to accommodate Hess's concerns. *Id.* at 4; PGW St. 11-RJ at 1-2.

charge on gas loaned to suppliers of firm customers;³⁶⁸ (3) update and provide the Marketing File for Commercial and Industrial ("C&I") customers monthly instead of quarterly;³⁶⁹ and (4) run the customer enrollment processing jobs at 10:00 a.m. and 12 noon to provide additional opportunities for suppliers to fix their customer enrollment mistakes.³⁷⁰ These steps should make easier and less expensive for Hess and other suppliers to operate on PGW's system.

PGW witness Muntzer explained how Hess's other proposals would jeopardize the Company's ability to maintain control and reliability of its system, result in unnecessary and costly use of LNG and storage assets, and be very expensive to implement, and therefore why Hess's proposals should not be adopted.³⁷¹ The operational limitations of the Company's system are of particular significance to understanding why Hess's proposals should not be adopted. As Mr. Muntzer explained, the Company is served by only two interstate pipeline in capacity constrained Southeastern Pennsylvania, its gate stations are located on pipeline laterals instead of mainlines, and it contracts with interstate pipelines for storage services because the Company is not storage rich and owns no underground storage.³⁷² The Company maintains the safety and reliability of its system and firm service through coordinated operation of the Company's

³⁶⁸ *Id.* at 9.

³⁶⁹ *Id.* at 13.

³⁷⁰ *Id.* at 15. Of course, instead of waiting until the enrollment deadline, suppliers could submit enrollments on the day before the deadline to permit additional time to correct their mistakes. *Id.* at 14.

³⁷¹ PGW St. 11 at 3-4; PGW St. 11-RJ at 1-2 (extend day-ahead nomination deadline to 2:00 p.m.); PGW St. 11 at 3-4; PGW St. 11-RJ at 2-4 (require PGW to accept retroactive nominations); PGW St. 11 at 5-7 (eliminate daily balancing); PGW St. 11 at 7-8; PGW St. 11-RJ at 3 (change daily balancing tolerance level/penalty); PGW St. 11 at 8 (reduce month end cash out rates); PGW St. 11 at 10-11; PGW St. 11-RJ at 4-5 (imbalance netting/trading); PGW St. 11 at 13-14; PGW St. 11-RJ at 5-7 (changes to provision of customer information and customer enrollment processes).

³⁷² PGW St. 11 at 5-6.

upstream supply system assets.³⁷³ The Company's daily balancing requirements, which are the focus of Hess's proposals, are crucial to the Company's ability to maintain control and reliability of its system, and Hess's proposals to relax or weaken these requirements – aside from the costs to firm customers and to PGW – simply present too much risk to the Company and its firm customers.³⁷⁴

2. IGS residential customer aggregation proposal

IGS made two undeveloped proposals which IGS believes would help to develop retail competition on the Company's system: (1) a market share threshold ("MST") type of process as used in PECO's electric service territory; and (2) auctioning the Company's SOLR obligation to suppliers after the MST process produced meaningful retail competition. IGS conditioned its MST proposal on making the Company's billing system, in IGS's view, workable for gas choice. Mr. Muntzer explained why IGS was wrong in concluding that the Company's billing system is "unacceptable" and that the Company is unable or unwilling to invest in modifications to its billing system.³⁷⁵ Moreover, Mr. Muntzer explained the excessive and unreasonable cost to implement an experimental MST process on the Company's system as well as a wholesale SOLR auction.³⁷⁶ Accordingly, the record supports only rejection of IGS's undeveloped proposals.

F. Gas Safety

³⁷³ *Id.* at 6.

³⁷⁴ In addition, IGS, which has not been a supplier on PGW's system, argues that some of the Company's supplier tariff provisions are "open-ended," "one-sided" or "potentially costly" provisions and are impeding the development of competition. IGS witness Parisi identified only two (2) provisions, (Sections 4.1 and 7.5) and Mr. Muntzer explained why IGS's concerns are overstated and do not require any changes to the supplier tariff. PGW St. 11 at 18-19. Also, as stated above, the Company stipulated with IGS concerning the Company's commitment to gas choice. Accordingly, the record supports rejection of IGS's concerns and vague proposals.

³⁷⁵ PGW St. 11 at 16.

³⁷⁶ *Id.* at 16-18.

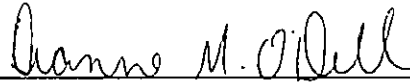
In response to an issue raised by OTS witness Graeser concerning PGW's class 2 leak repair policy,³⁷⁷ the Company and OTS entered into a stipulation in which PGW agreed to conduct an independent evaluation which shall include the costs and benefits of PGW's present policy as well as a projection of the cost and benefits of any modifications of that policy. PGW agreed that the evaluation will occur in conjunction with its pending study regarding its cast iron main replacement program. The Class 2 leak repair evaluation report shall be completed within nine months of entry date of the Commission Order in this proceeding. PGW believes that the Stipulation is a reasonable resolution of this issue and should be approved.

³⁷⁷ OTS St. 5 at 5-6; PGW responded to OTS's testimony at St. 5R at 10-13; PGW Hearing Exh. 3.

IV. CONCLUSION

For the reasons stated above, Philadelphia Gas Works respectfully requests the Commission issue an Order consistent with this Brief and which incorporates the Proposed Ordering Paragraphs as set forth in Appendix H hereto.

Respectfully submitted,



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Dated: June 12, 2007

APPENDIX A

SECRETARY'S BUREAU

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SECRETARY'S BUREAU

**Appendix A - Part I Bad Debt
Expenses Calculated on Total
Revenues**

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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		\$ 114,834	\$ 116,734	\$ 112,487	\$ 106,113	\$ 105,845	\$ 105,471
Gas Transport Service	4,679	6,147	7,256		7,256	7,869	8,461	8,983	9,465	9,908
Heating	713,159	821,190	820,732	6,497 A	827,229	845,817	816,568	762,697	757,378	749,166
Proposed Base Rate	-	-	-	(3,396) B	(3,396)	-	-	-	-	-
Weather Normalization Adjustment	(1,365)	12,500	-							
Unbilled Adjustment	(803)	2,513	(732)		(732)	521	(377)	(714)	(59)	(91)
Total Gas Revenues	830,550	956,562	942,090	3,101	945,191	970,981	937,139	877,079	872,629	864,454
Appliance Repair & Other Revenues	10,695	10,669	10,532		10,532	10,743	10,957	11,177	11,400	11,628
Other Operating Revenues	21,912	17,865	18,032		18,032	18,438	17,813	16,678	16,581	16,426
Total Other Operating Revenues	32,807	28,534	28,564	-	28,564	29,181	27,770	27,855	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	3,101	973,755	1,000,142	965,909	904,934	900,610	892,508
OPERATING EXPENSES										
Natural Gas	509,700	639,180	630,836	4,546 C	635,382	658,487	623,363	582,396	558,243	550,889
Other Raw Material	4	5	5		5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	4,546	635,387	658,492	623,368	582,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	339,813	(1,445)	338,368	341,650	342,541	342,533	342,362	341,614
Gas Processing	18,584	16,206	15,715		15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,455	27,377	34,698		34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536		16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944		7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125		14,125	14,168	14,388	14,657	14,863	15,152
Account Management	7,695	7,928	7,625		7,625	7,690	7,767	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	52,258	(8,579) D	43,679	47,729	43,864	40,087	36,854	34,124
Marketing	2,592	2,470	2,992		2,992	3,086	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	(240) E	43,723	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	(460) F	37,324	41,944	45,904	49,654	53,719	58,128
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)		(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)		(7,950)	(7,258)	(7,529)	(7,376)	(7,220)	(7,008)
Amortization of Restructuring Costs	1,087	1,087	-		-	-	-	-	-	-
Pensions	14,702	17,297	15,075		15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485		6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-		-	-	383	507	639	753
Pro Forma Adjustments	-	-	217		217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)		(6,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	229,932	(9,279)	220,653	236,697	239,559	241,072	243,473	247,170
Depreciation	35,904	36,928	38,213		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	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)		(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	268,128	(9,279)	258,849	278,151	280,407	283,136	286,993	290,653
TOTAL OPERATING EXPENSES	793,012	917,374	898,969	(4,733)	894,236	936,643	903,775	845,537	845,241	841,547
OPERATING INCOME	70,345	67,722	71,685	7,834	79,519	63,499	62,134	59,397	55,369	50,961
Other Income	4,778	8,198	11,212		11,212	11,343	9,620	7,723	7,820	7,160
INCOME BEFORE INTEREST	75,123	75,920	82,897	7,834	90,731	74,842	71,754	67,120	63,189	58,121
INTEREST										
Long-Term Debt	53,856	51,778	56,437	2,708 G	59,145	56,698	61,578	61,236	65,202	64,046
Other	6,123	9,561	13,186		13,186	13,229	13,643	13,684	14,076	14,059
AFUDC	(907)	(1,168)	(1,202)		(1,202)	(1,002)	(1,036)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557		5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	2,708	76,686	74,131	79,036	78,430	82,400	81,074
NET INCOME	11,272	10,417	8,919	5,126	14,045	711	(7,282)	(11,310)	(19,277)	(22,953)
City Payment	-	-	-		-	-	-	-	-	-
Net Earnings	\$ 11,272	\$ 10,417	\$ 8,919	\$ 5,126	\$ 14,045	\$ 711	\$ (7,282)	\$ (11,310)	\$ (19,277)	\$ (22,953)

Appendix A - Part II Bad Debt
Expense Calculated on Gas Revenue

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-08	BUDGET 2006-07	Adjustments	Revised 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	\$ 3,101	\$ 945,191	\$ 970,961	\$ 937,139	\$ 877,079	\$ 872,629	\$ 864,454
Other Operating Revenues	32,807	28,534	28,564		28,564	29,181	28,770	27,855	27,981	28,054
Total Operating Revenues	863,357	985,098	970,654	3,101	973,755	1,000,142	965,909	904,934	900,610	892,508
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,097	11,250		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	18,000		
AFUDC (Interest)	907	1,168	1,202		1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,001,106	3,101	1,004,207	1,030,487	994,565	931,665	909,415	900,627
FUNDS APPLIED										
Fuel Costs	509,704	639,185	630,841	4,546	635,387	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	268,128	(10,564)	257,564	278,151	280,407	283,136	286,993	290,653
Total Operating Expenses	793,012	917,374	898,969	(6,018)	892,951	936,643	903,775	845,537	845,241	841,547
Less: Non-Cash Expenses	39,338	40,554	41,887	-	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	857,082	(6,018)	851,064	893,343	859,163	799,630	797,856	794,143
Funds Available to Cover Debt Service	130,103	139,541	144,024	9,119	153,143	137,144	135,402	132,035	111,559	108,484
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748		35,748	34,368	32,368	30,155	30,745	32,184
Debt Service Coverage 1975 Bonds	3.35	3.33	4.03		4.28	3.99	4.18	4.38	3.63	3.31
Net Available after Prior Debt Service	91,297	97,592	108,276	9,119	117,395	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	9,119	117,395	102,776	103,034	101,880	80,814	74,320
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	5,145	58,458	67,813	71,727	84,111	85,579	92,018
New Proposed Bond Debt Service	-	-	-		-	-	-	-	-	-
Total New Debt Service	45,999	32,467	53,313	5,145	58,458	67,813	71,727	84,111	85,579	92,018
Debt Service Coverage 1998 Bonds	1.94	3.01	2.03		2.01	1.52	1.44	1.21	0.94	0.81
Net Available after 1998 Debt Service	43,300	65,125	54,963	3,974	58,937	34,963	31,307	17,769	(4,765)	(17,696)
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987		1,987	1,966	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	27.66		29.66	17.60	15.73	8.95	(2.40)	(8.92)
Net Available To Service Aggregate Debt Serv	111,075	114,154	122,295	9,119	131,414	115,298	113,638	110,192	107,894	102,563
Aggregate Debt Service	88,790	76,402	91,048	5,145	96,193	104,167	106,085	116,252	118,312	126,164
Fixed Coverage Charge	1.25	1.48	1.34		1.37	1.11	1.07	0.95	0.91	0.81
Fixed Coverage Charge including \$18.0 City Fee	1.04	1.21	1.12		1.15	0.94	0.92	0.82	0.79	0.71

Appendix A - Part I Bad Debt Expenses Calculated on Total Revenues

PHILADELPHIA GAS WORKS
CASHFLOW STATEMENT
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-08	BUDGET 2006-07	Adjustments	Revised 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	\$ 8,919	\$ 5,126	\$ 14,045	\$ 711	\$ (7,282)	\$ (11,310)	\$ (19,277)	\$ (22,953)
Depreciation & Amortization	42,281	43,928	46,007		46,007	47,128	48,468	49,476	50,999	50,755
Earnings on Restricted Funds	(3,265)	3,899	38		38	-	-	-	-	-
Elimination of Accrued Interest on Refunded Debt	-	3,186				-	-	-	-	-
Increased/(Decreased) Other Assets/Liabilities	(6,917)	(1,024)	911		911	716	808	915	(8,203)	(11,639)
Available From Operations	43,371	60,406	55,875	5,126	61,001	48,555	41,994	39,081	23,519	16,163
Funds Required for Capital	68,000	60,195	72,000		72,000	60,000	63,000	61,000	60,000	58,000
Grant Income	18,000	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	20,000		20,000	55,000	5,000			
TOTAL SOURCES	139,697	168,305	165,875	5,126	171,001	181,555	127,994	118,081	83,519	74,163
USES										
Net Construction Expenditures	66,910	68,057	75,152		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	5,145 H	41,820	47,010	46,530	54,530	45,929	48,920
PMA Lease/Subordinate Debt	1,255	1,310	1,370		1,370	1,430	1,500	1,565	1,640	1,715
Capital Lease	1,947	-	-		-	-	-	-	-	-
Debt Reduction Funding										
Temporary Financing Repayment	850	-	-		-	-	-	-	-	-
City Loan Repayment/Status	-	-	2,000		2,000	43,000	-	-	-	-
Distribution of Earnings	18,000	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	(8,118)		(8,118)	(5,193)	(16,830)	(7,090)	(4,960)	1,431
Cash Needs	128,142	172,706	125,079	5,145	130,224	182,844	136,955	137,823	122,196	129,986
Cash Surplus (Shortfall)	11,555	(4,401)	40,796	(19)	40,777	(1,289)	(8,961)	(19,742)	(38,677)	(55,823)
TOTAL USES	139,697	168,305	165,875	5,126	171,001	181,555	127,994	118,081	83,519	74,163
Cash - Beginning of Period	3,666	15,221	10,820		10,820	51,616	50,327	41,366	21,624	(17,053)
Cash - Surplus (Shortfall)	11,555	(4,401)	40,796	(19)	40,777	(1,289)	(8,961)	(19,742)	(38,677)	(55,823)
ENDING CASH	15,221	10,820	51,616	(19)	51,597	50,327	41,366	21,624	(17,053)	(72,876)
Outstanding Commercial Paper	49,900	70,000	90,000		110,000	145,000	150,000	150,000	150,000	150,000
City Loan Outstanding	45,000	45,000	43,000		43,000	-	-	-	-	-
Internally Generated Funds	-	-	-		-	-	-	-	-	-

Appendix A - Part I Bad Debt Expenses Calculated on Total Revenues

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-08	BUDGET 2006-07	Adjustments	Revised 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	\$ 3,101	\$ 945,191	\$ 970,981	\$ 937,139	\$ 877,079	\$ 872,629	\$ 864,454
Other Operating Revenues	32,807	28,534	28,564		28,564	29,181	28,770	27,855	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	3,101	973,755	1,000,142	965,909	904,934	900,610	892,508
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,097	11,250		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	18,000	18,000	18,000
AFUDC (Interest)	907	1,168	1,202		1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,001,106	3,101	1,004,207	1,030,487	994,565	931,665	909,415	900,627
FUNDS APPLIED										
Fuel Costs	509,704	639,185	630,841	4,546	635,387	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	268,128	(9,279)	258,849	278,151	280,407	283,136	286,993	290,653
Total Operating Expenses	793,012	917,374	898,969	(4,733)	894,236	936,643	903,775	845,537	845,241	841,547
Less: Non-Cash Expenses	39,338	40,554	41,887	-	41,887	43,300	44,812	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	857,082	(4,733)	852,349	893,343	859,163	799,630	797,856	794,143
Funds Available to Cover Debt Service	130,103	139,541	144,024	7,834	151,858	137,144	135,402	132,035	111,559	106,484
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748		35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	4.03		4.25	3.99	4.18	4.38	3.63	3.31
Net Available after Prior Debt Service	91,297	97,592	108,276	7,834	116,110	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	7,834	116,110	102,776	103,034	101,880	80,814	74,320
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	5,145	58,458	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	5,145	58,458	67,813	71,727	84,111	85,579	92,016
Debt Service Coverage 1998 Bonds	1.94	3.01	2.03		1.99	1.52	1.44	1.21	0.94	0.81
Net Available after 1998 Debt Service	43,300	65,125	54,963	2,689	57,652	34,963	31,307	17,769	(4,765)	(17,696)
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987		1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	27.66		29.01	17.60	15.73	8.95	(2.40)	(8.92)
Net Available To Service Aggregate Debt Serv	111,075	114,154	122,295	7,834	130,129	115,298	113,638	110,192	107,694	102,563
Aggregate Debt Service	88,790	76,402	91,048	5,145	96,193	104,167	106,085	116,252	118,312	126,164
Fixed Coverage Charge	1.25	1.49	1.34		1.35	1.11	1.07	0.95	0.91	0.81
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	1.12		1.14	0.94	0.92	0.82	0.79	0.71

**Appendix A - Part I Bad Debt
Expenses Calculated on Total
Revenues**

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

	Actual 8/31/05	Estimate 8/31/06	Budget 8/31/07	Adjustments	Revised 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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940
Sinking Fund Reserve	104,530	93,800	102,050	5,622	107,672	102,050	110,300	110,300	118,550	118,550
Capital Improvement Fund	102,701	39,732	99,843	44,378	144,221	39,843	108,993	47,993	120,143	62,143
Cash	15,221	10,820	51,616	(19)	51,597	50,327	41,366	21,624	(17,053)	(72,876)
Gas	273,805	264,254	243,806		243,806	226,927	211,043	195,196	181,647	170,269
Other	12,522	785	506		506	352	350	350	350	350
Accrued Gas Revenues	8,787	11,300	10,568		10,568	11,089	10,712	9,998	9,939	9,848
Reserve for Uncollectible	(207,480)	(191,631)	(183,489)		(183,489)	(173,618)	(162,382)	(149,869)	(136,623)	(123,247)
Accounts Receivable:	87,634	84,708	71,391		71,391	64,750	59,723	55,675	55,313	57,220
Materials & Supplies	129,984	183,784	180,389		180,389	176,809	162,083	159,236	155,999	152,694
Other Current Assets	(164)	2,986	3,056		3,056	3,236	3,441	3,596	3,751	3,906
Deferred Debits	2,796	8,448	3,228		3,228	2,487	2,362	2,262	2,337	2,387
Unamortized Bond Issuance Expense	39,094	42,089	46,912		46,912	43,166	47,671	43,651	47,920	43,676
Unamortized Extraordinary Loss	38,494	55,859	50,301		50,301	45,095	40,244	35,726	31,552	27,624
Deferred Environmental	9,513	9,513	9,513		9,513	8,000	6,500	5,000	3,500	2,000
Other Assets	8,297	3,411	2,881		2,881	2,925	3,030	3,138	3,250	3,365
TOTAL ASSETS	1,519,822	1,548,001	1,670,970	49,981	1,720,951	1,627,510	1,721,465	1,652,680	1,707,797	1,599,629
EQUITY & LIABILITIES										
City Equity	222,646	233,063	241,982	5,126	247,108	242,693	235,411	224,101	186,824	145,871
Revenue Bonds	1,045,371	1,042,430	1,154,385	44,855	1,199,240	1,105,945	1,207,915	1,151,820	1,254,251	1,203,616
TECA Accretions	14,313	12,608	13,913		13,913	15,314	16,818	18,434	10,933	
Unamortized Discount	(9,484)	(5,113)	(5,683)		(5,683)	(5,201)	(5,732)	(5,217)	(5,733)	(5,220)
Unamortized Premium	22,901	20,797	18,826		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	44,855	1,226,296	1,133,014	1,234,184	1,178,553	1,271,447	1,208,946
Notes Payable	49,900	70,000	90,000		90,000	145,000	150,000	150,000	150,000	150,000
City Loan	45,000	45,000	43,000		43,000	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468		59,468	57,930	52,987	53,688	53,234	52,826
Customer Deposits	6,280	8,250	9,000		9,000	8,750	8,500	8,000	7,500	7,000
Other Current Liabilities	3,734	3,431	2,129		2,129	2,137	2,195	2,254	2,313	2,372
Deferred Credits	14,608	5,814	4,724		4,724	1,323	1,326	1,331	1,336	1,341
Accrued Interest	9,591	12,224	14,374		14,374	13,945	15,963	15,427	17,387	16,837
Accrued Taxes & Wages	3,861	4,231	2,796		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	3,000
Other Liabilities	24,183	19,981	19,056		19,056	16,901	14,811	12,717	10,626	8,536
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,670,970	49,981	1,720,951	1,627,510	1,721,465	1,652,680	1,707,797	1,599,629

**Appendix A - Part I Bad Debt
 Expenses Calculated on Total
 Revenues**

Capitalization

	FY2005	FY2006	FY2007	Adjustments	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012
Total Capitalization	1,295,747	1,303,785	1,423,423	42,527	1,473,404	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	44,855	1,226,296	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		0.83	0.82	0.84	0.84	0.87	0.89
Capitalization Ratio	4.82	4.59	4.88		4.96	4.67	5.24	5.26	6.81	8.29
Plant in Service	1,517,046	1,573,346	1,641,403		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		75,152	78,597	87,755	70,818	61,587	59,920
Total Plant	1,573,346	1,641,403	1,716,555		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)		(666,765)	(706,330)	(747,155)	(789,246)	(832,777)	(876,292)
Net Utility Plant	981,722	1,012,851	1,049,790		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940

Appendix A - Part I Bad Debt

Brief - \$100.0M + \$10.0M Rate Increase
Bad Debt 4.5% on TOTAL Revenues

Expenses Calculated on Total Revenues

PHILADELPHIA GAS WORKS STATEMENT OF INCOME (Dollars In Thousands)

JRB-BRIEF-13B-TR

	ACTUAL 2004-05	ESTIMATE 2005-06	Test Year BUDGET 2006-07	Adjustments	Revised 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		\$ 115,126	\$ 117,022	\$ 112,771	\$ 106,389	\$ 108,117	\$ 105,739
Gas Transport Service	4,679	6,147	7,256		7,256	7,889	8,461	8,983	9,465	9,908
Heating	713,159	821,190	824,440	7,100 A	831,540	849,529	820,284	766,421	761,108	752,898
Proposed Base Rate	-	-	100,000	(3,396) B	96,604	100,000	100,000	100,000	100,000	100,000
Weather Normalization Adjustment	(1,365)	12,500	-		-	-	-	-	-	-
Unbilled Adjustment	(803)	2,513	505		505	522	(376)	(713)	(58)	(89)
Total Gas Revenues	830,550	956,562	1,047,327	3,704	1,051,031	1,074,962	1,041,140	981,080	978,630	968,456
Appliance Repair & Other Revenues	10,895	10,669	10,532		10,532	10,743	10,957	11,177	11,400	11,628
Other Operating Revenues	21,912	17,865	20,008		20,008	20,414	19,789	18,654	18,557	18,402
Total Other Operating Revenues	32,807	28,534	30,540	-	30,540	31,157	30,746	29,831	29,957	30,030
Total Operating Revenues	863,357	985,096	1,077,867	3,704	1,081,571	1,106,119	1,071,886	1,010,911	1,008,587	998,486
OPERATING EXPENSES										
Natural Gas	509,700	639,180	630,835	4,524 C	635,360	658,487	623,363	562,396	558,243	550,889
Other Raw Material	4	5	5		5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	4,524	635,365	658,492	623,368	562,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	447,026	(820)	446,206	447,627	448,518	448,510	448,339	447,592
Gas Processing	18,584	18,206	15,715		15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,455	27,377	34,698		34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536		16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944		7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125		14,125	14,168	14,398	14,657	14,863	15,152
Account Management	7,695	7,928	7,625		7,625	7,890	7,787	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	59,546	(11,042) D	48,504	58,962	56,235	52,563	48,645	48,943
Marketing	2,592	2,470	2,992		2,992	3,088	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	(240) E	43,723	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	(460) F	37,324	41,944	45,904	49,654	53,719	58,126
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)		(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)		(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		15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485		6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-		-	-	383	507	639	753
Pro Forma Adjustments	-	-	217		217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)		(6,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	237,220	(11,742)	225,478	249,930	251,930	253,548	255,264	259,989
Depreciation	35,904	36,928	38,213		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	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)		(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	275,416	(11,742)	263,674	289,384	292,778	295,612	298,784	303,472
TOTAL OPERATING EXPENSES	793,012	917,374	906,257	(7,218)	899,039	947,876	916,146	858,013	857,032	854,366
OPERATING INCOME	70,345	67,722	171,610	10,922	182,532	158,243	155,740	152,898	149,555	144,120
Other Income	4,778	8,198	17,131	-	17,131	19,082	18,437	20,343	21,898	22,907
INCOME BEFORE INTEREST	75,123	75,920	188,741	10,922	199,663	177,325	174,177	173,241	171,436	167,027
INTEREST										
Long-Term Debt	53,856	51,778	56,437	2,708 G	59,145	56,698	54,265	51,809	48,884	46,024
Other	6,123	9,561	13,186		13,186	13,229	13,134	13,028	12,941	12,805
AFUDC	(907)	(1,168)	(1,202)		(1,202)	(1,002)	(1,038)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557		5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	2,708	76,686	74,131	71,214	68,347	65,013	61,798
NET INCOME	11,272	10,417	114,763	8,214	122,977	103,194	102,963	104,894	106,423	105,229
City Payment	-	-	-		-	-	-	-	-	-
Net Earnings	\$ 11,272	\$ 10,417	\$ 114,763	\$ 8,214	\$ 122,977	\$ 103,194	\$ 102,963	\$ 104,894	\$ 106,423	\$ 105,229

Appendix A - Part I Bad Debt

Brief - \$100.0M + \$10.0M Rate Increase
Bad Debt 4.5% on TOTAL Revenues

Expenses Calculated on Total Revenues

PHILADELPHIA GAS WORKS
CASHFLOW STATEMENT
(Dollars In Thousands)

JRB-BRIEF-13B-TR

	ACTUAL 2004-05	ESTIMATE 2005-06	Test Year BUDGET 2006-07	Adjustments	Revised 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	\$ 8,214	\$ 122,977	\$ 103,194	\$ 102,963	\$ 104,894	\$ 106,423	\$ 105,229
Depreciation & Amortization	42,281	43,928	46,007	-	46,007	47,128	47,959	48,821	49,864	49,501
Earnings on Restricted Funds	(3,265)	3,899	(381)	-	(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 Available From Operations	(6,917)	(1,024)	911	-	911	716	808	915	(8,203)	(11,639)
	43,371	60,406	161,300	8,214	169,514	148,799	147,760	148,405	140,321	163,707
Funds Required for Capital	68,000	60,195	72,000	-	72,000	60,000	39,843	-	-	-
Grant Income	18,000	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	8,214	259,514	226,799	205,603	166,405	140,321	163,707
USES										
Net Construction Expenditures	66,910	68,057	75,152	-	75,152	62,597	64,755	83,018	61,587	59,920
LNG & BCCS	-	-	-	-	-	16,000	23,000	7,800	-	-
Funded Debt Reduction:										
Revenue Bonds	35,387	29,906	38,675	5,145 H	41,820	47,010	46,530	47,920	39,479	36,020
PMA Lease/Subordinate Debt	1,255	1,310	1,370	-	1,370	1,430	1,500	1,565	1,640	1,715
Capital Lease	1,947	-	-	-	-	-	-	-	-	-
Debt Reduction Funding	-	-	40,000	-	40,000	15,000	55,000	35,000	20,000	40,000
Post Retirement Benefit Funding	-	-	-	-	-	-	-	-	-	-
Temporary Financing Repayment	850	-	40,000	-	40,000	20,000	10,000	-	-	-
City Loan Repayment/Status	-	-	2,000	-	2,000	43,000	-	-	-	-
Distribution of Earnings	18,000	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	-	1,159	(873)	(11,595)	(5,138)	99	2,840
Cash Needs	128,142	172,706	214,356	5,145	219,501	222,164	207,190	168,165	140,805	158,495
Cash Surplus (Shortfall)	11,555	(4,401)	36,944	3,069	40,013	4,635	(1,587)	(1,760)	(484)	5,212
TOTAL USES	139,697	168,305	251,300	8,214	259,514	226,799	205,603	166,405	140,321	163,707
Cash - Beginning of Period	3,666	15,221	10,820	-	10,820	47,764	52,399	50,812	49,052	48,568
Cash - Surplus (Shortfall)	11,555	(4,401)	36,944	3,069	40,013	4,635	(1,587)	(1,760)	(484)	5,212
ENDING CASH	15,221	10,820	47,764	3,069	50,833	52,399	50,812	49,052	48,568	53,780
Outstanding Commercial Paper	49,900	70,000	30,000	30,000	30,000	10,000	-	-	-	-
City Loan Outstanding	45,000	45,000	43,000	43,000	43,000	-	-	-	-	-
Internally Generated Funds	-	-	-	-	-	-	47,912	70,818	61,587	59,920

Appendix A - Part I Bad Debt

Brief - \$100.0M + \$10.0M Rate Increase
Bad Debt 4.5% on TOTAL Revenues

Expenses Calculated on Total Revenues

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

JRB-BRIEF-13B-TR

	ACTUAL <u>2004-05</u>	ESTIMATE <u>2005-06</u>	Test Year BUDGET <u>2006-07</u>	Adjustments	Revised 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	\$ 3,704	\$ 1,051,031	\$ 1,074,962	\$ 1,041,140	\$ 981,080	\$ 976,630	\$ 988,456
Other Operating Revenues	32,807	28,534	30,540		30,540	31,157	30,746	29,831	29,957	30,030
Total Operating Revenues	863,357	985,096	1,077,867	3,704	1,081,571	1,108,119	1,071,886	1,010,911	1,006,587	998,486
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,097	16,750	-	16,750	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	18,000	-
AFUDC (Interest)	907	1,168	1,202	-	1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,113,819	3,704	1,117,523	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	4,524	635,365	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	275,416	(1,200)	263,674	289,384	292,778	295,612	298,784	303,472
Total Operating Expenses	793,012	917,374	906,257	(7,218)	899,039	947,876	918,146	858,013	857,032	854,366
Less: Non-Cash Expenses	39,338	40,554	41,887	-	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	884,370	(7,218)	857,152	904,576	871,534	812,106	809,647	806,962
Funds Available to Cover Debt Service	130,103	139,541	249,449	10,922	260,371	237,388	233,855	231,931	212,043	236,006
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748		35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	6.98		7.28	6.91	7.22	7.69	6.90	7.34
Net Available after Prior Debt Service	91,297	97,592	213,701	10,922	224,623	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	10,922	224,623	203,020	201,487	201,776	181,298	203,842
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	5,145	58,458	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	5,145	58,458	67,813	66,852	67,966	65,143	60,885
Debt Service Coverage 1998 Bonds	1.84	3.01	4.01		3.84	2.89	3.01	2.97	2.78	3.35
Net Available after 1998 Debt Service	43,300	65,125	160,388	5,777	166,165	135,207	134,635	133,810	116,155	142,957
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987		1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.78	80.72		83.83	88.08	87.88	87.38	58.43	72.05
Net Available To Service Aggregate Debt Serv	111,075	114,154	228,139	10,922	239,061	217,781	216,061	216,313	215,941	211,469
Aggregate Debt Service	88,790	76,402	91,048	5,145	96,193	104,167	101,210	100,107	97,876	95,033
Fixed Coverage Charge	1.25	1.49	2.51		2.49	2.09	2.13	2.16	2.21	2.23
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	2.09		2.09	1.78	1.81	1.83	1.86	1.87

**Appendix A - Part I Bad Debt
Expenses Calculated on Total
Revenues**

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

	Actual 8/31/05	Estimate 8/31/06	Budget 8/31/07	Adjustments	Revised 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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	
Sinking Fund Reserve	104,530	93,800	102,050	5,622	112,050	102,050	102,050	102,050	102,050	102,050	
Capital Improvement Fund	102,701	39,732	99,843	44,378	139,843	39,843	-	-	-	-	
Debt Reduction Funding	-	-	40,419		40,419	57,658	116,628	157,853	185,616	-	
Cash	15,221	10,820	47,764	3,069	50,833	52,399	50,812	49,052	48,568	53,780	
Gas	273,805	264,254	254,134		254,134	240,307	224,591	205,778	186,746	167,304	
Other	12,522	785	506		506	352	350	350	350	350	
Accrued Gas Revenues	8,787	11,300	11,805		11,805	12,327	11,951	11,238	11,180	11,091	
Reserve for Uncollectible	(207,480)	(191,631)	(185,777)		(185,777)	(174,639)	(160,774)	(143,237)	(121,782)	(98,725)	
Accounts Receivable:	87,634	84,708	80,668		80,668	78,347	76,118	74,129	76,494	80,020	
Materials & Supplies	129,984	183,784	180,389		180,389	176,809	162,083	159,236	155,999	152,694	
Other Current Assets	(164)	2,986	3,056		3,056	3,236	3,441	3,596	3,751	3,906	
Deferred Debits	2,796	8,448	3,228		3,228	2,487	2,362	2,262	2,337	2,387	
Unamortized Bond Issuance Expense	39,094	42,089	46,912		46,912	43,166	39,574	36,138	32,868	29,740	
Unamortized Extraordinary Loss	38,494	55,859	50,301		50,301	45,095	40,244	35,726	31,552	27,624	
Deferred Environmental	9,513	9,513	9,513		9,513	8,000	6,500	5,000	3,500	2,000	
Other Assets	8,297	3,411	2,881		2,881	2,925	3,030	3,138	3,250	3,365	
TOTAL ASSETS	1,519,822	1,548,001	1,716,814	53,069	1,769,883	1,700,837	1,738,594	1,792,659	1,828,520	1,656,506	
EQUITY & LIABILITIES											
City Equity	222,646	233,063	347,826	8,214	356,040	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	44,855	1,199,240	1,105,945	1,057,915	1,008,430	967,311	724,576	929,576
TECA Accretions	14,313	12,608	13,913		13,913	15,314	16,818	18,434	10,933		
Unamortized Discount	(9,484)	(5,113)	(5,683)		(5,683)	(5,201)	(4,738)	(4,295)	(3,885)	(3,509)	(3,509)
Unamortized Premium	22,901	20,797	18,826		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	44,855	1,226,296	1,133,014	1,085,178	1,036,085	986,355	731,617	936,617
Notes Payable	49,900	70,000	30,000		30,000	10,000	-	-	-	-	-
City Loan	45,000	45,000	43,000		43,000	-	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468		59,468	57,930	52,987	53,688	53,234	52,826	
Customer Deposits	6,280	8,250	9,000		9,000	8,750	8,500	8,000	7,500	7,000	
Other Current Liabilities	3,734	3,431	2,129		2,129	2,137	2,195	2,254	2,313	2,372	
Deferred Credits	14,608	5,814	4,724		4,724	1,323	1,326	1,331	1,336	1,341	
Accrued Interest	9,591	12,224	14,374		14,374	13,945	13,526	13,097	12,725	12,385	
Accrued Taxes & Wages	3,861	4,231	2,796		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	3,000	
Other Liabilities	24,183	19,981	19,056		19,056	16,901	14,811	12,718	10,627	8,536	
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,716,814	53,069	1,769,883	1,700,837	1,738,594	1,792,659	1,828,520	1,656,506	

Appendix A - Part I Bad Debt Expenses Calculated on Total Revenues

<u>Capitalization</u>	FY2005	FY2006	FY2007	Adjustments	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	<u>Normal Amortiz. FY2012</u>
Total Capitalization	1,295,747	1,303,785	1,529,267	42,527	1,582,336	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	44,855	1,226,296	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		0.77	0.72	0.66	0.61	0.57	0.47	0.53
Capitalization Ratio	4.82	4.59	3.40		3.44	2.51	1.96	1.57	1.32	0.88	1.12
Plant in Service	1,517,046	1,573,346	1,641,403		1,641,403	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		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		1,716,555	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)		(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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	1,198,940

Appendix A - Part II Bad Debt
Expense Calculated on Gas Revenue

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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		\$ 114,834	\$ 116,734	\$ 112,487	\$ 106,113	\$ 105,845	\$ 105,471
Gas Transport Service	4,679	6,147	7,256		7,256	7,889	8,461	8,983	9,465	9,908
Heating	713,159	821,190	820,732	6,497 A	827,229	845,817	816,568	762,697	757,378	749,166
Proposed Base Rate	-	-	-	(3,398) B	(3,398)	-	-	-	-	-
Weather Normalization Adjustment	(1,365)	12,500	-		-	-	-	-	-	-
Unbilled Adjustment	(803)	2,513	(732)		(732)	521	(377)	(714)	(59)	(91)
Total Gas Revenues	830,550	956,562	942,090	3,101	945,191	970,961	937,139	877,079	872,629	864,454
Appliance Repair & Other Revenues	10,895	10,669	10,532		10,532	10,743	10,957	11,177	11,400	11,628
Other Operating Revenues	21,912	17,865	18,032		18,032	18,438	17,813	16,678	16,581	16,426
Total Other Operating Revenues	32,807	28,534	28,564	-	28,564	29,181	28,770	27,655	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	3,101	973,755	1,000,142	965,909	904,934	900,610	892,508
OPERATING EXPENSES										
Natural Gas	509,700	639,180	630,836	4,546 C	635,382	658,487	623,363	562,396	558,243	550,889
Other Raw Material	4	5	5		5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	4,546	635,387	658,492	623,368	562,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	339,813	(1,445)	338,368	341,650	342,541	342,533	342,362	341,614
Gas Processing	18,584	16,206	15,715		15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,455	27,377	34,698		34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536		16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944		7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125		14,125	14,168	14,398	14,657	14,863	15,152
Account Management	7,695	7,928	7,625		7,625	7,690	7,787	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	52,258	(9,864) D	42,394	47,729	43,864	40,087	36,854	34,124
Marketing	2,592	2,470	2,992		2,992	3,088	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	(240) E	43,723	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	(460) F	37,324	41,944	45,804	49,654	53,719	58,126
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)		(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)		(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		15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485		6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-		-	-	383	507	639	753
Pro Forma Adjustments	-	-	217		217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)		(6,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	229,932	(10,564)	219,368	238,697	239,559	241,072	243,473	247,170
Depreciation	35,904	36,928	38,213		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	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)		(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	268,128	(10,564)	257,564	278,151	280,407	283,136	286,993	290,653
TOTAL OPERATING EXPENSES	793,012	917,374	898,969	(6,018)	892,951	936,643	903,775	845,537	845,241	841,547
OPERATING INCOME	70,345	67,722	71,685	9,119	80,804	63,499	62,134	59,397	55,369	50,961
Other Income	4,778	8,198	11,212		11,212	11,343	9,620	7,723	7,820	7,160
INCOME BEFORE INTEREST	75,123	75,920	82,897	9,119	92,016	74,842	71,754	67,120	63,189	58,121
INTEREST										
Long-Term Debt	53,856	51,778	56,437	2,708 G	59,145	56,698	61,578	61,236	65,202	64,046
Other	6,123	9,581	13,186		13,186	13,229	13,643	13,684	14,076	14,059
AFUDC	(907)	(1,168)	(1,202)		(1,202)	(1,002)	(1,036)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557		5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	2,708	76,688	74,131	79,036	78,430	82,466	81,074
NET INCOME	11,272	10,417	8,919	6,411	15,330	711	(7,282)	(11,310)	(19,277)	(22,953)
City Payment	-	-	-		-	-	-	-	-	-
Net Earnings	\$ 11,272	\$ 10,417	\$ 8,919	\$ 6,411	\$ 15,330	\$ 711	\$ (7,282)	\$ (11,310)	\$ (19,277)	\$ (22,953)

Appendix A - Part II. Bad Debt
Expense Calculated on Gas Revenue

PHILADELPHIA GAS WORKS
CASHFLOW STATEMENT
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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	\$ 8,919	\$ 6,411	\$ 15,330	\$ 711	\$ (7,282)	\$ (11,310)	\$ (19,277)	\$ (22,953)
Depreciation & Amortization	42,281	43,928	46,007		46,007	47,128	48,468	49,476	50,999	50,755
Earnings on Restricted Funds	(3,265)	3,899	38		38	-	-	-	-	-
Elimination of Accrued Interest on Refunded Debt	-	3,186				-	-	-	-	-
Increased/(Decreased) Other Assets/Liabilities	(6,917)	(1,024)	911		911	716	808	915	(8,203)	(11,639)
Available From Operations	43,371	60,406	55,875	6,411	62,286	48,555	41,994	39,081	23,519	16,163
Funds Required for Capital	68,000	60,185	72,000		72,000	60,000	63,000	61,000	60,000	58,000
Grant Income	18,000	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	20,000		20,000	55,000	5,000			
TOTAL SOURCES	139,697	168,305	165,875	6,411	172,286	181,555	127,994	118,081	83,519	74,163
USES										
Net Construction Expenditures	66,910	68,057	75,152		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	36,875	5,145 H	41,820	47,010	46,530	54,530	45,929	48,920
PMA Lease/Subordinate Debt	1,255	1,310	1,370		1,370	1,430	1,500	1,565	1,640	1,715
Capital Lease	1,947	-	-		-	-	-	-	-	-
Debt Reduction Funding										
Temporary Financing Repayment	850	-	-		-	-	-	-	-	-
City Loan Repayment/Status	-	-	2,000		2,000	43,000	-	-	-	-
Distribution of Earnings	18,000	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	(8,118)		(8,118)	(5,193)	(16,830)	(7,090)	(4,960)	1,431
Cash Needs	128,142	172,706	125,079	5,145	130,224	182,844	136,955	137,823	122,196	129,986
Cash Surplus (Shortfall)	11,555	(4,401)	40,796	1,266	42,062	(1,289)	(8,961)	(19,742)	(38,677)	(55,823)
TOTAL USES	139,697	168,305	165,875	6,411	172,286	181,555	127,994	118,081	83,519	74,163
Cash - Beginning of Period	3,666	15,221	10,820		10,820	51,616	50,327	41,366	21,624	(17,053)
Cash - Surplus (Shortfall)	11,555	(4,401)	40,796	1,266	42,062	(1,289)	(8,961)	(19,742)	(38,677)	(55,823)
ENDING CASH	15,221	10,820	51,616	1,266	52,882	50,327	41,366	21,624	(17,053)	(72,876)
Outstanding Commercial Paper	49,900	70,000	90,000		110,000	145,000	150,000	150,000	150,000	150,000
City Loan Outstanding	45,000	45,000	43,000		43,000	-	-	-	-	-
Internally Generated Funds	-	-	-		-	-	-	-	-	-

Appendix A - Part II Bad Debt PHILADELPHIA GAS WORKS
Expense Calculated on Gas Reenue BALANCE SHEET

(Dollars in Thousands)

	Actual 8/31/05	Estimate 8/31/06	Budget 8/31/07	Adjustments	Revised 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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940
Sinking Fund Reserve	104,530	93,800	102,050	5,622	107,672	102,050	110,300	110,300	118,550	118,550
Capital Improvement Fund	102,701	39,732	99,843	44,378	144,221	39,843	108,993	47,993	120,143	62,143
Cash	15,221	10,820	51,616	1,266	52,882	50,327	41,366	21,624	(17,053)	(72,876)
Gas	273,805	264,254	243,806		243,806	226,927	211,043	195,196	181,647	170,269
Other	12,522	785	506		506	352	350	350	350	350
Accrued Gas Revenues	8,787	11,300	10,568		10,568	11,089	10,712	9,998	9,939	9,848
Reserve for Uncollectible	(207,480)	(191,631)	(183,489)		(183,489)	(173,618)	(162,382)	(149,869)	(136,623)	(123,247)
Accounts Receivable:	87,634	84,708	71,391		71,391	64,750	59,723	55,675	55,313	57,220
Materials & Supplies	129,984	183,784	180,389		180,389	176,809	162,083	159,236	155,999	152,694
Other Current Assets	(164)	2,986	3,056		3,056	3,236	3,441	3,596	3,751	3,906
Deferred Debits	2,796	8,448	3,228		3,228	2,487	2,362	2,262	2,337	2,387
Unamortized Bond Issuance Expense	39,094	42,089	46,912		46,912	43,166	47,671	43,651	47,920	43,676
Unamortized Extraordinary Loss	38,494	55,859	50,301		50,301	45,095	40,244	35,726	31,552	27,624
Deferred Environmental	9,513	9,513	9,513		9,513	8,000	6,500	5,000	3,500	2,000
Other Assets	8,297	3,411	2,881		2,881	2,925	3,030	3,138	3,250	3,365
TOTAL ASSETS	1,519,822	1,548,001	1,670,970	51,266	1,722,236	1,627,510	1,721,465	1,652,680	1,707,797	1,599,629
EQUITY & LIABILITIES										
City Equity	222,646	233,063	241,982	6,411	248,393	242,693	235,411	224,101	186,824	145,871
Revenue Bonds	1,045,371	1,042,430	1,154,385	44,855	1,199,240	1,105,945	1,207,915	1,151,820	1,254,251	1,203,616
TECA Accretions	14,313	12,608	13,913		13,913	15,314	16,818	18,434	10,933	
Unamortized Discount	(9,484)	(5,113)	(5,683)		(5,683)	(5,201)	(5,732)	(5,217)	(5,733)	(5,220)
Unamortized Premium	22,901	20,797	18,826		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	44,855	1,226,296	1,133,014	1,234,184	1,178,553	1,271,447	1,208,946
Notes Payable	49,900	70,000	90,000		90,000	145,000	150,000	150,000	150,000	150,000
City Loan	45,000	45,000	43,000		43,000	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468		59,468	57,930	52,987	53,688	53,234	52,826
Customer Deposits	6,280	8,250	9,000		9,000	8,750	8,500	8,000	7,500	7,000
Other Current Liabilities	3,734	3,431	2,129		2,129	2,137	2,195	2,254	2,313	2,372
Deferred Credits	14,608	5,814	4,724		4,724	1,323	1,326	1,331	1,336	1,341
Accrued Interest	9,591	12,224	14,374		14,374	13,945	15,963	15,427	17,387	16,837
Accrued Taxes & Wages	3,861	4,231	2,796		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	3,000
Other Liabilities	24,183	19,981	19,056		19,056	16,901	14,811	12,717	10,626	8,536
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,670,970	51,266	1,722,236	1,627,510	1,721,465	1,652,680	1,707,797	1,599,629

Appendix A - Part II Bad Debt

Capitalization

Expense Calculated on Gas Revenue

	FY2005	FY2006	FY2007	Adjustments	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012
Total Capitalization	1,295,747	1,303,785	1,423,423	42,527	1,474,689	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	44,855	1,226,296	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		0.83	0.82	0.84	0.84	0.87	0.89
Capitalization Ratio	4.82	4.59	4.88		4.94	4.67	5.24	5.26	6.81	8.29
Plant in Service	1,517,046	1,573,346	1,641,403		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		75,152	78,597	87,755	70,818	61,587	59,920
Total Plant	1,573,346	1,641,403	1,716,555		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)		(666,765)	(706,330)	(747,155)	(789,246)	(832,777)	(876,292)
Net Utility Plant	981,722	1,012,851	1,049,790		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940

Appendix A - Part II Bad Debt
 Expense Calculated on Gas Revenue

PHILADELPHIA GAS WORKS
 STATEMENT OF INCOME
 (Dollars in Thousands)

	Actual	Estimate	Best Year Budget		Revised Budget	Forecast	Forecast	Forecast	Forecast	Forecast
	2004-05	2005-06	2006-07	Adjustments	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
OPERATING REVENUES										
Non-Heating	\$ 114,880	\$ 114,212	\$ 115,126		\$ 115,126	\$ 117,022	\$ 112,771	\$ 106,389	\$ 106,117	\$ 105,739
Gas Transport Service	4,679	6,147	7,256		7,256	7,889	8,461	8,983	9,465	9,908
Heating	713,159	821,190	824,440	7,100 A	831,540	849,529	820,284	766,421	761,106	752,898
Proposed Base Rate	-	-	100,000	(3,396) B	96,604	100,000	100,000	100,000	100,000	100,000
Weather Normalization Adjustment	(1,385)	12,500	-		-	-	-	-	-	-
Unbilled Adjustment	(803)	2,513	505		505	522	(376)	(713)	(58)	(89)
Total Gas Revenues	830,550	956,562	1,047,327	3,704	1,051,031	1,074,962	1,041,140	981,080	976,630	988,456
Appliance Repair & Other Revenues	10,895	10,669	10,532		10,532	10,743	10,957	11,177	11,400	11,628
Other Operating Revenues	21,912	17,865	20,008		20,008	20,414	19,789	18,654	18,557	18,402
Total Other Operating Revenues	32,807	28,534	30,540	-	30,540	31,157	30,746	29,831	29,957	30,030
Total Operating Revenues	863,357	985,096	1,077,867	3,704	1,081,571	1,106,119	1,071,886	1,010,911	1,006,587	998,486
OPERATING EXPENSES										
Natural Gas	509,700	639,180	630,836	4,524 C	635,360	658,487	623,363	562,396	558,243	550,889
Other Raw Material	4	5	5		5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	4,524	635,365	658,492	623,368	562,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	447,026	(820)	446,206	447,627	448,518	448,510	448,339	447,592
Gas Processing	18,584	16,206	15,715		15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,455	27,377	34,698		34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536		16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944		7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125		14,125	14,168	14,398	14,657	14,863	15,152
Account Management	7,695	7,928	7,625		7,625	7,690	7,787	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	59,546	(12,416) D	47,130	58,962	58,235	52,563	48,645	46,943
Marketing	2,592	2,470	2,992		2,992	3,088	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	(240) E	43,723	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	(460) F	37,324	41,944	45,804	49,654	53,719	58,126
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)		(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)		(7,950)	(7,258)	(7,529)	(7,379)	(7,220)	(7,008)
Amortization of Restructuring Costs	1,087	1,087	-		-	-	-	-	-	-
Pensions	14,702	17,287	15,075		15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485		6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-		-	-	383	507	639	753
Pro Forma Adjustments	-	-	217		217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)		(8,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	237,220	(13,116)	224,104	249,930	251,930	253,548	255,264	259,989
Depreciation	35,904	36,928	38,213		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	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)		(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
	35,045	37,068	38,196		38,196	39,454	40,648	42,064	43,520	43,483
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	275,416	(13,116)	262,300	289,384	292,778	295,612	298,784	303,472
TOTAL OPERATING EXPENSES	793,012	917,374	906,257	(8,592)	897,665	947,876	916,146	858,013	857,032	854,366
OPERATING INCOME	70,345	67,722	171,610	12,296	183,906	158,243	155,740	152,898	149,555	144,120
Other Income	4,778	8,198	17,131		17,131	19,082	18,437	20,343	21,881	22,907
INCOME BEFORE INTEREST	75,123	75,920	188,741	12,296	201,037	177,325	174,177	173,241	171,436	167,027
INTEREST										
Long-Term Debt	53,856	51,778	56,437	2,708 G	59,145	56,898	54,265	51,809	48,884	46,024
Other	6,123	9,561	13,186		13,186	13,229	13,134	13,028	12,941	12,805
AFUDC	(907)	(1,168)	(1,202)		(1,202)	(1,002)	(1,038)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557		5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	2,708	76,686	74,131	71,214	68,347	65,013	61,798
NET INCOME	11,272	10,417	114,763	9,588	124,351	103,194	102,963	104,894	106,423	105,229
City Payment	-	-	-		-	-	-	-	-	-
Net Earnings	\$ 11,272	\$ 10,417	\$ 114,763	\$ 9,588	\$ 124,351	\$ 103,194	\$ 102,963	\$ 104,894	\$ 106,423	\$ 105,229

Appendix A - Part II Bad Debt
 Expense Calculated on Gas Revenue

PHILADELPHIA GAS WORKS
 CASHFLOW STATEMENT
 (Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-08	Test Year BUDGET 2006-07	Adjustments	Revised 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	\$ 9,588	\$ 124,351	\$ 103,194	\$ 102,963	\$ 104,894	\$ 106,423	\$ 105,229
Depreciation & Amortization	42,281	43,928	46,007	-	46,007	47,128	47,959	48,821	49,864	49,501
Earnings on Restricted Funds	(3,265)	3,899	(381)	-	(381)	(2,239)	(3,970)	(6,225)	(7,763)	20,616
Elimination of Accrued Interest on Refunded Debt	-	3,188	-	-	-	-	-	-	-	-
Increased/(Decreased) Other Assets/Liabilities	(8,917)	(1,024)	911	-	911	716	608	915	(8,203)	(11,639)
Available From Operations	43,371	60,406	161,300	9,588	170,888	148,799	147,760	148,405	140,321	183,707
Funds Required for Capital	68,000	60,195	72,000	-	72,000	60,000	39,843	-	-	-
Grant Income	18,000	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	139,897	168,305	251,300	9,588	260,888	226,799	205,603	166,405	140,321	163,707
USES										
Net Construction Expenditures	68,910	68,057	75,152	-	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	29,806	36,675	5,145 H	41,820	47,010	46,530	47,920	39,479	38,020
PMA Lease/Subordinate Debt	1,255	1,310	1,370	-	1,370	1,430	1,500	1,585	1,640	1,715
Capital Lease	1,947	-	-	-	-	-	-	-	-	-
Debt Reduction Funding	-	-	40,000	-	40,000	15,000	55,000	35,000	20,000	40,000
Post Retirement Benefit Funding	-	-	-	-	-	-	-	-	-	-
Temporary Financing Repayment	850	-	40,000	-	40,000	20,000	10,000	-	-	-
City Loan Repayment/Status	-	-	2,000	-	2,000	43,000	-	-	-	-
Distribution of Earnings	18,000	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	-	1,159	(873)	(11,595)	(5,138)	99	2,840
Cash Needs	128,142	172,706	214,356	5,145	219,501	222,164	207,190	168,165	140,805	158,495
Cash Surplus (Shortfall)	11,555	(4,401)	36,944	4,443	41,387	4,635	(1,587)	(1,760)	(484)	5,212
TOTAL USES	139,897	168,305	251,300	9,588	260,888	226,799	205,603	166,405	140,321	163,707
Cash - Beginning of Period	3,666	15,221	10,820	-	10,820	47,764	52,399	50,812	49,052	48,568
Cash - Surplus (Shortfall)	11,555	(4,401)	36,944	4,443	41,387	4,635	(1,587)	(1,760)	(484)	5,212
ENDING CASH	15,221	10,820	47,764	4,443	52,207	52,399	50,812	49,052	48,568	53,780
Outstanding Commercial Paper	49,900	70,000	30,000	30,000	30,000	10,000	-	-	-	-
City Loan Outstanding	45,000	45,000	43,000	43,000	43,000	-	-	-	-	-
Internally Generated Funds	-	-	-	-	-	-	47,912	70,818	61,587	59,920

Appendix A - Part II Bad Debt
 Expense Calculated on Gas Revenues

PHILADELPHIA GAS WORKS
 DEBT SERVICE COVERAGE
 (Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	Test Year BUDGET 2006-07	Adjustments	Revised 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	\$ 1,047,327	\$ 3,704	\$ 1,051,031	\$ 1,074,962	\$ 1,041,140	\$ 981,080	\$ 976,630	\$ 968,456
Other Operating Revenues	32,807	28,534	30,540		30,540	31,157	30,746	29,831	29,957	30,030
Total Operating Revenues	863,357	985,096	1,077,867	3,704	1,081,571	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	-	16,750	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	18,000	
AFUDC (Interest)	907	1,168	1,202	-	1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,381	1,113,819	3,704	1,117,523	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	4,524	635,365	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	275,416	(1,200)	282,300	289,384	292,778	295,612	298,784	303,472
Total Operating Expenses	793,012	917,374	906,257	(8,592)	897,665	947,876	916,146	858,013	857,032	854,366
Less: Non-Cash Expenses	39,338	40,554	41,887	-	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	864,370	(8,592)	855,778	904,576	871,534	812,106	809,647	806,962
Funds Available to Cover Debt Service	130,103	139,541	249,449	12,296	261,745	237,388	233,855	231,931	212,043	236,006
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748		35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	6.98		7.32	6.91	7.22	7.69	6.90	7.34
Net Available after Prior Debt Service	91,297	97,592	213,701	12,296	225,997	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	12,296	225,997	203,020	201,487	201,776	181,298	203,842
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	5,145	58,458	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	5,145	58,458	67,813	66,852	67,966	65,143	60,885
Debt Service Coverage 1998 Bonds	1.94	3.01	4.01		3.87	2.99	3.01	2.97	2.78	3.35
Net Available after 1998 Debt Service	43,300	65,125	160,388	7,151	167,539	135,207	134,635	133,810	116,155	142,957
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,988	1,987		1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	80.72		84.32	68.08	67.66	67.38	58.43	72.05
Net Available To Service Aggregate Debt Serv	111,075	114,154	228,139	12,296	240,435	217,781	216,061	216,313	215,941	211,469
Aggregate Debt Service	88,790	76,402	91,048	5,145	96,193	104,167	101,210	100,107	97,876	95,033
Fixed Coverage Charge	1.25	1.49	2.51		2.50	2.09	2.13	2.16	2.21	2.23
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	2.09		2.11	1.78	1.81	1.83	1.86	1.87

Appendix A - Part II Bad Debt
 Expense Calculated on Gas Revenue
 PHILADELPHIA GAS WORKS
 BALANCE SHEET
 (Dollars in Thousands)

	Actual 8/31/05	Estimate 8/31/06	Budget 8/31/07	Adjustments	Revised 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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	
Sinking Fund Reserve	104,530	93,800	102,050	5,622	112,050	102,050	102,050	102,050	102,050	102,050	
Capital Improvement Fund	102,701	39,732	99,843	44,378	139,843	39,843	-	-	-	-	
Debt Reduction Funding	-	-	40,419		40,419	57,658	116,628	157,853	185,616	-	
Cash	15,221	10,820	47,764	4,443	52,207	52,399	50,812	49,052	48,568	53,780	
Gas	273,805	264,254	254,134		254,134	240,307	224,591	205,778	186,746	167,304	
Other	12,522	785	506		506	352	350	350	350	350	
Accrued Gas Revenues	8,787	11,300	11,805		11,805	12,327	11,951	11,238	11,180	11,091	
Reserve for Uncollectible	(207,480)	(191,631)	(185,777)		(185,777)	(174,639)	(160,774)	(143,237)	(121,782)	(98,725)	
Accounts Receivable:	87,634	84,708	80,668		80,668	78,347	76,118	74,129	76,494	80,020	
Materials & Supplies	129,984	183,784	180,389		180,389	176,809	162,083	159,236	155,999	152,694	
Other Current Assets	(164)	2,986	3,056		3,056	3,236	3,441	3,596	3,751	3,906	
Deferred Debits	2,796	8,448	3,228		3,228	2,487	2,362	2,262	2,337	2,387	
Unamortized Bond Issuance Expense	39,094	42,089	46,912		46,912	43,166	39,574	36,138	32,868	29,740	
Unamortized Extraordinary Loss	38,494	55,859	50,301		50,301	45,095	40,244	35,726	31,552	27,624	
Deferred Environmental	9,513	9,513	9,513		9,513	8,000	6,500	5,000	3,500	2,000	
Other Assets	8,297	3,411	2,881		2,881	2,925	3,030	3,138	3,250	3,365	
TOTAL ASSETS	1,519,822	1,548,001	1,716,814	54,443	1,771,257	1,700,837	1,738,594	1,792,659	1,828,520	1,656,506	
EQUITY & LIABILITIES											
City Equity	222,646	233,063	347,826	9,588	357,414	451,020	553,983	658,877	747,300	834,529	834,529
Revenue Bonds	1,045,371	1,042,430	1,154,385	44,855	1,199,240	1,105,945	1,057,915	1,008,430	967,311	724,576	929,576
TECA Accretions	14,313	12,608	13,913		13,913	15,314	16,818	18,434	10,933		
Unamortized Discount	(9,484)	(5,113)	(5,683)		(5,683)	(5,201)	(4,738)	(4,295)	(3,885)	(3,509)	(3,509)
Unamortized Premium	22,901	20,797	18,826		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	44,855	1,226,296	1,133,014	1,085,178	1,036,085	986,355	731,617	936,617
Notes Payable	49,900	70,000	30,000		30,000	10,000	-	-	-	-	-
City Loan	45,000	45,000	43,000		43,000	-	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468		59,468	57,930	52,987	53,688	53,234	52,826	
Customer Deposits	6,280	8,250	9,000		9,000	8,750	8,500	8,000	7,500	7,000	
Other Current Liabilities	3,734	3,431	2,129		2,129	2,137	2,195	2,254	2,313	2,372	
Deferred Credits	14,608	5,814	4,724		4,724	1,323	1,326	1,331	1,336	1,341	
Accrued Interest	9,591	12,224	14,374		14,374	13,945	13,526	13,097	12,725	12,385	
Accrued Taxes & Wages	3,861	4,231	2,796		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	3,000	
Other Liabilities	24,183	19,981	19,056		19,056	16,901	14,811	12,718	10,627	8,536	
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,716,814	54,443	1,771,257	1,700,837	1,738,594	1,792,659	1,828,520	1,656,506	
											Normal

Appendix A - Part II Bad Debt
 Expense Calculated on Gas Reenue

<u>Capitalization</u>	FY2005	FY2006	FY2007	Adjustments	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	<u>Normal Amortiz.</u> FY2012
Total Capitalization	1,295,747	1,303,785	1,529,267	42,527	1,583,710	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	44,855	1,226,296	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		0.77	0.72	0.66	0.61	0.57	0.47	0.53
Capitalization Ratio	4.82	4.59	3.40		3.43	2.51	1.96	1.57	1.32	0.88	1.12
Plant in Service	1,517,046	1,573,346	1,641,403		1,641,403	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		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		1,716,555	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)		(666,765)	(706,330)	(747,155)	(789,245)	(832,777)	(876,292)	(876,292)
Net Utility Plant	981,722	1,012,851	1,049,790		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	1,198,940

APPENDIX B

SECRETARY'S BUREAU

2007 JUN 12 PM 4: 06

SECRETARY'S BUREAU

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME - BRINGDOWN
BAD DEBT 4.5% of TOTAL REVENUES

(Dollars in Thousands)

	2001 + \$36M	As Filed Current Rates 2007	Adjust.	Revised Current Rates 2007	Earnings Differential
Operating Revenues					
1 Total Gas Revenues	\$ 766,280	\$ 942,090	\$ 3,704	\$ 945,794	
2 Total Other Operating Revenues	28,026	28,564	-	28,564	
3 Total Operating Revenues	794,306	970,654	3,704	974,358	
4					
Operating Expenses					
6 Fuel	415,065	630,841	4,524	635,365	
7					
8 Contribution Margin (lines 3 minus 6)	379,241	339,813	(820)	338,993	
9					
10 Other Operating & Maintenance	206,766	229,932	(11,344)	218,588	
11 Depreciation/Cost of Removal	32,537	38,196	-	38,196	
12 Sub Total Other Oper. & Maint. & Depreciation	239,303	268,128	(11,344)	256,784	
13					
14 Total Operating Expenses (lines 6 + 12)	654,368	898,969	(6,820)	892,149	
15					
16 Operating Income (lines 3 minus 14)	139,938	71,685	10,524	82,209	
17					
18 Other Income	6,106	11,212	50	11,262	
19					
20 Income Before Interest	146,044	82,897	10,574	93,471	
21					
22 Total Interest	57,789	73,978	2,708	76,686	
23					
24 Net Income	\$ 88,255	\$ 8,919	\$ 7,866	\$ 16,785	\$ 71,470

* Differential from PGW \$100.0 Million Base Rate Increase - \$83.215 Million.

* Bad Debt Expense 4.5% of Total Revenues (\$970,654 @ 4.5% = \$43,679) PGW \$52,258 - \$43,679 = (\$8,579).

**PHILADELPHIA GAS WORKS
STATEMENT OF INCOME - BRINGDOWN
BAD DEBT 4.5% of GAS REVENUES**

(Dollars in Thousands)

	2001 + \$36M	As Filed Current Rates 2007	Adjust.	Revised Current Rates 2007	Earnings Differential
Operating Revenues					
1 Total Gas Revenues	\$ 766,280	\$ 942,090	\$ 3,704	\$ 945,794	
2 Total Other Operating Revenues	28,026	28,564	-	28,564	
3 Total Operating Revenues	794,306	970,654	3,704	974,358	
4					
Operating Expenses					
6 Fuel	415,065	630,841	4,524	635,365	
7					
8 Contribution Margin (lines 3 minus 6)	379,241	339,813	(820)	338,993	
9					
10 Other Operating & Maintenance	206,766	229,932	(12,629)	217,303	
11 Depreciation/Cost of Removal	32,537	38,196	-	38,196	
12 Sub Total Other Oper. & Maint. & Depreciation	239,303	268,128	(12,629)	255,499	
13					
14 Total Operating Expenses (lines 6 + 12)	654,368	898,969	(8,105)	890,864	
15					
16 Operating Income (lines 3 minus 14)	139,938	71,685	11,809	83,494	
17					
18 Other Income	6,106	11,212	50	11,262	
19					
20 Income Before Interest	146,044	82,897	11,859	94,756	
21					
22 Total Interest	57,789	73,978	2,708	76,686	
23					
24 Net Income	<u>\$ 88,255</u>	<u>\$ 8,919</u>	<u>\$ 9,151</u>	<u>\$ 18,070</u>	<u>\$ 70,185</u>

* Differential from PGW \$100.0 Million Base Rate Increase - \$81.930 Million.

* Bad Debt Expense 4.5% of Gas Revenues (\$942,090 @ 4.5% = \$42,394) PGW \$52,258 - \$42,394 = (\$9,864).

APPENDIX C

JUL 12 2007

2007 JUL 12 PM 4: 06

SECRETARY'S BUREAU

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars In Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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		\$ 114,834	\$ 116,734	\$ 112,487	\$ 106,113	\$ 105,845	\$ 105,471
Gas Transport Service	4,679	6,147	7,256		7,256	7,889	8,481	8,983	9,465	9,908
Heating	713,159	821,190	820,732	6,497 A	827,229	845,817	816,568	762,697	757,378	749,168
Proposed Base Rate	-	-	-	(3,396) B	(3,396)	-	-	-	-	-
Weather Normalization Adjustment	(1,365)	12,500	-	25,000	-	25,000	25,000	25,000	25,000	25,000
Unbilled Adjustment	(803)	2,513	(732)	-	(732)	521	(377)	(714)	(59)	(91)
Total Gas Revenues	830,550	956,562	942,090	28,101	970,191	995,961	962,139	902,079	897,629	889,454
Appliance Repair & Other Revenues	10,895	10,669	10,532		10,532	10,743	10,957	11,177	11,400	11,628
Other Operating Revenues	21,912	17,865	18,032		18,032	18,438	17,813	16,678	16,581	15,426
Total Other Operating Revenues	32,807	28,534	28,564	-	28,564	28,181	28,770	27,855	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	28,101	998,755	1,025,142	990,909	929,934	925,610	917,508
OPERATING EXPENSES										
Natural Gas	509,700	639,180	630,836	4,546 C	635,382	658,487	623,363	562,396	558,243	550,889
Other Raw Material	4	5	5		5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	4,546	635,387	658,492	623,368	562,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	339,813	23,555	363,368	366,650	367,541	367,533	367,362	366,614
Gas Processing	18,584	16,206	15,715		15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,455	27,377	34,698		34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536		16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944		7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125		14,125	14,168	14,398	14,657	14,863	15,152
Account Management	7,695	7,928	7,625		7,625	7,690	7,787	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	52,258	(7,314) D	44,944	47,729	43,864	40,087	36,854	34,124
Marketing	2,592	2,470	2,992		2,992	3,088	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	(240) E	43,723	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	(460) F	37,324	41,944	45,904	49,654	53,719	58,128
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)		(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,803)	(7,950)		(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		15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485		6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-		-	-	383	507	639	753
Pro Forma Adjustments	-	-	217		217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)		(6,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	229,932	(8,014)	221,918	238,697	239,559	241,072	243,473	247,170
Depreciation	35,904	36,928	38,213		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	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)		(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	268,128	(8,014)	260,114	278,151	280,407	283,136	286,993	290,653
TOTAL OPERATING EXPENSES	793,012	917,374	898,969	(3,466)	895,501	936,643	903,775	845,537	845,241	841,547
OPERATING INCOME	70,345	67,722	71,685	31,569	103,254	88,499	87,134	84,397	80,369	75,961
Other Income	4,778	8,188	11,212		11,212	11,343	9,620	7,723	7,820	7,160
INCOME BEFORE INTEREST	75,123	75,920	82,897	31,569	114,466	99,842	96,754	92,120	88,189	83,121
INTEREST										
Long-Term Debt	53,856	51,778	56,437	2,708 G	59,145	56,698	61,578	61,236	65,202	64,046
Other	6,123	9,561	13,186		13,186	13,229	13,643	13,684	14,076	14,059
AFUDC	(907)	(1,168)	(1,202)		(1,202)	(1,002)	(1,036)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557		5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	2,708	76,686	74,131	79,036	78,430	82,466	81,074
NET INCOME	11,272	10,417	8,919	28,861	37,780	25,711	17,718	13,690	5,723	2,047
City Payment	-	-	-		-	-	-	-	-	-
Net Earnings	\$ 11,272	\$ 10,417	\$ 8,919	\$ 28,861	\$ 37,780	\$ 25,711	\$ 17,718	\$ 13,690	\$ 5,723	\$ 2,047

PHILADELPHIA GAS WORKS
CASHFLOW STATEMENT
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised BUDGET 2008-07	FORECAST 2007-08	FORECAST 2008-09	FORECAST 2009-10	FORECAST 2010-11	FORECAST 2011-12
SOURCES										
Net Income	\$ 11,272	\$ 10,417	\$ 8,919	\$ 28,861	\$ 37,780	\$ 25,711	\$ 17,718	\$ 13,690	\$ 5,723	\$ 2,047
Depreciation & Amortization	42,281	43,928	46,007		46,007	47,128	48,468	49,476	50,999	50,755
Earnings on Restricted Funds	(3,265)	3,899	38		38	-	-	-	-	-
Elimination of Accrued Interest on Refunded Debt	-	3,186				-	-	-	-	-
Increased/(Decreased) Other Assets/Liabilities	(8,917)	(1,024)	911		911	716	808	915	(8,203)	(11,639)
Available From Operations	43,371	60,406	55,875	28,861	84,736	73,555	66,894	64,081	48,519	41,163
Funds Required for Capital	68,000	60,195	72,000		72,000	60,000	63,000	61,000	60,000	58,000
Grant Income	18,000	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	20,000		20,000	31,000			14,000	30,000
TOTAL SOURCES	139,697	168,305	165,875	28,861	194,736	182,555	147,994	143,081	122,519	129,163
USES										
Net Construction Expenditures	66,910	68,057	75,152		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	5,145 H	41,820	47,010	46,530	54,530	45,929	48,920
PMA Lease/Subordinate Debt	1,255	1,310	1,370		1,370	1,430	1,500	1,565	1,640	1,715
Capital Lease	1,947	-	-		-	-	-	-	-	-
Debt Reduction Funding										
Temporary Financing Repayment	850	-		25,000	25,000		11,000	5,000		
City Loan Repayment/Status	-	-	2,000		2,000	43,000				
Distribution of Earnings	18,000	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	(8,118)		(8,118)	(5,193)	(16,830)	(7,090)	(4,960)	1,431
Cash Needs	128,142	172,706	125,079	30,145	155,224	182,844	147,955	142,823	122,196	129,986
Cash Surplus (Shortfall)	11,555	(4,401)	40,796	(1,284)	39,512	(289)	39	258	323	(823)
TOTAL USES	139,697	168,305	165,875	28,861	194,736	182,555	147,994	143,081	122,519	129,163
Cash - Beginning of Period	3,666	15,221	10,820		10,820	50,332	50,043	50,082	50,340	50,663
Cash - Surplus (Shortfall)	11,555	(4,401)	40,796	(1,284)	39,512	(289)	39	258	323	(823)
ENDING CASH	15,221	10,820	51,616	(1,284)	50,332	50,043	50,082	50,340	50,663	49,840
Outstanding Commercial Paper	49,900	70,000	90,000		65,000	96,000	85,000	80,000	94,000	124,000
City Loan Outstanding	45,000	45,000	43,000		43,000	-	-	-	-	-
Internally Generated Funds	-	-	-		-	-	-	-	-	-

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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	\$ 958,562	\$ 942,090	\$ 28,101	\$ 970,191	\$ 995,961	\$ 982,139	\$ 902,079	\$ 897,629	\$ 889,454
Other Operating Revenues	32,807	28,534	28,564		28,564	29,181	28,770	27,855	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	28,101	998,755	1,025,142	990,909	929,934	925,610	917,508
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,087	11,250		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	18,000		
AFUDC (Interest)	907	1,168	1,202		1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,001,106	28,101	1,029,207	1,055,487	1,019,565	956,665	934,415	925,627
FUNDS APPLIED										
Fuel Costs	509,704	639,185	630,841	4,546	635,387	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	268,128	(8,014)	280,114	278,151	280,407	283,136	288,993	290,653
Total Operating Expenses	793,012	917,374	898,969	(3,468)	895,501	936,643	903,775	845,537	845,241	841,547
Less: Non-Cash Expenses	39,338	40,554	41,887	-	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	857,082	(3,468)	853,614	893,343	859,163	799,630	797,856	794,143
Funds Available to Cover Debt Service	130,103	139,541	144,024	31,569	175,593	162,144	180,402	157,035	136,559	131,484
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748		35,748	34,388	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	4.03		4.91	4.72	4.96	5.21	4.44	4.09
Net Available after Prior Debt Service	91,297	97,592	108,276	31,569	139,845	127,776	128,034	126,880	105,814	99,320
Other Capital Leases	1,998	-	-		-	-	-	-	-	-
Net Available after Prior Capital Leases	89,299	97,592	108,276	31,569	139,845	127,776	128,034	126,880	105,814	99,320
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	5,145	58,458	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	5,145	58,458	67,813	71,727	84,111	85,579	92,016
Debt Service Coverage 1998 Bonds	1.84	3.01	2.03		2.39	1.88	1.79	1.51	1.24	1.08
Net Available after 1998 Debt Service	43,300	65,125	54,963	26,424	81,387	59,963	56,307	42,769	20,235	7,304
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987		1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	27.66		40.96	30.19	28.29	21.54	10.18	3.68
Net Available To Service Aggregate Debt Serv	111,075	114,154	122,295	31,569	153,864	140,298	138,838	135,192	132,694	127,563
Aggregate Debt Service	88,790	78,402	91,048	5,145	96,193	104,167	106,085	116,252	118,312	126,164
Fixed Coverage Charge	1.25	1.49	1.34		1.60	1.35	1.31	1.16	1.12	1.01
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	1.12		1.35	1.15	1.12	1.01	0.97	0.88

PHILADELPHIA GAS WORKS
BALANCE SHEET
(Dollars in Thousands)

	Actual 8/31/05	Estimate 8/31/06	Budget 8/31/07	Adjustments	Revised 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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940
Sinking Fund Reserve	104,530	93,800	102,050	5,622	107,672	107,672	115,922	115,922	124,172	124,172
Capital Improvement Fund	102,701	39,732	99,843	44,378	144,221	84,221	153,371	92,371	164,521	106,521
Cash	15,221	10,820	51,616	(1,284)	50,332	50,043	50,082	50,340	50,663	49,840
Gas	273,805	264,254	243,806		243,806	226,927	211,043	195,196	181,647	170,269
Other	12,522	785	506		506	352	350	350	350	350
Accrued Gas Revenues	8,787	11,300	10,568		10,568	11,089	10,712	9,998	9,939	9,848
Reserve for Uncollectible	(207,480)	(191,631)	(183,489)		(183,489)	(173,618)	(162,382)	(149,869)	(136,623)	(123,247)
Accounts Receivable:	87,634	84,708	71,391		71,391	64,750	59,723	55,675	55,313	57,220
Materials & Supplies	129,984	183,784	180,389		180,389	176,809	162,083	159,236	155,999	152,694
Other Current Assets	(164)	2,986	3,056		3,056	3,236	3,441	3,596	3,751	3,906
Deferred Debits	2,796	8,448	3,228		3,228	2,487	2,362	2,262	2,337	2,387
Unamortized Bond Issuance Expense	39,094	42,089	46,912		46,912	43,166	47,671	43,651	47,920	43,676
Unamortized Extraordinary Loss	38,494	55,859	50,301		50,301	45,095	40,244	35,726	31,552	27,624
Deferred Environmental	9,513	9,513	9,513		9,513	8,000	6,500	5,000	3,500	2,000
Other Assets	8,297	3,411	2,881		2,881	2,925	3,030	3,138	3,250	3,365
TOTAL ASSETS	1,519,822	1,548,001	1,670,970	48,716	1,719,686	1,677,226	1,780,181	1,731,396	1,825,513	1,772,345
EQUITY & LIABILITIES										
City Equity	222,646	233,063	241,982	28,861	270,843	296,554	314,272	327,962	315,685	299,732
Revenue Bonds	1,045,371	1,042,430	1,154,385	44,855	1,199,240	1,150,800	1,252,770	1,196,675	1,299,106	1,248,471
TECA Accretions	14,313	12,608	13,913		13,913	15,314	16,818	18,434	10,933	
Unamortized Discount	(9,484)	(5,113)	(5,683)		(5,683)	(5,201)	(5,732)	(5,217)	(5,733)	(5,220)
Unamortized Premium	22,901	20,797	18,826		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	44,855	1,226,296	1,177,869	1,279,039	1,223,408	1,316,302	1,253,801
Notes Payable	49,900	70,000	90,000		65,000	96,000	85,000	80,000	94,000	124,000
City Loan	45,000	45,000	43,000		43,000	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468		59,468	57,930	52,987	53,688	53,234	52,826
Customer Deposits	6,280	8,250	9,000		9,000	8,750	8,500	8,000	7,500	7,000
Other Current Liabilities	3,734	3,431	2,129		2,129	2,137	2,195	2,254	2,313	2,372
Deferred Credits	14,608	5,814	4,724		4,724	1,323	1,326	1,331	1,336	1,341
Accrued Interest	9,591	12,224	14,374		14,374	13,945	15,963	15,427	17,387	16,837
Accrued Taxes & Wages	3,861	4,231	2,796		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	3,000
Other Liabilities	24,183	19,981	19,056		19,056	16,901	14,811	12,717	10,626	8,536
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,670,970	73,716	1,719,686	1,677,226	1,780,181	1,731,396	1,825,513	1,772,345

Capitalization

	FY2005	FY2006	FY2007	Adjustments	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012
Total Capitalization	1,295,747	1,303,785	1,423,423	42,527	1,497,139	1,474,423	1,593,311	1,551,370	1,631,987	1,553,533
Total Long Term Debt	1,073,101	1,070,722	1,181,441	44,855	1,226,296	1,177,869	1,279,039	1,223,408	1,316,302	1,253,801
Debt to Equity Ratio	0.83	0.82	0.83		0.82	0.80	0.80	0.79	0.81	0.81
Capitalization Ratio	4.82	4.59	4.88		4.53	3.97	4.07	3.73	4.17	4.18
Plant in Service	1,517,046	1,573,346	1,641,403		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		75,152	78,597	87,755	70,818	61,587	59,920
Total Plant	1,573,346	1,641,403	1,716,555		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)		(566,765)	(706,330)	(747,155)	(789,246)	(832,777)	(876,292)
Net Utility Plant	981,722	1,012,851	1,049,790		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940

APPENDIX D

SECRET

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SECRETARY'S BUREAU

APPENDIX D

CITY-PFMC MANAGEMENT AGREEMENT AS AMENDED THROUGH BILL NO. 980456 (approved June 25, 1998) [UNOFFICIAL COMPILATION AND RESTATEMENT]

Note: Council authorized the City to enter into the Management Agreement through Bill #455 (approved December 29, 1972). As of June 30, 2000, the Agreement had been further amended by authority of Bill #1021 (approved December 14, 1973), Bill #1870 (approved May 30, 1975), Bill #396 (approved November 1, 1976), Bill #1410 (approved June 22, 1978), Bill #1874 (approved April 10, 1979), Bill #1948 (approved June 11, 1979), Bill #319 (approved September 5, 1980), Bill #320 (approved September 5, 1980), Bill #321 (approved September 5, 1980), Bill #750 (approved June 23, 1981), Bill #1315 (approved September 22, 1982), Bill #1314 (approved December 3, 1982), Bill #787 (approved April 11, 1990), Bill #1258 (approved December 28, 1995), Bill #970647 (approved October 30, 1997), Bill #980456 (approved June 25, 1998), and Bill #000583 (approved November 15, 2000). The Agreement was next amended by authority of Bill #020246 (approved May 15, 2002).

There are two (2) parts to Appendix D:

Part I: The agreement with all amendments through June 25, 1998.

Part II: Bill #970647 (approved October 30, 1997), Bill #980456 (approved June 25, 1998).

Please note that Bill #000583 (approved November 15, 2000) and Bill #020246 (approved May 15, 2002) are not included in the enclosed agreement as they were created after the Gas Choice Act came into effect.

Appendix D -- Part I

CITY-PFMC MANAGEMENT AGREEMENT
AS AMENDED THROUGH BILL NO. 980456 (approved June 25, 1998)
[UNOFFICIAL COMPILATION AND RESTATEMENT]

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

WITNESSETH:

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

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

WHEREAS, the Gas Works' Strategic Plan contains among its five strategies product and market expansion; and

WHEREAS, an increase in the Gas Works' revenues will lessen the financial burden from competition in the gas business and therefore lessen the financial burden on current gas customers; and

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

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

SECTION I

General

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

2. City, to the extent that it has or shall have the authority or power so to do, authorizes and empowers Company to maintain, change, alter, replace, repair and operate the Gas

Appendix D -- Part I

Works and appurtenances along and beneath the surfaces of the highways, streets, avenues, lanes, alleys, ways and public places in City, for the supply and distribution of gas, subject to provisions hereinafter set forth. For these purposes Company may enter upon, occupy and open all said highways, streets, avenues, lanes, alleys, ways and public places, and supply and distribute gas throughpipes laid therein.

3. (a) Subject to the limitations of subparagraphs 3(b) and 3(c), City, to the extent it has or shall have the authority or power so to do, authorizes and empowers Company to operate the Gas Works for the acquisition, marketing, brokering, aggregation and supply of electric power to persons, businesses and other entities situate within the City of Philadelphia. This authorization shall be exercised through a Venture Agreement with QST Energy, Inc. (the "Venture Agreement") relating to the PECO Energy Company Electric Pilot Program which Company is further authorized to negotiate. The Venture Agreement shall provide for such steps as may be necessary to acquire, market, broker, aggregate and supply safe, efficient and reliable electric power within the City and such other terms and conditions as the City Solicitor deems necessary or appropriate in the interests of the City.

(b) Company shall take no action of any kind to carry out the authorization set forth in subparagraph 3(a) after December 31, 1998 without further City Council authorization by ordinance. Any request to extend the authorization beyond December 31, 1998 shall be made no later than May 1, 1998 and the request for extension shall be submitted along with a report showing how well and whether the pilot program has performed in meeting the following performance goals:

The Gas Works' articulated performance goals include: (i) obtaining one thousand customers in all customer classes; (ii) testing the effectiveness and the adaptability of the Gas Works' current application and technology processes and procedures as they apply to a competitive business environment; (iii) no out-of-pocket costs to the Gas Works; (iv) retaining 90% of customers who have selected PGW/QST; (v) obtaining one hundred customers who had originally selected other competitors as their supplier; and (vi) achieving a customer satisfaction rating of 7 (on a scale of 1 to 10) as determined by customer surveys.

Within ten (10) calendar days of the effective date of the Venture Agreement, the Gas Works shall provide a written report to the Mayor, City Council and the Gas Commission regarding the plan to meet its obligations in subparagraph 3(c)(iii). In addition, the Gas Works shall provide a written monthly status report to the Mayor, City Council and the Gas Commission regarding the progress made in attaining each of the foregoing performance goals in the preceding month. The report shall be submitted to the Mayor and filed with the Gas Commission and the Chief Clerk and the Council President on the 15th day of each month.

(c) Any other provisions of this Agreement to the contrary notwithstanding, the authorization set forth in subparagraph 3(a) is granted subject to the satisfaction of the following conditions:

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(i) The Venture Agreement with QST Energy, Inc. must be approved or confirmed by City Council Resolution prior to the adoption, by ordinance of City Council, of Bill No. 970647.

(ii) QST Energy, Inc. shall indemnify, defend and hold harmless the City, the Gas Works and Company, and their respective officers, directors, employees and agents, from any and all losses, costs (including, but not limited to, litigation costs and counsel fees), claims, suits in law or equity, actions, damages, liability and expenses arising out of or relating to the acquisition, marketing, brokering, aggregation, operation, supply, and/or distribution of energy in connection with the Venture Agreement, whether caused in whole or in part by any acts or omission of QST Energy, Inc., City, the Gas Works or Company (including their respective officers, directors, agents, employees and contractors). This obligation to indemnify, defend and hold harmless City, the Gas Works and Company, and their respective officers, directors, employees and agents, shall survive the termination or expiration of the Venture Agreement.

(iii) The Venture Agreement shall provide that there is no obligation on the part of City, Gas Works or Company to provide any funds on or after October 23, 1997 in the performance of Company's obligations and duties under the Venture Agreement and the Venture Agreement shall prohibit the expenditure of any City, Gas Works or Company funds other than for the support of in kind contributions provided by existing staff on the Gas Works' payroll. Company shall make no commitment, financial or otherwise to QST Energy, Inc beyond the use of Gas Works' staff, materials, supplies and equipment existing as of October 23, 1997 and in absolutely no event shall any General Fund revenues of the City be made available in support of or in connection with the Venture Agreement.

(iv) The Venture Agreement shall provide that QST Energy, Inc. shall have and maintain insurance in such types and limits as deemed appropriate by the City, including, but not limited to, general liability insurance, workers' compensation/employer liability insurance, automobile liability insurance, and professional liability insurance, all as necessary.

(v) The Venture Agreement shall provide that QST Energy, Inc. shall not compete, directly or indirectly, with the Company in the acquisition, marketing, brokering, aggregation, operation, supply, and/or distribution of electric power or of gas to persons, businesses and other entities situate within the City of Philadelphia, in each instance, for a period of no less than one (1) year after the earlier of the termination or expiration of the Venture Agreement or December 31, 1998, without further City Council authorization.

(d) Additionally, subject to the limitations of subparagraphs 3(d)(1) and 3(d)(2), City, to the extent it has or shall have the authority or power so to do, authorizes and empowers Company to operate the Gas Works for the acquisition, marketing, brokering, aggregation and supply of electric power to persons, businesses and other entities situate within

Appendix D -- Part I

the City of Philadelphia through a venture with a Pennsylvania licensed electricity generation supplier. This authorization shall be exercised subject to the following conditions.

(1) For an interim period beginning no earlier than June 15, 1998 and ending no later than December 31, 1998, the Gas Works is authorized to negotiate and enter into an interim venture agreement (the "Interim Venture Agreement") with a Pennsylvania licensed electricity generation supplier in which that license shall be used as a basis for securing electric supply customers in the interim period. The Interim Venture Agreement shall provide for such steps as may be necessary to acquire customers and market inside the City, together with such other terms and conditions as the City Solicitor deems necessary or appropriate in the interest of the City as follows.

(A) The partner shall be selected on the basis of certain criteria, which shall include but not be limited to:

(i) relevant skills and experience, which may include gas and electricity experience in the wholesale markets, significant national presence, ownership of low-cost electric generation and natural gas assets; and extensive risk management expertise; and

(ii) financial strength, which may include willingness and ability to make a financial commitment to the venture and good record of profitability; and

(iii) other relevant strengths, which may include a good track record for partnering, a corporate culture compatible with that of the Gas Works; exclusive supply and asset management services; and willingness to covenant not to compete in the Gas Works' target markets.

(B) The Interim Venture Agreement shall provide that the Gas Works shall not incur any out-of-pocket expenses and that all such expenses shall be borne by the partner. The disbursement of the Venture gains shall reflect the Gas Works' share of these expenses and shall be delineated in the Final Venture Agreement.

(C) The Interim Venture Agreement shall provide that failure of City Council to approve the Final Venture Agreement by December 31, 1998 shall result in the termination of the Interim Venture Agreement without fault or penalty to the City or the Gas Works.

(2) No later than September 15, 1998, PGW shall submit the Final Venture Agreement to Council for its approval. Approval of the Final Venture Agreement by City Council shall act as authorization for the Company to operate the Gas Works for the acquisition, marketing, brokering, aggregation and supply of electric power to persons, businesses and other entities situate within the City of Philadelphia after December 31, 1998 under such terms and

Appendix D -- Part I

conditions as are set forth in the Final Venture Agreement.

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

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

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

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

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

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

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

SECTION II

Production, Purchase and Delivery of Gas

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

Appendix D -- Part I

maximum requirements of gas users in the City of Philadelphia.

2. Company may purchase natural gas or other gas from other parties pursuant to contracts and agreements for such purchases which are first submitted to the Gas Commission for its recommendations and approved by City Council; except that in temporary or emergency situations, Company may purchase natural or other gas from other parties and then seek the approval for such purchase or purchases from the Gas Commission and City Council within 30 days after the initiation of such purchase. In the event such temporary purchase shall be disapproved such supply if continuing shall immediately terminate. Company shall have the right to contract with others for the distribution and/or transmission of such gas to the Gas Works or its facilities which are ancillary, attendant or related in any manner to purchase of gas after such contracts are first submitted to the Gas Commission for its recommendations and approved by City Council.

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

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

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

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

SECTION III

Appendix D -- Part I

Standards of Gas and Electricity

1. *General*

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

Company may supply electric power in accordance with all applicable laws, regulations and standards established or administered by the Federal Energy Regulatory Commission and the Pennsylvania Public Utilities Commission pursuant to Section 1, Paragraph 3 of this Agreement.

2. *Testing--Facilities and Inspection*

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

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

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

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

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

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3. *Heating Value--Requirements And Determination*

The monthly average total heating value of the gas, when determined as provided below, shall not be less than 950 British Thermal Units per cubic foot, measured at a temperature of 60° Fahrenheit and a pressure of 30 inches of mercury. The daily average total heating value shall not differ from the monthly average total heating value to such extent as to interfere with the satisfactory functioning of consumer appliances.

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

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

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

4. *Purity--Requirements and Determination*

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

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

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

5. *Pressure Regulations*

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

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

Appendix D -- Part I

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

SECTION IV

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

1. *Accounting Methods*

(a) *In General*

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

(b) *Depreciation*

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

(c) *Employee Retirement Costs*

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

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

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An additional amount, as determined by the Director of Finance, shall be placed in a retirement fund to be held and invested by the Sinking Fund Commission. Such additional amount shall be determined by the Director of Finance after taking into consideration the current payrolls, the retirement schedules then in effect applicable to various classes of employees and the extent to which it appears desirable and reasonable to build up such fund in current and future years. To this end, the Director of Finance at appropriate times shall obtain competent actuarial advice and shall have available at all times a report made within the immediately preceding five (5) years by a competent actuary based upon an actuarial investigation of the pertinent factors with the costs to be paid by the Gas Works. Payment out of such funds shall be subject to the approval of the Director of Finance as to amounts and when and how payable.

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

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

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

2. *Budgets*

(a) *Operating Budget and Forecast*

There shall be prepared annually an operating budget for the ensuing year and an operating forecast for four (4) years comprising the ensuing year and the three (3) years next following. Such budget and forecast shall be prepared by Company with the aid of the Director of Finance; shall be consistent with the accounting methods prescribed in Section IV (1); and in general shall be in form and extent satisfactory to the Director of Finance and Gas Commission. The operating budget and forecast shall be subject to the approval of the Gas Commission.

(b) *Capital Budget and Forecast*

There shall be prepared annually a proposed capital budget for the ensuing

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

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

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

- (i) funds generated within the business through charges to customers or otherwise; and
- (ii) funds to be obtained through capital loans.

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

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

(c) *Expenditures Pursuant to Budgets*

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

3. *Temporary Financing*

Short-term loans not exceeding twenty million dollars in amount or twelve

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

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

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

4. *Financial Statements*

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

All books, records and accounts of the Gas Works shall be kept separate and apart from all other books, records and accounts of Company. The City Controller and the Director of Finance and Gas Commission may examine or cause to be examined the books, records and accounts of Gas Works for the purpose of auditing and reporting upon such financial statement to the Mayor, the Gas Commission, the City Council, the City Solicitor and the Director of Finance; and the Director of Finance, Gas Commission and the City Controller shall at all times hereafter, for such purpose or for the purpose of ascertaining any facts in relation to the operation of the Gas Works and the performance of the obligations of Company, have full and free access at all reasonable hours to the related books, records and accounts of Gas Works.

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

SECTION V

Insurance; Eminent Domain

1. *Insurance*

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

2. *Eminent Domain*

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

SECTION VI

Gas Commission

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

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

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

Appendix D -- Part I

party prior to the expiration of their respective terms.

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

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

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

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

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

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

SECTION VII

Gas Rates

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

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

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

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

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

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

FY1996	\$700,000
FY1997	\$725,000
FY1998	\$750,000
FY1999	\$775,000
FY2000	\$800,000
FY2001 and thereafter	The prior fiscal year's maximum amount adjusted to reflect the percentage change in the Consumer Price Index for All Urban Consumer (CPI-U). All Items Index, Philadelphia, Pennsylvania, United States Department of Labor, Bureau of Labor Statistics, as most recently published and available to the Director of Finance on March 1 of each such fiscal year; and

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

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

(iv) Expenses of the Gas Commission; and

(v) All sinking fund charges payable in respect of principal and interest on all obligations of the City issued for or with respect to the Gas Works and, with

Appendix D -- Part I

respect to Gas Works Revenue Bonds issued pursuant to The First Class City Revenue Bond Act, such additional amount as may be required to comply with any rate covenant and sinking fund reserve requirement approved by ordinance of City Council in connection with the authorization or issuance of Gas Works Revenue Bonds.

(b) Sufficient also (together with the excess on a cumulative basis of internally generated funds available for the purposes set forth below in this subparagraph (b) of prior years beginning after June 30, 1974, to the extent that such excess shall not have been applied to such purposes and shall be available for the payment of general expenses of such fiscal year and, subject and subordinate to the payment or provision for payment of all operation and maintenance costs and all sinking fund and sinking fund reserve requirements as set forth in subparagraph (a) of this subsection 1., together with the excess funds provided by revenues of such fiscal year not required for such purposes):

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

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

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

(c) Anything to the contrary herein contained notwithstanding, Company may continue to budget and report revenues and expenses in the form and by the methods heretofore used and the Gas Works shall continue to pay out of its revenues all of the expenses set forth in this subsection 1, and all other expenses necessary and proper to the operation of the Gas Works, excepting only the Company's own personnel and administrative costs which are payable out of the management fee. For the purposes of clauses (a) and (b) of this subsection 1., to the extent that operating expenses do not represent an actual outflow of funds (e.g., depreciation) such amount may be included in ascertaining whether revenues are sufficient to meet other costs, expenses and requirements of said clauses (a) and (b). Company shall at all times to the extent of its authority observe and comply with all terms, covenants and provisions of all ordinances enacted by City Council relating to the Gas Works including without limitation, ordinances enacted pursuant to The First Class City Revenue Bond Act authorizing Gas Works Revenue Bonds.

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

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

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

5. In the determination of rate schedules for gas, the Gas Commission shall establish and apply non-discriminatory rates based on suitable and reasonable classification of the services provided, taking into consideration the preparation of such schedules, the nature and purpose of the use, the quantity used, the time of year when used, the available supply of gas and other competing fuels, the maximum demand, and such other factors, including state, and federal laws, regulations or guide lines, as may be appropriate to the economics of the purchase, manufacture, distribution and sale of gas and consistent with the intent and purpose of this ordinance and/or Agreement. Such rates may provide for sufficient revenue to stabilize them over a reasonable number of years.

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

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

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

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SECTION VIII

Purchases and Sales of Non-Gas Items

1. Except in the purchase of unique articles or articles which for any other reason cannot be obtained in the open market, or, except in the purchase or sale of electricity pursuant to Section 1, Paragraph 3, competitive bids shall be secured, pursuant to procurement standards adopted and promulgated by the Gas Commission, before any purchase, by contract or otherwise, is made or before any contract is awarded for material and supplies, construction, alterations, repairs or maintenance or for rendering any services to Company other than professional services or for the purchase of any other item, thing or service, and the purchase shall be made from or the contract shall be awarded to the lowest responsible bidder."

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

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

SECTION IX

Legal Services

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

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

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

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SECTION X

Company's Obligations During Disputes

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

SECTION XI

Definitions

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

1. *Director of Finance* - The Director of Finance of the City of Philadelphia.
2. *City Solicitor* - The City Solicitor of the City of Philadelphia.
3. *City Controller* - The City Controller of the City of Philadelphia.
4. *Mayor* - The Mayor of the City of Philadelphia.
5. *City Council* - The City Council of the City of Philadelphia.
6. *Streets Commissioner* - The Commissioner of the Department of Streets of the City of Philadelphia.
7. *Gas Works* - All of the property, both personal and real, including mains and pipes, which together constitute the plant and equipment of the Philadelphia Gas Works.
8. *Non-Gas Items* - Non-gas items include but are not limited to every tangible or intangible article, item or thing except natural gas and substitute natural gas.

SECTION XII

Term

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

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In the absence of such notice, the term shall be extended for further two (2) year periods upon the terms and conditions herein.

SECTION XIII

Other Agreements

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

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

SECTION XIV

Counterparts

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

SECTION XV

Effectiveness

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

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

Appendix D -- Part I

[signatures of parties omitted]

Note: Council authorized the City to enter into the Management Agreement through Bill #455 (approved December 29, 1972). As of June 30, 2000, the Agreement had been further amended by authority of Bill #1021 (approved December 14, 1973), Bill #1870 (approved May 30, 1975), Bill #396 (approved November 1, 1976), Bill #1410 (approved June 22, 1978), Bill #1874 (approved April 10, 1979), Bill #1948 (approved June 11, 1979), Bill #319 (approved September 5, 1980), Bill #320 (approved September 5, 1980), Bill #321 (approved September 5, 1980), Bill #750 (approved June 23, 1981), Bill #1315 (approved September 22, 1982), Bill #1314 (approved December 3, 1982), Bill #787 (approved April 11, 1990), Bill #1258 (approved December 28, 1995), Bill #970647 (approved October 30, 1997), and Bill #980456 (approved June 25, 1998). The Agreement was next amended by authority of Bill #000583 (approved November 15, 2000). The above text is an unofficial restatement reflecting all amendments through June 25, 1998.

Bill No. 980456

Certified Copy



(Bill No. 980456)

AN ORDINANCE

Explanation:

[Brackets] indicate matter deleted.

Italics indicate new matter added.

CERTIFICATION: This is a true and correct copy of the original Bill, Passed by the City Council on June 18, 1998 The Bill was Signed by the Mayor on June 25, 1998

Marie B. Hauser
Chief Clerk of the City Council

Authorizing the Mayor to enter into an amendment to the Agreement authorized by ordinance approved December 29, 1972 (Bill No. 455), as amended, between the City of Philadelphia and the Philadelphia Facilities Management Corporation relating to the operation and management of the Philadelphia Gas Works ("the Gas Works"), under certain terms and conditions, by authorizing the Philadelphia Facilities Management Corporation, on behalf of the City and the Gas Works, to enter into the electric supply business, under certain terms and conditions.

THE COUNCIL OF THE CITY OF PHILADELPHIA HEREBY ORDAINS:

SECTION 1. The Mayor is hereby authorized to enter into an amendment to Section I of the Agreement authorized by ordinance approved December 29, 1972 (Bill No. 455), as amended, between the City of Philadelphia and Philadelphia Facilities Management Corporation ("Agreement"), which amendment shall be substantially in the following form, with such changes as the City Solicitor deems necessary or appropriate to protect the interests of the City:

SECTION I

City of Philadelphia

Bill No. 980456

Certified Copy

General

* * *

3. * * *

(d) Additionally, subject to the limitations of subparagraphs 3(d)(1) and 3(d)(2), City, to the extent it has or shall have the authority or power so to do, authorizes and empowers Company to operate the Gas Works for the acquisition, marketing, brokering, aggregation and supply of electric power to persons, businesses and other entities situate within the City of Philadelphia through a venture with a Pennsylvania licensed electricity generation supplier. This authorization shall be exercised subject to the following conditions.

(1) For an interim period beginning no earlier than June 15, 1998 and ending no later than December 31, 1998, the Gas Works is authorized to negotiate and enter into an interim venture agreement (the "Interim Venture Agreement") with a Pennsylvania licensed electricity generation supplier in which that license shall be used as a basis for securing electric supply customers in the interim period. The Interim Venture Agreement shall provide for such steps as may be necessary to acquire customers and market inside the City, together with such other terms and conditions as the City Solicitor deems necessary or appropriate in the interests of the City as follows.

(A) The partner shall be selected on the basis of certain criteria, which shall include but not be limited to:

(i) relevant skills and experience, which may include gas and electricity experience in the wholesale markets, significant national presence, ownership of low-cost electric

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City of Philadelphia

Bill No. 980456

Certified Copy

generation and natural gas assets; and extensive risk management expertise; and

(ii) financial strength, which may include willingness and ability to make a financial commitment to the venture and good record of profitability; and

(iii) other relevant strengths, which may include a good track record for partnering, a corporate culture compatible with that of the Gas Works; exclusive supply and asset management services; and willingness to covenant not to compete in the Gas Works' target markets.

(B) The Interim Venture Agreement shall provide that the Gas Works shall not incur any out-of-pocket expenses and that all such expenses shall be borne by the partner. The disbursement of the Venture gains shall reflect the Gas Works' share of these expenses and shall be delineated in the Final Venture Agreement.

(C) The Interim Venture Agreement shall provide that failure of City Council to approve the Final Venture Agreement by December 31, 1998 shall result in the termination of the Interim Venture Agreement without fault or penalty to the City or the Gas Works.

(2) No later than September 15, 1998, PGW shall submit the Final Venture Agreement to Council for its approval. Approval of the Final Venture Agreement by City Council shall act as authorization for the Company to operate the Gas Works for the acquisition, marketing, brokering, aggregation and supply of electric power to persons, businesses and other entities situate within the City of Philadelphia after December 31, 1998 under such terms and conditions as are set forth in the Final Venture Agreement.

Bill No. 970647

Certified Copy

1, Paragraph 3, competitive bids shall be secured, pursuant to procurement standards adopted and promulgated by the Gas Commission, before any purchase, by contract or otherwise, is made or before any contract is awarded for material and supplies, construction, alterations, repairs or maintenance or for rendering any services to Company other than professional services or for the purchase of any other item, thing or service, and the purchase shall be made from or the contract shall be awarded to the lowest responsible bidder."

CERTIFICATION: This is a true and correct copy of the original Bill, Passed by the City Council on October 30, 1997 The Bill was Signed by the Mayor on October 30, 1997

Marie B. Hauser

Marie B. Hauser
Chief Clerk of the City Council



(Bill No. 970647)

AN ORDINANCE

Authorizing the Mayor to enter into an amendment to the Agreement authorized by ordinance approved December 29, 1972 (Bill No. 455), as amended, between the City of Philadelphia and the Philadelphia Facilities Management Corporation relating to the operation and management of the Philadelphia Gas Works, under certain terms and conditions, by authorizing the Philadelphia Facilities Management Corporation, on behalf of the City and the Philadelphia Gas Works, to enter into the electric supply business, under certain terms and conditions.

THE COUNCIL OF THE CITY OF PHILADELPHIA HEREBY ORDAINS:

SECTION 1. The Mayor is hereby authorized to enter into an amendment to the "Whereas" clauses of the Agreement authorized by ordinance approved December 29, 1972 (Bill No. 455), as amended, between the City of Philadelphia and Philadelphia Facilities Management Corporation ("Agreement"), which amendment shall be substantially in the following form, with such changes as the City Solicitor deems necessary or desirable to protect the interests of the City:

WITNESSETH:

City of Philadelphia

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

[4.] 5. * * *

[5.] 6. * * *

[6.] 7. * * *

[7.] 8. * * *

SECTION 3. The Mayor is hereby authorized to enter into an amendment to SECTION III of the Agreement authorized by ordinance approved December 29, 1972 (Bill No. 455), as amended, between the City of Philadelphia and Philadelphia Facilities Management Corporation ("Agreement"), which amendment shall be substantially in the following form, with such changes as the City Solicitor deems necessary or desirable to protect the interests of the City:

Appendix D - Part II

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the Gas Works for the acquisition, marketing, brokering, aggregation and supply of electric power to persons, businesses and other entities situate within the City of Philadelphia. This authorization shall be exercised through a Venture Agreement with QST Energy, Inc. (the "Venture Agreement") relating to the PECO Energy Company Electric Pilot Program which Company is further authorized to negotiate. The Venture Agreement shall provide for such steps as may be necessary to acquire, market, broker, aggregate and supply safe, efficient and reliable electric power within the City and such other terms and conditions as the City Solicitor deems necessary or appropriate in the interests of the City.

(b) Company shall take no action of any kind to carry out the authorization set forth in subparagraph 3(a) after December 31, 1998 without further City Council authorization by ordinance. Any request to extend the authorization beyond December 31, 1998 shall be made no later than May 1, 1998 and the request for extension shall be submitted along with a report showing how well and whether the pilot program has performed in meeting the following performance goals:

The Gas Works' articulated performance goals include: (i) obtaining one thousand customers in all customer classes; (ii) testing the effectiveness and the adaptability of the Gas Works' current application and technology processes and procedures as they apply to a competitive business environment; (iii) no out-of-pocket costs to the Gas Works; (iv) retaining 90% of customers who have selected PGW/QST; (v) obtaining one hundred customers who had originally selected other competitors as their supplier; and (vi) achieving a customer satisfaction rating of 7 (on a scale of 1 to 10) as determined by customer surveys.

Within ten (10) calendar days of the effective date of the

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Venture Agreement, the Gas Works shall provide a written report to the Mayor, City Council and the Gas Commission regarding the plan to meet its obligations in subparagraph 3(c)(iii). In addition, the Gas Works shall provide a written monthly status report to the Mayor, City Council and the Gas Commission regarding the progress made in attaining each of the foregoing performance goals in the preceding month. The report shall be submitted to the Mayor and filed with the Gas Commission and the Chief Clerk and the Council President on the 15th day of each month.

(c) Any other provisions of this Agreement to the contrary notwithstanding, the authorization set forth in subparagraph 3(a) is granted subject to the satisfaction of the following conditions:

(i) The Venture Agreement with QST Energy, Inc., must be approved or confirmed by City Council Resolution prior to the adoption, by ordinance of City Council, of Bill No. 970647.

(ii) QST Energy, Inc. shall indemnify, defend and hold harmless the City, the Gas Works and Company, and their respective officers, directors, employees and agents, from any and all losses, costs (including, but not limited to, litigation costs and counsel fees), claims, suits in law or equity, actions, damages, liability and expenses arising out of or relating to the acquisition, marketing, brokering, aggregation, operation, supply, and/or distribution of energy in connection with the Venture Agreement, whether caused in whole or in part by any acts or omission of QST Energy, Inc., City, the Gas Works or Company (including their respective officers, directors, agents, employees and contractors). This obligation to indemnify, defend and hold harmless City, the Gas Works and Company, and their respective officers, directors, employees and agents, shall survive the termination or expiration of the Venture

Appendix D - Part II City of Philadelphia

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Agreement.

(iii) The Venture Agreement shall provide that there is no obligation on the part of City, Gas Works or Company to provide any funds on or after October 23, 1997 in the performance of Company's obligations and duties under the Venture Agreement and the Venture Agreement shall prohibit the expenditure of any City, Gas Works or Company funds other than for the support of in kind contributions provided by existing staff on the Gas Works' payroll. Company shall make no commitment, financial or otherwise to QST Energy, Inc. beyond the use of Gas Works' staff, materials, supplies and equipment existing as of October 23, 1997 and in absolutely no event shall any General Fund revenues of the City be made available in support of or in connection with the Venture Agreement.

(iv) The Venture Agreement shall provide that QST Energy, Inc. shall have and maintain insurance in such types and limits as deemed appropriate by the City, including, but not limited to, general liability insurance, workers' compensation/employer liability insurance, automobile liability insurance, and professional liability insurance, all as necessary.

(v) The Venture Agreement shall provide that QST Energy, Inc. shall not compete, directly or indirectly, with the Company in the acquisition, marketing, brokering, aggregation, operation, supply, and/or distribution of electric power or of gas to persons, businesses and other entities situate within the City of Philadelphia, in each instance, for a period of no less than one (1) year after the earlier of the termination or expiration of the Venture Agreement or December 31, 1998, without further City Council authorization.

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* * *

WHEREAS, The City desires to provide quality gas and electric services to its citizens at reasonable rates through the Gas Works; and

WHEREAS The Gas Works' Strategic Plan contains among its five strategies product and market expansion; and

WHEREAS, an increase in the Gas Works' revenues will lessen the financial burden from competition in the gas business and therefore lessen the financial burden on current gas customers;

* * *

SECTION 2. The Mayor is hereby authorized to enter into an amendment to Section I of the Agreement authorized by ordinance approved December 29, 1972 (Bill No. 455), as amended, between the City of Philadelphia and Philadelphia Facilities Management Corporation ("Agreement"), which amendment shall be substantially in the following form, with such changes as the City Solicitor deems necessary or desirable to protect the interests of the City:

SECTION I

General

* * *

3. (a) Subject to the limitations of subparagraphs 3(b) and 3(c), City, to the extent it has or shall have the authority or power so to do, authorizes and empowers Company to operate

Appendix D - Part II

City of Philadelphia

Bill No. 970647

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"SECTION III

Standards of Gas and Electricity

1. General

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

Company may supply electric power in accordance with all applicable laws, regulations and standards established or administered by the Federal Energy Regulatory Commission and the Pennsylvania Public Utilities Commission pursuant to Section 1, Paragraph 3 of this Agreement."

SECTION 4. The Mayor is hereby authorized to enter into an amendment to SECTION VIII of the Agreement authorized by ordinance approved December 29, 1972 (Bill No. 455), as amended, between the City of Philadelphia and Philadelphia Facilities Management Corporation ("Agreement"), which amendment shall be substantially in the following form, with such changes as the City Solicitor deems necessary or desirable to protect the interests of the City:

"SECTION VIII

Purchases and Sales of Non-Gas Items

1. Except in the purchase of unique articles or articles which for any other reason cannot be obtained in the open market, or, except in the purchase or sale of electricity pursuant to Section

APPENDIX E

SECRETARY'S BUREAU

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SECRETARY'S BUREAU

hearings. In addition, three citizens' organizations; Consumer Education and Protective Association, Association of Community Organizations for Reform Now and Action Alliance of Senior Citizens appeared and were represented by counsel.

The Commission, pursuant to due public notice, scheduled a pre-hearing conference on May 19, 1982 which was attended by all parties. Provision was made for pre-hearing discovery. Thereafter, a total of 15 days of hearings were held in Philadelphia, including a public session on July 15, 1982, at which PGW's ratepayers and other interested members of the public presented their views and comments on the proposed increase.

During the course of the proceeding, PGW introduced the written and oral testimony of eight witnesses and submitted 68 exhibits. Opposing parties presented four witnesses, 69 exhibits and various schedules. In addition, City of Philadelphia Finance Director Rodney L. Johnson, appeared on July 23, 1982 as a Commission witness. The record was officially closed on July 28, 1982, and Briefs and Reply Briefs were filed by the parties.

Oral Argument before the Commission en banc was held on August 23, 1982, and, in addition, a PGW witness presented further testimony as to PGW's Gas Cost Rate submission. The complete record, now before the Commission, consists of 2654 pages of transcript.

After hearing oral argument for almost a full day, and analyzing and considering this voluminous transcript of testimony, the exhibits and briefs, the Commission is now confronted with a most difficult and onerous task. We must fairly resolve the very serious and complex issues raised by the parties, in order to determine just and reasonable rates.

Over a number of days, this Commission has spent many hours considering, and, indeed, agonizing over the logic of stubborn facts and the emotional but sincere presentations made at the Hearings by ratepayers, associations and other interested parties who appeared and presented their views. Although their prime concern was the proposed rate increase, a number of witnesses also stressed the need for energy conservation.¹ We were truly impressed with the plight of these witnesses. However, in exercising our duty, both the Commission and public are confronted with the inescapable fact that gas bills are reflecting the huge increase in the cost of natural gas in recent years under the process of deregulation initiated in 1978. Indeed, the cost of natural gas represents more than 60 percent of

1. The Commission has made clear its view that energy conservation is a matter of the highest priority for everyone. Anticipating that this Rate Case would be completed early in September 1982, the Commission has already scheduled public hearings on the subject of conservation for September 13 and 14, 1982.

PGW's expenses. We reiterate that neither the Commission, nor the Mayor, nor the City Council has any direct control over the price of natural gas. Gas consumers and their representatives should be expressing their concern to the President and Congress in Washington, D.C. who do have the power and authority to control the price of natural gas.

We do, however, have the power and the duty to require PGW to tighten its belt, adopt cost-cutting measures, freeze manpower expense levels, improve collection of delinquent accounts receivables, operate on a more efficient basis, set achievable operating goals, manage its funds more prudently; while at the same time providing adequate, safe, reliable service to the public at the lowest possible cost; and, in addition, to allow the Company to achieve sufficient earnings to meet its obligations, attract capital and provide sufficient and adequate debt service coverage to maintain its bond rating.

In adopting this approach, the Commission specifically recognizes that there are many customers who honestly desire to pay their gas bills, but, who, by reason of legitimate economic reasons, are unable to do so. The majority of ratepayers who conscientiously pay their bills, should not be saddled with excessive rates to cover the delinquencies of those who can not or will not.

Appropriate remedial social assistance must be afforded for those who truly are unable to pay. At the same time, appropriate remedial action by way of strengthened customer service regulations must be adopted to deal with those who are able, but unwilling to pay for their gas usage.

This Commission further recognizes that while there is a need to keep gas rates from unjust and unreasonable escalation, the financial integrity of PGW must be maintained. This is essential in order to preserve the "A" ratings of PGW bonds by providing for sufficient earnings, by taking effective steps to increase collections, by setting management goals and objectives, and by prudent and efficient money management; all designed to satisfy the rating agencies that the interests of bondholders are being adequately protected.

II. STANDARD TO BE APPLIED IN SETTING RATES

PGW maintains that the method by which rates are to be set is established in Section VII of the PFMC/City Agreement, and is the so-called "cash flow" method. PGW cites the prior Commission Order dated November 27, 1981, pp. 7-8; and Action Alliance of Senior Citizens v. Philadelphia Gas Commission, 45 Pa. Cmlth. 234, 390 A.2d 1155 (1979), to support its position.

Section VII, paragraph 1 of the Agreement requires, inter alia, that the Commission fix and regulate rates and charges for supplying gas to customers which will in each fiscal year produce revenues, at a minimum:

- (1) Sufficient to pay all of the operation and maintenance costs and expenses of conducting the Gas Works Enterprise and to pay the interest and amortization becoming due in each fiscal year on debt incurred for the Gas Works.
- (2) Sufficient also to make base payments to the City.
- (3) To provide appropriations for prepayment of debt and for capital additions which have been determined by the Gas Commission to be reasonable and which have been approved by City Council; and
- (4) To provide cash, or equivalent for working capital in such reasonable amounts as may be determined by Company to be necessary and as shall be approved by the Gas Commission.

Public Counsel concedes that the Management Agreement requires that PGW revenues be sufficient to cover the aforesaid items and acknowledges that a serious cash flow problem exists (PC Brief, p. 8). However, Public Counsel suggests that an alternative approach to the cash flow method of accounting be utilized (PC Brief, Sections II, III and IV).

Thus, there is no dispute between PGW and Public Counsel as to the existence of a cash flow problem (PC Brief, p. 8). However, there is a substantial dispute about how to resolve it.

PGW insists on a literal cash-flow methodology to establish a revenue requirement, while Public Counsel maintains that it is more appropriate to establish rates by the accrual method. Public Counsel suggests that an appropriate level of earnings be established for PGW which should, under normal conditions provide sufficient cash flow to meet PGW's needs, and the requirements of the Management Agreement (PC Brief, p. 25).

Public Counsel argues that PGW's method provides excessive coverages and earnings to solve the problem and is the least equitable solution, and that a more balanced approach is possible which will moderate the rate increase but which will be just as effective in resolving the cash flow problem (PC Brief, p. 14).

PGW argues that Public Counsel Witness' methodology is complicated, confusing (PGW Initial Brief, p. 3) and indeed contravenes the Management Agreement (PGW Initial Brief, p. 2; and PGW Reply Brief, pp. 12-14).

In the final analysis, PGW sets its rates by determining its revenue requirement on the cash-flow method. It then tests the projected revenues to determine whether

they provide adequate debt service coverage (Katz, Schedule XXII). Public Counsel witnesses, on the other hand, set rates by determining PGW's revenue requirement based on a debt service coverage recommendation (Belmont, Schedule 1) and, then, tests whether those earnings provide adequate cash-flow to PGW, to cover all requirements of the Management Agreement (Hagstrom, Schedule 2) (PC Brief, pp. 26, 27), utilizing an accrual method of accounting (PC Brief, pp. 27-30).

This Commission, in determining what rates to approve, both in the past and in the present case, has applied and continues to apply the standard that the rates to be charged the customers of PGW must be just and reasonable. This Commission will not be deterred in its duty by the application of labels. In this context, we find it unnecessary to be strictly bound by technical accounting terminology. We have examined each and every projected item of expenditure to determine its prudence, and whether such projection falls within the so-called zone of reasonableness, which hereinafter we discuss more fully. Just and reasonable rates require the establishment by this Commission of a proper balance between the interests of the consumers in receiving essential public utility gas service at the lowest possible rates, and the interest of the utility in receiving sufficient rates to meet its reasonable ex-

penses and capital needs. F.P.C. v. Hope Natural Gas Co., 320 U.S. 591 (1944); F.P.C. v. Natural Gas Pipeline Co., 315 U.S. 575 (1942).

We recognize that we are governed by the requirements of the Management Agreement that the rates we establish must be sufficient to produce revenues to cover all of the items contained in Section VII thereof reasonably projected and, indeed, the revenue level herein established is reasonably designed to do so.

Further, we reiterate our acceptance of the principle of "normalization" and find that this does not violate the Management Agreement. Thus, the level of costs must be estimated for the fiscal year 1982-83, since no one can know now exactly what the actual costs of PGW's operation will be at the end of the year.

We, therefore, accept as just and reasonable, the fundamental and widely recognized principle of utility rate making, that rates should be based upon reasonable projections of normal costs of operation and that unusual events (whether increasing or decreasing costs of operation) should be factored out. Washington Utilities and Transportation Comm. v. Washington Natural Gas Co., 32 PUR 4th 530, 534 (1979); Re: Central Maine Power Co., 26 PUR 4th 547, 549 (1978); Pittsburgh v. Pa. PUC, 208 Pa. Super 260 (1966); unless, of course, there are compelling and extraordinary reasons for consideration thereof.

This Commission recognizes, as do all parties to this proceeding, that reasonable minds may and will differ in projecting expense levels and other items for rate making purposes. There is no precise mathematical formula for the Commission to employ in judging the evidence and arriving at a reasonable conclusion.

Thus, by reason of numerous variable factors, which may be affected by future economic and political considerations (state of economy, inflation, deregulation, cost of fuel, interest rates, fuel assistance programs, improved collections, etc.) together with such other factors as potential savings to be achieved by improved management systems, operations and practices, "belt tightening," public perception of the proposed strengthening of Customer Service Regulations to reduce delinquencies and accounts receivable, coupled with the unpredictability of the weather, there may be ranges of values within which responsible projections may be made and deemed just and reasonable. This range is the so-called "zone of reasonableness".

The Commission, therefore, in making its findings, conclusions and Order within this zone of reasonableness, has attempted, with reasoned consistency, to balance the consumer interest in receiving vital public utility service at the lowest possible rates, with the interest of the utility, (a) in receiving reasonable and sufficient rates to

meet all of its reasonable costs, including capital costs, (b) in maintaining its financial integrity, (c) in raising additional capital at reasonable cost, and (d) in maintaining its bond rating. Federal Power Comm. v. Hope Natural Gas, 320 U.S. 591, 602 (1944).

In this context, it must be noted that the ultimate test of utility rates is their future impact. The United States Supreme Court has clearly stated that:

Under the statutory standard "just and reasonable" it is the result reached, not the method employed, which is controlling. (citations omitted). It is not theory, but the impact of the rate order which counts. Federal Power Commission v. Hope Natural Gas Co., supra.

Following the above reasoning, the Commission has mandated and made appropriate adjustments to reflect more prudent money management, a labor expense freeze, normalized costs of operations, revenues and cost trends and projected improved collections of delinquent accounts receivables. These adjustments involve essentially discrete items which we will consider seriatim.

III. OPERATING EXPENSES

A. Labor and Fringe Costs

PGW has projected Labor and Fringe Costs for fiscal 1983 at \$94.4 million dollars which includes pension expenses, payroll taxes, insurance expenses and the estimated effects of an assumed 8% wage increase as a result of

APPENDIX F

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SECURITY'S BUREAU

Appendix F

REVISED
Exhibit HSG-1

Summary of Results

Philadelphia Gas Works
Class COS Study - 2006- REVISED (Mar30)
Future Test Year Ended August 31, 2007 (\$000s)

	Total	Residential Non-Heat RC-1	Residential Heat RC-2	Commercial Non-Heat RC-3	Commercial Heat RC-4	Industrial Non-Heat RC-5	Industrial Heat RC-6	Municipal Non-Heat RC-7	Municipal Heat RC-8	Housing Auth. GS RC-9
7 <u>Revenues at Current Rates</u>										
8 Gas Full Tariff Revenue	609,786	16,040	405,998	18,706	93,235	3,788	8,063	2,882	11,043	9,102
9 Non-Gas Full Tariff Revenue	<u>434,342</u>	<u>17,341</u>	<u>311,866</u>	<u>12,989</u>	<u>62,906</u>	<u>2,537</u>	<u>5,438</u>	<u>1,583</u>	<u>5,908</u>	<u>6,254</u>
10 Full tariff gas revenue at current rates	1,044,127	33,382	717,864	31,695	156,141	6,324	13,501	4,465	16,952	15,356
11 Other revenue / Adjustments	<u>31,585</u>	<u>2,601</u>	<u>26,535</u>	<u>273</u>	<u>1,100</u>	<u>26</u>	<u>76</u>	<u>9</u>	<u>33</u>	<u>526</u>
12 Net revenues	1,075,712	35,982	744,399	31,968	157,241	6,351	13,577	4,474	16,985	15,882
13										
14 <u>Operating Expenses</u>										
15 Supply, Storage and Transmission	651,439	16,495	439,531	18,690	99,228	3,875	8,616	3,043	12,161	9,804
16 Other Operating expenses	234,080	18,374	180,140	4,947	20,176	736	1,926	359	1,241	2,188
17 Universal Service and Energy Conservation	<u>108,546</u>	<u>3,061</u>	<u>77,470</u>	<u>3,569</u>	<u>17,791</u>	<u>723</u>	<u>1,538</u>	<u>550</u>	<u>2,107</u>	<u>1,737</u>
18 Total Operating Expenses	994,066	37,930	697,141	27,206	137,195	5,334	12,080	3,952	15,509	13,728
19										
20 Income before Interest and Surplus	81,646	(1,948)	47,258	4,762	20,046	1,017	1,496	522	1,476	2,153
21 Interest and Surplus	<u>81,646</u>	<u>4,627</u>	<u>59,649</u>	<u>1,868</u>	<u>2,497</u>	<u>286</u>	<u>718</u>	<u>241</u>	<u>983</u>	<u>911</u>
Current Revenue OVER (UNDER) Total										
22 Requirements- Before Rate Increase Requirement	(0)	(6,575)	(12,391)	2,894	10,549	731	779	281	493	1,242
23										
24 Rate Increase Requirement	<u>100,000</u>	<u>5,667</u>	<u>73,057</u>	<u>2,288</u>	<u>11,632</u>	<u>350</u>	<u>879</u>	<u>296</u>	<u>1,204</u>	<u>1,116</u>
25 <u>Current Revenue OVER (UNDER) Total Requirements- Including Rate Increase Requirement</u>	<u>(100,000)</u>	<u>(12,242)</u>	<u>(85,448)</u>	<u>606</u>	<u>(1,083)</u>	<u>380</u>	<u>(100)</u>	<u>(15)</u>	<u>(712)</u>	<u>126</u>
26 <u>AS ORIGINALLY FILED</u>	<u>(100,000)</u>	<u>(12,257)</u>	<u>(86,038)</u>	<u>594</u>	<u>(1,203)</u>	<u>377</u>	<u>(111)</u>	<u>(18)</u>	<u>(730)</u>	<u>113</u>
Increase (Decrease) in Tariff Rates for Full										
27 Cost of Service with Rate Increase Requirement	9.6%	36.7%	11.9%	(1.9%)	0.7%	(6.0%)	0.7%	0.3%	4.2%	(0.8%)
28										
29 Rate Base	1,409,193	79,861	1,029,515	32,239	163,917	4,939	12,387	4,166	16,970	15,728
30										
31 Return on Rate Base at Present Rates (Before All Interest and Surplus)	5.8%	(2.4%)	4.6%	14.8%	12.2%	20.6%	12.1%	12.5%	8.7%	13.7%
32										
	(0.0000)	#####	#####	12,760.8554	119,856.3073	3,426.8282	#####	3,497.5405	#####	#####

Philadelphia Gas Works
Class COS Study - 2006- REVISED (Mar30)
Future Test Year Ended August 31, 2007 (\$000s)

	Total	NGV	BPS	BPS	BPS	LBS	LBS	LBS	LBS	LBX	Co-Gen	GTS/IT
		Direct	Small	Large	A/C	Small	Large	Large	Large	Large	InDirect	Trans only
		RC-10	RC-11	RC-12	RC-13	RC-14	RC-15	RC-16	RC-17	RC-18	RC-19	RC-20
Revenues at Current Rates												
8 Gas Full Tariff Revenue	609,786	4	2,549	26,172	1,108	6,029	4,076	218	24	587	162	0
9 Non-Gas Full Tariff Revenue	434,342	1	47	146	3	22	13	2	6	12	10	7,256
10 Full tariff gas revenue at current rates	1,044,127	5	2,597	26,317	1,111	6,051	4,089	220	30	599	172	7,256
11 Other revenue / Adjustments	31,585	0	62	145	6	31	21	6	0	4	1	130
12 Net revenues	1,075,712	5	2,659	26,462	1,117	6,082	4,110	226	30	602	173	7,386
Operating Expenses												
15 Supply, Storage and Transmission	651,439	4	1,963	23,250	1,314	6,362	4,516	247	27	652	191	1,471
16 Other Operating expenses	234,080	1	192	1,021	37	186	122	9	10	27	9	2,379
17 Universal Service and Energy Conservation	108,546	1	0	0	0	0	0	0	0	0	0	0
18 Total Operating Expenses	994,066	5	2,155	24,271	1,351	6,548	4,638	256	37	679	200	3,850
20 Income before Interest and Surplus	81,646	(0)	504	2,191	(234)	(466)	(528)	(30)	(7)	(76)	(27)	3,537
21 Interest and Surplus	81,646	0	128	1,183	49	255	173	8	4	29	8	1,030
Current Revenue OVER (UNDER) Total Requirements- Before Rate Increase Requirement												
22	(0)	(0)	376	1,008	(282)	(721)	(701)	(37)	(11)	(105)	(35)	2,507
24 Rate Increase Requirement	100,000	0	157	1,449	60	312	212	9	4	36	10	1,261
Current Revenue OVER (UNDER) Total Requirements- Including Rate Increase Requirement												
25	(100,000)	(1)	219	(441)	(342)	(1,033)	(913)	(47)	(15)	(141)	(45)	1,246
26 AS ORIGINALLY FILED	(100,000)	(1)	216	(467)	(342)	(1,037)	(916)	(47)	(15)	(142)	(46)	2,076
Increase (Decrease) in Tariff Rates for Full Cost of Service with Rate Increase Requirement												
27	9.6%	14.9%	(8.4%)	1.7%	30.7%	17.1%	22.3%	21.2%	50.1%	23.6%	26.4%	(17.2%)
29 Rate Base	1,409,193	6	2,212	20,423	839	4,394	2,985	133	61	504	144	17,769
31 Return on Rate Base at Present Rates (Before All Interest and Surplus)	5.8%	(0.1%)	22.8%	10.7%	(27.8%)	(10.6%)	(17.7%)	(22.2%)	(11.6%)	(15.1%)	(18.7%)	19.9%
32	(0.0000)	0.0000	2,360.7039	#####	#####	4,657.2227	3,158.1213	#####	6.5273	#####	#####	#####

REVISED

Exhibit HSG-7

Company's Proposed Revenue Allocation and Proposed Rates

Exhibit HSG-7A	Company's Tentative Revenue Allocation
Exhibit HSG-7B	Development of Company's Proposed Delivery Charges
Exhibit HSG-7C	Results of Company's Proposed Rates

Philadelphia Gas Works
 Class COS Study - 2006- REVISED (Mar30)
 Future Test Year Ended August 31, 2007 (\$000s)

Company's Tentative Revenue Allocation

	Total	Residential Non-Heat RC-1	Residential Heat RC-2	Commercial Non-Heat RC-3	Commercial Heat RC-4	Industrial Non-Heat RC-5	Industrial Heat RC-6	Municipal Non-Heat RC-7	Municipal Heat RC-8	Distribution Areas QS RC-9	NGV Direct RC-10
8 <u>Tariff Revenue at Present Rates</u>											
9 Customer Charge	73,990	7,379	59,678	1,210	4,197	152	364	72	120	554	0
10 Delivery Charge / RCEC	221,459	6,250	158,239	7,450	37,134	1,508	3,209	844	3,233	3,593	0
11 USEC	131,636	3,712	93,949	4,329	21,575	877	1,866	667	2,555	2,106	1
12 Gas Revenue / Transport	617,042	16,040	405,998	18,706	93,235	3,788	8,063	2,882	11,043	9,102	4
13 Full tariff gas revenue at current rates	<u>1,044,127</u>	<u>33,382</u>	<u>717,864</u>	<u>31,695</u>	<u>156,141</u>	<u>6,324</u>	<u>13,501</u>	<u>4,465</u>	<u>16,952</u>	<u>15,356</u>	<u>5</u>
14											
15 <u>Tentative Revenue Allocation</u>											
16 Customer Charge	74,051	7,379	59,678	1,210	4,197	152	364	72	120	554	0
17 Delivery Charge / RCEC	321,397	12,191	221,538	10,999	58,337	1,764	4,795	1,394	4,884	5,495	0
18 USEC	131,636	3,712	93,949	4,329	21,575	877	1,866	667	2,555	2,106	1
19 Gas Revenue	617,042	16,040	405,998	18,706	93,235	3,788	8,063	2,882	11,043	9,102	4
20 Full tariff gas revenue at proposed rates	<u>1,144,126</u>	<u>39,323</u>	<u>781,163</u>	<u>35,245</u>	<u>177,345</u>	<u>6,581</u>	<u>15,086</u>	<u>5,015</u>	<u>18,603</u>	<u>17,257</u>	<u>6</u>
21											
22 Rate Base	<u>1,409,193</u>	<u>79,861</u>	<u>1,029,515</u>	<u>32,239</u>	<u>163,917</u>	<u>4,939</u>	<u>12,387</u>	<u>4,166</u>	<u>16,970</u>	<u>15,728</u>	<u>6</u>
23											
24 <u>Distribution Revenue (Delivery Charge and Customer Charge)</u>											
25 Tentative Revenue Allocation	395,448	19,570	281,216	12,210	62,534	1,917	5,158	1,466	5,004	6,049	1
26 Revenue at Present Rates	<u>295,449</u>	<u>13,629</u>	<u>217,917</u>	<u>8,661</u>	<u>41,331</u>	<u>1,660</u>	<u>3,573</u>	<u>916</u>	<u>3,353</u>	<u>4,147</u>	<u>0</u>
27 Tentative Increase	99,999	5,941	63,299	3,549	21,203	257	1,586	550	1,651	1,901	0
28											
29 <u>Interest Before Income and Surplus- Present Rates</u>											
30 Present Rates	81,646	(1,948)	47,258	4,762	20,046	1,017	1,496	522	1,476	2,153	(0)
31 Tentative Revenue Allocation	181,645	3,993	110,557	8,311	41,250	1,273	3,082	1,073	3,127	4,055	0
32											
33 <u>Return on Rate Base</u>											
34 Present Rates	5.79%	(2.44%)	4.59%	14.77%	12.23%	20.58%	12.08%	12.54%	8.70%	13.69%	(0.11%)
35 Tentative Revenue Allocation	12.89%	5.00%	10.74%	25.78%	25.16%	25.78%	24.88%	25.75%	18.43%	25.78%	5.00%
36											
37 <u>Relative Rates of Return on Rate Base</u>											
38 Present Rates	100.0%	(42.1%)	79.2%	254.9%	211.1%	355.3%	208.5%	216.4%	160.1%	236.3%	(1.9%)
39 Tentative Revenue Allocation	100.0%	38.8%	83.3%	200.0%	195.2%	200.0%	193.0%	199.8%	142.9%	200.0%	38.8%
40											
41 Progress Toward Unity		56.9%	19.7%	35.5%	14.3%	60.8%	14.3%	14.3%	14.3%	26.6%	39.9%
42 Constraint											
		Min. 5% Return	20% Progress Toward Unity	Max. 2X System Avg Ret.	Max. Progress Toward Unity	Max. 2X System Avg Ret.	Max. Progress Toward Unity	Max. Progress Toward Unity	Max. Progress Toward Unity	Max. 2X System Avg Ret.	Min. 5% Return

1 **Philadelphia Gas Works**
 2 **Class Cost of Service Study - 2006 REVISED (Mar30)**
Future Test Year Ended August 31, 2007 (\$000s)
 4 **Development of Company's Proposed Delivery Charges**
 5 **Based on Tentative Revenue Allocation**

	Tentative Revenue Allocation	Annual Sales (mcf)	Proposed Delivery Charge Rate (\$ / mcf)
6			
7 Residential:			
8 Residential Non-Heating	12,191	1,387,356	
9 Residential Non-Heating-Senior		74,732	
10 Residential Heating	221,538	32,855,506	
11 Residential Heating-Senior		4,151,233	
12 PHA/GS (a)	1,868	270,534	
13 PHA/GS- Senior (a)		10,840	
14	<u>235,597</u>	<u>38,750,201</u>	<u>\$6.0799</u>
15			
16 Commercial:			
17 Commercial Non-Heat	10,999	1,705,062	
18 Commercial Heat	58,337	8,498,417	
19	<u>69,337</u>	<u>10,203,479</u>	<u>\$6.7954</u>
20			
21 Industrial:			
22 Industrial Non-Heat	1,764	345,261	
23 Industrial Heat	4,795	734,898	
24	<u>6,559</u>	<u>1,080,159</u>	<u>\$6.0723</u>
25			
26 Municipal:			
27 Municipal Non-Heat	1,394	262,687	
28 Municipal Heat	4,884	1,006,599	
29	<u>6,278</u>	<u>1,269,286</u>	<u>\$4.9459</u>
30			
31 NGV	<u>0,340</u>	<u>367</u>	<u>\$0.9254</u>
32			
33 PHA Rate 8 (a)	<u>3,628</u>	<u>548,297</u>	<u>\$6.6140</u>
34			

35 (a) Tentative Revenue Allocation of \$5,495 split based on sales volumes.

Philadelphia Gas Works
 Class COS Study - 2006- REVISED (Mar30)
 Future Test Year Ended August 31, 2007 (\$000s)

REVISED (Mar30)
 Exhibit HSG-7C
 Page 1 of 3

Results of Company's Proposed Rates

	Total	Residential Non-Heat RC-1	Residential Heat RC-2	Commercial Non-Heat RC-3	Commercial Heat RC-4	Industrial Non-Heat RC-5	Industrial Heat RC-6
<u>Income (before Interest and Surplus)- Company's Proposed Rates</u>							
9 Full Tariff Revenues at Proposed Rates	1,144,126	36,021	784,622	35,832	176,758	6,913	14,754
10 Full Tariff Revenues at Present Rates	<u>1,044,127</u>	<u>33,382</u>	<u>717,864</u>	<u>31,695</u>	<u>156,141</u>	<u>6,324</u>	<u>13,501</u>
11 Increase in Full Tariff Revenue	99,999	2,639	66,758	4,136	20,616	589	1,253
12 Income before Interest and Surplus- Present Rates	81,646	(1,948)	47,258	4,762	20,046	1,017	1,496
13 Income before Interest and Surplus- Proposed Rates	<u>181,645</u>	<u>691</u>	<u>114,016</u>	<u>8,898</u>	<u>40,663</u>	<u>1,606</u>	<u>2,750</u>
14 Rate Base	1,409,193	79,861	1,029,515	32,239	163,917	4,939	12,387
<u>Return on Rate Base at Company's Proposed Rates (Before Interest and Surplus)</u>							
18 Return on Rate Base- Proposed Rates	12.89%	0.87%	11.07%	27.60%	24.81%	32.51%	22.20%
19 Return on Rate Base- Present Rates	5.79%	(2.44%)	4.59%	14.77%	12.23%	20.58%	12.08%
20 Relative Rate of Return- Proposed Rates	100%	7%	86%	214%	192%	252%	172%
22 Relative Rate of Return- Present Rates	100%	(42%)	79%	255%	211%	355%	209%
23 Progress Toward Unity		34%	32%	26%	17%	40%	33%
24 Subsidy- Proposed Rates	(1)	(9,603)	(18,689)	4,743	19,533	969	1,153
26 Subsidy- Present Rates	(0)	(6,575)	(12,391)	2,894	10,549	731	779
27 % Increase in Full Tariff Revenue at Proposed Rates	9.6%	7.9%	9.3%	13.1%	13.2%	9.3%	9.3%
29 % Increase in Non-Gas Tariff Revenue at Proposed Rates	23.0%	15.2%	21.4%	31.8%	32.8%	23.2%	23.0%
30 % Increase in Distribution Revenue at Proposed Rates	33.8%	19.4%	30.6%	47.8%	49.9%	35.5%	35.1%

APPENDIX H

SECRETARY'S OFFICE
2007 JUN 12 PM 4:06
SECRETARY'S OFFICE

APPENDIX H

PROPOSED ORDERING PARAGRAPHS

THEREFORE;

IT IS RECOMMENDED:

1. That the Philadelphia Gas Works' Supplement No. 16 to Tariff Gas – Pa. P.U.C. No.2 filed December 22, 2006 and docketed at R-00061931 is approved as just, reasonable and in the public interest.
2. That Philadelphia Gas Works is hereby authorized to file a Tariff supplement designed to change the rules and regulations as proposed in Supplement No. 16, as well as to change the rates so as to produce \$100,000,000 in additional annual revenue as proposed by the Company, on less than statutory notice, to be effective for service rendered on and after September 29, 2007.
3. That Philadelphia Gas Works shall allocate the authorized increase in operating revenue to each customer class and rate schedule in the manner proposed by the Company.
4. That Philadelphia Gas Works is hereby authorized to file a Gas Cost Rate (GCR) Tariff supplement to retain gas off-system sales proceeds and capacity release credits as proposed by the Company.
5. That, in accordance with Section 2212(e) of the Gas Choice Act, the rates for Philadelphia Gas Works are hereby being established in accordance with the Cash Flow Method and specific revenue requirements identified in Section VII of the Management Agreement Ordinance, as well as its three bond covenants.
6. That Philadelphia Gas Works is hereby authorized to file a Supplier Tariff supplement implementing the changes proposed by the Company.
7. That the Stipulation concerning Class 2 Leak Repair Policy between PGW and OTS (PGW Hearing Exhibit 3) is hereby approved.
8. That the Formal Complaints filed at Docket Nos. R-00061931C0001 through R-00061931C0067 are denied and dismissed.
9. That after acceptance and approval by the Commission of the tariff revisions filed by Philadelphia Gas Works, the Investigation at Docket No. R-00061931 and the Complaints at Docket Nos. R-00061931C0001 through R-00061931C0067 shall be terminated and the record marked closed.

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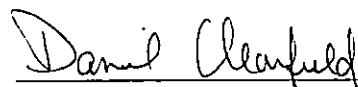
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Dated: June 12, 2007

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COMMONWEALTH OF PENNSYLVANIA



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June 13, 2007

HAND DELIVERED

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

ORIGINAL

Re: **Pennsylvania Public Utility Commission v. Philadelphia Gas Works**
Docket No. R-00061931

DOCUMENT
FOLDER

Dear Secretary McNulty:

Enclosed for filing are the original and nine (9) copies of the Table of Contents which were inadvertently omitted from the physical copies of the Main Brief, submitted on June 12, 2007, on behalf of the Office of Small Business Advocate in the above-docketed proceeding. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

Please attach this Table of Contents to the first page of the Brief.

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

Sincerely,

Sharon E. Webb
Assistant Small Business Advocate
Attorney ID No. 73995

DOCKETED
JUN 14 2007

Enclosures

SECRETARY'S BUREAU
2007 JUN 13 AM 3:41

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SECRETARY'S CUREAU
2001 JUL 13 AM 3:41

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY :
COMMISSION :

v. :

DOCKET NO. R-00061931

PHILADELPHIA GAS WORKS :

2007 JUN 13 AM 3:41
SECRETARY'S BUREAU

CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Table of Contents to the Main Brief, on behalf of the Office of Small Business Advocate, by e-mail and first class mail (unless otherwise noted) upon the persons addressed below:

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Date: June 13, 2007



Sharon E. Webb
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COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

June 14, 2007

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

2007 JUN 14 AM 2:42
SECRETARY'S BUREAU

Re: Pennsylvania Public Utility Commission v.
Philadelphia Gas Works

Docket No. R-00061931

Dear Secretary McNulty:

On June 12, 2007 Office of Trial Staff filed the Main Brief on the above-captioned proceeding. The original cover letter listed docket number R-00061391 and should have read R-00061931.

Sincerely,

Richard A. Kanaskie
Prosecutor
Office of Trial Staff
PA Attorney I.D. #80409

Enclosure
RAK/clp

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June 15, 2007

VIA HAND DELIVERY

James McNulty
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DOCUMENT FOLDER

SECRETARY'S BUREAU

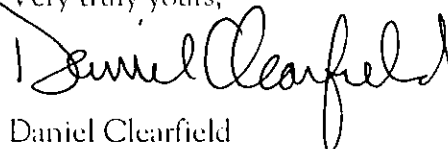
2007 JUN 15 PM 3:57

Re: Pennsylvania Public Utility Commission v. Philadelphia
Gas Works, Docket No. R-00061931

Dear Secretary McNulty:

On June 12, 2007, Philadelphia Gas Works filed its Main Brief with regard to the above-referenced matter. Appendix A to the Brief had a typographical error and also had one schedule out of correct order. Accordingly, we are submitting an original and nine copies of a Corrected Appendix A.

Very truly yours,



Daniel Clearfield

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

DC/lww
Enclosure

cc: Hon. Cynthia Fordham w/enc.
Hon. Angela Jones w/enc.
Cert of Service/w enc.

HAR:73821.1/PHI211-236005

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CORRECTED
APPENDIX A

SECRETARY'S BUREAU

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Brief - Present Rates
Appendix A - Part I
Bad Debt Expenses Calculated on Total Revenues

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars in Thousands)

JRB-BRIEF-13A-TR

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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		\$ 114,834	\$ 116,734	\$ 112,487	\$ 106,113	\$ 105,845	\$ 105,471
Gas Transport Service	4,679	6,147	7,256		7,256	7,889	8,461	8,983	9,465	9,908
Heating	713,159	821,190	820,732	6,497 A	827,229	845,817	816,568	762,697	757,378	749,166
Proposed Base Rate	-	-	-	(3,396) B	(3,396)	-	-	-	-	-
Weather Normalization Adjustment	(1,365)	12,500	-		-	-	-	-	-	-
Unbilled Adjustment	(803)	2,513	(732)		(732)	524	(377)	(714)	(59)	(91)
Total Gas Revenues	830,550	956,562	942,090	3,101	945,191	970,961	937,139	877,079	872,629	864,454
Appliance Repair & Other Revenues	10,895	10,669	10,532		10,532	10,743	10,957	11,177	11,400	11,628
Other Operating Revenues	21,912	17,865	18,032		18,032	18,438	17,813	16,678	16,581	16,426
Total Other Operating Revenues	32,807	28,534	28,564	-	28,564	29,181	28,770	27,855	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	3,101	973,755	1,000,142	965,909	904,934	900,610	892,508
OPERATING EXPENSES										
Natural Gas	509,700	639,180	630,836	4,546 C	635,382	658,487	623,363	562,396	558,243	550,889
Other Raw Material	4	5	5		5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	4,546	635,387	658,492	623,368	562,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	339,813	(1,445)	338,368	341,650	342,541	342,533	342,362	341,614
Gas Processing	18,584	16,206	15,715		15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,455	27,377	34,698		34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536		16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944		7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125		14,125	14,168	14,398	14,657	14,863	15,152
Account Management	7,695	7,928	7,625		7,625	7,690	7,787	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	52,258	(8,579) D	43,679	47,729	43,864	40,087	36,854	34,124
Marketing	2,592	2,470	2,992		2,992	3,088	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	(240) E	43,723	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	(460) F	37,324	41,944	45,904	49,654	53,719	58,126
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)		(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)		(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		15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485		6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-		-	-	383	507	639	753
Pro Forma Adjustments	-	-	217		217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)		(6,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	229,932	(9,279)	220,653	238,697	239,559	241,072	243,473	247,170
Depreciation	35,904	36,928	38,213		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	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)		(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
Sub Total Other Oper. & Maint. & Depreciation	263,308	278,189	268,128	(9,279)	258,849	278,151	280,407	283,136	286,993	290,653
TOTAL OPERATING EXPENSES	793,012	917,374	898,969	(4,733)	894,236	936,643	903,775	845,537	845,241	841,547
OPERATING INCOME	70,345	67,722	71,685	7,834	79,519	63,499	62,134	59,397	55,369	50,961
Other Income	4,778	8,198	11,212		11,212	11,343	9,620	7,723	7,820	7,160
INCOME BEFORE INTEREST	75,123	75,920	82,897	7,834	90,731	74,842	71,754	67,120	63,189	58,121
INTEREST										
Long-Term Debt	53,856	51,778	56,437	2,708 G	59,145	56,698	61,578	61,236	65,202	64,046
Other	6,123	9,561	13,186		13,186	13,229	13,643	13,684	14,076	14,059
AFUDC	(907)	(1,168)	(1,202)		(1,202)	(1,002)	(1,036)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557		5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	2,708	76,686	74,131	79,036	78,430	82,466	81,074
NET INCOME	11,272	10,417	8,919	5,126	14,045	711	(7,282)	(11,310)	(19,277)	(22,953)
City Payment	-	-	-		-	-	-	-	-	-
Net Earnings	\$ 11,272	\$ 10,417	\$ 8,919	\$ 5,126	\$ 14,045	\$ 711	\$ (7,282)	\$ (11,310)	\$ (19,277)	\$ (22,953)

Brief - Present Rates
Appendix A - Part I
Bad Debt Expenses Calculated on Total Revenues

PHILADELPHIA GAS WORKS
CASHFLOW STATEMENT
(Dollars in Thousands)

JRB-BRIEF-13A-TR

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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	\$ 8,919	\$ 5,126	\$ 14,045	\$ 711	\$ (7,282)	\$ (11,310)	\$ (19,277)	\$ (22,953)
Depreciation & Amortization	42,281	43,928	46,007		46,007	47,128	48,468	49,476	50,999	50,755
Earnings on Restricted Funds	(3,265)	3,899	38		38	-	-	-	-	-
Elimination of Accrued Interest on Refunded Debt	-	3,186	-		-	-	-	-	-	-
Increased/(Decreased) Other Assets/Liabilities	(6,917)	(1,024)	911		911	716	808	915	(8,203)	(11,639)
Available From Operations	43,371	60,406	55,875	5,126	61,001	48,555	41,994	39,081	23,519	16,163
Funds Required for Capital	68,000	60,195	72,000		72,000	60,000	63,000	61,000	60,000	58,000
Grant Income	18,000	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	20,000		20,000	55,000	5,000	-	-	-
TOTAL SOURCES	139,697	168,305	165,875	5,126	171,001	181,555	127,994	118,081	83,519	74,163
USES										
Net Construction Expenditures	66,910	68,057	75,152		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	5,145 H	41,820	47,010	46,530	54,530	45,929	48,920
PMA Lease/Subordinate Debt	1,255	1,310	1,370		1,370	1,430	1,500	1,565	1,640	1,715
Capital Lease	1,947	-	-		-	-	-	-	-	-
Debt Reduction Funding										
Temporary Financing Repayment	850	-	-		-	-	-	-	-	-
City Loan Repayment/Status	-	-	2,000		2,000	43,000	-	-	-	-
Distribution of Earnings	18,000	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	(8,118)		(8,118)	(5,193)	(16,830)	(7,090)	(4,960)	1,431
Cash Needs	128,142	172,706	125,079	5,145	130,224	182,844	136,955	137,823	122,196	129,986
Cash Surplus (Shortfall)	11,555	(4,401)	40,796	(19)	40,777	(1,289)	(8,961)	(19,742)	(38,677)	(55,823)
TOTAL USES	139,697	168,305	165,875	5,126	171,001	181,555	127,994	118,081	83,519	74,163
Cash - Beginning of Period	3,666	15,221	10,820		10,820	51,616	50,327	41,366	21,624	(17,053)
Cash - Surplus (Shortfall)	11,555	(4,401)	40,796	(19)	40,777	(1,289)	(8,961)	(19,742)	(38,677)	(55,823)
ENDING CASH	15,221	10,820	51,616	(19)	51,597	50,327	41,366	21,624	(17,053)	(72,876)
Outstanding Commercial Paper	49,900	70,000	90,000		110,000	145,000	150,000	150,000	150,000	150,000
City Loan Outstanding	45,000	45,000	43,000		43,000	-	-	-	-	-
Internally Generated Funds	-	-	-		-	-	-	-	-	-

Brief - Present Rates
Appendix A - Part I
Bad Debt Expenses Calculated on Total Revenues

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

JRB-BRIEF-13A-TR

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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	\$ 3,101	\$ 945,191	\$ 970,961	\$ 937,139	\$ 877,079	\$ 872,629	\$ 864,454
Other Operating Revenues	32,807	28,534	28,564		28,564	29,181	28,770	27,855	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	3,101	973,755	1,000,142	965,909	904,934	900,610	892,508
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,097	11,250		11,250	11,343	9,520	7,723	7,820	7,160
City Grant	18,000	18,000	18,000		18,000	18,000	18,000	18,000		
AFUDC (Interest)	907	1,168	1,202		1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,001,106	3,101	1,004,207	1,030,487	994,565	931,665	909,415	900,627
FUNDS APPLIED										
Fuel Costs	509,704	639,185	630,841	4,546	635,387	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	268,128	(9,279)	258,849	278,151	280,407	283,136	286,993	290,653
Total Operating Expenses	793,012	917,374	898,969	(4,733)	894,236	936,643	903,775	845,537	845,241	841,547
Less: Non-Cash Expenses	39,338	40,554	41,887	-	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	857,082	(4,733)	852,349	893,343	859,163	799,630	797,856	794,143
Funds Available to Cover Debt Service	130,103	139,541	144,024	7,834	151,858	137,144	135,402	132,035	111,559	106,484
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748		35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	4.03		4.25	3.99	4.18	4.38	3.63	3.31
Net Available after Prior Debt Service	91,297	97,592	108,276	7,834	116,110	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	7,834	116,110	102,776	103,034	101,880	80,814	74,320
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	5,145	58,458	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	5,145	58,458	67,813	71,727	84,111	85,579	92,016
Debt Service Coverage 1998 Bonds	1.94	3.01	2.03		1.99	1.52	1.44	1.21	0.94	0.81
Net Available after 1998 Debt Service	43,300	65,125	54,963	2,689	57,652	34,963	31,307	17,769	(4,765)	(17,696)
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987		1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	27.66		29.01	17.60	15.73	8.95	(2.40)	(8.92)
Net Available To Service Aggregate Debt Serv	111,075	114,154	122,295	7,834	130,129	115,298	113,638	110,192	107,694	102,563
Aggregate Debt Service	88,790	76,402	91,048	5,145	96,193	104,167	106,085	116,252	118,312	126,164
Fixed Coverage Charge	1.25	1.49	1.34		1.35	1.11	1.07	0.95	0.91	0.81
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	1.12		1.14	0.94	0.92	0.82	0.79	0.71

PHILADELPHIA GAS WORKS
BALANCE SHEET
(Dollars in Thousands)

	Actual 8/31/05	Estimate 8/31/06	Budget 8/31/07	Revised Budget 8/31/07 Adjustments	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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940
Sinking Fund Reserve	104,530	93,800	102,050	5,622	107,672	102,050	110,300	110,300	118,550	118,550
Capital Improvement Fund	102,701	39,732	99,843	44,378	144,221	39,843	108,993	47,993	120,143	62,143
Cash	15,221	10,820	51,616	(19)	51,597	50,327	41,366	21,624	(17,053)	(72,876)
Gas	273,805	264,254	243,806		243,806	226,927	211,043	195,196	181,647	170,269
Other	12,522	785	506		506	352	350	350	350	350
Accrued Gas Revenues	8,787	11,300	10,568		10,568	11,089	10,712	9,998	9,939	9,848
Reserve for Uncollectible	(207,480)	(191,631)	(183,489)		(183,489)	(173,618)	(162,382)	(149,869)	(136,623)	(123,247)
Accounts Receivable:	87,634	84,708	71,391		71,391	64,750	59,723	55,675	55,313	57,220
Materials & Supplies	129,984	183,784	180,389		180,389	176,809	162,083	159,236	155,999	152,694
Other Current Assets	(154)	2,986	3,056		3,056	3,236	3,441	3,596	3,751	3,906
Deferred Debits	2,796	8,448	3,228		3,228	2,487	2,362	2,262	2,337	2,387
Unamortized Bond Issuance Expense	39,094	42,089	46,912		46,912	43,166	47,671	43,651	47,920	43,676
Unamortized Extraordinary Loss	38,494	55,859	50,301		50,301	45,095	40,244	35,726	31,552	27,624
Deferred Environmental	9,513	9,513	9,513		9,513	8,000	6,500	5,000	3,500	2,000
Other Assets	8,297	3,411	2,881		2,881	2,925	3,030	3,138	3,250	3,365
TOTAL ASSETS	1,519,822	1,548,001	1,670,970	49,981	1,720,951	1,627,510	1,721,465	1,652,680	1,707,797	1,599,629
EQUITY & LIABILITIES										
City Equity	222,646	233,063	241,982	5,126	247,108	242,693	235,411	224,101	186,824	145,871
Revenue Bonds	1,045,371	1,042,430	1,154,385	44,855	1,199,240	1,105,945	1,207,915	1,151,820	1,254,251	1,203,616
TECA Accretions	14,313	12,608	13,913		13,913	15,314	16,818	18,434	10,933	
Unamortized Discount	(9,484)	(5,113)	(5,683)		(5,683)	(5,201)	(5,732)	(5,217)	(5,733)	(5,220)
Unamortized Premium	22,901	20,797	18,826		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	44,855	1,226,296	1,133,014	1,234,184	1,178,553	1,271,447	1,208,946
Notes Payable	49,900	70,000	90,000		90,000	145,000	150,000	150,000	150,000	150,000
City Loan	45,000	45,000	43,000		43,000	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468		59,468	57,930	52,987	53,688	53,234	52,826
Customer Deposits	6,280	8,250	9,000		9,000	8,750	8,500	8,000	7,500	7,000
Other Current Liabilities	3,734	3,431	2,129		2,129	2,137	2,195	2,254	2,313	2,372
Deferred Credits	14,608	5,814	4,724		4,724	1,323	1,326	1,331	1,336	1,341
Accrued Interest	9,591	12,224	14,374		14,374	13,945	15,963	15,427	17,387	16,837
Accrued Taxes & Wages	3,861	4,231	2,796		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	3,000
Other Liabilities	24,183	19,981	19,056		19,056	16,901	14,811	12,717	10,626	8,536
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,670,970	49,981	1,720,951	1,627,510	1,721,465	1,652,680	1,707,797	1,599,629

Appendix A - Part I

Bad Debt Expenses Calculated on Total Revenues

Capitalization

	FY2005	FY2006	FY2007	Adjustments	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012
Total Capitalization	1,295,747	1,303,785	1,423,423	42,527	1,473,404	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	44,855	1,226,296	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		0.83	0.82	0.84	0.84	0.87	0.89
Capitalization Ratio	4.82	4.59	4.88		4.96	4.67	5.24	5.26	6.81	8.29
Plant in Service	1,517,046	1,573,346	1,641,403		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		75,152	78,597	87,755	70,818	61,587	59,920
Total Plant	1,573,346	1,641,403	1,716,555		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)		(666,765)	(706,330)	(747,155)	(789,246)	(832,777)	(876,292)
Net Utility Plant	981,722	1,012,851	1,049,790		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940

Appendix A - Part I

STATEMENT OF INCOME

Bad Debt Expenses Calculated on Total Revenues

(Dollars in Thousands)

	Test Year		BUDGET	Adjustments	Revised		FORECAST	FORECAST	FORECAST	FORECAST	FORECAST
	ACTUAL	ESTIMATE			BUDGET	BUDGET					
	2004-05	2005-06	2006-07		2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	
OPERATING REVENUES											
Non-Heating	\$ 114,880	\$ 114,212	\$ 115,126		\$ 115,126	\$ 117,022	\$ 112,771	\$ 106,389	\$ 106,117	\$ 105,739	
Gas Transport Service	4,679	6,147	7,256		7,256	7,889	8,461	8,983	9,465	9,908	
Heating	713,159	821,190	824,440	7,100 A	831,540	849,529	820,284	766,421	761,106	752,898	
Proposed Base Rate	-	-	100,000	(3,396) B	96,604	100,000	100,000	100,000	100,000	100,000	
Weather Normalization Adjustment	(1,365)	12,500	-		-	-	-	-	-	-	
Unbilled Adjustment	(803)	2,513	505		505	522	(376)	(713)	(58)	(89)	
Total Gas Revenues	830,550	956,562	1,047,327	3,704	1,051,031	1,074,962	1,041,140	981,080	976,630	968,456	
Appliance Repair & Other Revenues	10,895	10,669	10,532		10,532	10,743	10,957	11,177	11,400	11,628	
Other Operating Revenues	21,912	17,865	20,008		20,008	20,414	19,789	18,654	18,557	18,402	
Total Other Operating Revenues	32,807	28,534	30,540	-	30,540	31,157	30,746	29,831	29,957	30,030	
Total Operating Revenues	863,357	985,096	1,077,867	3,704	1,081,571	1,106,119	1,071,886	1,010,911	1,006,587	998,486	
OPERATING EXPENSES											
Natural Gas	509,700	639,180	630,836	4,524 C	635,360	658,487	623,363	562,396	558,243	550,889	
Other Raw Material	4	5	5		5	5	5	5	5	5	
Sub-Total Fuel	509,704	639,185	630,841	4,524	635,365	658,492	623,368	562,401	558,248	550,894	
CONTRIBUTION MARGINS	353,653	345,911	447,026	(820)	446,206	447,627	448,518	448,510	448,339	447,592	
Gas Processing	18,584	16,206	15,715		15,715	17,245	17,458	17,670	17,935	18,270	
Field Services	28,455	27,377	34,698		34,698	35,786	35,925	35,847	36,348	36,846	
Distribution	15,115	15,382	16,536		16,536	16,837	17,152	17,477	17,832	18,217	
Collection	10,971	9,225	7,944		7,944	7,771	7,872	7,974	8,101	8,230	
Customer Service	12,512	12,026	14,125		14,125	14,168	14,398	14,657	14,863	15,152	
Account Management	7,695	7,928	7,625		7,625	7,690	7,787	7,825	7,922	8,019	
Bad Debt Expense	70,424	61,519	59,546	(11,042) D	48,504	58,962	56,235	52,563	48,645	46,943	
Marketing	2,592	2,470	2,992		2,992	3,088	3,031	3,065	3,140	3,132	
Administrative & General	43,391	47,931	43,963	(240) E	43,723	43,394	44,257	45,591	46,415	47,379	
Health Insurance	33,571	34,804	37,784	(460) F	37,324	41,944	45,904	49,654	53,719	58,126	
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)		(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)	
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)		(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		15,075	14,611	14,265	13,911	13,571	13,233	
Taxes	6,218	5,678	6,485		6,485	6,636	6,700	6,760	6,815	6,877	
Environmental Expenses	-	-	-		-	-	383	507	639	753	
Pro Forma Adjustments	-	-	217		217	603	250	250	-	-	
Cost / Labor Savings	-	(1,105)	(6,274)		(6,274)	-	-	-	-	-	
Sub-Total Other Oper. & Maintenance	248,263	241,123	237,220	(11,742)	225,478	249,930	251,930	253,548	255,264	259,989	
Depreciation	35,904	36,928	38,213		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	3,200	
To Clearing Accounts	(4,502)	(3,062)	(3,217)		(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)	
	35,045	37,066	38,196	-	38,196	39,454	40,848	42,064	43,520	43,483	
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	275,416	(11,742)	263,674	289,384	292,778	295,612	298,784	303,472	
TOTAL OPERATING EXPENSES	793,012	917,374	906,257	(7,218)	899,039	947,876	916,146	858,013	857,032	854,366	
OPERATING INCOME	70,345	67,722	171,610	10,922	182,532	158,243	155,740	152,898	149,555	144,120	
Other Income	4,778	8,198	17,131	-	17,131	19,082	18,437	20,343	21,881	22,907	
INCOME BEFORE INTEREST	75,123	75,920	188,741	10,922	199,663	177,325	174,177	173,241	171,436	167,027	
INTEREST											
Long-Term Debt	53,856	51,778	56,437	2,708 G	59,145	56,698	54,265	51,809	48,884	46,024	
Other	6,123	9,561	13,186		13,186	13,229	13,134	13,028	12,941	12,805	
AFUDC	(907)	(1,168)	(1,202)		(1,202)	(1,002)	(1,036)	(1,008)	(985)	(959)	
Loss From Extinguishment of Debt	4,779	5,332	5,557		5,557	5,206	4,851	4,518	4,173	3,928	
Total Interest	63,851	65,503	73,978	2,708	76,686	74,131	71,214	68,347	65,013	61,798	
NET INCOME	11,272	10,417	114,763	8,214	122,977	103,194	102,963	104,894	106,423	105,229	
City Payment	-	-	-		-	-	-	-	-	-	
Net Earnings	\$ 11,272	\$ 10,417	\$ 114,763	\$ 8,214	\$ 122,977	\$ 103,194	\$ 102,963	\$ 104,894	\$ 106,423	\$ 105,229	

PHILADELPHIA GAS WORKS
CASHFLOW STATEMENT
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	Test Year BUDGET 2006-07	Adjustments	Revised 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	\$ 8,214	\$ 122,977	\$ 103,194	\$ 102,963	\$ 104,894	\$ 106,423	\$ 105,229
Depreciation & Amortization	42,281	43,928	46,007	-	46,007	47,128	47,959	48,821	49,864	49,501
Earnings on Restricted Funds	(3,265)	3,899	(381)	-	(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 Available From Operations	(6,917)	(1,024)	911	-	911	716	808	915	(8,203)	(11,639)
	43,371	60,406	161,300	8,214	169,514	148,799	147,760	148,405	140,321	163,707
Funds Required for Capital	68,000	60,195	72,000	-	72,000	60,000	39,843	-	-	-
Grant Income	18,000	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	8,214	259,514	226,799	205,603	166,405	140,321	163,707
USES										
Net Construction Expenditures	66,910	68,057	75,152	-	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	5,145	41,820	47,010	46,530	47,920	39,479	36,020
PMA Lease/Subordinate Debt	1,255	1,310	1,370	-	1,370	1,430	1,500	1,565	1,640	1,715
Capital Lease	1,947	-	-	-	-	-	-	-	-	-
Debt Reduction Funding	-	-	40,000	-	40,000	15,000	55,000	35,000	20,000	40,000
Post Retirement Benefit Funding	-	-	-	-	-	-	-	-	-	-
Temporary Financing Repayment	850	-	40,000	-	40,000	20,000	10,000	-	-	-
City Loan Repayment/Status	-	-	2,000	-	2,000	43,000	-	-	-	-
Distribution of Earnings	18,000	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	-	1,159	(873)	(11,595)	(5,138)	99	2,840
Cash Needs	128,142	172,706	214,356	5,145	219,501	222,164	207,190	168,165	140,805	158,495
Cash Surplus (Shortfall)	11,555	(4,401)	36,944	3,069	40,013	4,635	(1,587)	(1,760)	(484)	5,212
TOTAL USES	139,697	168,305	251,300	8,214	259,514	226,799	205,603	166,405	140,321	163,707
Cash - Beginning of Period	3,666	15,221	10,820	-	10,820	47,764	52,399	50,812	49,052	48,568
Cash - Surplus (Shortfall)	11,555	(4,401)	36,944	3,069	40,013	4,635	(1,587)	(1,760)	(484)	5,212
ENDING CASH	15,221	10,820	47,764	3,069	50,833	52,399	50,812	49,052	48,568	53,780
Outstanding Commercial Paper	49,900	70,000	30,000	30,000	30,000	10,000	-	-	-	-
City Loan Outstanding	45,000	45,000	43,000	43,000	43,000	-	-	-	-	-
Internally Generated Funds	-	-	-	-	-	-	47,912	70,818	61,587	59,920

Brief - \$100.0M + \$10.0M Rate Increase
Appendix A - Part I
Bad Debt Expenses Calculated on Total Revenues

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

JRB-BRIEF-13B-TR

	ACTUAL 2004-05	ESTIMATE 2005-06	Test Year BUDGET 2006-07	Adjustments	Revised 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	\$ 1,047,327	\$ 3,704	\$ 1,051,031	\$ 1,074,962	\$ 1,041,140	\$ 981,080	\$ 976,630	\$ 968,456
Other Operating Revenues	32,807	28,534	30,540	-	30,540	31,157	30,746	29,831	29,957	30,030
Total Operating Revenues	863,357	985,096	1,077,867	3,704	1,081,571	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	-	16,750	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	-	1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,113,819	3,704	1,117,523	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	4,524	635,365	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	275,416	(1,200)	263,674	289,384	292,778	295,612	298,784	303,472
Total Operating Expenses	793,012	917,374	906,257	(7,218)	899,039	947,876	916,146	858,013	857,032	854,366
Less: Non-Cash Expenses	39,338	40,554	41,887	-	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	864,370	(7,218)	857,152	904,576	871,534	812,106	809,647	806,962
Funds Available to Cover Debt Service	130,103	139,541	249,449	10,922	260,371	237,388	233,855	231,931	212,043	236,006
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748	-	35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	6.98	-	7.28	6.91	7.22	7.69	6.90	7.34
Net Available after Prior Debt Service	91,297	97,592	213,701	10,922	224,623	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	10,922	224,623	203,020	201,487	201,776	181,298	203,842
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	5,145	58,458	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	5,145	58,458	67,813	66,852	67,966	65,143	60,885
Debt Service Coverage 1998 Bonds	1.94	3.01	4.01	5.145	3.84	2.99	3.01	2.97	2.78	3.35
Net Available after 1998 Debt Service	43,300	65,125	160,388	5,777	166,165	135,207	134,635	133,810	116,155	142,957
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987	-	1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	80.72	-	83.63	68.08	67.66	67.38	58.43	72.05
Net Available To Service Aggregate Debt Serv	111,075	114,154	228,139	10,922	239,061	217,781	216,061	216,313	215,941	211,469
Aggregate Debt Service	88,790	76,402	91,048	5,145	96,193	104,167	101,210	100,107	97,876	95,033
Fixed Coverage Charge	1.25	1.49	2.51	-	2.49	2.09	2.13	2.16	2.21	2.23
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	2.09	-	2.09	1.78	1.81	1.83	1.86	1.87

PHILADELPHIA GAS WORKS
BALANCE SHEET
(Dollars in Thousands)

	Actual 8/31/05	Estimate 8/31/06	Budget 8/31/07	Adjustments	Revised 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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	
Sinking Fund Reserve	104,530	93,800	102,050	5,622	112,050	102,050	102,050	102,050	102,050	102,050	
Capital Improvement Fund	102,701	39,732	99,843	44,378	139,843	39,843	-	-	-	-	
Debt Reduction Funding	-	-	40,419		40,419	57,658	116,628	157,853	185,616	-	
Cash	15,221	10,820	47,764	3,069	50,833	52,399	50,812	49,052	48,568	53,780	
Gas	273,805	264,254	254,134		254,134	240,307	224,591	205,778	186,746	167,304	
Other	12,522	785	506		506	352	350	350	350	350	
Accrued Gas Revenues	8,787	11,300	11,805		11,805	12,327	11,951	11,238	11,180	11,091	
Reserve for Uncollectible	(207,480)	(191,531)	(185,777)		(185,777)	(174,639)	(160,774)	(143,237)	(121,782)	(98,725)	
Accounts Receivable:	87,634	84,708	80,668		80,668	78,347	76,118	74,129	76,494	80,020	
Materials & Supplies	129,984	183,784	180,389		180,389	176,809	162,083	159,236	155,999	152,694	
Other Current Assets	(164)	2,986	3,056		3,056	3,236	3,441	3,596	3,751	3,906	
Deferred Debits	2,796	8,448	3,228		3,228	2,487	2,362	2,262	2,337	2,387	
Unamortized Bond Issuance Expense	39,094	42,089	46,912		46,912	43,166	39,574	36,138	32,868	29,740	
Unamortized Extraordinary Loss	38,494	55,859	50,301		50,301	45,095	40,244	35,726	31,552	27,624	
Deferred Environmental	9,513	9,513	9,513		9,513	8,000	6,500	5,000	3,500	2,000	
Other Assets	8,297	3,411	2,881		2,881	2,925	3,030	3,138	3,250	3,365	
TOTAL ASSETS	1,519,822	1,548,001	1,716,814	53,069	1,769,883	1,700,837	1,738,594	1,792,659	1,828,520	1,656,506	
EQUITY & LIABILITIES											
City Equity	222,646	233,063	347,826	8,214	356,040	451,020	553,983	658,877	747,300	834,529	834,529
Revenue Bonds	1,045,371	1,042,430	1,154,385	44,855	1,199,240	1,105,945	1,057,915	1,008,430	967,311	724,576	929,576
TECA Accretions	14,313	12,608	13,913		13,913	15,314	16,818	18,434	10,933		
Unamortized Discount	(9,484)	(5,113)	(5,683)		(5,683)	(5,201)	(4,738)	(4,295)	(3,885)	(3,509)	(3,509)
Unamortized Premium	22,901	20,797	18,826		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	44,855	1,226,296	1,133,014	1,085,178	1,036,085	986,355	731,617	936,617
Notes Payable	49,900	70,000	30,000		30,000	10,000	-	-	-	-	-
City Loan	45,000	45,000	43,000		43,000	-	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468		59,468	57,930	52,987	53,688	53,234	52,826	
Customer Deposits	6,280	8,250	9,000		9,000	8,750	8,500	8,000	7,500	7,000	
Other Current Liabilities	3,734	3,431	2,129		2,129	2,137	2,195	2,254	2,313	2,372	
Deferred Credits	14,608	5,814	4,724		4,724	1,323	1,326	1,331	1,336	1,341	
Accrued Interest	9,591	12,224	14,374		14,374	13,945	13,526	13,097	12,725	12,385	
Accrued Taxes & Wages	3,861	4,231	2,796		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	3,000	
Other Liabilities	24,183	19,981	19,056		19,056	16,901	14,811	12,718	10,627	8,536	
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,716,814	53,069	1,769,883	1,700,837	1,738,594	1,792,659	1,828,520	1,656,506	

Appendix A - Part I

Bad Debt Expenses Calculated on Total Revenues

<u>Capitalization</u>	FY2005	FY2006	FY2007	Adjustments	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	<u>Normal Amortiz FY2012</u>
Total Capitalization	1,295,747	1,303,785	1,529,267	42,527	1,582,336	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	44,855	1,226,296	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		0.77	0.72	0.66	0.61	0.57	0.47	0.53
Capitalization Ratio	4.82	4.59	3.40		3.44	2.51	1.96	1.57	1.32	0.88	1.12
Plant in Service	1,517,046	1,573,346	1,641,403		1,641,403	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		75,152	78,597	87,755	70,818	61,567	59,920	59,920
Total Plant	1,573,346	1,641,403	1,716,555		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)		(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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	1,198,940

Brief - Present Rates
Appendix A - Part II
Bad Debt Expense Calculated on Gas Revenues

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars in Thousands)

JRB-BRIEF-13A-GR

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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		\$ 114,834	\$ 116,734	\$ 112,487	\$ 106,113	\$ 105,845	\$ 105,471
Gas Transport Service	4,679	6,147	7,256		7,256	7,889	8,461	8,983	9,465	9,908
Heating	713,159	821,190	820,732	6,497 A	827,229	845,817	816,568	762,697	757,378	749,166
Proposed Base Rate	-	-	-	(3,396) B	(3,396)	-	-	-	-	-
Weather Normalization Adjustment	(1,365)	12,500	-							
Unbilled Adjustment	(803)	2,513	(732)		(732)	521	(377)	(714)	(59)	(91)
Total Gas Revenues	830,550	956,562	942,090	3,101	945,191	970,961	937,139	877,079	872,629	864,454
Appliance Repair & Other Revenues	10,895	10,669	10,532		10,532	10,743	10,957	11,177	11,400	11,628
Other Operating Revenues	21,912	17,865	18,032		18,032	18,438	17,813	16,678	16,581	16,426
Total Other Operating Revenues	32,807	28,534	28,564	-	28,564	29,181	28,770	27,855	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	3,101	973,755	1,000,142	965,909	904,934	900,610	892,508
OPERATING EXPENSES										
Natural Gas	509,700	639,180	630,836	4,546 C	635,382	658,487	623,363	562,396	558,243	550,889
Other Raw Material	4	5	5		5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	4,546	635,387	658,492	623,368	562,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	339,813	(1,445)	338,368	341,650	342,541	342,533	342,362	341,614
Gas Processing	18,584	16,206	15,715		15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,455	27,377	34,698		34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536		16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944		7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125		14,125	14,168	14,398	14,657	14,863	15,152
Account Management	7,695	7,928	7,625		7,625	7,690	7,787	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	52,258	(9,864) D	42,394	47,729	43,864	40,087	36,854	34,124
Marketing	2,592	2,470	2,992		2,992	3,088	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	(240) E	43,723	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	(460) F	37,324	41,944	45,904	49,654	53,719	58,126
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)		(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)		(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		15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485		6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-		-	-	383	507	639	753
Pro Forma Adjustments	-	-	217		217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)		(6,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	229,932	(10,564)	219,368	238,697	239,559	241,072	243,473	247,170
Depreciation	35,904	36,928	38,213		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	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)		(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
35,045	37,066	38,196	-	38,196	39,454	40,848	42,064	43,520	43,483	
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	268,128	(10,564)	257,564	278,151	280,407	283,136	286,993	290,653
TOTAL OPERATING EXPENSES	793,012	917,374	898,969	(6,018)	892,951	936,643	903,775	845,537	845,241	841,547
OPERATING INCOME	70,345	67,722	71,685	9,119	80,804	63,499	62,134	59,397	55,369	50,961
Other Income	4,778	8,198	11,212		11,212	11,343	9,620	7,723	7,820	7,160
INCOME BEFORE INTEREST	75,123	75,920	82,897	9,119	92,016	74,842	71,754	67,120	63,189	58,121
INTEREST										
Long-Term Debt	53,856	51,778	56,437	2,708 G	59,145	56,698	61,578	61,236	65,202	64,046
Other	6,123	9,561	13,186		13,186	13,229	13,643	13,684	14,076	14,059
AFUDC	(907)	(1,168)	(1,202)		(1,202)	(1,002)	(1,036)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557		5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	2,708	76,686	74,131	79,036	78,430	82,466	81,074
NET INCOME	11,272	10,417	8,919	6,411	15,330	711	(7,282)	(11,310)	(19,277)	(22,953)
City Payment	-	-	-		-	-	-	-	-	-
Net Earnings	\$ 11,272	\$ 10,417	\$ 8,919	\$ 6,411	\$ 15,330	\$ 711	\$ (7,282)	\$ (11,310)	\$ (19,277)	\$ (22,953)

Brief - Present Rates
Appendix A - Part II
Bad Debt Expense Calculated on Gas Revenues

PHILADELPHIA GAS WORKS
CASHFLOW STATEMENT
(Dollars in Thousands)

JRB-BRIEF-13A-GR

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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	\$ 8,919	\$ 6,411	\$ 15,330	\$ 711	\$ (7,282)	\$ (11,310)	\$ (19,277)	\$ (22,953)
Depreciation & Amortization	42,281	43,928	46,007		46,007	47,128	48,468	49,476	50,999	50,755
Earnings on Restricted Funds	(3,265)	3,899	38		38	-	-	-	-	-
Elimination of Accrued Interest on Refunded Debt	-	3,186				-	-	-	-	-
Increased/(Decreased) Other Assets/Liabilities Available From Operations	(6,917)	(1,024)	911		911	716	808	915	(8,203)	(11,639)
	43,371	60,406	55,875	6,411	62,286	48,555	41,994	39,081	23,519	16,163
Funds Required for Capital	68,000	60,195	72,000		72,000	60,000	63,000	61,000	60,000	58,000
Grant Income	18,000	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	20,000		20,000	55,000	5,000	-	-	-
TOTAL SOURCES	139,697	168,305	165,875	6,411	172,286	181,555	127,994	118,081	83,519	74,163
USES										
Net Construction Expenditures	66,910	68,057	75,152		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	5,145 H	41,820	47,010	46,530	54,530	45,929	48,920
PMA Lease/Subordinate Debt	1,255	1,310	1,370		1,370	1,430	1,500	1,565	1,640	1,715
Capital Lease	1,947	-	-		-	-	-	-	-	-
Debt Reduction Funding										
Temporary Financing Repayment	850	-	-		-	-	-	-	-	-
City Loan Repayment/Status	-	-	2,000		2,000	43,000	-	-	-	-
Distribution of Earnings	18,000	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	(8,118)		(8,118)	(5,193)	(16,830)	(7,090)	(4,960)	1,431
Cash Needs	128,142	172,706	125,079	5,145	130,224	182,844	136,955	137,823	122,196	129,986
Cash Surplus (Shortfall)	11,555	(4,401)	40,796	1,266	42,062	(1,289)	(8,961)	(19,742)	(38,677)	(55,823)
TOTAL USES	139,697	168,305	165,875	6,411	172,286	181,555	127,994	118,081	83,519	74,163
Cash - Beginning of Period	3,666	15,221	10,820		10,820	51,616	50,327	41,366	21,624	(17,053)
Cash - Surplus (Shortfall)	11,555	(4,401)	40,796	1,266	42,062	(1,289)	(8,961)	(19,742)	(38,677)	(55,823)
ENDING CASH	15,221	10,820	51,616	1,266	52,882	50,327	41,366	21,624	(17,053)	(72,876)
Outstanding Commercial Paper	49,900	70,000	90,000		110,000	145,000	150,000	150,000	150,000	150,000
City Loan Outstanding	45,000	45,000	43,000		43,000	-	-	-	-	-
Internally Generated Funds	-	-	-		-	-	-	-	-	-

Brief - Present Rates
Appendix A - Part II
Bad Debt Expense Calculated on Gas Revenues

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

JRB-BRIEF-13A-GR

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	Adjustments	Revised 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	\$ 3,101	\$ 945,191	\$ 970,961	\$ 937,139	\$ 877,079	\$ 872,629	\$ 864,454
Other Operating Revenues	32,807	28,534	28,564		28,564	29,181	28,770	27,355	27,981	28,054
Total Operating Revenues	863,357	985,096	970,654	3,101	973,755	1,000,142	965,909	904,934	900,610	892,508
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,097	11,250		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	18,000		
AFUDC (Interest)	907	1,168	1,202		1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,001,106	3,101	1,004,207	1,030,487	994,565	931,665	909,415	900,627
FUNDS APPLIED										
Fuel Costs	509,704	639,185	630,841	4,546	635,387	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	268,128	(10,564)	257,564	278,151	280,407	283,136	286,993	290,653
Total Operating Expenses	793,012	917,374	898,969	(6,018)	892,951	936,643	903,775	845,537	845,241	841,547
Less: Non-Cash Expenses	39,338	40,554	41,887	-	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	857,082	(6,018)	851,064	893,343	859,163	799,630	797,856	794,143
Funds Available to Cover Debt Service	130,103	139,541	144,024	9,119	153,143	137,144	135,402	132,035	111,559	106,484
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748		35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	4.03		4.28	3.99	4.18	4.38	3.63	3.31
Net Available after Prior Debt Service	91,297	97,592	108,276	9,119	117,395	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	9,119	117,395	102,776	103,034	101,880	80,814	74,320
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	5,145	58,458	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	5,145	58,458	67,813	71,727	84,111	85,579	92,016
Debt Service Coverage 1998 Bonds	1.94	3.01	2.03		2.01	1.52	1.44	1.21	0.94	0.81
Net Available after 1998 Debt Service	43,300	65,125	54,963	3,974	58,937	34,963	31,307	17,769	(4,765)	(17,696)
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987		1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	27.66		29.66	17.60	15.73	8.95	(2.40)	(8.92)
Net Available To Service Aggregate Debt Serv	111,075	114,154	122,295	9,119	131,414	115,298	113,638	110,192	107,694	102,563
Aggregate Debt Service	88,790	76,402	91,048	5,145	96,193	104,167	106,085	116,252	118,312	126,164
Fixed Coverage Charge	1.25	1.49	1.34		1.37	1.11	1.07	0.95	0.91	0.81
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	1.12		1.15	0.94	0.92	0.82	0.79	0.71

PHILADELPHIA GAS WORKS
BALANCE SHEET
(Dollars in Thousands)

	Actual 8/31/05	Estimate 8/31/06	Budget 8/31/07	Adjustments	Revised 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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940
Sinking Fund Reserve	104,530	93,800	102,050	5,622	107,672	102,050	110,300	110,300	118,550	118,550
Capital Improvement Fund	102,701	39,732	99,843	44,378	144,221	39,843	108,993	47,993	120,143	62,143
Cash	15,221	10,820	51,616	1,266	52,882	50,327	41,366	21,624	(17,053)	(72,876)
Gas	273,805	264,254	243,806		243,806	226,927	211,043	195,196	181,647	170,269
Other	12,522	785	506		506	352	350	350	350	350
Accrued Gas Revenues	8,787	11,300	10,568		10,568	11,089	10,712	9,998	9,939	9,848
Reserve for Uncollectible	(207,480)	(191,631)	(183,489)		(183,489)	(173,618)	(162,382)	(149,869)	(136,623)	(123,247)
Accounts Receivable:	87,634	84,708	71,391		71,391	64,750	59,723	55,675	55,313	57,220
Materials & Supplies	129,984	183,784	180,389		180,389	176,809	162,083	159,236	155,999	152,694
Other Current Assets	(164)	2,986	3,056		3,056	3,236	3,441	3,596	3,751	3,906
Deferred Debits	2,796	8,448	3,228		3,228	2,487	2,362	2,262	2,337	2,387
Unamortized Bond Issuance Expense	39,094	42,089	46,912		46,912	43,166	47,671	43,651	47,920	43,676
Unamortized Extraordinary Loss	38,494	55,859	50,301		50,301	45,095	40,244	35,726	31,552	27,624
Deferred Environmental	9,513	9,513	9,513		9,513	8,000	6,500	5,000	3,500	2,000
Other Assets	8,297	3,411	2,881		2,881	2,925	3,030	3,138	3,250	3,365
TOTAL ASSETS	1,519,822	1,548,001	1,670,970	51,266	1,722,236	1,627,510	1,721,465	1,652,680	1,707,797	1,599,629
EQUITY & LIABILITIES										
City Equity	222,646	233,063	241,982	6,411	248,393	242,693	235,411	224,101	186,824	145,871
Revenue Bonds	1,045,371	1,042,430	1,154,385	44,855	1,199,240	1,105,945	1,207,915	1,151,820	1,254,251	1,203,616
TECA Accretions	14,313	12,608	13,913		13,913	15,314	16,818	18,434	10,933	
Unamortized Discount	(9,484)	(5,113)	(5,683)		(5,683)	(5,201)	(5,732)	(5,217)	(5,733)	(5,220)
Unamortized Premium	22,901	20,797	18,826		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	44,855	1,226,296	1,133,014	1,234,184	1,178,553	1,271,447	1,208,946
Notes Payable	49,900	70,000	90,000		90,000	145,000	150,000	150,000	150,000	150,000
City Loan	45,000	45,000	43,000		43,000	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468		59,468	57,930	52,987	53,688	53,234	52,826
Customer Deposits	6,280	8,250	9,000		9,000	8,750	8,500	8,000	7,500	7,000
Other Current Liabilities	3,734	3,431	2,129		2,129	2,137	2,195	2,254	2,313	2,372
Deferred Credits	14,608	5,814	4,724		4,724	1,323	1,326	1,331	1,336	1,341
Accrued Interest	9,591	12,224	14,374		14,374	13,945	15,963	15,427	17,387	16,837
Accrued Taxes & Wages	3,861	4,231	2,796		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	3,000
Other Liabilities	24,183	19,981	19,056		19,056	16,901	14,811	12,717	10,626	8,536
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,670,970	51,266	1,722,236	1,627,510	1,721,465	1,652,680	1,707,797	1,599,629

Brief - Present Rates
Appendix A - Part II
Bad Debt Expense Calculated on Gas Revenues

Capitalization

	FY2005	FY2006	FY2007	Adjustments	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012
Total Capitalization	1,295,747	1,303,785	1,423,423	42,527	1,474,689	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	44,855	1,226,296	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		0.83	0.82	0.84	0.84	0.87	0.89
Capitalization Ratio	4.82	4.59	4.88		4.94	4.67	5.24	5.26	6.81	8.29
Plant in Service	1,517,046	1,573,346	1,641,403		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		75,152	78,597	87,755	70,818	61,587	59,920
Total Plant	1,573,346	1,641,403	1,716,555		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)		(666,765)	(706,330)	(747,155)	(789,246)	(832,777)	(876,292)
Net Utility Plant	981,722	1,012,851	1,049,790		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940

Brief - \$100.0M + \$10.0M Rate Increase
Appendix A - Part II
Bad Debt Expense Calculated on Gas Revenues

PHILADELPHIA GAS WORKS
STATEMENT OF INCOME
(Dollars in Thousands)

JRB-BRIEF-13B-GR

	ACTUAL	ESTIMATE	Test Year		Revised	FORECAST	FORECAST	FORECAST	FORECAST	FORECAST
	2004-05	2005-06	2006-07	Adjustments	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
OPERATING REVENUES										
Non-Heating	\$ 114,880	\$ 114,212	\$ 115,126		\$ 115,126	\$ 117,022	\$ 112,771	\$ 106,389	\$ 106,117	\$ 105,739
Gas Transport Service	4,679	6,147	7,256		7,256	7,889	8,461	8,983	9,465	9,908
Heating	713,159	821,190	824,440	7,100 A	831,540	849,529	820,284	766,421	761,106	752,898
Proposed Base Rate	-	-	100,000	(3,396) B	96,604	100,000	100,000	100,000	100,000	100,000
Weather Normalization Adjustment	(1,365)	12,500	-		-	-	-	-	-	-
Unbilled Adjustment	(803)	2,513	505		505	522	(376)	(713)	(58)	(89)
Total Gas Revenues	830,550	956,562	1,047,327	3,704	1,051,031	1,074,962	1,041,140	981,080	976,630	968,456
Appliance Repair & Other Revenues	10,895	10,669	10,532		10,532	10,743	10,957	11,177	11,400	11,628
Other Operating Revenues	21,912	17,865	20,008		20,008	20,414	19,789	18,654	18,557	18,402
Total Other Operating Revenues	32,807	28,534	30,540	-	30,540	31,157	30,746	29,831	29,957	30,030
Total Operating Revenues	863,357	985,096	1,077,867	3,704	1,081,571	1,106,119	1,071,886	1,010,911	1,006,587	998,486
OPERATING EXPENSES										
Natural Gas	509,700	639,180	630,836	4,524 C	635,360	658,487	623,363	562,396	558,243	550,889
Other Raw Material	4	5	5		5	5	5	5	5	5
Sub-Total Fuel	509,704	639,185	630,841	4,524	635,365	658,492	623,368	562,401	558,248	550,894
CONTRIBUTION MARGINS	353,653	345,911	447,026	(820)	446,206	447,627	448,518	448,510	448,339	447,592
Gas Processing	18,584	16,206	15,715		15,715	17,245	17,458	17,670	17,935	18,270
Field Services	28,455	27,377	34,698		34,698	35,786	35,925	35,847	36,348	36,846
Distribution	15,115	15,382	16,536		16,536	16,837	17,152	17,477	17,832	18,217
Collection	10,971	9,225	7,944		7,944	7,771	7,872	7,974	8,101	8,230
Customer Service	12,512	12,026	14,125		14,125	14,168	14,398	14,657	14,863	15,152
Account Management	7,695	7,928	7,625		7,625	7,690	7,787	7,825	7,922	8,019
Bad Debt Expense	70,424	61,519	59,546	(12,416) D	47,130	58,962	56,235	52,563	48,645	46,943
Marketing	2,592	2,470	2,992		2,992	3,088	3,031	3,085	3,140	3,132
Administrative & General	43,391	47,931	43,963	(240) E	43,723	43,394	44,257	45,591	46,415	47,379
Health Insurance	33,571	34,804	37,784	(460) F	37,324	41,944	45,904	49,654	53,719	58,126
Capitalized Fringe Benefits	(10,348)	(10,099)	(11,261)		(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,180)
Capitalized Administrative Charges	(6,706)	(6,603)	(7,950)		(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		15,075	14,611	14,265	13,911	13,571	13,233
Taxes	6,218	5,678	6,485		6,485	6,636	6,700	6,760	6,815	6,877
Environmental Expenses	-	-	-		-	-	383	507	639	753
Pro Forma Adjustments	-	-	217		217	603	250	250	-	-
Cost / Labor Savings	-	(1,105)	(6,274)		(6,274)	-	-	-	-	-
Sub-Total Other Oper. & Maintenance	248,263	241,123	237,220	(13,116)	224,104	249,930	251,930	253,548	255,264	259,989
Depreciation	35,904	36,928	38,213		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	3,200
To Clearing Accounts	(4,502)	(3,062)	(3,217)		(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
	35,045	37,066	38,196	-	38,196	39,454	40,848	42,064	43,520	43,483
Sub Total Other Oper. & Maint. & Depreciation	283,308	278,189	275,416	(13,116)	262,300	289,384	292,778	295,612	298,784	303,472
TOTAL OPERATING EXPENSES	793,012	917,374	906,257	(8,592)	897,665	947,876	916,146	858,013	857,032	854,366
OPERATING INCOME	70,345	67,722	171,610	12,296	183,906	158,243	155,740	152,898	149,555	144,120
Other Income	4,778	8,198	17,131	-	17,131	19,082	18,437	20,343	21,881	22,907
INCOME BEFORE INTEREST	75,123	75,920	188,741	12,296	201,037	177,325	174,177	173,241	171,436	167,027
INTEREST										
Long-Term Debt	53,856	51,778	56,437	2,708 G	59,145	56,698	54,265	51,809	48,884	46,024
Other	6,123	9,561	13,186		13,186	13,229	13,134	13,028	12,941	12,805
AFUDC	(907)	(1,168)	(1,202)		(1,202)	(1,002)	(1,036)	(1,008)	(985)	(959)
Loss From Extinguishment of Debt	4,779	5,332	5,557		5,557	5,206	4,851	4,518	4,173	3,928
Total Interest	63,851	65,503	73,978	2,708	76,686	74,131	71,214	68,347	65,013	61,798
NET INCOME	11,272	10,417	114,763	9,588	124,351	103,194	102,963	104,894	106,423	105,229
City Payment	-	-	-		-	-	-	-	-	-
Net Earnings	\$ 11,272	\$ 10,417	\$ 114,763	\$ 9,588	\$ 124,351	\$ 103,194	\$ 102,963	\$ 104,894	\$ 106,423	\$ 105,229

PHILADELPHIA GAS WORKS
CASHFLOW STATEMENT
(Dollars in Thousands)

	ACTUAL 2004-05	ESTIMATE 2005-06	Test Year BUDGET 2006-07	Adjustments	Revised 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	\$ 9,588	\$ 124,351	\$ 103,194	\$ 102,963	\$ 104,894	\$ 106,423	\$ 105,229
Depreciation & Amortization	42,281	43,928	46,007	-	46,007	47,128	47,959	48,821	49,864	49,501
Earnings on Restricted Funds	(3,265)	3,899	(381)	-	(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	-	911	716	808	915	(8,203)	(11,639)
Available From Operations	43,371	60,406	161,300	9,588	170,888	148,799	147,760	148,405	140,321	163,707
Funds Required for Capital	68,000	60,195	72,000	-	72,000	60,000	39,843	-	-	-
Grant Income	18,000	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	9,588	260,888	226,799	205,603	166,405	140,321	163,707
USES										
Net Construction Expenditures	66,910	68,057	75,152	-	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	5,145	41,820	47,010	46,530	47,920	39,479	36,020
PMA Lease/Subordinate Debt	1,255	1,310	1,370	-	1,370	1,430	1,500	1,565	1,640	1,715
Capital Lease	1,947	-	-	-	-	-	-	-	-	-
Debt Reduction Funding	-	-	40,000	-	40,000	15,000	55,000	35,000	20,000	40,000
Post Retirement Benefit Funding	-	-	-	-	-	-	-	-	-	-
Temporary Financing Repayment	850	-	40,000	-	40,000	20,000	10,000	-	-	-
City Loan Repayment/Status	-	-	2,000	-	2,000	43,000	-	-	-	-
Distribution of Earnings	18,000	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	-	1,159	(873)	(11,595)	(5,138)	99	2,840
Cash Needs	128,142	172,706	214,356	5,145	219,501	222,164	207,190	168,165	140,805	158,495
Cash Surplus (Shortfall)	11,555	(4,401)	36,944	4,443	41,387	4,635	(1,587)	(1,760)	(484)	5,212
TOTAL USES	139,697	168,305	251,300	9,588	260,888	226,799	205,603	166,405	140,321	163,707
Cash - Beginning of Period	3,666	15,221	10,820	-	10,820	47,764	52,399	50,812	49,052	48,568
Cash - Surplus (Shortfall)	11,555	(4,401)	36,944	4,443	41,387	4,635	(1,587)	(1,760)	(484)	5,212
ENDING CASH	15,221	10,820	47,764	4,443	52,207	52,399	50,812	49,052	48,568	53,780
Outstanding Commercial Paper	49,900	70,000	30,000	30,000	30,000	10,000	-	-	-	-
City Loan Outstanding	45,000	45,000	43,000	43,000	43,000	-	-	-	-	-
Internally Generated Funds	-	-	-	-	-	-	47,912	70,818	61,587	59,920

Brief - \$100.0M + \$10.0M Rate Increase
Appendix A - Part II
Bad Debt Expense Calculated on Gas Revenues

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

JRB-BRIEF-13B-GR

	ACTUAL	ESTIMATE	Test Year		Revised	FORECAST	FORECAST	FORECAST	FORECAST	FORECAST
	2004-05	2005-06	BUDGET	Adjustments	BUDGET	2007-08	2008-09	2009-10	2010-11	2011-12
FUNDS PROVIDED										
Total Gas Revenues	\$ 830,550	\$ 956,562	\$ 1,047,327	\$ 3,704	\$ 1,051,031	\$ 1,074,962	\$ 1,041,140	\$ 981,080	\$ 976,630	\$ 968,456
Other Operating Revenues	32,807	28,534	30,540		30,540	31,157	30,746	29,831	29,957	30,030
Total Operating Revenues	863,357	985,096	1,077,867	3,704	1,081,571	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	-	16,750	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	18,000	
AFUDC (Interest)	907	1,168	1,202	-	1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,113,819	3,704	1,117,523	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	4,524	635,365	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	275,416	(1,200)	262,300	289,384	292,778	295,612	298,784	303,472
Total Operating Expenses	793,012	917,374	906,257	(8,592)	897,665	947,876	916,146	858,013	857,032	854,366
Less: Non-Cash Expenses	39,338	40,554	41,887	-	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	864,370	(8,592)	855,778	904,576	871,534	812,106	809,647	806,962
Funds Available to Cover Debt Service	130,103	139,541	249,449	12,296	261,745	237,388	233,855	231,931	212,043	236,006
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748		35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	6.98		7.32	6.91	7.22	7.69	6.90	7.34
Net Available after Prior Debt Service	91,297	97,592	213,701	12,296	225,997	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	12,296	225,997	203,020	201,487	201,776	181,298	203,842
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	5,145	58,458	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	5,145	58,458	67,813	66,852	67,966	65,143	60,885
Debt Service Coverage 1998 Bonds	1.94	3.01	4.01		3.87	2.99	3.01	2.97	2.78	3.35
Net Available after 1998 Debt Service	43,300	65,125	160,388	7,151	167,539	135,207	134,635	133,810	116,155	142,957
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987		1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	80.72		84.32	68.08	67.66	67.38	58.43	72.05
Net Available To Service Aggregate Debt Serv	111,075	114,154	228,139	12,296	240,435	217,781	216,061	216,313	215,941	211,469
Aggregate Debt Service	88,790	76,402	91,048	5,145	96,193	104,167	101,210	100,107	97,876	95,033
Fixed Coverage Charge	1.25	1.49	2.51		2.50	2.09	2.13	2.16	2.21	2.23
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	2.09		2.11	1.78	1.81	1.83	1.86	1.87

PHILADELPHIA GAS WORKS
BALANCE SHEET
(Dollars in Thousands)

	Actual 8/31/05	Estimate 8/31/06	Budget 8/31/07	Adjustments	Revised 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		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	
Sinking Fund Reserve	104,530	93,800	102,050	5,622	112,050	102,050	102,050	102,050	102,050	102,050	
Capital Improvement Fund	102,701	39,732	99,843	44,378	139,843	39,843	-	-	-	-	
Debt Reduction Funding	-	-	40,419		40,419	57,658	116,628	157,853	185,616	-	
Cash	15,221	10,820	47,764	4,443	52,207	52,399	50,812	49,052	48,568	53,780	
Gas	273,805	264,254	254,134		254,134	240,307	224,591	205,778	186,746	167,304	
Other	12,522	785	506		506	352	350	350	350	350	
Accrued Gas Revenues	8,787	11,300	11,805		11,805	12,327	11,951	11,238	11,180	11,091	
Reserve for Uncollectible	(207,480)	(191,531)	(185,777)		(185,777)	(174,639)	(160,774)	(143,237)	(121,782)	(98,725)	
Accounts Receivable:	87,634	84,708	80,668		80,668	78,347	76,118	74,129	76,494	80,020	
Materials & Supplies	129,984	183,784	180,389		180,389	176,809	162,083	159,236	155,999	152,694	
Other Current Assets	(164)	2,986	3,056		3,056	3,236	3,441	3,596	3,751	3,906	
Deferred Debits	2,796	8,448	3,228		3,228	2,487	2,362	2,262	2,337	2,387	
Unamortized Bond Issuance Expense	39,094	42,089	46,912		46,912	43,166	39,574	36,138	32,868	29,740	
Unamortized Extraordinary Loss	38,494	55,859	50,301		50,301	45,095	40,244	35,726	31,552	27,624	
Deferred Environmental	9,513	9,513	9,513		9,513	8,000	6,500	5,000	3,500	2,000	
Other Assets	8,297	3,411	2,881		2,881	2,925	3,030	3,138	3,250	3,365	
TOTAL ASSETS	1,519,822	1,548,001	1,716,814	54,443	1,771,257	1,700,837	1,738,594	1,792,659	1,828,520	1,656,506	
EQUITY & LIABILITIES											
City Equity	222,646	233,063	347,826	9,588	357,414	451,020	553,983	658,877	747,300	834,529	Normal 834,529
Revenue Bonds	1,045,371	1,042,430	1,154,385	44,855	1,199,240	1,105,945	1,057,915	1,008,430	967,311	724,576	929,576
TECA Accretions	14,313	12,608	13,913		13,913	15,314	16,818	18,434	10,933		
Unamortized Discount	(9,484)	(5,113)	(5,683)		(5,683)	(5,201)	(4,738)	(4,295)	(3,885)	(3,509)	(3,509)
Unamortized Premium	22,901	20,797	18,826		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	44,855	1,226,296	1,133,014	1,085,178	1,036,085	986,355	731,617	936,617
Notes Payable	49,900	70,000	30,000		30,000	10,000	-	-	-	-	-
City Loan	45,000	45,000	43,000		43,000	-	-	-	-	-	-
Accounts Payable	63,918	72,285	59,468		59,468	57,930	52,987	53,688	53,234	52,826	
Customer Deposits	6,280	8,250	9,000		9,000	8,750	8,500	8,000	7,500	7,000	
Other Current Liabilities	3,734	3,431	2,129		2,129	2,137	2,195	2,254	2,313	2,372	
Deferred Credits	14,608	5,814	4,724		4,724	1,323	1,326	1,331	1,336	1,341	
Accrued Interest	9,591	12,224	14,374		14,374	13,945	13,526	13,097	12,725	12,385	
Accrued Taxes & Wages	3,861	4,231	2,796		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	3,000	
Other Liabilities	24,183	19,981	19,056		19,056	16,901	14,811	12,718	10,627	8,536	
TOTAL EQUITY & LIABILITIES	1,519,822	1,548,001	1,716,814	54,443	1,771,257	1,700,837	1,738,594	1,792,659	1,828,520	1,656,506	

<u>Capitalization</u>	FY2005	FY2006	FY2007	Adjustments	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	<u>Normal Amortiz FY2012</u>
Total Capitalization	1,295,747	1,303,785	1,529,267	42,527	1,583,710	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	44,855	1,226,296	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		0.77	0.72	0.66	0.61	0.57	0.47	0.53
Capitalization Ratio	4.82	4.59	3.40		3.43	2.51	1.96	1.57	1.32	0.88	1.12
Plant in Service	1,517,046	1,573,346	1,641,403		1,641,403	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		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		1,716,555	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)		(666,765)	(705,330)	(747,155)	(789,246)	(832,777)	(876,292)	(876,292)
Net Utility Plant	981,722	1,012,851	1,049,790		1,049,790	1,088,822	1,135,752	1,164,479	1,182,535	1,198,940	1,198,940

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document upon the participants listed below in accordance with the requirements of § 1.54 (relating to service by a participant).

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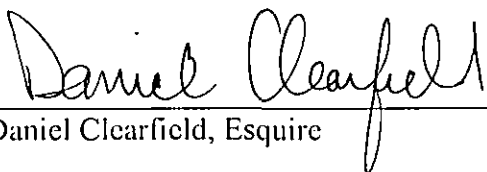
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SCHOOL REFORM COMMISSION
440 N. BROAD STREET, SUITE 313
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ORIGINAL

Via UPS

June 20, 2007

Pennsylvania Public Utility Commission
Secretary's Bureau
Commonwealth Keystone Building
2nd Floor, Room N-201
400 North Street
Harrisburg, PA 17120-3265

RECEIVED

JUN 20 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00061931

Dear Secretary:

I represent The School District of Philadelphia, Intervenor. Enclosed for filing are the original and nine copies of the Reply Brief of The School District with Certificate of Service. Kindly time-stamp the enclosed extra copy and return it to me in the enclosed envelope. Also enclosed is a copy of the Brief on a CD in Microsoft Word.

Thank you very much.

Very truly yours,

DOCUMENT
FOLDER

Miles H. Shore

Miles H. Shore
Assistant General Counsel

MHS/jmc
Enclosures

cc: Administrative Law Judges
Service List of Active Parties

55

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

JUN 20 2007
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PENNSYLVANIA PUBLIC UTILITY
COMMISSION :
:
:
V. :
:
PHILADELPHIA GAS WORKS :

Docket No. R00061931

REPLY BRIEF

OF

**THE SCHOOL DISTRICT OF PHILADELPHIA,
INTERVENOR**

**DOCUMENT
FOLDER**

DOCKETED
JUN 22 2007

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I.-II. INTRODUCTION AND SUMMARY OF ARGUMENT

By this Reply Brief, The School District of Philadelphia (“the School District”) urges the Commission: (1) to grant the School District the relief it has requested with respect to funding and refunding of the costs of service line extensions to School District facilities (2) to deny PGW’s request to eliminate the credit to the Gas Cost Rate (“GCR”) from margins on off-system sales and capacity release credits; (3) to find the recommendations and proposals by the Hess Company (“Hess”) and Interstate Gas Supply, Inc. (“IGS”) to be reasonable and appropriate for fostering competitive natural gas supply on PGW’s system; and (4) to adopt the recommendation of OTS for allocating any increase in revenue requirement granted to PGW in this case. The discussion on these topics is organized in accordance with the standardized brief format per Pre-Hearing Order #4.

[III. RATE BASE]

[IV. REVENUES]

[V. EXPENSES]

[VI. TAXES]

[VII. RATE OF RETURN]

VIII. MISCELLANEOUS ISSUES

A. Section 10 - PGW’s Tariff

In its Main Brief, the School District makes the case that PGW should be ordered to undertake a reasonable remedy – accounting and payment – for PGW’s discriminatory practices against the School District in connection with the funding and refunding of service line extension costs pursuant to Section 10 of PGW’s Gas Service Tariff. PGW

in its Main Brief does little more than state its version of disputed facts and relies on its interpretation of the Tariff in defense of its policy, imposed for nearly a decade, to require the School District pay the full costs up-front for service line extensions and to deny owing the School District any refunds for any extensions during that same time period. PGW Main Br. at 87-89. For the reasons stated in the School District's Main Brief, the Commission should grant the School District's requested relief, as set forth in its proposed ordering paragraph. School District Main Br. at 11.

B. GCR Credits

PGW proposes to retain 100% of the margins from off-system sales and capacity releases in lieu of crediting such revenues to the GCR to reduce supply customer bills. PGW Main Br. at 73-77. PGW claims that retaining such funds to fund construction projects will provide a greater benefit to customers in the long-run by avoiding debt financing for such projects. *Id.* OCA and OTS oppose PGW's proposal. OTS Main Br. at 44-48; OCA Main Br. at 33-35. OCA appropriately observes that, "[T]he current credit saves real dollars – right now. Money they can use to buy food, medicine, bus tokens, etc. PGW's proposal does not and cannot deliver such immediate results." OCA Main Br. at 35. The School District supports OTS's and OCA's opposition.

In the School District's case, it has established a current and urgent need for cash in light of its current budget shortfall of \$73 million and anticipated budget reductions in FY2008. School District St. 1 at 5. Eliminating the GCR credit would have a further negative impact on the School District's fiscal matters.

Moreover, from the School District's perspective, PGW's proposal amounts to no more than an exercise in transferring public funds among governmental entities. The

School District's budget is funded primarily by the Commonwealth and the City of Philadelphia. *Id.* at 4,5. Both governmental bodies should expect the School District to apply the funds to meet its core mission of educating the City's student population. It is doubtful either body intended to provide funds to the School District only to have the School District pass through a portion to PGW to fund its notion of what is akin to "ratepayer equity" and in the process deprive the School District of much needed resources meant for its core mission.

C. Competition Issues

Hess recommends a number of revisions to PGW's tariffs and modifications of PGW's operating practices to facilitate customer choice of a natural gas supplier. Hess Main Br. at 9-27. Interstate Gas Supply, Inc. ("IGS") proposes a "market supply threshold" (or "MST") pilot program to migrate residential and small commercial customers to competitive suppliers, and also recommends that PGW take steps to improve its billing system. IGS Main Br. at 11,12. The School District supports these recommendations of Hess and IGS to enhance customer choice for supply of natural gas on PGW's system, in furtherance of the objectives and mandate of Chapter 22 of the Public Utility Code (the "Gas Choice Act").

The School District asserts that increased customer choice will serve to reduce the pressure that PGW's substantial gas supply costs place on PGW's financial condition. School District St. 4 at 17. The School District has also presented the fact that PGW's past and current operating practices have caused the School District to incur substantial costs in procuring competitive supply, through delays in data coordination. *Id.* at 18. These facts reinforce the urgency and need for the Commission to find that Hess's and

IGS's above-stated recommendations to facilitate retail supply competition on the PGW system are appropriate and should be implemented.

IX. RATE STRUCTURE

A. Cost Of Service/

B. Revenue Allocation

The School District supports OTS's "first dollar" (or "targeted scale-back") recommendation for allocating to customer classes any increase in revenue requirement granted to PGW in this proceeding. OTS Main Br. at 60-63. OSBA also supports OTS's recommendation as an alternative to OSBA's recommendation for any revenue requirement increase granted that is less than \$73 million. OSBA Main Br. at 6. The School District posits that OTS's recommendation represents a fair compromise among the revenue requirement increase allocations proposed in this proceeding.¹

As stated by all parties, a fully allocated cost of service study ("COSS") is a guiding basis for designing a utility's rates. OTS witness Joseph Kubas recommends two substantive adjustments to PGW's filed cost of service study (COSS). Mr. Kubas proposes reallocation of costs under Account 385 – Industrial Measuring and Regulating Station Equipment Costs – from the residential customers to industrial and interruptible customers. OTS Main Br. at 57-58.

Mr. Kubas also recommends the use of an "average and excess" method for allocating the investment in distribution mains among the customer classes, and recommends that 50 percent of the investment cost be assigned to average (or annual)

¹ OTS indicates its allocation method is premised on the Commission granting PGW less than its requested revenue requirement increase in this case. OTS Main Br. at 60.

commodity demand and 50 percent assigned to excess demand. In contrast, PGW witness Howard Gorman recommends that 25 percent of the cost be assigned based on number of customers and the remaining 75 percent be assigned to design-day peak demand. PGW Main Br. at 77-79; OCA Main Br. at 55; OCA Main Br. at 45-52. OCA witness Richard Galligan recommends a “peak and average” method and assigns 20 percent of the investment cost to average demand and 80 percent to peak demand. OCA Main Br. at 54.

Mr. Kubas also takes into account in developing his recommendation the fact that PGW has understated net revenues at present rates from residential heating customers. OTS Main Br. at 14,15. He proposes applying the amount of understated net revenues to reduce non-residential class rates, said amount adjusted per PGW’s rebuttal testimony. OTS St. 3 at 21; OTS Main Br. at 63.

The School District has prepared the following table comparing the relative returns to PGW at present rates by customer class supported by PGW, OCA and OTS, respectively (based on their respective COSS):

Relative Rates Of Return At Present Rates (Stated On Percentage Basis – Total Return = 100%)				Relative Rates Of Return @ OTS Proposed Rates
Customer Class	PGW Position 2	OTS Position 3	OCA Position 4	Applying OTS Targeted Scale-Back Method⁵
Residential Non-Heating	(42)	(41)	(34)	11
Residential Heating	79	85	93	107
Commercial Non-Heating	255	233	216	126

² PGW Main Br., App F. Ex. HSG-7C, line 22.

³ OTS St. 3, Schedule 4, line 12 (nos. multiplied by 100 to produce a percentage)

⁴ OCA St. 3, Ex. RAG-1, pps. 5 and 6 of 7, line 22

⁵ OTS St. 3, Schedule 8, line 16 (does not reflect adjustment per PGW rebuttal testimony re understated net revenues from residential heating customers)

Commercial Heating	211	193	201	105
Industrial Non-Heating	355	290	295	158
Industrial Heating	209	174	195	94
Municipal Non-Heating	216	191	196	141
Municipal Heating	150	134	152	108
Housing Authority	236	222	240	121

The table also presents the relative rates of return resulting from the application of OTS's targeted scale-back allocation method at proposed rates. The School District submits that the table shows that the record in this case positions OTS's recommended adjustments to PGW's COSS as a reasonable compromise among the competing COSS in this case. The table also shows that OTS's targeted scale-back method for allocating any revenue requirement increase granted to PGW reasonably balances the rate design objectives of moving customer classes to the average rate of return with due consideration given to the principle of gradualism (i.e., avoiding an increase imposed on a customer class that would result in "rate shock").

For the foregoing reasons, the Commission should adopt OTS's targeted scale-back recommendation for allocating any increase in revenue requirement granted to PGW in this case among customer classes.

[C. Tarriff Structure]

[D. Summary and Alternatives]

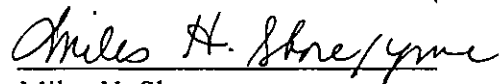
X. CONCLUSION

The Commission should deny PGW's requested rate relief in this proceeding. PGW has failed to meet its burden of proof for its requested rate relief. In denying PGW's request, the Commission should also grant the School District the relief it seeks

with respect to funding and refunding of service line extension costs, adopt the targeted scale-back method recommended by OTS for allocating any revenue requirement

increase granted to PGW, deny PGW's request to eliminate the credit to the GCR from margins on off-system sales and capacity releases and adopt the recommendations of Hess and IGS to foster competitive natural gas supply on PGW's system.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that I am serving a true copy of the attached Reply Brief, in accordance with the requirements of 52 Pa.Code §1.54, upon the following persons by electronic mail, with a hard copy by First Class Mail, postage prepaid:

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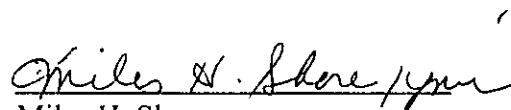
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**Re: Pennsylvania Public Utility Commission, et al. v. Philadelphia Gas Works;
Docket No. R-00061931**

Dear Secretary McNulty:

Enclosed please find the original and nine (9) copies of the Reply Brief on behalf of the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG") in the above-referenced proceeding.

As evidenced by the attached Certificate of Service, all parties to the proceeding are being served with a copy of this filing. Please date stamp the extra copy of this transmittal letter and kindly return it to our messenger for our filing purposes. Thank you.

Very truly yours,

McNEES WALLACE & NURICK LLC

By 
Charis Mincavage

Counsel to the Philadelphia Industrial and
Commercial Gas Users Group

CM/lhi
Enclosures

c: Administrative Law Judge Cynthia Fordham (via e-mail and Federal Express)
Administrative Law Judge Angela Jones (via e-mail and Federal Express)
Certificate of Service

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
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v.

PHILADELPHIA GAS WORKS

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DOCKET NO. R-00061931

REPLY BRIEF OF
THE PHILADELPHIA INDUSTRIAL AND COMMERCIAL
GAS USERS GROUP

Building Owners' and Managers'
Association of Philadelphia
Philadelphia College of Osteopathic Medicine
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I. INTRODUCTION

On December 22, 2006, Philadelphia Gas Works ("PGW" or "Company") filed with the Pennsylvania Public Utility Commission ("PUC" or "Commission") Supplement No. 16 to Tariff Gas – Pa. P.U.C. No. 2, requesting approval of proposed changes in rates designed to produce over approximately \$100 million in additional annual revenues.

On June 12, 2007, the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG") filed a Main Brief ("M.B.") in this proceeding. PICGUG received Main Briefs from the following parties: PGW; Office of Consumer Advocate ("OCA"); Office of Trial Staff ("OTS"); Office of Small Business Advocate ("OSBA"); Action Alliance of Senior Citizens of Greater Philadelphia and Tenant Union Representative Network (collectively, "AA"); School District of Philadelphia ("SDP"); Interstate Gas Supply, Inc. ("IGS");¹ Hess Corporation ("Hess"); and Philadelphia Housing Authority ("PHA").

As discussed more fully herein, PICGUG files this Reply Brief in order to respond to certain issues raised in the Main Briefs of other parties.²

¹ In its Main Brief, IGS addresses the lack of competition on PGW's system for residential and small commercial customers. IGS M.B., pp. 1-3. To that end, IGS recommends implementation of a pilot that would migrate a certain number of customers to competitive Natural Gas Suppliers ("NGSs") pursuant to a Market Share Threshold ("MST") program. IGS's proposal implies that such a program would only apply to residential and small commercial customers, which is appropriate in light of the fact that some large commercial and industrial customers are already transporting on PGW's system. Thus, implementation of an MST program for these larger customers would be problematic, especially if these customers already maintain competitive supply contracts with NGSs. Accordingly, PICGUG submits that, if IGS's proposal is adopted by the Commission, this proposal, including the costs for implementation, must only apply to residential and small commercial customers.

² PICGUG's Reply Brief will not respond to every argument contained in all of the parties' Main Briefs but only those issues necessitating additional response. PICGUG's decision not to respond to all arguments should not be construed as agreement with the positions of any party on any of the outstanding issues in this proceeding.

II. SUMMARY OF ARGUMENT

Although numerous issues have been raised in this proceeding, PICGUG's Reply Brief addresses concerns specific to large commercial and industrial customers. First, the PUC's resolution of PGW's Restructuring Proceeding indicated that any implementation of cost-based Interruptible Transportation ("IT") rates should be addressed in PGW's first base rate proceeding after Restructuring. Unfortunately, in this base rate proceeding, PGW continues to argue against implementation of cost-based rates in order to preserve the benefits received by the Company through the current IT rate margins. In light of PUC regulations and recent Commonwealth Court of Pennsylvania ("Commonwealth Court") precedent, PGW's arguments for maintaining margin-based rates must be rejected, and the Commission must implement viable, competitive cost-based IT rates on the Company's system.

Second, PGW's current rate structure results in non-residential firm sales customers subsidizing residential firm sales customers. Although the Commonwealth Court has specifically indicated that cost to serve must be the polestar in establishing rates, PGW's proposed allocation of any rate increase would exacerbate these cross-subsidies by moving the customer classes farther from their cost to serve. In order to address these problems, the PUC must reject PGW's rate allocation proposal and implement an alternative that moves all classes closer to their cost to serve.

Finally, the PUC has implemented a policy indicating that Customer Assistance Program ("CAP") costs should only be allocated to the customer class that benefits from these programs, which is the residential class. Because neither PGW nor the OCA has presented any reasons that would except PGW from this policy, the proposal by the OSBA to phase-out CAP allocation to non-residential firm sales customers over the next three years must be adopted by the PUC.

III. RATE STRUCTURE

A. COST OF SERVICE: PGW's Opposition to the Implementation of Cost-Based Interruptible Transportation Rates Inappropriately Ignores Commonwealth Court Precedent and Commission Regulations.

Throughout this proceeding, PICGUG has addressed the need to eliminate PGW's margin-based IT rates, as these rates result in the subsidization of other classes by IT customers, deprive IT customers of meaningful, competitive transportation rates, and move the IT class further from the Company's cost to serve. PICGUG M.B., pp. 6-19. Unfortunately, PGW ignores these concerns, instead focusing on inappropriate and irrelevant arguments that fail to address the requirements of both the Commonwealth Court and this Commission. Because PGW fails to present any reason that would obviate the Company from adhering to the aforementioned requirements, PGW's claims must be dismissed.

As discussed more fully in PICGUG's Main Brief, the Commonwealth Court has already held that, for unbundled rates in a competitive supply market, the cost to serve is the polestar that must be achieved. PICGUG M.B., pp. 8-10. Moreover, this Commission, in examining the need for just and reasonable transportation rates, has determined that transportation regulations were promulgated to create a viable alternative to natural gas sales service provided by the Natural Gas Distribution Company ("NGDC"), and, to that end, transportation rates must be cost, not margin, based. Id. at 11-14. Not surprisingly, PGW's Main Brief fails to address any of these requirements, instead offering a limited number of "justifications" as to why cost-based IT rates are unnecessary on PGW's system. PGW M.B., pp. 82-84. Further review, however, indicates that PGW's arguments are baseless and must be rejected by the Commission.

First, PGW claims that cost-based interruptible transportation rates are unnecessary because PGW's system is already "open" for competition. PGW M.B., p. 82. Unfortunately, PGW

ignores the fact that the Commonwealth Court, when indicating that rate structures must be set primarily on a Cost of Service Study ("COSS") basis, did not caveat this requirement based upon the level of competition on a utility's system. PICGUG M.B., pp. 9-10. Similarly, in setting forth regulations for establishing transportation rates, the PUC found that the focus should be on recovery of the fixed costs, rather than the margin available to the NGDC; the PUC did not allow for any modifications based on whether the NGDC's system is "competitive." Id. at 10-14. In other words, the level of competition on PGW's system is irrelevant to the requirement that PGW maintain cost-based IT rates.

PGW seeks to bolster this argument through irrelevant claims that the Company has a number of customers currently on Rate IT, and the amount of throughput being delivered on PGW's system has "increased tenfold" since 2002. PGW M.B., pp. 82-83. Interestingly, however, PGW neglects to mention that, while most NGDCs have been allowing large industrial customers to transport natural gas since the mid-1980's, PGW failed to provide even a remotely viable transportation rate schedule to this category of customers until the Company's Restructuring Proceeding in 2002. In fact, prior to the Restructuring Proceeding, PGW required a customer to transport at least 75,000 Dth of natural gas per year in order to be eligible to transport on the Company's system. See Evidentiary Hearings Transcript at 640-41. Comparatively, PGW's current IT rate allows a customer to transport as little as 2,500 Dth of natural gas per year for purposes of eligibility. See PGW Gas Tariff – Pa. PUC No. 2, Original Page No. 113.

As a result of PGW's Restructuring Proceeding, the Company has made several changes to its Rate IT that has enabled more customers to transport on PGW's system; however, this increase in customers must be tempered by the fact that, prior to 2002, the Company's transportation program was virtually non-existent. To suggest that PGW's IT "margin-based" rates are the sole

reason for this increase in transportation levels inappropriately ignores the overarching problems with PGW's transportation program prior to implementation of the Competition Act. In addition, while PGW has made progress with respect to these issues, the Company's interruptible transportation rates are not nearly as competitive in comparison to other NGDCs' systems in which customers have been able to obtain cost-based transportation rates for almost two decades.³ PICGUG M.B., pp. 13-14.

Accordingly, PGW's assertion that cost-based rates are unnecessary due to the "openness" of PGW's system is irrelevant when examining these rates pursuant to Commonwealth Court precedent and Commission regulations. In addition, PGW's claims of competition on its system cannot be examined in the vacuum proposed by the Company, but rather, must be viewed in light of PGW's history and the current status of competition among other NGDCs in the Commonwealth. Under such review, it is evident that PGW's margin-based rates fail to adhere to the aforementioned requirements of the Commonwealth Court and the PUC.

In a second attempt to negate the need for cost-based transportation rates, PGW argues that the Company is negotiating "reasonable" rates based on its current margin-based, maximum rates.⁴ PGW M.B., pp. 82-83. Contrary to PGW's claims, however, such "willingness to negotiate

³ For example, one PICGUG member, whose facility is within PGW's service territory but is located directly across the street from PECO Energy Company ("PECO"), has been offered a rate by PGW that is 350% higher than the equivalent, cost-based rate on PECO's system. PICGUG M.B., p. 14.

⁴ In that same vein, PGW claims that PICGUG changed in its position in this proceeding, from that of seeking cost-based rates to opposing the need for customers to negotiate lower rates with PGW. PGW M.B., p. 83. Unfortunately, PGW misinterprets PICGUG's arguments in this proceeding. Specifically, PICGUG has continuously argued for the need for cost-based IT rates. As part of PGW's Rebuttal Testimony in this proceeding, however, the Company argued that PGW's ability to negotiate rates below the maximum margin-based rates obviated the need for cost-based rates. Rebuttal Testimony of Craig White, PGW Statement No. 5-R, pp. 3-5. In response, PICGUG's Surrebuttal Testimony indicated that such "negotiation" did not resolve such issues, as customers' abilities to transport on PGW's system are based upon the Company's sole discretion in terms of negotiating a contract. Surrebuttal Testimony of Lewis Cohen, PICGUG Statement No. 1-S, pp. 2-4. To suggest that PICGUG changed its position fails to fully comprehend the issues involved in this argument.

reasonable" rates does not ensure that customers are obtaining cost-based transportation rates. For example, while the Company submits that it has negotiated multi-year agreements with some customers, PGW fails to mention that the Company maintains full and complete discretion with respect to any such negotiation. PICGUG M.B., pp. 14-15. Thus, any multi-year agreement in place may enable a customer to currently transport on PGW's system; however, the ability to continue to transport at the end of the agreement is dependent upon PGW's willingness to negotiate a viable rate under the terms of a new contract. Id.

Similarly, PGW does not have any type of documented protocol in place with respect to such negotiations, as evidenced by the Company's rapidly changing position with respect to the negotiations that occurred between PGW and the Philadelphia College of Osteopathic Medicine ("PCOM"). In addition to being unaware that negotiations even occurred between PCOM and PGW, the Company's witness also seemed to be unacquainted with the fact that these negotiations resulted in PCOM being offered the maximum, margin-based transportation rate, which is 350% higher than the equivalent cost-based rate on PECO's system. PICGUG M.B., pp. 14-16. Thus, while PGW claims to have negotiated contracts with "most" customers that currently enable these customers to transport on PGW's system, these "negotiations" are not a panacea for long-term resolution, as not all customers on PGW's system have been able to achieve "adequate" negotiated rates.

Finally, PGW submits that cost-based rates cannot be implemented for Rate IT customers because imposing "dramatic cuts" in the IT rates would violate the approved theory of gradualism. PGW M.B., p. 82. Interestingly, while PGW has proposed a rate allocation with respect to firm sales customers that purportedly accounts for gradualism in moving these customers closer to their

cost to serve, PGW has continually maintained that the maximum margin-based rates for interruptible transportation customers cannot be modified. Id. at 79-80.

As part of this argument, PGW argues against the implementation of cost-based IT rates because such movement would eliminate the current subsidy that IT customers are providing to PGW's other customer classes. PGW M.B., p. 82. Again, PGW's proposed rate allocation for the firm sales customers at least considers the need to progress towards eliminating the subsidization of residential firm sales customers by non-residential firm sales customers, even if the Company's proposal does not actually result in such movement. See Section III.B., infra. The Company, however, seems to feel justified in requiring interruptible transportation customers to continue such subsidization without any potential for future relief. Id.

Moreover, PGW's concerns regarding the need for this continued subsidization by IT customers in light of the Company's requested \$100 million rate increase is unfounded due to the well-reasoned and substantiated arguments presented by the OCA and OTS indicating that PGW does not require a rate increase of any more than \$22.5 million to \$25 million. OCA M.B., pp. 1-4; OTS M.B., pp. 1-2. Because PGW has failed to meet its burden of proving that a rate increase is warranted in this proceeding, the Company's concerns regarding maintaining the margin provided by Rate IT customers should also be rejected, thereby providing an appropriate opportunity for the Commission to implement cost-based IT rates.

Cost-based rates are required for PGW's IT customers pursuant to the requirements of Commonwealth Court precedent and PUC regulations. None of the arguments presented by PGW in this proceeding warrant anything less than movement by the Commission with respect to implementing these cost-based rates. To continue to maintain margin-based rates would be unjust, unreasonable, and inappropriately discriminatory. 66 Pa. C.S. §§ 1301, 1304 (requiring that rates

be "just and reasonable" and not provide "any unreasonable preference" to any classes of customers). In order to ensure that PGW's customers, similar to those customers on other NGDCs' systems in the Commonwealth, are provided the opportunity to obtain viable and competitive transportation rates, the Commission must require PGW to implement cost-based IT rates.

B. REVENUE ALLOCATION: PGW's Proposed Rate Allocation Would Unreasonably Result in Non-Residential Firm Sales Customers Continuing to Subsidize Residential Firm Sales Customers.

Currently, PGW's non-residential firm sales customers are subsidizing residential firm sales customers. Unfortunately, PGW's proposal to allocate any rate increase received in this proceeding would continue this subsidization by assigning non-residential firm sales customers an increase above the system average, while allocating residential firm sales customers an increase below the system average. Because PGW has not presented any substantive basis for implementing such an unjust and unreasonable rate increase, the Commission must reject the Company's proposed rate allocation and implement an alternative proposal, such as the ones submitted by the OSBA or OTS, which would move PGW closer to eliminating the aforementioned subsidizations.⁵

The only justification PGW can offer with respect to its proposed rate allocation is a claim that the Company's relative rate of return approach would result in all of the rate classes moving closer to unity with the system average. PGW M.B., p. 80. Although the Commonwealth Court has previously indicated that the COSS is the polestar in terms of setting

⁵ The OCA proposes modifications to the Company's COSS, which, according to the OCA, indicate that the residential class is moving closer to its cost to serve. OCA M.B., p. 70. Several other parties have also made arguments regarding the Company's COSS, which indicate the opposite. See OSBA M.B., pp. 39-41. Regardless of any such minor modifications to the Company's COSS, the OSBA, OTS, and PICGUG agree that that Company's proposed rate increase would still result in an unjust and inequitable allocation of any rate increase to the non-residential firm sales customers. OSBA M.B., pp. 39-41; OTS M.B., pp. 55-57; PICGUG M.B., pp. 19-22.

rates, further review of PGW's proposal indicates that it does not result in the customer classes moving closer to their cost to serve.⁶ PICGUG M.B., pp. 19-22.

As noted by the OSBA, PGW's proposal moves classes farther away from their cost to serve, resulting in an increase in the current cross-subsidies among the rate classes. OSBA M.B., pp. 36-38. Generally, the goal of moving customer classes towards their cost to serve is accomplished by proposing a greater rate increase in the classes in which the rate of return is below the system average rate of return and a lesser increase (or no increase) for classes where the rate of return is well above the system average rate of return. OTS M.B., p. 58. Unfortunately, PGW burdens those classes with a rate of return above the system average with the largest percentages of the overall rate increase, while the residential customer class, which is the class with a rate of return below the system average, receives an increase that is below the average increase. *Id.* at 58-59. Based upon mere common sense, PGW's proposal is flawed.

In order to address the flaws contained in PGW's proposal, the Commission must implement a rate allocation that will move all customer classes closer to their cost to serve. To that end, both the OSBA and OTS present alternatives that address the requirements of utilizing the polestar of cost to serve while accounting for gradualism among the rate classes.⁷ OSBA

⁶ Although the Commonwealth Court determined that cost to serve must be the preeminent factor in setting rates, the OCA suggests that the "polestar" is merely a guide and other considerations, such as rate shock and gradualism, must be recognized. OCA M.B., pp. 64-66. The OCA seems to misinterpret the Commonwealth Court's finding, which provides that "gradualism is but one of many factors to be considered and weighed by the Commission in determining rate designs, and principles of gradualism cannot be allowed to trump all other valid ratemaking concerns and do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time." *Lloyd v. Pa. Pub. Util. Comm'n*, 904 A.2d 1010, 1020 (Pa. Commw. Ct. 2006). In other words, gradualism may be a factor considered by the Commission, but it cannot overshadow the polestar of moving customers close to their cost to serve, especially when subsidization is occurring among the classes.

⁷ Contrary to the implications of the OCA, the proposals of the OSBA and OTS account for gradualism and rate shock. OCA M.B., p. 69. Unlike PGW's proposal, however, the OSBA and OTS also ensure that the customer classes move closer to their cost to serve, as required by Commonwealth Court precedent. OSBA M.B., pp. 45-48; OTS M.B., p. 63.

M.B., pp. 45-48; OTS M.B., pp. 58-63. Either of these alternatives, assuming arguendo that the Commission grants PGW a rate increase, provides a more reasonable basis upon which to allocate any rate increase to the Company's customers.

C. TARIFF STRUCTURE: Pursuant to Commission Precedent, Because Only Residential Customers Benefit from Customer Assistance Programs, Only Residential Customers Should Be Allocated the Costs of these Programs.

Although this proceeding provides a suitable opportunity to address PGW's inappropriate allocation of CAP costs to non-residential firm sales customers, the Company chose not to offer any modifications to this allocation. Regardless, the OSBA reasonably proposed to phase-out the allocation of CAP costs to non-residential firms sales customers over the next three years.⁸ Although the OCA and PGW present several arguments in opposition to the OSBA's proposal, none of these arguments provide a substantive basis upon which to ignore PUC precedent requiring the allocation of CAP costs to only residential customers. OCA M.B., pp. 88-95; PGW M.B., p. 80. Accordingly, the PUC should dismiss the OCA and PGW arguments and, instead, adopt the phase-out proposal presented by the OSBA.

First, the OCA correctly notes that Section 2203(6) of the Natural Gas Choice and Competition Act ("Competition Act") provides, in part, that the PUC may create "an appropriate nonbypassable, competitively neutral cost-recovery mechanism which is designed to recover fully the [NGDC's] universal service and energy conservations costs over the life of these programs." 66 Pa.C.S. § 2203(6). Unfortunately, the OCA misinterprets this provision by

⁸ On December 18, 2006, the Commission entered an Order resolving its investigation into various issues related to CAP, including whether the costs of these programs should be allocated to all customers. Customer Assistance Programs: Funding Levels and Cost Recovery Mechanisms, Docket No. M-00051923, Order (Dec. 18, 2006)(hereinafter, "CAP Order"). As part of this Order, the PUC resoundingly concluded that CAP costs should be allocated to only the customer class whose members are eligible for the program (i.e., the residential customer class). Id. at 31; PICGUG M.B., pp. 23-25. Appropriately, PGW does not allocate CAP costs to interruptible customers, which is in line with PUC policy.

suggesting that the term "nonbypassable" requires all customers to remit the costs for CAP. OCA M.B., p. 88. A brief examination of the Commission's deliberation on this very issue, however, quickly dispenses with this erroneous conclusion.

Specifically, the Commission reviewed this issue as part of its investigation into CAP issues and specifically declared that "[w]e disagree with the argument of OCA that the creation of a 'non-bypassable' surcharge for recovery of universal service costs shows a legislative intent to recover universal service costs from all customer classes." CAP Order, p. 31, n.24; see also OSBA M.B., p. 21. To that end, the PUC definitively declared that "the creation of a 'non-bypassable' recovery mechanism does not reflect a legislative intent to extend recovery of universal service costs to business customers." Id. In addition, the Commission has specifically ruled against the OCA's interpretation of the term "nonbypassable" in subsequent proceedings where this argument has been raised. OSBA M.B., pp. 21-22 (citing PPL Gas Utilities Corporation, Docket Nos. R-00061398, et al., Order (Feb. 8, 2007), p. 116; and Metropolitan Edison Company and Pennsylvania Electric Company, Docket Nos. R-00061366, et al., Order (Jan. 11, 2007), p. 182).

The PUC has specifically determined that the "nonbypassable" terminology used in the Competition Act does not provide a basis for unjustly allocating CAP costs to non-residential customers. Moreover, the Commission has consistently affirmed this determination in subsequent proceedings. Because the OCA inappropriately interprets Section 2203(6) of the Competition Act, contrary to numerous holdings by the PUC, the Commission must reject this argument.

The OCA and PGW also argue that CAP provides a "public good," which should require all firm sales customers to remit the costs of these programs.⁹ OCA M.B., pp. 88-92; PGW M.B., p. 80. Once again, however, Commission precedent with respect to this issue clearly rejects this ambiguous and intangible argument.

Contrary to the OCA and PGW positions, the PUC's review of CAP has consistently been guided by basic principles of cost-causation rather than notions of intangible "public goods." As a primary example, the CAP Order clearly solidified the principle that "[u]niversal service programs, by their nature, are narrowly tailored to the residential customers and therefore, should be funded only by the residential class." CAP Order, p. 32. As such, the Commission has specifically elected to continue its policy of "allocating CAP costs to the only customer class whose members are eligible for the program – residential customers."¹⁰ *Id.* at 31.

Moreover, neither PGW nor the OCA have provided any quantitative analysis demonstrating the specific magnitude of the social benefits the OCA and the Company believe non-residential customers receive from CAP. OSBA M.B., pp. 26-28. Even assuming, arguendo, that some type of value was provided, balancing social benefits with the cost

⁹ In that same vein, the OCA cites a provision of the Electricity Generation Customer Choice and Competition Act as "declaring universal service programs to be a 'public good' and that the public purpose is promoted through these programs." OCA M.B., p. 88; 66 Pa. C.S. § 2802(17). As correctly noted by the OSBA, however, rather than promoting the claim that universal service programs constitute a "public good," Section 2802(17) merely provides that "[t]he public purpose is to be promoted by continuing universal service and energy conservation policies ... and full recovery of such costs ... through a nonbypassable rate mechanism." OSBA M.B., pp. 30-31. Thus, this Section does not equate the "public purpose" to a "public good."

¹⁰PGW submits that cost causation principles cannot apply to CAP because, under this premise, only actual participants in CAP would be paying CAP costs, thereby defeating the purpose of the program. PGW M.B., p. 80. Obviously, PGW's concept of cost causation is illogical, especially in light of the PUC findings. As correctly noted by the PUC, only customers eligible for CAP should pay for the costs of CAP. CAP Order, p. 32. While not all residential customers may be actual participants in CAP at a specific time, if any residential customer's financial circumstances were to change, this customer may, in turn, become an actual CAP participant. Conversely, a non-residential customer is never eligible for assistance from CAP regardless of their financial situation. Thus, PGW's baseless argument must be rejected.

responsibility for those benefits is better left to the government spending and tax policymakers; utility regulators must rely on cost causation principles. Id. at 28-29. In addition to ringing hollow in light of recent PUC findings, the OCA's and PGW's argument that CAP provides a "public good" is irrelevant with respect to regulatory ratemaking.

Finally, despite the PUC's unambiguous statement of policy, the OCA and PGW inexplicably submit that the CAP Order supports the position that PGW should be permitted to maintain its current allocation of universal service costs to non-residential firm sales customers. This argument is a clear misreading of the Commission's holding in that proceeding.

Although the PUC noted, as part of its investigation, that PGW's cost allocation was determined prior to the PUC's oversight of the Company, the CAP Order does not provide any prohibition against modifying PGW's inappropriate CAP allocation on a going-forward basis. PICGUG M.B., p. 24. Moreover, when examining the question of how any CAP costs should be allocated among the different rate classes, the PUC references PGW's recommendation that costs be allocated to all firm customers; however, the PUC notes that, in light of its decision that CAP should only be allocated to residential customers, this issue was moot. Id.; see also OSBA M.B., pp. 23-24. Thus, contrary to the OCA's claim that the PUC has acquiesced with respect to PGW's inappropriate allocation of CAP costs to non-residential firm sales customers, further reading of the CAP Order indicates an assumption by the PUC that this issue will be addressed, pursuant to the terms of the CAP Order, at a later time. Accordingly, the OCA's argument must be rejected.

PGW and the OCA have failed to submit any evidence requiring the continued allocation of CAP costs to non-residential firm sales customers, especially in light of recent PUC precedent. Conversely, the OSBA's proposal to phase-out the allocation of CAP costs to non-residential

firm customers over a three-year period clearly addresses PUC precedent while also attending to the concerns of gradualism. Accordingly, the OSBA's proposal should be adopted by the Commission.

D. SUMMARY AND ALTERNATIVES: *In Order to Ensure Just and Reasonable Rates for PGW's Customers, the Commission Must Require PGW to Implement Cost-Based IT Rates, Move All Firm Sales Customers Closer to their Cost to Serve, and Allocate Customer Assistance Program Costs Only to the Residential Customer Class.*

The Public Utility Code demands that all utilities maintain just, reasonable, and non-discriminatory rates for all customers. 66 Pa. C.S. §§ 1301, 1304. In order to ensure that PGW's rates meet these requirements, the Commission must take the opportunities presented in this proceeding to address the flaws inherent in PGW's rate structure. First, the PUC must implement cost-based IT rates to ensure that larger customers are provided the same viable and competitive transportation rates as those customers on other NGDCs' systems. Second, the PUC must adopt one of the alternative proposals presented by the OSBA or OTS for allocating any rate increase to firm sales customers, as these proposals will ensure that all firm sales customers are moving closer to their cost to serve. Finally, the PUC must eliminate any allocation of CAP costs to non-residential firm sales customers to ensure that PGW adheres to PUC policy. Because the OSBA's phase-out proposal addresses this issue while still accounting for gradualism concerns, the PUC should accept this proposal.

IV. CONCLUSION

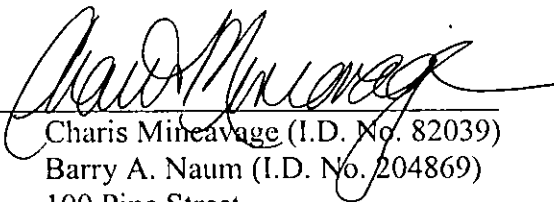
WHEREFORE, the Philadelphia Industrial and Commercial Gas Users Group respectfully submits that the Pennsylvania Public Utility Commission require Philadelphia Gas

Works to:

- (1) Implement cost-based rates for the Interruptible Transportation Rate Schedule;
- (2) Adopt the OSBA or OTS proposals to allocate any resulting rate increase among the firm sales customers;
- (3) Apply a three-year phase out of any Universal Service and Energy Conservation Costs so that these costs are no longer allocated to non-residential sales customers; and
- (4) Provide any other relief that the Commission deems just and reasonable.

Respectfully submitted,

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Dated: June 21, 2007

CERTIFICATE OF SERVICE

I hereby certify that I am this day serving a true copy of the foregoing document upon the participants listed below in accordance with the requirements of Section 1.54 (relating to service by a participant).

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Dated this 21st day of June, 2007, in Harrisburg, Pennsylvania.



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2007 JUN 21 PM 2:45
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ORIGINAL

Re: Pennsylvania Public Utility Commission v. Philadelphia Gas Works
Docket No. R-00061931

Dear Secretary:

Enclosed for filing is an original and nine (9) copies each of the Reply Brief of the Philadelphia Housing Authority in the above-captioned proceeding.

Copies are being served on all active parties of record.

Very truly yours,

Philip L. Hinerman

**DOCUMENT
FOLDER**

PLH/mn

Enclosures

cc: The Honorable Cynthia W. Fordham (w/encl.)
The Honorable Angela T. Jones (w/encl.)
Parties of Record (w/encl.)

A Pennsylvania Limited Liability Partnership

California Delaware Florida Nevada New Jersey New York Pennsylvania

41

ORIGINAL

BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

2007 JUN 21 PM 2:45
SECRET

**REPLY BRIEF OF THE
PHILADELPHIA HOUSING AUTHORITY**

DOCKETE
JUN 22 2007

**DOCUMENT
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BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY :
COMMISSION :

v. :

Docket No. R-00061931

PHILADELPHIA GAS WORKS :

**REPLY BRIEF OF THE
PHILADELPHIA HOUSING AUTHORITY**

I. INTRODUCTION

In its Main Brief, the Philadelphia Housing Authority (“PHA”) set out the basis for its position that PHA and its tenants have dramatically overpaid PGW and should not receive a further rate increase. In fact, PHA should receive a rate reduction. PHA has helped subsidize excessive rates for years. In these days of PHA budget reductions and financial complications, the rates charged PHA can no longer be sustained.

II. SUMMARY OF ARGUMENT

As acknowledged by the Office of Trial Staff (“OTS”) and the Office of Small Business Advocate (“OSBA”), PGW’s proposed new rates cause PHA’s share of costs to increase dramatically more than the system average increase. See OSBA Main Brief, p. 38; OTC Main Brief, p. 61-63. While both OTS and OSBA advocate either a reduction or no increase in the PHA rate, these recommendations do not go far enough. For years, PHA has been billed at the highest of all possible rates. Rather than continuing this practice, the Commission should mandate a consolidation of all PHA accounts currently billed into one rate class which is the lowest rate, be it the PHA, Municipal or Residential Rate.

III. REVENUES

PHA has no additional comments.

IV. EXPENSES

PHA has no additional comments.

V. MISCELLANEOUS ISSUES

A. PHA's Entitlement to Reclassification

In PHA's Main Brief, it raises the point that PGW's proposed PHA Rate increase unfairly impacts PHA. Two intervenors, OTS and OSBA, have pointed out that PGW's proposed rate increase belies PGW's stated intention to systematically move rate classes closer to cost. See OSBA Main Brief, p. 38; OTS Main Brief, p. 61-63. As shown in PHA's Main Brief, at p. 4, PGW's proposed rate increase only exacerbates the current situation by increasing the existing gulf between rates for residential and municipal gas customers and the rates for PHA and its residents.

It is not enough to merely freeze the Municipal, PHA and Industrial Rates, as is advocated in OTS' Main Brief at p. 63. Given the considerable and well-documented reductions in funding of PHA, which have forced dramatic changes at PHA, it is also inappropriate, unjust and unreasonable to merely maintain the current rates at a level above the Residential and Municipal Rates.

At the current rate, PHA Conventional Site billings exceeded, by \$660,000 per year, the billings for the same usage if computed at the current Municipal Rate. PHA Ex. 2-SUR, p. 3. The proposed PHA rate increase exceeds the proposed Municipal and Residential Rate increases by an even higher margin. PHA Main Brief, p. 4-5. The proposed increase would force PHA to

divert funding from its own projects and its mandate of providing affordable housing to persons with limited income, in order to give PGW funds to make up shortfall in other rates.

B. The Past and Future Billing Rate

PHA requested in its Main Brief that both the Conventional Sites, currently invoiced at the PHA Rate, and its Scattered Sites and Housing Choice properties (collectively “Scattered Sites”), be reclassified to the Municipal Rate class or to the lowest rate class ultimately determined by the Commission.

1. Past Billings Were At The Highest Rate

Historically, PHA has been billed at higher rates than necessary. PHA demonstrated in its testimony and cross examination that it could have been billed under one of three rate classes – the PHA Rate, the Municipal Rate or the Residential Rate. As acknowledged by PGW in its Main Brief at p. 85, if PGW has selected the highest rate, such conduct would violate Section 1303 of the Code. That Code section states that, if more than one rate is applicable, PGW should compute bills “under the rate most advantageous to the patron”. Instead, it has billed PHA at the most “disadvantageous” rate.

The point was underscored at the hearing by the testimony of Craig White. The Residential Rate is defined in both the current and the proposed tariff to apply to “residential and public housing authority customers”. Proposed Tariff, 25th Revised Page 83. Mr. White denied that this language included PHA. In its Main Brief at p. 85, PGW states that this language “plainly does not cover PHA’s conventional sites”. As to those sites, PGW contends “PHA, not its customers, are the customer of record”. PGW Main Brief, p. 85.

In addition, Mr. White could not state a reason for the disparity that began at least in 1993. PHA Main Brief, p. 4-5. White Exhibit CW-10. This arbitrary action by PGW is a source of PHA's historic overpayment.

PGW does not read the words "public housing authority customers" in the Residential Rate tariff to apply to the PHA even though PHA is a "public" entity which is a "housing authority" acknowledged to be a PGW "customer".¹ PGW has not, and cannot, provide a reading of the tariff provision that supports its contention that PHA is not a "public housing authority customer".

At a minimum, PHA should have been billed at the lower GS-Residential Rate. Furthermore, at p. 9 of its Main Brief, PHA cites reasons for its qualification for the Municipal Rate. Obviously, it was not billed at this rate either. This overbilling is a source of PHA's historic overpayments.

2. Reclassification of PHA to the Municipal Rate

PHA's request to be reclassified to the Municipal Rate class or to the lowest rate class was addressed by PGW. PHA Main Brief at 8-10. PGW states that it does not oppose a reclassification of Conventional Sites to the Municipal Rate, but would refuse to apply the Municipal Rate to Scattered Site properties. PGW Main Brief at p. 84-85. PGW also conditioned its agreement to reclassification upon its ability to recover from its remaining customers any lost revenues from PHA service. PGW Main Brief at p. 85. That condition, along with the knowledge that PHA's Conventional Site properties comprise less than half its total number of

¹ See Definitions set for at pp. 5-6, infra.

accounts², make the offer to only reclassify the PHA Rate to the Municipal Rate of less benefit to PHA and its residents.

Instead of accepting PGW's offer to partially reassign PHA to the Municipal Rate, PHA requests the reclassification of all of its residents' accounts, whether Conventional or Scattered Sites, to the lowest rate after any rate increase. The plain language of the Tariff, which PGW has attempted to dismiss as irrelevant, supports PHA's proposal.

The Proposed Tariff defines a "Customer" and a "Residential Customer" as follows:

Customer - A person, partnership, association, corporation or other entity that purchases Gas Service from the Company. The term shall include a Customer who transfers service to another address in the Company's service territory. A Customer may fall into one or more of the following categories:

(i) Residential Customer – Any Customer in a dwelling (including an apartment whose primary use of Gas Service is for household purposes such as space heating, air conditioning, cooking, water heating. The term 'Residential Customer' shall be used interchangeably with the term 'Customer with Residential service.' A Residential Customer shall include any adult occupant whose name appears on the mortgage, deed or lease of the property, and any adult occupant who is a tenant in a Residential Building (for which the residential utility service is provided) pursuant to an oral agreement.

Proposed Tariff at First Revised Page 11.

The Proposed Tariff contains no definition of a Philadelphia Housing Authority Customer. PHA, however, is unquestionably a Customer.

The PHA Rate is available not just in Conventional Sites, but for

² PHA currently has approximately 7,765 Conventional Site houses, served at the PHA Rate, along with 4,175 Scattered Site Properties and 13,896 Housing Choice Voucher properties, which are served at the Residential Rate.

[a]ll Gas usage in single and multiple dwelling Residential Buildings, containing less than 10 dwelling units, provided, and only so long as, Gas is used exclusively for cooking, water heating and space heating for all such Residential buildings owned and operated by the Philadelphia Housing Authority, except (a) buildings operated by the Philadelphia Housing Authority, prior to the original effective date of this rate (January 1, 1969), and (b) buildings for which, in the judgment of the Company, such Gas Service cannot be provided economically.

Proposed Tariff, Fifteenth Revised Page 90.

“Residential Buildings” include buildings:

[c]ontaining one or more dwelling units occupied by one or more Tenants, but excluding nursing homes, hotels and motels.

Proposed Tariff, First Revised Page 13.

A “Tenant” is defined as

Any person or group of persons whose dwelling unit in a Residential Building is provided gas pursuant to an oral or written rental arrangement for such dwelling unit, but who is not the Customer of record of PGW for such Gas Service.

Id.

The PHA Rate definition covers most, if not all, of PHA’s Scattered Site properties.

Residential Buildings are occupied by Tenants, irrespective of the Tenants’ status as customers of record. PGW has not stated and cannot state that gas service cannot be provided economically to the Scattered Sites properties at a lower rate. Moreover, as the PHA Rate for Residential Buildings is not premised on the number of meters on the property, PGW cannot seek to exclude Scattered Sites properties on the grounds that they are separately metered.

Among the reasons PGW gave for its refusal to reclassify Scattered Site accounts were that Scattered Site residents are customers of records and had none of the hallmarks of a governmental agency of the type PGW contends is eligible for the Municipal Rate. PGW Main Brief at 84-85. There is no difference in the qualification of the residents billed at the Residential Rate and those billed at the PHA Rate. The “customer of record” in the GS-Residential Rate is, again, a distinction without a difference. The customers are all PHA tenants who meet the same financial qualifications as those PHA tenants whose gas usage is billed under the PHA Rate.

C. PHA’s Status As A Rate Class

In its Main Brief, PGW, at p. 81, states that both the School District of Philadelphia and PHA must be treated “as part of their respective classes for the purposes of allocating costs and designing rates, and such function, not be performed on an individual customer by customer basis as is the apparent desire of the parties.”

Frankly, PHA is its own “respective class”. It is the only customer being billed at the PHA rate. As such, the “function” of reviewing rates and allocating costs, considering such things as payment history, can be performed on a customer by customer basis when that customer is only PHA. To determine the reasonableness of the rates charged to PHA, and the effect on the customers, one only need review the current economic conditions at PHA to determine if that rate is reasonable and just.

Monies spent on gas services are a significant factor in PHA’s bottom line. To pay higher gas rates, monies must be taken from projects which advance the mission of PHA – to provide affordable housing for low income Philadelphians. Although it makes sense from a regulatory standpoint to insure that PGW is allowed a rate which recovers its cost of services,

that rate should not grant PGW a license to redirect public funds from other public agencies in excess of those costs.

Accordingly, either the PHA Rate should be adjusted to provide the lowest possible cost to PHA, or PHA should be reassigned to the class with the lowest possible rate, currently the Municipal Rate. In any event, all of PHA's accounts should be consolidated into one rate class. In support of this request, PHA has demonstrated that PGW impermissibly uses profits to subsidize other rate classes. The proposed rate increase should be rejected and a balanced approach adopted.

D. Direct Vendor Payments

Only OCA suggests that the PHA payments under the direct vendor program should be expanded. See OCA Main Brief at p. 101. The sole basis for this expansion is testimony of Roger Colton, which is addressed in PHA's Main Brief at p. 11-13. Rather than restating its prior discussion, PHA merely points out that Mr. Colton's suggestion ignores insurmountable issues, including federal court litigation in the McDowell case and PHA's new status as a "Moving to Work Agency". Mr. Colton admitted that he was unfamiliar with these issues at the hearing.

E. PHA's "False Assertions"

At p. 86 of PGW's Main Brief, PGW states that PHA has made four "false assertions" which are not supported by the record. PGW's own "assertions" as to what PHA said are not supported by the testimony cited by PGW.

All four "assertions" are purportedly in Ms. Mondre's surrebuttal testimony. PGW cites Ms. Mondre's testimony at PHA Ex. 2-SUR at 4. That testimony states, clearly and up front, that Ms. Mondre was not provided by PGW (despite requests from PHA) with the information necessary to make a specific estimate of payments that may have been made under the vendor

program. The allegedly false statements cited by PGW and PHA's refutation of the citations are as follows:

1. PHA asserts that it was over billed by as much as \$4 million dollars for 800 scattered site tenant properties in the vendor program

Ms. Mondre, at PHA Ex. 2-SUR, p. 4:1-4, states that she is unaware of the number of PHA tenants in the utility allowance program who have also applied for the CRP Program. The reason for her lack of knowledge is based on PGW's declining to provide records of CRP participation due to confidentiality concerns.

2. Some or all of the vendor program tenants are enrolled in the CRP Program.

Again, Ms. Mondre states that she was not advised of the number of PHA tenants who are enrolled in the CRP. PGW declined to provide the information citing confidentiality of the names of the CRP participants. Now, for the first time, counsel provides improper additional testimony, stating that none of the tenants in the vendor program are CRP participants. PGW Main Brief at p. 87. This "fact" is not in the record.

3. PHA pays the vendor program utility allowance directly to PGW regardless of the invoice amount.

Ms. Mondre gave no testimony that addresses this issue.

4. PGW's over billing is a result of PGW recovering vendor program billings from PHA at full residential rates.

Again, Ms. Mondre acknowledged that she was not advised of the number of residents who have applied for the CRP Program and for whom PHA makes direct utility allowance payments.

What is the net result of these purported “false assertions” and how should the Commission view them? Aside from the fact that Ms. Mondre acknowledged not being provided with information, and, therefore, the related testimony is not “false” as PGW states, all of these points only relate to the total amount that PHA has overpaid. No party has contested the statement that PHA has significantly overpaid for gas prices at a rate exceeding the cost of gas services. As they are related to this rate proceeding, however, the important point is that PGW has perpetuated the overpayment by assessing PHA an increased charge that exceeds the increase in Residential and Municipal Rates and greatly exceeds the cost of service. PHA requests the adjustments set forth herein.

VI. RATE STRUCTURE

A. Cost of Service

It is undisputed that PGW’s own cost of service study shows PHA will pay much more than the cost of service.

B. Revenue Allocation

PHA’s Main Brief focused on the unjust and unreasonable allocation of a disproportionate amount of PGW’s costs to the PHA Rate class. PHA Main Brief at p. 8-10. Other participants’ main briefs evaluated the issue of revenue allocation among the various rate classes, and support PHA’s contention that PGW has utterly failed to prove that making PHA continue to pay more than its fair share through the imposition of a higher revenue allocation is in any way just or reasonable.

1. PGW’s Rate Design and Proposed Revenue Allocation

PGW’s stated objectives in its rate design were to move each rate class towards unity between the class relative rates of return and the system average rate of return, while adhering to

the principal of gradualism so as to avoid the “rate shock” associated with large increases. PGW Main Brief at p. 79-80. Whatever PGW’s intentions, however, its proposed allocations move the rates of return further away from unity, not closer, and increase the amount of cross-subsidization to excessive levels. OSBA Main Brief at p. 37, citing PGW Stmt. 5 at 10.

2. OTS and OSBA Proposed Revenue Allocations

OTS and OSBA’s proposed revenue allocations are based on the principle that those rate classes with the lowest rate of return should be assessed the highest rate increases. OTS Main Brief at p. 58, 63. OSBA Main Brief at p. 37-38.³ This is consistent with the use of the Cost of Service Study (“COSS”) and a “polestar” in revenue allocations in order to make revenue received from a class match the costs of service to that class. Lloyd v. Pa. PUC, 904 A.2d 1010 (Pa. Commw. 2006), petition for allowance of appeal denied.

OTS used an adjusted version of PGW’s COSS to develop its own proposals for revenue allocations. OTS Main Brief at p. 57. OTS recommends using a first dollar relief targeted scaleback formula for allocating increases among the various rate classes. OTS Main Brief at p. 60-63. OSBA voiced its general agreement with OTS’s methodology and results, provided the total amount of any revenue increase granted by the Commission does not exceed \$73 million. OSBA Main Brief at p. 6.

OTS has advocated the use of the Targeted Scaleback method to lessen the burden of revenue allocations upon classes with the largest rates of return, in this case the industrial, commercial and housing GS (“PHA”) rates. OTS Main Brief at p. 58-59. The “first dollar relief” proposal would reduce PHA’s and other affected classes’ rate increases by setting dollar

³ OCA generally agreed with PGW’s allocation method and results at page 69 of its Main Brief, but not with the \$100 million revenue increase request. OCA recommended that any allocation be based upon a revenue increase of \$22.5 million. OCA Main Brief at p. 1-2.

thresholds above which an increase would have to rise before the class would be required to pay more. OTS Main Brief at p. 59, 63.

According to OTS' revised scaleback calculations, PHA would not be required to contribute revenues to the rate increase unless the Commission approved an increase for PGW in excess of \$74,231,000 against the \$100 million total requested increase. OTS Main Brief at p. 63. Residential and MS Rate customers would bear the increased costs associated with the first \$74,231,000 of the increase. Id.

OTS, for reasons enumerated at length at pages 8-13 and 27-52 of its Main Brief, does not believe that PGW has established its entitlement to anything close to the \$100 million revenue increase it requested. Instead, OTS has proposed a \$25 million overall revenue increase, geared primarily to debt retirement. OTS Main Brief at p. 1-2. It then applied the proposed revenue increases as a percentage of the \$100 million requested amount. OTS Main Brief at p. 63.

PHA believes the OTS method, modified by reclassification of PHA charges, best fits the standards for revenue allocations. It utilizes the PGW cost of service analysis as the starting point, and balances the needs of the company and the consumer, in accordance with Lloyd. It curtails or eliminates cross-subsidization. It follows recommended practice by imposing the greatest revenue increases upon those classes who have been receiving the most help from other ratepayers while taking gradualism into account. For these reasons, PHA supports OTS' suggested revenue allocation and its proposed \$25 million overall revenue increase, and requests the entry of the ordering paragraph below.

C. Tariff Structure

PHA has no additional comment.

D. Summary and Alternatives

PHA advocates reclassification of all PHA residents under the lowest applicable rate.

VII. CONCLUSION

Based on the foregoing, PHA's Scattered Site properties are eligible for reclassification to the PHA Rate class or, in the alternative, the lower of the Municipal or Residential Rate. In fact, all PHA residents should be billed under the same rate. That rate should acknowledge the status of PHA residents as persons with limited income and PHA's own status as an organization charged with operating affordable housing for those individuals.

Proposed Findings and Ordering Paragraphs are attached.

Respectfully submitted,



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Dated: June 21, 2007

PROPOSED FINDINGS AND ORDERING PARAGRAPHS

1. Philadelphia Housing Authority ("PHA") has contested both the proposed increase in its rate and its classification under the PHA Rate.
2. The cost of service study prepared by PGW demonstrates that the proposed PHA increase, as well as the historic rates, greatly exceed the cost of service.
3. PGW has offered nothing to meet its burden of proof that the proposed increase in the PHA Rate is reasonable and just.
4. Additionally, PHA has presented support for the fact that it should be classified under the Municipal Rate.
5. PHA has also presented support for the fact that its tenants, billed under the Residential Rate, should receive either the PHA Rate or the MS Rate, whichever is lower.
6. PHA has also demonstrated that, in the past and in the proposed tariff, it is a "public housing authority customer", clearly entitled to be billed at the Residential Rate, under § 3055 of the Code.
7. The Commission finds that there will be no increase granted in the PHA Rate.
8. The Commission finds that PHA and its tenants currently billed under the Residential Rate, should, in the future, be treated as being under either the Municipal Rate, the PHA Rate or the Residential Rate, whichever is lower.
9. PGW is directed to provide compliance tariffs incorporating each of the above findings.

CERTIFICATE OF SERVICE

I hereby certify that I am serving a true and correct copy of the foregoing Reply Brief of the Philadelphia Housing Authority in accordance with the requirements of 52 Pa. Code §1.54 upon the following person(s) via First Class Mail, postage prepaid:

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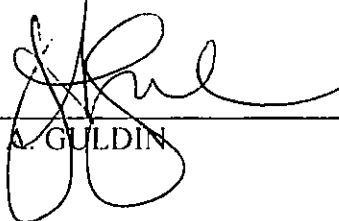
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