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BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

TESTIMONY OF

GARY KRELLENSTEIN

ON BEHALF OF

PHILADELPHIA GAS WORKS

DOCKET No. R-00061931

December 2006

I. QUALIFICATIONS AND PURPOSE OF TESTIMONY

Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

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

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

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

Q. SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS.

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

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

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

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

Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND.

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

Q. WHAT IS YOUR EMPLOYMENT EXPERIENCE?

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

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

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

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

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

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

II. INVESTMENT COMMUNITY PERSPECTIVE ON PGW

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

A. 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).

Q. HAVE YOUR READ MS. BISGAIER'S TESTIMONY?

A. Yes.

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

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

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

A. Yes.

Q. PLEASE EXPLAIN.

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

returns (preservation of capital is a key consideration for most tax-exempt investors). Consequently, the market for low or sub-investment grade municipal bonds is very shallow and often requires the participation of "cross-over" buyers (investors from the high yield taxable markets who will only minimally factor in the bond's tax-exempt status and require significantly higher rates-of-return). If PGW had to access the capital markets with below investment grade ratings, the yield penalty it would most likely incur in the current financial environment would be excessive (the premium could easily be 35% to100% over investment grade rates depending of structure, maturity, calls features, size, etc.) and it would have a severe negative impact on the utility's financial operations and its cost of service to customers.

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

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

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

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

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

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

A. PGW has made substantial progress. That progress is reflected in the data presented by Mr. Bogdonavage and Ms. Bisgaier, such as the 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 periodically and the implementation of the Weather Normalization Clause. It is also demonstrated by the willingness of lenders, such as JPMorgan, to increase PGW's ability to borrow under the commercial paper program and the action taken by Fitch Rating Services in September of this year when they removed PGW from credit watch and changed the outlook to "stable."

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

A. No. 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, resulting in significantly higher costs for both the utility and its customers or additional adverse consequences.

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

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

REBUTTAL TESTIMONY OF

JOYCE S. WILKERSON

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

May 4, 2007

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. Joyce S. Wilkerson. My business address is Room 204 City Hall, Philadelphia, PA 19103.

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

A. I am employed by the City of Philadelphia. I am Chief of Staff to the Mayor.

Q. SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS.

A. I have been employed by the City for 15 years. I served as Secretary for Strategic Initiatives in this Administration before becoming Chief of Staff. I was Chief of Staff in the Office of City Council President for six years. I worked as a staff attorney at the Redevelopment Authority for six years, and as a staff attorney for Community Legal Services for seven years. I also served as a Faculty Fellow at the University of Pennsylvania.

Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I have an B.A. degree from the University of Pennsylvania and a J.D. from Boalt Hall School of Law of the University of California.

Q. HAVE YOU EVER TESTIFIED BEFORE ANY REGULATORY AGENCIES?

A. No.

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

A. While serving in the Office of City Council President, I became generally familiar with PGW regarding its relationship to the City budget process and its various obligations including the annual $18 million payment, annual capital budget review, and certain initiatives taken by prior management that were reviewed and rejected by City Council. As part of the Mayor's Transition Team following the election in 2000, I worked directly

on utility issues that would face Mayor Street when he took office. Of critical concern were those relating to PGW. After taking office, I worked closely with the Mayor to manage the crisis created by decisions made under prior PGW management. I was appointed to serve as a member and as Vice Chair of PGW's Board of Directors, Philadelphia Facilities Management Corporation (PFMC).

PFMC met weekly to work with the new management team to stabilize PGW and begin the work on its recovery. Our concern at that time was not only that PGW might fail, but that its failure would have a serious negative impact on the City, its general financial condition, and its ability to issue long term bonds in the future.

I remain Vice Chair of PFMC and have remained very engaged in all aspects of the details of PGW operations and their impact on the City. The work of the current management team should be recognized as a major achievement. While the Company is not yet as financially healthy or stable as it needs to be, the progress made during the last seven years has been steady and dramatic.

At issue now is whether PGW will be given the resources needed to meet its operating needs and to make the utility viable, thus removing the potential to bring down the financial outlook of the City.

Q. ARE YOU FAMILIAR WITH PGW'S RATE FILING CURRENTLY PENDING BEFORE THE COMMISSION?

A. Yes. As Vice Chairman of Philadelphia Facilities Management Corporation, PGW's Board of Director's, I reviewed the filing and approved it. I believe that the current management of PGW has made dramatic improvements in PGW's operations and financial performance. I also believe that, while there is room for further efficiency

improvements, that potential is not nearly adequate to meet the need for viability accurately presented in this filing.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to respond to those parties that advocate that the City provide the resources to meet PGW's needs rather than through the proposed rate increase.

Q. ARE YOU FAMILIAR WITH THE TESTIMONY OF OTHER PARTIES IN THIS CASE WHO SUGGEST THAT THE CITY, AS OWNER OF PGW, SHOULD PROVIDE PGW WITH THE RESOURCES NEEDED TO IMPROVE ITS FINANCIAL INDICATORS OVER THE NEXT FIVE YEARS?

A. Yes. I have read the testimony of Mr. Lelash.

Q. HOW DO YOU RESPOND?

A. The City has no ability to provide the resources needed by PGW without seriously eroding the provision of fundamental City services such as police and fire protection and the most basic social services needed by our citizens and jeopardizing the City's own fiscal stability. Those critical services, in fact, are already underfunded and, in some cases, are not providing appropriate levels of service. Unfortunately, with the already enacted tax rates, the City will experience continued revenue reduction that will mandate further reductions in essential services.

Furthermore, the City has no legal obligation to provide the financial assistance demanded by other parties. Section VII.1 of City ordinance, the City's Management Agreement with PFMC, provides that rates and charges must be sufficient to produce revenues that will cover all costs of operating PGW and all necessary capital costs. The Natural Gas Choice and Competition Act, at 66 Pa. C.S. Section 2212(e), provides, "Notwithstanding any provision of this title to the contrary, in determining the city

natural gas distribution operation's revenue requirement and approving overall rates and charges, the commission shall follow the same ratemaking methodology and requirements that were applicable to the city natural gas distribution operation prior to the assumption of jurisdiction by the commission and such obligation shall continue until the date on which all approved bonds have been retired, redeemed, advance refunded or otherwise defeased." As the City's gas works revenue bonds remain outstanding, we believe that the Public Utility Commission has the obligation to set rates that do not require the City to make additional contributions to PGW's operating or capital budgets.

Q. HAS THE CITY ALREADY PROVIDED RESOURCES TO PGW?

A. Yes. The City provided PGW with a $45 million interest free revolving loan in FY 2000 in order to ensure that PGW had the ability to pay expenses, including gas purchases, in a timely manner. The City has on several occasions, extended the repayment date of the loan, again without charge. I am informed that the cost of such a credit facility would be approximately $2-3 million annually if it had been obtained conventionally (which was not an option at the time that it was originally proposed). Further, the City has agreed, in every year since FY 2004 to grant back to PGW the $18 million City payment required by ordinance (and authorized to be collected in rates by the Public Utility Code). Please understand that this decision was made to protect PGW from an imminent downgrade to junk bond status, the implications of which were too serious to consider.

These actions have come at a cost, to date, to the City of $72 million. The Administration has also agreed to extend the grant-back period for the $18 million through FY 2010 for a total commitment of $126 million.

Q. WHY DID THE CITY PROVIDE THIS SUPPORT?

A. As the Commission is well aware, PGW has been in financial crisis since the late 1990s. The Company has gone through several years in which, without the support that the City has provided, PGW would not have been able to meet its bond ordinance-required coverages, or had sufficient cash or short term borrowing capability (i.e., liquidity) to pay its gas debt service bills. In 2002, despite extensive support from the City, PGW requested and received a $36 million emergency rate increase from the PUC, without which it was threatened with a downgrade to junk bond status and the loss of its commercial paper program. That increase would have been much higher if the City had not pledged to forego the City Payment to which it was legally entitled.

Q. WHY CAN'T THE CITY CONTINUE TO GRANT BACK THE $18 MILLION CITY PAYMENT, FORGIVE REPAYMENT OF THE $45 MILLION LOAN OR MAKE OTHER CONTRIBUTIONS TO PROVIDE CAPITAL TO PGW FOR CONSTRUCTION AND DEBT REPAYMENT?

A. There are at least two important reasons. First, the City simply can not afford to continue to make such extensive contributions to this one City asset. 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.

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.

Q. DO YOU HAVE ANY CONCERN ABOUT THE IMPACT OF THE RATE INCREASE ON PGW'S LOW-INCOME CUSTOMERS?

A. Of course. The first obligation, however, is to ensure that PGW remains financially viable and able to provide safe and reliable service at a reasonable cost. PGW must survive. No one is well-served if PGW fails. We cannot afford to use the increased burden of the rate increase as an excuse that prevents us from fixing PGW. Customers below 150% of the federal poverty standard[1] have the Customer Responsibility Program. Participants in that program will be shielded from any impact of the rate increase because their responsibility is based on a percentage of their income. Though not all eligible

[1] The 2007 federal poverty standard for a family of four is $20,650. 150% of the federal poverty standards for a family of four is $30,975 per year. Federal Register, January 24, 2007, at 3147.

customers participate in the program, PGW and the City have made aggressive and effective efforts to attract customers to the program. It is my experience that participation in this program is like that of all other public benefits programs – not all of those eligible take advantage of the program. There are many reasons for that failure, almost all of them beyond the control of PGW.

As for other customers, I certainly understand and empathize with the burdens additional rate increases impose on them, but there is no other realistic solution.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. No. I have one additional comment. City budget and spending authority is a very important City function and should be performed without interference from parties or bodies that have no expertise or broad responsibility for protecting the public interest of the City and its citizens. The City's responsibility and authority on these matters are articulated and protected under the Pennsylvania Constitution and the Philadelphia Home Rule Charter. For that reason, I believe that it is inappropriate for the Public Utility Commission to play any role in mandating City expenditures to meet the needs of PGW. I do, of course, understand and respect the propriety of PUC review of PGW rates to ensure that they meet standard Commission requirements.

PGW St. 10
5/21/07 hearing
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BEFORE THE
PENNSYLVANIA PUBLIC UTLITY COMMISION

REBUTTAL TESTIMONY OF

ROB DUBOW

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

May 4, 2007

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. I am Rob Dubow. My work address is 1429 Walnut Street 14th Floor, Philadelphia, PA 19102.

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

A. I am employed as the Executive Director of the Pennsylvania Intergovernmental Cooperation Authority (PICA).

Q. WHAT IS PICA?

A. The Pennsylvania Intergovernmental Cooperation Authority (PICA) was created on June 5, 1991 by virtue of the Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class (P.L. 9, No. 6), 53 P.S. 12720.101 et seq., as amended (the **PICA Act**) for the purpose of providing financial assistance to the City of Philadelphia (City) in overcoming a severe financial crisis. The Act provides that the Authority shall have certain financial and oversight functions. The Authority had the power to issue bonds to grant or lend the proceeds thereof to the City. Such power to issue debt for such purposes has expired; however, the Authority remains authorized under the Act to issue refunding bonds and grant or lend the proceeds to the City.

The Authority also has the power, in its oversight capacity, to exercise certain advisory and review powers with respect to the City's financial affairs, including the power to review and approve five-year financial plans prepared at least annually by the City. The City's original Financial Plan, which covered fiscal years 1992-1996, was prepared by the Mayor, approved by City Council on April 29, 1992 and approved by the Authority on May 18, 1992, The Authority has

approved fourteen subsequent Financial Plans including most recently the Financial Plan for Fiscal Years 2007-2011.

Q. SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS.

A. I served as Chief Financial Officer of the Commonwealth of Pennsylvania from 2004 to 2005. From 2000 to 2004, I served as Budget Director for the City of Philadelphia, where I had also been a deputy budget director and an assistant budget director. Before working for the City, I served as a Senior Financial Analyst for PICA, a Research Associate at the Pennsylvania Economy League and a reporter for the Associated Press.

Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I received a B.A. from the University of Pennsylvania in 1981 and an M.B.A. from the Wharton School of the University of Pennsylvania in 1987.

Q. HAVE YOU EVER TESTIFIED BEFORE ANY REGULATORY AGENCIES?

A. No.

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

A. In the exercise of my responsibilities at PICA and at the City, I have regularly reviewed PGW's own financial data and as well as external reports such as those published by, for example, bond rating agencies related to PGW's financial performance. My staff and I meet at least annually with PGW to review and discuss PGW's financial performance and potential impact on the City budget and five-year plan.

Q. ARE YOU FAMILIAR WITH PGW'S RATE FILING CURRENTLY PENDING BEFORE THE COMMISSION?

A. Yes, in general terms.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to respond to those parties that advocate that City taxpayers should provide the resources to meet PGW's needs to avoid raising customer rates.

Q. ARE YOU FAMILIAR WITH THE TESTIMONY OF OTHER PARTIES IN THIS CASE WHO SUGGEST THAT THE CITY, AS OWNER OF PGW, SHOULD PROVIDE PGW WITH THE RESOURCES NEEDED TO SOLVE ITS PROBLEM?

A. Yes, I have read the testimony of Mr. Lelash.

Q. HOW DO YOU RESPOND?

A. My independent review of the current financial status of the City indicates that Philadelphia simply is not in a position to make the kinds of contributions to PGW discussed in Mr. Lelash's testimony.

A number of PICA's reports, including ones dated July 5, 2006, September 14, 2006, November 2006, and March 6, 2007 identify PGW as one of the most significant risks to the City budget. The nature of that risk posed by PGW to the City budget is that PGW will fail to meet its obligations to the City because of the fragility of PGW's own financial difficulties. Those financial difficulties are the subject of the current proceeding and are referenced in the PICA reports to which I refer.

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 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.

Q. HAS THE CITY ALREADY PROVIDED RESOURCES TO PGW?

A. Yes. The City provided PGW with a loan of $45 million in 2000 in order to ensure that PGW had the ability to pay expenses, including gas purchases, in a timely manner. For the same reason, the City agreed to extend the date on which that loan had to be repaid. The City has further agreed, in every year since 2004 to grant back to PGW the $18 million City payment required by ordinance. Those actions by the City have come at a cost to the City. The City has had to compensate for the loss of $18 million each year, which is part of the reason that the City has reduced crucial funding for agencies that provide key services.

Q. ARE YOU AWARE THAT THE CITY'S FIVE YEAR PLAN DOES NOT INCLUDE RECEIPT OF PGW'S $18 MILLION PAYMENT?

A. Yes, the Plan says that PGW will again make the payment to the City in FY11, if finances permit. The Plan does not, however, include the $18 million in its revenue projections.

One of the reasons PICA has listed PGW as a major risk to the City budget and five year plan is the threat that PGW will be unable to repay the $45 million loan timely. Including the $18 million payment in the City's projections

would simply heighten the risk that the City would not receive the payments that the Plan includes from PGW. Because including those payments in the Plan would make it more likely that the City would miss its revenue projections, PICA Staff believes that it was prudent to exclude them from the Plan

The impact of not receiving the $18 million, of course, would be that the City would have less funding available for other services, which, as discussed above, are already underfunded.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes, it does.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

REBUTTAL TESTIMONY OF

WILLIAM C. MUNTZER

ON BEHALF OF
PHILADELPHIA GAS WORKS

Docket No. R-00061931

May 4, 2007

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

A. My name is William Muntzer. I serve as PGW's Chief of Staff.

Q. HOW LONG HAVE YOU HELD THIS POSITION?

A. I assumed the position of Chief of Staff in January 2005.

Q. WHAT ARE YOUR VARIOUS JOB RESPONSIBILITIES?

A. In my present position I am responsible for overseeing the development and implementation of many of the major components of PGW's Field Operations Initiative including the development and implementation the company's new Mobile system. I am also responsible for all Federal Regulatory activities associated with interstate pipeline transportation and storage.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.

A. I received both my Master's and Bachelor's Degrees in Business from LaSalle University in Philadelphia.

Q. HAVE YOU EVER PROVIDED TESTIMONY TO THIS COMMISSION?

A. Yes, I provided written testimony in the Company's 2002 base rate case (R-00017034), and I submitted written testimony for the Company in prior GCR proceedings.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am responding to the comments and proposals of Hess Corporation witness Randy Magnani concerning PGW's operational rules relating to nominations and imbalances (tolerances, cash outs, penalties and trading), and communications and information exchange between suppliers and PGW. I also respond to Interstate Gas Supply, Inc. witness Vincent Parisi's comments and proposals concerning our

billing system and his proposals for a retail market share threshold process and a wholesale Supplier of Last Resort (SOLR) auction.

Q. WHAT IS YOUR EXPERIENCE WITH GAS CHOICE?

A. In my former role as Director - Corporate Initiatives, I was tasked with coordinating and leading PGW's Gas Choice implementation program.

Q. WHAT ARE HESS'S GENERAL COMMENTS IN THIS PROCEEDING?

A. Mr. Magnani asserts that retail gas competition on PGW's system is low . He attributes this to PGW's operational rules which natural gas suppliers (NGSs) must follow, and PGW's processes for communication with NGSs and for exchanging customer and NGS-specific information with NGSs, which Hess asserts present barriers to entry and growth in the retail gas supply market in PGW's service territory.

I. OPERATIONAL RULES

Q. WHAT OPERATIONAL RULES DOES HESS IDENTIFY AS PRESENTING PROBLEMS FOR SUPPLIERS?

A. Mr. Magnani identifies these basic areas: (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 cash outs for firm transportation customers for annual imbalances; and (4) tools that should be available to NGSs to mitigate the impact of the cash out process on customer rates.

Q. WHAT ARE HESS'S SPECIFIC COMMENTS AND PROPOSALS CONCERNING PGW'S NOMINATION RULES?

A. Hess asserts that PGW's 12:00 p.m. deadline for day-ahead nominations puts NGSs at a disadvantage because upstream pipeline contracts may still be provided to NGSs for nomination before the pipeline nomination deadlines of 12:30 p.m., so PGW's deadline should be extended to at least 2:00 p.m. Hess argues that a later deadline will reduce the potential for nomination errors that may result in penalties and higher prices to customers, and that may reduce PGW's risks associated with covering short term supply imbalances on its system. Hess also suggests that PGW should accept retroactive nominations when a pipeline has confirmed that it has issued one, especially when the retroactive nomination is the result of a simple or unintentional error or a disruption in supply beyond the control of the NGS.

Q. WHAT IS YOUR RESPONSE?

A. I disagree that PGW's 12:00 p.m. deadline may put NGSs at a disadvantage in view of the pipeline nomination deadlines of 12:30 p.m. If Hess's contention is that they require an additional half hour to get their calculations in order, the Company will gladly entertain that request. Now that the Company has some operational experience with Gas Choice, it believes that it can extend the deadline to 12:30 p.m. without unduly jeopardizing the safety and reliability of our system. However, we cannot agree to extend our deadline further or accept retroactive nominations even if confirmed by the pipelines to permit NGSs to clean up their mistakes, for several reasons. We do not doubt that Hess's intentions are pure and that errors may be caused unintentionally due to many reasons, including understaffing or lack of customer expertise, but we cannot anticipate NGS or

customer mistakes – whether intentional or unintentional. Attempting to do so would put us in a position where we are required to make subjective judgments about NGS or customer business activities, and our actions could be perceived as arbitrary or providing favoritism. Extending our deadline to equal the pipelines' deadline will provide a rule that removes a *potential* disadvantage to NGSs, treats all suppliers equally under all circumstances, and does not put PGW in a position where it is required to pass judgment on NGS actions or decisions. Also, PGW currently allows intra day nominations on a best efforts basis, a process that suppliers can use to address these concerns.

Q. WHAT ARE HESS'S SPECIFIC COMMENTS AND PROPOSALS CONCERNING BALANCING AND RECONCILIATION OF NGS DELIVERIES AND CONSUMPTION BY NGS INTERRUPTIBLE CUSTOMERS?

A. Mr. Magnani asserts that PGW's daily balancing requirements for interruptible customers should be replaced with a purely monthly balanced program so that, instead of cashing out NGSs on a daily basis (when the imbalance exceeds the 5% daily tolerance) and at the end of the month (when the monthly imbalance exceeds the 2.5% tolerance), there is a reconciliation of deliveries and consumption only at the end of the month. He argues that these tolerances impose higher levels of performance on NGSs than PGW could be expected to adhere to. He also argues that the cash out rates are too high and should be market based with tiered penalty levels tied to levels of performance tolerances. Finally, Mr. Magnani proposes that if the elimination of daily balancing is demonstrated not to be feasible, the

daily tolerance level and daily imbalance penalty of $0.50 per Dth, as well as the month-end cash out rates, should be changed to market based levels.

Q. IS THE ELIMINATION OF DAILY BALANCING ON PGW'S SYSTEM FEASIBLE?

A. No. The daily balancing requirement and penalties for interruptible customers are necessary for PGW to maintain control and reliability of its system, and to avoid unnecessary LNG withdrawals and excessive storage injections and withdrawals. These costs would then flow to the remaining system customers. PGW's goal in establishing the daily imbalance tolerance and penalties is to create strong incentives to NGSs to accurately nominate and deliver gas supply. To the extent that suppliers fail to deliver natural gas sufficient to satisfy their interruptible customers' needs, PGW's ability to meet its firm and supplier of last resort (SOLR) service customer needs could be threatened. Under deliveries result in PGW having to utilize its scarce storage resources for suppliers when the Company may need the capacity to assure adequate supplies for firm sales customers during design day conditions.

Unlike many other Pennsylvania natural gas distribution companies that are served by multiple pipelines, PGW is served by only two, Texas Eastern Transmission Corporation ("Texas Eastern") and Transcontinental Gas Pipeline Company ("Transco"), in the capacity constrained Southeastern Pennsylvania area. In addition, PGW's gate stations are located on pipeline laterals rather than mainlines, which further constrains deliverability. Because no other pipelines feed this area, PGW has less operational flexibility and can be limited in its

movement of gas supplies across the pipelines by operational flow orders on those pipelines.

Further, PGW is not storage rich and does not own underground storage on its system. For its storage services, PGW contracts with the interstate pipelines. PGW's storage deliverability is approximately one half the daily deliverability quantity as its firm transportation capacity on Texas Eastern and Transco (Pipeline FT Capacity). In a normal winter season (December through March) the Company fully utilizes its Pipeline FT Capacity and storage balancing assets, which represent a significant supply source during the winter and have been structured to maximize the utilization of Pipeline FT Capacity to ensure adequate flexibility to maintain system reliability. As storage levels decline, the maximum quantities of gas deliverable from storage are ratcheted down under the storage contracts. Therefore, it is operationally critical to maintain storage at levels sufficient to meet customer demands not only for design day conditions (meaning a zero degree average temperature day) and days late in the winter that are very cold, but also throughout the year when customer demand exceeds original projections and deliveries.

Pipeline FT Capacity and storage balancing assets operate together to enable PGW to respond rapidly and efficiently to meet fluctuations in customers' firm demand. This coordinated operation of the Company's upstream supply system assets enables PGW to satisfy firm load in the winter and to balance daily unexpected swings in firm load throughout the year.

The problem with Hess's proposal is that it will exacerbate unexpected daily swings in load, which could cause the Company to inefficiently dispatch gas to its own customers resulting in increased GCR costs, and a potential loss of control of its system. The purpose of the daily balancing requirements and penalties is to ensure that deliveries meet expectations and consumption. As Mr. Magnani admits, monthly balancing allows an NGS to be out of balance on any given day. Removal of the daily penalty mechanism would subject PGW to wide swings on its system which would strain the coordinated operation of the Company's upstream supply system assets in a manner not anticipated, to the detriment of firm customers. Removal of the daily balancing requirements means that a supplier could opt to deliver no gas on day 1 and double its delivery on day 2 while remaining in compliance. To take this scenario further, the supplier could elect to deliver any quantity on any day of the month so long as nominations were within the monthly tolerance level. If this were to occur PGW's firm customers will be harmed by inefficiencies associated with unnecessary LNG withdrawals and excessive storage injections and withdrawals.

Q. WHAT IS YOUR RESPONSE TO HESS'S ALTERNATIVE PROPOSAL TO CHANGE THE DAILY TOLERANCE LEVEL, AND TO REDUCE THE DAILY IMBALANCE PENALTY AND MONTH-END CASH OUT RATES TO MARKET BASED LEVELS?

A. This proposal is much more reasonable but PGW believes that the daily balancing tolerance and $0.50 per Dth plus incremental cost penalty are not unreasonable in order to completely assure the reliability of the system. The tolerance and penalty are designed to disincent suppliers from not complying with their obligation to

PGW if it were economically advantageous to use the assets in other markets. They require suppliers to coordinate with their customers. Reducing the daily tolerance level or daily balancing penalty would jeopardize the PGW's control and the reliability of its system, and impose unnecessary costs on firm customers, in the same manner as removing the daily penalty mechanism. In addition, the daily balancing tolerances and penalties are identical to those approved by the PUC for PGW's Transportation Pilot and Restructuring Tariff, as a result of a settlement with all interested parties.

The Company also believes that its month-end cash out rates (above the monthly carry over tolerance of 2.5%) are appropriate. Hess fails to recognize that in order to garner the rewards of providing commodity to customers in the markets it serves, it must adhere to the operational requirements of those systems and assume responsibility for its customers' actions. In order to achieve the discipline necessary to stay within the operational guidelines, suppliers have to devote the resources necessary to accurately forecast consumption themselves or, alternatively, they need to adopt similar penalties to ensure that their customers take a disciplined approach. Hess's argument that suppliers must either (1) incur daily penalties to avoid the monthly cash out or (2) remain, to the best of their ability, within the 5% tolerance and then incur the monthly cash out, is without merit. Again, suppliers should devote the resources necessary to actively manage their nominations in order to ensure that they stay within their monthly thresholds.

Q. WHAT ARE HESS'S SPECIFIC COMMENTS AND PROPOSALS CONCERNING FIRM TRANSPORTATION CUSTOMERS' ANNUAL IMBALANCES?

A. Hess asserts that the cash-out rate is based on the Company's Weighted Average Cost of Gas ("WACOG"), and that the rate lacks transparency because it is not clearly set forth in PGW's retail or supplier tariff. In addition to requesting that the rate be set forth in the supplier tariff, Hess requests that the rate should be set at a market-based rate.

Q. WHAT IS YOUR RESPONSE?

A. The Company is unclear on Hess' assertions regarding annual imbalances because PGW does not impose a cash-out for annual imbalances for firm transportation customers. The Company assumes responsibility for forecasting firm customers' daily load requirements. Additionally, the Company provides suppliers with a pro rata share of pipeline capacity for their firm pool(s). If the forecasted load exceeds the allotted pipeline capacity, the Company loans the supplier the difference from its own contracted interstate pipeline storage service. We only require that the loaned gas be returned to PGW, plus a carrying charge. The Company has elected to use the FERC interest rate since it is readily available to all parties and cannot be manipulated. To provide greater transparency, the Company agrees that this information should be set forth in the supplier tariff.

Q. WHAT ARE HESS'S SPECIFIC COMMENTS AND PROPOSALS CONCERNING MITIGATION TOOLS THAT SUPPLIERS CAN USE TO MINIMIZE THE FINANCIAL IMPACT OF IMBALANCES?

A. Hess identifies two tools – imbalance netting and trading. Imbalance netting occurs when suppliers net the differences between their own customer pools. Imbalance trading occurs between suppliers pools. Hess asserts that these services are available on many gas distribution systems. Mr. Magnani argues that

imbalance netting and trading are appropriate because the gas has already been delivered and consumed, and thus will have no net impact on PGW or its system reliability. Hess asserts that if executed perfectly, only suppliers that were out of balance on the same side as the overall system imbalance would pay imbalanced penalties. Hess proposes that our supplier tariff be amended to permit imbalance trading between suppliers and between their pools.

Q. WHAT IS YOUR RESPONSE?

A. PGW does not have automated systems in place to facilitate such complex netting and trading arrangements. Such a system would take several months to design, develop, test and implement, and could cost several hundred thousand dollars to complete. Funding for such a system was not contemplated in the Company's rate filing. Preliminary investigation indicates that this would require modifications to several existing systems. Finally, the costs cannot be ascertained until the Company defines all the business rules.

Finally, if this service is put into place, it should be limited to netting and trading for similar pools only (i.e. Firm to Firm, or Interruptible to Interruptible). Otherwise, this service would allow suppliers to game the system by moving gas to whichever pool presented the lowest penalty. Aside from gas being cut by suppliers, the firm pool delivery requirement is fairly straightforward. The supplier is responsible only for delivering a fixed amount each day during the month to the city gate. Because PGW would deny a nomination in excess of that amount, suppliers could only experience a shortfall on firm deliveries, and therefore there would be no corresponding excess with which to trade. For that

reason, it appears to make sense to allow such netting and trading for Interruptible service only.

Regardless of the ease or difficulty involved in developing such a system, Hess fails to demonstrate how such systems benefit the customers.

Q. PLEASE SUMMARIZE YOUR UNDERSTANDING OF HESS'S PROPOSALS CONCERNING PGW'S COMMUNICATIONS AND INFORMATION EXCHANGE PROCESSES.

A. Mr. Magnani argues that there are inadequacies and inefficiencies in the Company's processes for NGSs to obtain customer information and usage data, and customer enrollment.

II. COMMUNICATIONS AND INFORMATION EXCHANGE

Q. WHAT ARE HESS'S COMMENTS CONCERNING COMMUNICATION AND CUSTOMER INFORMATION EXCHANGE BETWEEN SUPPLIERS AND THE COMPANY?

A. Mr. Magnani asserts that PGW does not have an automated Electric Data Interchange ("EDI") system or any other automated systems to handle the exchange of customer-related information, such as customer usage, account numbers and meter information. Mr. Magnani states that because of this, suppliers must obtain this information directly from customers and that this is unduly administratively burdensome and often produced inaccurate information. Hess argues that PGW should provide a consistent, transparent and straightforward process by which suppliers can obtain customer-related information, preferably in an automated format.

Q. ARE HESS'S COMMENTS ACCURATE?

straightforward process by which suppliers can obtain customer-related information, preferably in an automated format.

Q. ARE HESS'S COMMENTS ACCURATE?

A. No. Mr. Magnani's comments are incorrect. His claims that PGW does not have EDI or any other automated systems is incorrect on two levels. PGW has an XML based system that uses EDI standards for its transactions. XML exceeds the capabilities of EDI and is considered cutting edge technology. XML provides a greater level of flexibility and is therefore purported to replace the now 20 year old EDI technology. However, PGW does not use its XML system for providing marketing information because it is simply not the appropriate mechanism for sending a Marketing File, which contains 12 months usage data which we prepare and provide quarterly to all approved suppliers. It seems as if Hess wants a different tool developed, whereby it could automatically request specific customer usage information at will electronically. However, because of customer privacy issues and the fact that this would require an entirely new system with associated security concerns, we cannot entertain Hess's proposal.

It should be noted that the Company does provide the suppliers with a quarterly Marketing file for all customers that have elected to participate in Gas Choice as mandated by PUC regulations. There is no reason why the suppliers cannot develop their own tools to perform search operations from this database.

The Company suspects that ~~the~~ Hess is encountering one of two problems. First, they may be marketing to customers that chose not to participate in Gas Choice. Therefore, these customers' information would not be included in the

request 12 months usage history once per year at no charge and share it with the supplier. Alternatively, a customer can change its Release Of Information (ROI) status simply by calling the company. The Company acknowledges that simply changing the customer's ROI status still requires the supplier to wait for the next available quarterly Marketing File. Therefore, instead of developing an entirely new system, the Company can agree to increase the frequency of the Marketing File run from quarterly to monthly to cut down on the time suppliers must wait for updated customer authorizations for release of their information.

Q. WHAT ARE HESS'S SPECIFIC COMMENTS AND PROPOSALS CONCERNING CUSTOMER ENROLLMENTS

A. Mr. Magnani correctly states that currently, customer enrollment is done by manual data entry by the 15th of the month. But Hess complains that if a supplier has initially met the deadline, there is no flexibility beyond the 15th to correct even minor errors which Hess asserts are the natural result of a manual process. Hess argues that in given the lack of an automated EDI process, flexibility must be provided within the enrollment rules to permit suppliers who have initially met the enrollment deadline to correct at least minor errors.

Q. WHAT IS YOUR RESPONSE?

A. A correction must be made to Mr. Magnani's assertions regarding manual processes. Suppliers are not limited to manual data entry to create an enrollment file. The Company has provided a front end tool to suppliers to assist them with the creation of enrollment files in the event that they lack the skills or expertise necessary to create the file automatically in the format required by PGW's systems. Hess has already generated and prepared its own bulk files, without

using PGW's front end application, and has successfully uploaded them to PGW's EBB. Lack of a vehicle for transporting files is not the issue.

On the surface, Hess's proposal to modify the date appears to be a small thing, but it is not. To maintain system integrity, we cannot permit changes to go into effect on the 16th of the month. Also, we would need to determine the cost for this requested change. Our Gas Choice system is actually comprised of a series of complex systems that were developed over several years specifically to meet the requirements of the Gas Choice and Competition Act, and this work was completed at great expense to the ratepayers. Examples of changes that would be need to implement Hess's proposal include coding changes to set up multiple tables for pending enrollments within the BCCS system because customers enrolled up to close of business on the 15th of the month are processed and then cleared. Customers enrolled on the 16th would need to have a new table because records for the previous month cannot be processed as a result of the one day lag. Hess's proposal would also require changes in the Transaction Management System, staging tables, etc.

Suppliers must be diligent about the enrollment information provided to the Company. Another alternative currently available to all suppliers is to submit enrollments by the 14th of the month instead of waiting until the last possible day. This provides another day for suppliers to correct their mistakes.

In order to address Hess's concerns, the Company is prepared to provide multiple opportunities on the 15th for suppliers to fix their mistakes by running the enrollment processing jobs at 10:00 a.m. and 12:00 p.m. PGW's rejection or

In order to address Hess's concerns, the Company is prepared to provide multiple opportunities on the 15th for suppliers to fix their mistakes by running the enrollment processing jobs at 10:00 a.m. and 12:00 p.m. PGW's rejection or acceptance is virtually instantaneous. Our final run would be made at close of business, after which no additional revisions could be made.

Q. DO YOU HAVE ANY COMMENTS ON ANY OTHER PORTION OF MR. MAGNANI'S TESTIMONY?

A. Yes. We agree with Mr. Magnani's comments that it is important for retail competition to grow in PGW's service territory, and we believe the Company's policies and practices reflect that agreement and the Company's commitment to retail competition.

III. BILLING SYSTEM AND AUCTION PROPOSALS

Q. PLEASE SUMMARIZE YOUR UNDERSTANDING OF IGS'S COMMENTS CONCERNING PGW'S BILLING SYSTEM.

A. Mr. Parisi acknowledges that PGW's financial position does not permit PGW to make the ~~charges~~ changes in its billing system that he believes are necessary to enable retail competition to develop, such as the ability to handle multiple rates. Mr. Parisi asserts that suppliers are unwilling to enter PGW's market and invest the money to bill their own customers. Mr. Parisi concludes that PGW is unable or unwilling to invest in modifications to its billing system because PGW sees no direct return from that investment, and that the current state of PGW's billing system is unacceptable.

Q. WHAT IS YOUR RESPONSE?

understanding is that Section 2205(c) of the Gas Competition Act provides that gas utilities may, at their election, provide billing for suppliers, and that PGW's tariff provides for utility bill ready consolidated billing. It is also my understanding that Section 2205(c)(3) provides that incremental billing costs for billing services rendered by the utility at its election on behalf of suppliers may be recovered thru fees charged to the suppliers, and that this subsection does not authorize recovery of these costs from the utility's supply customers. Finally, many suppliers prefer to render their own bills.

That said, the Company is currently exploring a new billing system for implementation in approximately 2010, and we are considering one that would be able to do rate ready consolidated billing. Our current BCCS system cannot do so, without great reprogramming expense and modifications to various interfaces. The exploratory costs alone to determine pricing to accomplish this reprogramming and interface work will be very expensive. On the surface, it appears imprudent to make expensive modifications to major systems that are slated to be replaced, especially since no existing suppliers or customers have expressed any interest in such a billing arrangement.

Q. DOES MR. PARISI HAVE ANY OTHER COMMENTS CONCERNING DEVELOPMENT OF COMPETITION ON PGW'S SYSTEM?

A. Yes. Interstate Gas Supply supports our proposal to use the revenue from off-system sales and capacity release to fund distribution system improvements, and acknowledges that our proposal provides value to all customers without creating an inequity between customer groups. Mr. Parisi also has two recommendations

A. Yes. Interstate Gas Supply supports our proposal to use the revenue from off-system sales and capacity release to fund distribution system improvements, and acknowledges that our proposal provides value to all customers without creating an inequity between customer groups. Mr. Parisi also has two recommendations that he believes would begin to develop retail competition. First, he proposes a market share threshold (MST) type of process as used on PECO's electric system and, after meaningful retail competition develops (he cites 30% customer shopping), implementing a Dominion East Ohio (DEO) model where the Company's SOLR obligation is auctioned off to suppliers.

But Mr. Parisi argues that before an MST process can be implemented, the Company must be required to spend the money to make its billing system, in his view, workable for choice, and be permitted to recover that money.

Q. WHAT IS YOUR RESPONSE?

A. I commend Mr. Parisi for recognizing the merit in our off-system sales and capacity release revenue proposal and supporting it. However, we have a number of concerns with his retail and wholesale auction proposals. Practically and realistically, the Company simply cannot do the billing that would be required for such a program, and it would be very expensive to get the Company's systems in a position to do it. As stated above, the Company is currently exploring a new billing system for implementation in approximately 2010. As the condition precedent under ~~Hess's~~ IGS's proposal is improving the billing system, ~~Hess's~~ IGS's proposal should be rejected for this reason alone. In addition, there are a host of Chapter 56 customer service billing and supplier/utility interaction issues with this type of

try this first before it is considered for PGW. These same concerns would also apply to any experiment involving auctioning the SOLR obligation.

Q. MR. PARISI ARGUES THAT SECTIONS 7.5 AND 4.1 OF THE SUPPLIER TARIFF ARE "OPEN-ENDED", "ONE-SIDED" OR "POTENTIALLY COSTLY" PROVISIONS THAT ARE IMPEDING COMPETITION. DO YOU AGREE?

A. Absolutely not. First, Section 7.5 simply requires the supplier to enter into a Firm Pooling Agreement. The Agreement contained in the back of the tariff simply identifies the parties, requires that they agree to follow the rules of the tariff, identifies the applicable state law, etc. It is not a cumbersome agreement to comprehend. The Company's discretion to revise the terms and conditions of the Agreement is circumscribed by a supplier's right to complain to the PUC. Also, as IGS has not been a supplier on PGW's system and does not identify any concerns with any particular provision of the Agreement, Mr. Parisi's criticism lacks substance.

Section 4.1 requires the supplier to fill out an application form and provides that the Company is the sole judge of the supplier's ability to safely and reliably serve the Company's customers. Make no mistake about it, as described above, PGW is loaning the suppliers gas during the winter and expecting the commodity to be returned in the summer. This gas could be worth millions of dollars. Absent a good credit history, followed by the appropriate financial surety, PGW would be doing its ratepayers and its stakeholders a great disservice if it did not vigilantly vet the applicants to protect the Company's financial interests. Moreover, my understanding is that Section 2205(a) of the Gas Competition Act

places the obligation on the utility to maintain the integrity of its system to ensure safe and reliable service to its customers, and also requires the utility to implement rules and procedures to carry out this obligation. Section 4.1 is fully consistent with the Company's authority and duty under the Act and, as with the Firm Pooling Agreement, Mr. Parisi does not identify any particular problem with the application.

These administrative provisions cannot possibly be construed as impeding competition or serving as a barrier to entry.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

R-00061931

PGW STATEMENT 11 - RJ

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Muntzer Oral Rejoinder

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

A. My name is William Muntzer. I serve as PGW's Chief of Staff.

Q. HAVE YOU PROVIDED TESTIMONY IN THIS CASE?

A. Yes. I provided rebuttal testimony (PGW St. 11) to respond to comments and proposals of Hess Corporation witness Randy Magnani concerning PGW's operational rules relating to nominations and imbalances, and communications and information exchange between suppliers and PGW. My rebuttal testimony also responded to Interstate Gas Supply, Inc. witness Vincent Parisi's comments and proposals concerning the Company's billing system, a retail market share threshold process, a wholesale Supplier of Last Resort (SOLR) auction, and supplier tariff issues.

Q. HAVE YOU REVIEWED MR. MAGNANI'S SURREBUTTAL TESTIMONY?

A. Yes.

Q. DO YOU HAVE A RESPONSE TO MR. MAGNANI'S POSITION THAT THE COMPANY'S WILLINGNESS TO EXTEND THE DEADLINE FOR DAY-AHEAD NOMINATIONS FROM 12 NOON TO 12:30 P.M. IS NOT ADEQUATE BECAUSE THAT STILL WOULD NOT PERMIT HESS TO NOMINATE GAS PURSUANT TO INTERSTATE PIPELINE CONTRACTS THAT ARE FINALIZED BY THE 12:30 PIPELINE DEADLINE?

A. Yes. First of all, the interstate pipeline nomination deadline per NAESB standards is 12 noon, the same as PGW's. Second, the Company does make exceptions and permits adjustments before the 4 p.m. end of gas day on a case by case basis when it won't adversely affect operations, and we have done so on several occasions for Hess.

Further, Mr. Magnani, suggests that they may be disadvantaged because "we may not be able to fully utilize the breadth of available gas contracts being traded on the pipelines". This statement alone indicates that the Hess may simply want additional time

to maximize profitability by seeking out the best possible deals in the market. While PGW appreciates Hess' desire to maximize profitability in the market, we cannot assume the administrative burden, on a mandatory basis, of allowing such late nominations. PGW will continue to accommodate the suppliers for such late nominations on a case by case basis when it won't adversely affect operations.

Q. MR. MAGNANI STATES THAT A LATER DEADLINE WOULD ALSO PERMIT CORRECTIONS OF NOMINATION ERRORS, ESPECIALLY THOSE THAT ARE CLEARLY INNOCENT MISTAKES AND NOT MEANT TO CREATE ARTIFICIAL ADVANTAGE FOR THE SUPPLIER. WHAT IS YOUR RESPONSE?

A. The Company also permits adjustments for these types of errors on a case by case basis when it won't adversely affect operations. We have allowed Hess to make these types of corrections in the past. However, the Company should not be required to accept such corrections on a mandatory basis.

Q. MR. MAGNANI ASSERTS THAT THE COMPANY SHOULD BE REQUIRED TO ACCEPT RETROACTIVE NOMINATIONS AUTHORIZED BY THE INTERSTATE PIPELINES "FOR SYMMETRY AND TO GIVE PRACTICAL EFFECT" TO THE PIPELINES' ACTION. DO YOU AGREE?

A. No. The concerns of an LDC go beyond simply accounting for the supplies used on its system, and accounting for retroactive nominations is not a "simple" accounting matter . All of the spreadsheets generated to track and account for the gas used on the system would have to be recast, which imposes additional administrative costs and burdens on the Company. Additionally, this activity would have to be allowed for all suppliers on the system, not just Hess. This activity would be burdensome if only one or two suppliers were involved, and it would become very much more burdensome if more suppliers serving more customers were involved. The Company should not be required to accept retroactive nominations authorized by the interstate pipelines simply to provide

symmetry or to give practical effect to a pipeline's acceptance of retroactive nominations. The Company should be permitted to continue its current practice of permitting nomination adjustments and correction of nomination errors when doing so won't adversely affect operations.

Q. MR. MAGNANI DISAGREES THAT THE DAILY TOLERANCE BAND AND PENALTIES ACT AS AN INCENTIVE FOR SUPPLIERS TO DELIVER THEIR CUSTOMERS REQUIRED VOLUMES DAILY AND AS A DISINCENTIVE TO SUPPLIER MISBEHAVIOR, AND THAT WIDENING THE TOLERANCE BANDS AND REDUCING THE PENALTIES WILL NOT REDUCE THE COMPANY'S CONTROL OVER THE RELIABILITY OF ITS SYSTEM OR IMPOSE ADDITIONAL AND UNNECESSARY COSTS ON GCR CUSTOMERS, BECAUSE THE DIFFERENCE IN SUPPLIERS' DAILY DELIVERIES UNDER A WIDENED TOLERANCE BAND WOULD BE VERY SMALL. WHAT IS YOUR RESPONSE?

A. Hess's incentive/disincentive argument is based on the assertion that suppliers cannot forecast more accurately than they do now. This assertion is contrary to a fundamental principle of competition that competitive suppliers bring expertise and economies of scale to the supply function to provide benefits to their customers. While the difference in one supplier's daily deliveries is small under Hess's hypothetical where the daily tolerance band is increased from 5% to 10%, this simple hypothetical does not extrapolate the increased daily swing that would result as IT competitive supply grows and there are more suppliers serving more customers. More important, this hypothetical does not account for a second tier of increased costs from the use LNG and storage to balance the increased daily swings.

Q. MR. MAGNANI ASSERTS THAT PGW DOES NOT NEED SOPHISTICATED SYSTEMS TO MANAGE IMBALANCE TRADING AND NETTING BECAUSE THE TRANSACTIONS WOULD BE HANDLED BETWEEN SUPPLIERS OUTSIDE THE PGW SYSTEM AND THE TRADED VOLUMES SIMPLY REPORTED INDEPENDENTLY TO PGW BY THE SUPPLIERS, AND WOULD

HAVE NO ADVERSE IMPACT ON THE COMPANY OR ITS GCR CUSTOMERS. WHAT IS YOUR RESPONSE?

A. First of all, Hess doesn't distinguish between IT and firm customers. Delivering the forecasted volumes for firm Gas Choice customers shouldn't be a problem because the Company tells the supplier how much gas to deliver. The only time the supplier has an imbalance is when it fails to deliver its Daily Delivery Quantity (DDQ). Gas usage by the customers above planned levels do not constitute an imbalance, it simply means that gas is loaned to the supplier by the Company and is later replenished.

All IT customers have daily reads, and those customers are placed into pools. The pool serves to mitigate imbalances to some degree because some customers will be over, while others will be under planned usage. Even if the proposed trading activity is handled outside PGW, making adjustments for the reported volumes would require the Company to go back after the fact and change pool records. An entire accounting tier would have to be added since the imbalances resulting from the nominations and metered usage for the pools would no longer match. For auditing purposes, the initial imbalance would have to be available plus the gas trades would have to be recorded. Additionally, PGW's Supplier Billing function would have to be rewritten since the imbalances, which are calculated in the New Energy Retail Office (NERO) program, are automatically passed to the BCCS billing system which handles all of the billing functions and populates the Oracle financial systems. This additional functionality would inherently add costs from both a systems and labor perspective. Also, trading between IT and firm supply pools would be extremely difficult since interruptible customers are read daily while firm customers are read monthly on a cycle basis and span calendar months.

Finally, under the Hess hypothetical for netting and trading, the Company would have used LNG or off system storage to replace the undelivered volumes, and may have been required to store the over delivered volumes because we would not know, on a daily basis, what volumes would be traded or netted after the fact.

Q. WHAT IS YOUR RESPONSE TO MR. MAGNANI'S SUGGESTION THAT PROVIDING CUSTOMER DATA UPON REQUEST, RATHER THAN QUARTERLY OR EVEN MONTHLY THROUGH THE MARKETING FILE, WOULD NOT REQUIRE ADDITIONAL SYSTEMS OR IMPOSE ADDITIONAL COSTS?

A. Hess underestimates the time and resources that would be required for PGW to provide such information upon request, and does not acknowledge that the system currently in place can accommodate its needs. First, the Company currently provides, in accordance with PUC regulations, a quarterly file containing all of the customers that have elected to participate in the Gas Choice Program. Due to the size of the file, it has been broken down into separate parts: Residential, Commercial and Industrial. Processing currently takes approximately 16 hours, 8 hours and 3 minutes, respectively.

Second, the Company also currently provides customer information to customers or their authorized agents once per year for free. Subsequent requests within the year require a nominal fee. Suppliers may serve as an Agent of the customer provided that the customer authorizes the release of information on its company letterhead.

Hess indicates that providing the Suppliers customer information upon request would not cost the Company anything. I think that it is important to explain the current process. The Company is operating a 10 year old billing system. In order to provide customer information to a supplier, a contact person must receive the request. That

person looks up the account and performs a "Print Screen" function in order to capture the information. The employee then pastes the picture of the screen into a Microsoft Word document, hand writes an envelope and mails it to the requesting customer. As you can see, this is a manual process. The Company expected the suppliers to use the Marketing File to make their own systems to extract the information.

Hess may not realize that they are requesting a system, but they are because none currently exists. To get the latest and greatest up-to-date information, the Company would have to run the Marketing Files every night. As mentioned earlier, this is a huge processing issue (24 hours and 3 minutes). Hess indicates that it would be no big deal to simply put the information into an Excel file and e-mail it to a supplier. In reality, such a commitment is a huge undertaking because it does not solve any of the administrative issues identified in the current process. The only change is that instead of pasting the picture of the information into a Word file, it would now be pasted into an Excel document. Also, instead of PGW providing this information only to customers that have a legitimate billing question or genuinely want to participate in Gas Choice, we would now be providing the information to suppliers' field representatives for every possible lead that they may want to explore. If we assume that a service territory as large as Philadelphia may attract 5 to 10 suppliers and each supplier has 10 field representatives and that each requests information for 5 customers per day, we could potentially receive 500 requests per day for information. The Company would be forced to incur huge labor costs or alternatively build a system that allows the suppliers to query the Marketing File. Either way, the Company would incur additional costs. In reality, the suppliers should be

developing their own tools and using their own resources to mine the information that the Company is already providing for them.

Q. DOES THIS COMPLETE YOUR REJOINDER TESTIMONY?

A. Yes.

OTS Statement No. 3
Witness: Joseph Kubas

5/21/07 hrg
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PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

Direct Testimony

of

Joseph Kubas

Office of Trial Staff

Concerning:

Revenue
Cost of Gas Expense
Cost of Service Issues
Rate Structure

Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?

A. My name is Joseph Kubas and my business address is Pennsylvania Public Utility Commission, P. O. Box 3265, Harrisburg, PA 17105-3265.

Q. IN WHAT CAPACITY ARE YOU EMPLOYED?

A. I am employed as a Fixed Utility Valuation Engineer with the Office of Trial Staff.

Q. WHAT IS YOUR EDUCATIONAL AND EMPLOYMENT EXPERIENCE?

A. An outline of my education and employment experience is attached as Appendix A.

Q. PLEASE DESCRIBE THE ROLE OF OTS IN RATE PROCEEDINGS.

A. OTS was established by the legislature and is responsible for protecting the public interest in rate proceedings. The OTS analysis in this proceeding is based on its responsibility to represent the public interest. This responsibility requires the balancing of the interests of ratepayers and the Company.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. The purpose of my direct testimony is to address the present rate revenues claims, cost of service study, and proposed rates related to Philadelphia Gas Works' (PGW or Company) request for $100,000,000 in additional annual revenue filed December 22, 2006.

Q. WHAT IS A TEST YEAR?

A. A test year is a specific 12-month period, set by regulation, which utilities use as the basis for operating statements that demonstrate their need for rate increases.[1] The operating statements may be based on historic data, or on a combination of historic and forecasted data. When the statements are based on historic data, the test year is considered to be a "historic test year." The period ending date of a historic test year may be no more than 120 days from the date that the rate case is filed. A "future test year" constitutes the 12 –month period immediately following the historic test year period. During the course of proceedings, utilities must submit the results of their actual experience in the future test year for each quarter starting with the day following the end of the required experienced 12-month period. A utility can elect either as the basis for setting rates.

Q. WHAT IS PGW'S CLAIMED TEST YEAR IN THIS PROCEEDING?

A. In this proceeding, the Company has selected a future test year ending August 31, 2007.

[1] Pa. Code § 53.52. (b)(2) and Pa. Code § 53.56. (a).

Q. WHAT IS PGW'S CLAIM FOR PRESENT RATE REVENUES FOR THE TEST YEAR ENDING AUGUST 31, 2007?

A. PGW has claimed that it will receive $970,654,000 in present rate revenues including transportation and miscellaneous revenue (PGW Volume IV, Part 2 of 2, Sch. III. A. 17).

Q. IS THIS $970,654,000 BASED ON A PROJECTED NUMBER OF CUSTOMERS AND PROJECTED SALES VOLUMES?

A. Yes. The Company projected the number of customers and projected normalized sales volumes by class to arrive at the $970,654,000 in total present rate revenue. The proper number of customers and sales volumes is critical in the determination of present and proposed revenue. A breakdown by customer class is shown on PGW Ex. HSG-6S which shows present tariff rate revenue of $1,044,127,000 before the Senior Citizen Discount (SCD) and other adjustments.

PRESENT RATE REVENUE

Q. HOW MANY RESIDENTIAL HEATING CUSTOMERS IS THE COMPANY PROJECTING FOR THE FUTURE TEST YEAR ENDING AUGUST 31, 2007?

A. The Company is reflecting 414,433 (369,201 tariff and 45,232 SCD) residential heating customers at present rates (PGW Ex. HSG-6S).

Q. WHAT IS THE MOST RECENT TWELVE MONTH PERIOD IN WHICH ACTUAL NUMBER OF CUSTOMERS AND NORMALIZED SALES ARE KNOWN?

A. The most recent 12-month period, in which the actual number of customers and normalized sales are known, is calendar year 2006. Calendar year customer data was also used in the Company's last base rate case (OTS Ex. No. 3, Sch. 2, p. 3). Therefore, in order to be consistent with the Company and what was done in the last base rate case, I will project the number of customers for the calendar year ending December 31, 2007 in this case.

Q. HOW MANY RESIDENTIAL HEATING CUSTOMERS DID THE COMPANY ACTUALLY HAVE IN 2006?

A. The Company's response to OTS-RE-17 indicates that for the twelve months ending December 31, 2006, the Company had an average of 419,977 residential heating customers (OTS Ex. No. 3, Sch. 1, p. 2).

Q. WHAT IS THE DIFFERENCE BETWEEN THE ACTUAL NUMBER OF RESIDENTIAL HEATING CUSTOMERS FOR THE YEAR ENDING DECEMBER 31, 2006 AND THE COMPANY'S PROJECTED NUMBER OF RESIDENTIAL HEATING CUSTOMERS AT THE END OF 2007?

A. The difference between the 419,977 actual residential heating customers and the 414,433 projected number of residential heating customers is 5,544 (419,977 - 414,433) residential heating customers.

Q. WHAT REASON DOES THE COMPANY GIVE FOR THE DROP IN THE NUMBER OF RESIDENTIAL HEATING CUSTOMERS?

A. The Company claims that it has lost residential heating customers in past years, and will continue to lose residential heating customer in the future as its support for reflecting fewer residential heating customers in 2007 compared to 2006 (PGW St. 5, p. 5). No specific analysis was provided in the filing for the projected loss of

5,544 residential heating customers between December 2006 and December 2007.

Q. DO YOU AGREE WITH THE COMPANY'S PROJECTED LOSS OF 5,544 RESIDENTIAL HEATING CUSTOMERS?

A. No. While I do recognize the Company is likely to lose residential heating customers, I do not believe the Company will lose 5,544 residential heating customers in 2007.

Q. HOW MANY RESIDENTIAL HEATING CUSTOMERS DO YOU BELIEVE THE COMPANY WILL LOSE IN 2007?

A. I believe that a more reasonable estimate would be for the Company to lose 1,794 residential heating customers in 2007.

Q. HOW DID YOU DETERMINE THAT IT IS MORE LIKELY THAT THE COMPANY WILL LOSE 1,794 RESIDENTIAL HEATING CUSTOMERS IN 2007?

A. The estimate is based on the actual five-year average loss of residential heating customers. In the last base rate case, the Company had 428,946 residential and SCD customers in the year ending December 31, 2001 (OTS Ex. No. 3, Sch. 2, p. 2-3). Comparing this 428,946 with the actual number of residential heating customers for

the year ending December 31, 2006, shown on the Company's response to OTS-17, indicates that the Company lost an average of 1,794 residential heating customers per year during that five-year period (OTS Ex. No. 3, Sch. 2, p. 1).

Q. WHY DID YOU SELECT A FIVE-YEAR PERIOD TO DETERMINE THE AVERAGE LOSS OF RESIDENTIAL HEATING CUSTOMERS?

A. The actual number of residential heating customers was known at the time of the Company's last base rate case in 2001, which was five years ago. I believe a five-year average is long enough to smooth out any short term variations as a result of the Company's collection and termination efforts and the enactment of new Chapter 56 regulations governing terminations.

Q. HOW MANY RESIDENTIAL HEATING CUSTOMERS DO YOU RECOMMEND THE COMPANY REFLECT AT PRESENT RATES?

A. I recommend that the Company reflect 418,183 residential heating customers at present rates. This 418,183 is 3,750 more customers than is reflected on PGW Ex. HSG-6S (OTS Ex. No. 3, Sch. 3, line 1). The 418,183 total residential heating customers, that I recommend, reflects a loss of 1,794 residential heating customers for the year ending December 31, 2007.

Q. WHAT LEVEL OF CUSTOMER CHARGE REVENUE WILL THESE 3,750 RESIDENTIAL HEATING CUSTOMERS PRODUCE AT PRESENT RATES?

A. These 3,750 residential heating customers that I determined will remain on the system will produce $540,000 in customer charge revenue at present rates (OTS Ex. No. 3, Sch. 3, line 11, column C).

Q. HOW MUCH USAGE REVENUE WILL THESE 3,750 RESIDENTIAL HEATING CUSTOMERS PRODUCE AT PRESENT RATES?

A. Assuming the average residential heating customer uses 89.3 Mcf per year as claimed by the Company, these 3,750 residential heating customers will produce an additional $5,956,600 in usage revenue at present rates (OTS Ex. No. 3, Sch. 3, line 9, column C).

Q. WHAT IS THE TOTAL AFFECT OF YOUR RECOMMENDATION ON PRESENT RATE REVENUE FROM RESIDENTIAL HEATING REVENUE?

A. My recommendation not to decrease the number of residential heating customers as much as the Company has projected results in $6,496,600 additional revenue at present rates (OTS Ex. No. 3, Sch. 3, line 13, column C).

Q. DID THE COMMISSION REJECT THE COMPANY'S USE OF BUDGETED PROJECTED LEVEL OF CUSTOMERS IN THE COMPANY'S LAST BASE RATE CASE?

A. Yes. The Commission rejected the use of the Company's budgeted customer numbers and sales volumes to determine present rate revenues in the Company's last base rate case at Docket No. R-00006042, Order entered October 4, 2001, p. 48.

Q. WHAT DID THE COMMISSION ACCEPT?

A. The Commission accepted my recommendation to use actual customer count levels based on actual data to determine the projected number of customers in the Company's last base rate case at Docket No. R-00006042, Order entered October 4, 2001, p. 48.

COST OF GAS EXPENSE

Q. DOES INCREASING THE NUMBER OF RESIDENTIAL HEATING CUSTOMERS OVER THE LEVEL THE COMPANY IS REFLECTING INCREASE THE COST OF GAS?

A. Yes. My recommendation to reflect 418,183 residential heating customers requires that the quantity of purchased gas reflected in the filing be increased by 334,875 Mcf.

Q. WHAT IS THE COST OF THIS ADDITIONAL 334,875 MCF OF GAS?

A. Purchasing the 334,875 Mcf will increase the cost of gas reflected in the filing by $3,673,900 (OTS Ex. No. 3, Sch. 3, line 15, column C).

Q. WHAT IS THE EFFECT ON NET INCOME BEFORE INTEREST AND SURPLUS AFTER REFLECTING 418,183 RESIDENTIAL HEATING CUSTOMERS AND PURCHASING 334,875 MDF OF GAS?

A. Net Income before interest and surplus increases by $2,822,700 ($6,496,600 - $3,673,900).

COST OF SERVICE

Q. WHAT IS THE PURPOSE OF A COST OF SERVICE STUDY?

A: A cost of service study is an analysis of costs which attempts to assign to each customer or rate class its proportionate share of the Company's total cost of service (i.e., the Company's total revenue requirement). The results of these studies can be utilized to determine the relative cost of service for each class and to help determine the individual class revenue requirements and show the subsidy each class receives or contributes to the Company's overall net income. In addition to the actual subsidy, a relative rate of return is also provided to show how the rate of return for each class compares to the system average rate of return.

Q. DID THE COMPANY PROVIDE A COST OF SERVICE STUDY IN THIS BASE RATE CASE?

A. Yes. The Company provided a cost of service study in PGW Volume II (PGW Ex. HSG-1-8).

Q. DO YOU AGREE WITH THE RESULTS OF PGW'S COST OF SERVICE STUDY?

A. No, I do not.

Q. WHY DO YOU DISAGREE WITH THE RESULTS OF PGW'S COST OF SERVICE STUDY?

A. There are two issues that cause me to disagree with the Company's cost of service study. The first issue is the way the Company classified and allocated the cost of distribution mains. The second issue is the way the Company allocated the cost of industrial measuring and regulatory station equipment.

Q. WHAT IS THE FIRST COST OF SERVICE ISSUE YOU WILL ADDRESS?

A. The first issue I will address is the classification and allocation of distribution main costs.

Q. HOW DID THE COMPANY CLASSIFY AND ALLOCATE THE FIXED COST AND DEPRECIATION EXPENSE OF DISTRIBUTION MAINS?

A. PGW classified 25% of the Company's distribution main investment as a customer cost and 75% as demand related (PGW Ex. HSG-3, p. 8, line 43).

Q. IS THIS THE PROPER WAY TO CLASSIFY AND ALLOCATE THE FIXED COST AND DEPRECIATION EXPENSE OF DISTRIBUTION MAINS?

A. No. The Commission has previously determined in a 1994 Opinion and Order in the Pennsylvania-American Water Company case at Docket No. R-00932670, Order entered July 26, 1994, at pages 111-115, that direct customer costs include "the depreciation, return and income taxes associated with meter and service investment, the operation and maintenance expense for meters and services, and the expense associated with meter reading and billing". Mains are not included in any of these categories and therefore should not be considered or classified as a customer cost. The basis for this determination is that the quantity and investment in mains does not change significantly if one customer joins or leaves the system. Mains were built to deliver gas, and the cost of mains cannot be assigned to one specific customer. Therefore, no portion of the fixed costs or depreciation expense associated with mains should be allocated to the customer cost function.

Q. HOW SHOULD THE FIXED COSTS AND DEPRECIATION EXPENSE OF MAINS BE ALLOCATED?

A. In my opinion, the fixed cost and depreciation expense of mains should be allocated on a volumetric basis utilizing the average and excess demand method (A&E method).

Q. WHERE IS THE A&E METHOD DESCRIBED?

A. This accepted method is also described in "Gas Rate Fundamentals, Fourth Edition, by the American Gas Association, copyright 1987, p. 144 - 145".

In this book, the A&E method is described as an allocation method based on the following criteria: 50% of the cost is allocated to the various classes based on the average volume of gas delivered to that class and 50% of the cost is allocated to the various classes based on the peak demand above the system average demand (excess over average). The two are combined to determine the total cost allocated to each class.

Q WHY DO YOU RECOMMEND THAT THE A&E METHOD BE USED TO ALLOCATE THE COST OF MAINS?

A. The A&E method is one of the methods accepted by the Commission and described in the Gas Rate Fundamentals guidebook as a reasonable method for allocating the

cost of distribution mains among the various classes that share the use of distribution mains. The A&E method reflects the fact that mains are built to deliver volumes of gas during both average and peak times. Therefore, an equal amount of weight should be given to both events.

Q. WHAT IS THE SECOND COST OF SERVICE ISSUE YOU WILL ADDRESS?

A. The second issue I will address is the allocation of Account 385 - Industrial Measuring and Regulating Station Equipment costs.

Q. WHAT IS INDUSTRIAL MEASURING AND REGULATING STATION EQUIPMENT USED FOR?

A. The Uniform System of Accounts for Natural Gas Companies defines Account 385 - Industrial Measuring and Regulating Station Equipment as only the cost of special installations of measuring and regulating station equipment located on the distribution system serving large industrial customers.

Q. HOW DID THE COMPANY ALLOCATE THE FIXED COST AND DEPRECIATION EXPENSE ASSOCIATED WITH INDUSTRIAL MEASURING AND REGULATING STATION EQUIPMENT?

A. The Company allocated 77.0% of the total cost of the industrial measuring and regulating station equipment to the residential class, with lesser amounts to the other tariff rate classes and nothing to the remaining customers in the interruptible classes (PGW Ex. HSG-1B, p. 4-6, and 13-15).

Q. DID THE COMPANY PROPERLY ALLOCATE THE FIXED COST AND DEPRECIATION EXPENSE OF INDUSTRIAL MEASURING AND REGULATING STATION EQUIPMENT?

A. No.

Q. HOW SHOULD THE FIXED COSTS AND DEPRECIATION EXPENSE ASSOCIATED WITH INDUSTRIAL MEASURING AND REGULATING STATION EQUIPMENT BE ALLOCATED?

A. I recommend that the fixed cost and depreciation expense associated with industrial measuring and regulation station equipment be allocated to the industrial and interruptible classes based on the number of customers in each of these classes.

Q WHY DO YOU RECOMMEND THAT THE FIXED COST AND DEPRECIATION EXPENSE ASSOCIATED WITH INDUSTRIAL MEASURING AND REGULATING STATION EQUIPMENT BE ALLOCATED BASED ON THE NUMBER OF INDUSTRIAL CUSTOMERS?

A. The Company did not install industrial measuring and regulation station equipment to serve the residential, commercial, municipal, or housing authority customers. Therefore, none of these costs associated with this plant should be allocated to these classes. Since the Company installed industrial measuring and regulation station equipment to serve industrial customers, it is reasonable to allocate these costs to the Industrial and Interruptible classes based on the number of industrial and interruptible customers.

Q. HOW DO THESE TWO RECOMMENDATIONS AFFECT THE COST OF SERVICE STUDY?

A. The costs allocated to the residential class will be reduced by $1,043,000, while the GTS/IT class will be allocated an additional $636,000 in cost. The remaining costs not allocated to the residential class are re-allocated to the other classes to a smaller extent as shown on OTS Ex. No. 3, Sch. 4, p. 1.

Q. DID YOU PREPARE A SCHEDULE THAT SHOWS THE RATES OF RETURN UNDER PRESENT RATES THAT INCORPORATES ALL OF YOUR RECOMMENDATIONS DESCRIBED ABOVE?

A. Yes. I prepared a schedule that shows the rates of return by class at present rates if the additional residential customers and gas costs are reflected, the A&E method is used to allocate the fixed cost and depreciation expense associated with distribution of mains, and the fixed cost and depreciation expense associated with industrial measuring and regulation station equipment is properly allocated to the industrial and interruptible classes (OTS Ex. No. 3, Sch. 4, p. 2-3). The schedule also shows the rates of return by class when the heating and non-heating rates of return are combined to determine the overall combined rate of return for each class. I will be using these results to formulate a scale-back recommendation.

SCALE BACK OF RATES

Q. DID YOU PREPARE A SCHEDULE THAT SUMMARIZES THE PRESENT REVENUE, THE REQUESTED INCREASE, AND PROPOSED REVENUE BY CLASS THE COMPANY IS REQUESTING?

A. Yes. I prepared OTS Ex. No. 3, Sch. 5 which shows the present rate revenue, the requested increase and proposed rate revenue the Company is requesting by class. The exhibit is based on the present and proposed revenue shown on PWG Ex. HSG-

7C.

Q. BRIEFLY DESCRIBE COMPANY'S PROPOSED RATE INCREASES.

A. For the residential, commercial, industrial, municipal, housing GS classes, the Company is proposing to keep the present customer charge in effect and increase the usage rates between 44% and 57% depending on the particular class. For the other interruptible class or flex-rate customers, the Company is proposing to increase each customer charge 23%, and keep their present usage rates in effect (OTS Ex. No. 3 Sch. 6).

Q. WHAT SHOULD BE ONE GOAL IN DESIGNING PROPOSED RATES?

A. One goal is to design proposed rates so that the revenue received from each class is equal to the cost of providing service to that class as determined by the cost of service study. This goal is generally 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. The exception to this rule is for rates paid by customers in the interruptible class. These customers typically receive negotiated or "flexed" usage rates that generally result in a rate of return that will be below the system average rate of return. Since these customers receive negotiated

usage rates, they are not normally increased in a base rate case.

Q. HOW DOES LIMITING THE INCREASE IN RATES FOR THE INTERRUPTIBLE CLASS AFFECT THE REVENUE THAT NEEDS TO BE RECEIVED FROM THE OTHER CLASSES?

A. The revenue received from the tariff rate customers must be greater than the corresponding cost of providing service to that tariff rate class because the Company offers flexible rates to interruptible customers. Because of this, the revenue received from the tariff rate classes must make up this revenue shortfall. When designing proposed rates, the rate of return for the tariff rate classes must exceed the system average rate of return because the rate of return for the interruptible class is below the system average rate of return.

Q. DID THE COMPANY FOLLOW THE RATEMAKING CONCEPT OF DESIGNING RATES SO THAT THE REVENUE RECEIVED FROM EACH CLASS IS EQUAL TO THE COST OF PROVIDING SERVICE TO THAT CLASS?

A. Generally not. As summarized on OTS Ex. No. 3, Sch. 5, the Company proposed that the largest percentage increase in rates go to the commercial and housing GS classes. According to the Company's cost of service study, the rate of return under

present rates is 12.6% for the commercial class and 13.6% for the Housing GS class (PWG Ex. HSG-7C, p.1-2). These percentages are more than twice the 5.8% system average rate of return at present rates. The Company did partially follow this concept by limiting the industrial class increase to 9.3%. The rate of return under present rates for the Industrial class is 14.4%, which is the highest rate of return at present rates (PWG Ex. HSG-7C, p.1). Given these high rates of return at present rates, I believe the Company should not have proposed any increase in rates for these three classes.

Q. WHAT DO YOU RECOMMEND TO CORRECT THIS PROPOSAL?

A. I recommend a targeted scale-back of proposed rates as described below to reduce and hopefully eliminate the increase proposed for these classes.

Q. WHAT IS THE IMPACT ON PROPOSED REVENUE BASED ON THE NUMBER OF RESIDENTIAL HEATING CUSTOMERS THAT YOU RECOMMEND?

A. If the Commission accepts my recommendation to reflect more residential heating customers than the Company is reflecting, it will increase proposed revenue by $7,100,000 (OTS Ex. No. 3, Sch. 8, line 2). However, this additional revenue will be offset by $3,674,000 in additional gas costs resulting in $3,426,000 in additional

net income before interest and surplus of $3,462,000 at proposed rates ($7,100,000 - $3,674,000 = $3,426,000).

Q. SHOULD THIS ADDITIONAL $3,426,000 IN NET RESIDENTIAL CLASS REVENUE BE USED TO REDUCE OTHER RATES?

A. Yes. The Company is proposing that the commercial, industrial, and housing GS class usage rates be increased to produce an additional $28,345,000 in revenue (OTS Ex. No. 3, Sch. 5, lines 6, 9, and 12). Therefore, I recommend the additional $3,426,000 in net revenue be used to reduce the $28,345,000 proposed increase in the commercial, industrial, and housing GS classes usage rates (OTS Ex. No. 3, Sch. 8, line 3). Reducing this proposed $28,345,000 increase by $3,426,000 leaves a $24,919,000 ($28,345,000 - $3,426,000) increase for these classes. The reduction in the proposed usage rates should be proportional to the percent increase the Company proposed for each usage rate in each class.

Q. WHY DO YOU RECOMMEND THAT THE $3,426,000 IN ADDITIONAL NET REVENUE BE USED TO REDUCE THE $28,345,000 INCREASE PROPOSED FOR THE COMMERCIAL, INDUSTRIAL AND HOUSING GS CLASSES?

A. At over 21.8%, the combined heating and non-heating rates of return for the

commercial, industrial and housing GS classes have the highest class rates of return under proposed rates (OTS Ex. No. 3, Sch. 7, lines 10 and 12). Therefore, in order to reduce these high rates of return under proposed rates, the entire $3,426,000 in additional net revenue should be used to reduce the $28,345,000 increase proposed for the commercial, industrial, and municipal GS classes.

Q. IF THE COMMISSION GRANTS LESS THAN THE FULL $100,000,000 INCREASE REQUESTED BY THE COMPANY, DO YOU RECOMMEND THAT ANY RATES NOT BE SCALED BACK?

A. Yes. If the Commission grants less than the full $100,000,000 increase, I recommend that none of the customer charge increases proposed for the Interruptible or flexed rate customers be scaled back. I also recommend that if a rate was not proposed to be increased, it should not be scaled-back. Similarly, I recommend that a rate not be scaled back below its present rate.

Q. WHY DO YOU RECOMMEND THAT NONE OF THE PROPOSED INTERRUPTIBLE OR FLEXED RATE CUSTOMER CHARGES BE REDUCED?

A. One of the interruptible classes is boiler plant service (BPS). The combined rate of return for the BPS classes is 10.3% under proposed rates. This 10.3% at proposed

rates is below the proposed system average rate 12.9% rate of return. Therefore, the small $45,000 increase in customer charge revenue for the BPS classes is reasonable and should not be scaled-back. The fact that the rates of return for the remaining interruptible classes are below zero, except the GTS / IT class which is below system average, is the reason the proposed increase in the customer charges for these classes should not be scaled back. Also, the percent increase these interruptible customers will experience, between a 0.1% and 3.3%, is small compared to the 9.6% overall increase in base rates proposed by the Company.

Q. WHY DO YOU RECOMMEND THAT NO RATE THAT WAS INCREASED BE DECREASED IF THE COMMISSION GRANTS LESS THAN THE FULL $100,000,000 INCREASE?

A. Since customers are used to paying these rates, they should not be reduced. Also, as described above, the Company did not propose to increase the usage rates for the interruptible customers. Also, since the rate of return for the interruptible classes is below the system average rate of return, with some rates of return being below zero, it would be unfair to reduce their present rates, when rates for other customers in the tariff rate classes are being increased.

Q. PLEASE SUMMARIZE YOUR SCALE-BACK RECOMMENDATION IF THE COMMISSION GRANTS LESS THAN A $100,000,000 INCREASE.

A. If the Commission grants less than a $100,000,000 increase, I recommend the following scale-back:

OTS Scale-Back Proposal

Increase Request: $100,000,000	**Classes**	**Remaining**
First $24,919,000 Reduction	Commercial, Industrial, and Housing GS Classes	$75,081,000
Next $1,317,000 Reduction	Municipal Class	$73,764,000
Below $73,764,000	Residential and Municipal Classes	

The reduction in usage rates should be proportional to the percent increase the Company proposed for each usage rate in each class. The first two steps above are shown on OTS Ex. No. 3, Sch.8, p.1, lines 4 and 5.

Q. WHY DO YOU RECOMMEND THAT THE FIRST $24,919,000 BE USED TO ELIMINATE THE REMAINING INCREASE PROPOSED FOR THE COMMERCIAL, INDUSTRIAL, AND HOUSING GS CLASSES?

A. At proposed rates, the rates of return for these classes is above the system average rate of return.

Q. WHAT INCREASE IS THE COMPANY PROPOSING FOR THE MUNICIPAL HEATING AND NON-HEATING CLASSES?

A. The Company is proposing that the municipal class usage rate be increased 57% to $4.9416 per Mcf. This higher usage rate will produce $454,000 in additional revenue from the municipal non-heating class, and a $1,741,000 in additional revenue from the municipal heating class. The combined increase is $2,195,000 ($454,000 + $1,741,000).

Q. AFTER ALLOCATING THE FIRST $24,919,000 INCREASE TO THE COMMERCIAL INDUSTRIAL AND HOUSING GS CLASSES, HOW MUCH OF THE REQUESTED INCREASE REMAINS?

A. Allocating the first $24,919,000 leaves an increase of $75,081,000 ($100,000,000 - $24,919,000).

Q. IF THE COMMISSION GRANTS LESS THAN A $75,081,000 INCREASE, WHERE SHOULD THE SECOND REDUCTION BE APPLIED?

A. If the Commission grants less than a $75,081,000 increase, I recommend that next $1,317,000 be used to eliminate 60% of the proposed $2,195,000 increase in the municipal class' usage rate (OTS Ex. No. 3, Sch. 8, line 5).

Q. WHY DO YOU RECOMMEND THAT THE NEXT $1,317,000 REDUCTION BE USED TO REDUCE 60 PERCENT OF THE $2,195,000 INCREASE PROPOSED FOR THE MUNICIPAL CLASS?

A. If the high rates of return for the commercial, industrial, and housing GS classes are reduced as I recommend above, the heating and non-heating municipal classes should be reduced next since this class has the next highest rate of return. The combined rate of return for the municipal heating and non-heating classes under proposed rates would be 18.5% (OTS Ex. No. 3, Sch. 7, p. 1, line 12, columns I-J). Reducing the proposed increase by 60% will reduce the rate of return for this class on a combined basis to 12.6% at this revenue level, which is within the range of rates of return for the commercial, industrial, and municipal GS classes described on OTS Ex. No. 3, Sch. 8, line 18, columns I-J.

Q. IF THE COMMISSION ACCEPTS YOUR RECOMMENDATION TO ALLOCATE THE NEXT $1,317,000 INCREASE TO REDUCE THE INCREASE PROPOSED FOR THE MUNICIPAL CLASS, HOW MUCH OF THE REQUESTED INCREASE REMAINS?

A. Allocating the next $1,317,000 to the municipal heating and non-heating classes leaves an increase of $73,764,000 ($75,081,000 - $1,317,000).

Q. IF THE COMMISSION GRANTS LESS THAN A $73,764,000 INCREASE, HOW SHOULD THE REMAINING RATES BE SCALED BACK?

A. If the Commission grants less than a $73,764,000 increase, I recommend that proposed residential usage rate as well as the remaining increase in the municipal usage rate be reduced proportionally so that the increases in these usage rates produce the revenue increase authorized by the Commission.

Q. DID YOU PREPARE A SCHEDULE THAT SUMMARIZES YOUR PROPOSED SCALE-BACK RECOMMENDATIONS?

A. Yes. I prepared OTS Ex. No. 3, Sch. 8 which begins with the Company's proposed revenue of $1,144,126, shows the additional residential heating revenue of $7,100,000, the additional gas cost, and the various scale-back levels described above. This schedule shows the revenue, expenses, and rates of return by class if the

Commission grants the Company a hypothetical $73,764,000 increase.

Q. DOES YOUR SCALE-BACK PROPOSAL CAUSE THE RATES OF RETURN FOR EACH OF THE TARIFF RATE CUSTOMERS TO MOVE TOWARDS THE SYSTEM AVERAGE RATE OF RETURN?

A. Yes. As described above, OTS Ex. No. 3, Sch. 8 shows the rate of return by class if the Commission grants a hypothetical $73,764,000 increase. Following the scale-back recommendation that I describe above, will cause rates of return for the residential, commercial, industrial, municipal, and housing GS classes to move closer to the proposed system average rate of return.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

Appendix A

JOSEPH KUBAS

PENNSYLVANIA PUBLIC UTILITY COMMISSION

PO BOX 3265

HARRISBURG, PA 17105-3265

Education: Bachelor of Science in Civil Engineering Technology, 1985, University of Pittsburgh at Johnstown, Johnstown, PA.

Continuing Education: Legal Principles and Practices of Surveying at the University of Maryland. Economics, Accounting, Lotus, at the Howard Community College. 33 Credit hours of accounting at the University of Pittsburgh at Johnstown. Managing Multiple Priorities at the Pennsylvania State University. Various PA-PUC and Utility Company Seminars.

Professional Exams: Engineer In Training, 1985,
Uniform Certified Public Accounting Exam, 1993.

Experience: **FIXED UTILITY VALUATION ENGINEER III**
December 1999 - Present

Pennsylvania Public Utility Commission
Office of Trial Staff

Duties: Perform the duties of a Fixed Utility Valuation Engineer III in the Office of Trial Staff (OTS).

Analyze and review valuation engineering, and rate structure data submitted by Water, Sewer, Telephone, Gas and Steam Heat utilities to justify utility service rates or alternative forms of regulation, by researching, analyzing, and reviewing rate case filings, tariff filings, acquisitions and investigations. Participate in on-site inspections of utility properties to determine the used and usefulness of the plant-in service and make recommendations. Prepare interrogatories in the areas of rate base, rate structure, revenue and quality of service in

order to obtain additional information regarding a utility's filing. Analyze present revenue, proposed revenue, rate structure and tariff issues. Recommend adjustments to rate base, depreciation, revenue and rate structure and other issues concerning utilities. Prepare testimony and exhibits for the purpose of establishing the OTS positions in formal and informal proceedings before the Commission. Participate in Commission consultative report proceedings and collaboratives undertaken by the Commission.

Experience: **FIXED UTILITY VALUATION ENGINEER II**
April 1996 - December 1999

Pennsylvania Public Utility Commission
Office of Trial Staff and Bureau of Fixed Utility Services

Duties: Perform the duties of a Fixed Utility Valuation Engineer II in the Office of Trail Staff (OTS) and Bureau of Fixed Utility Services.

Experience: **FIXED UTILITY VALUATION ENGINEER TRAINEE, I & II**
May 1993 - March 1996

Pennsylvania Public Utility Commission
Office of Trial Staff
Telecommunications and Water Division

Duties: Perform the duties of a Fixed Utility Valuation Engineer II in the Rate Structure/Engineering Section of the Telecommunications and Water Division of the Office of Trial Staff (OTS).

Experience: **CIVIL ENGINEER**
May 1985 - January 1991

Clark Finefrock & Sackett Inc.
7135 Minstrel Way
Columbia, MD 21045

Duties: Engineering, Surveying, Computer, and Field Inspection work related to land development projects in Maryland.

Testimony Before the Pennsylvania Public Utility Commission

1.	National Utilities Inc. (Water)	R-00953416	April 1996
2.	Consumer Pennsylvania Water Company - Roaring Creek Division	R-00973869	May 1997
3.	Philadelphia Suburban Water Company	R-00973952	August 1997
4.	Bell Atlantic - Pennsylvania Inc.	P-00971307	March 1998
5.	City of Bethlehem- Bureau of Water	R-00984375	September 1998
6.	Pennsylvania Telephone Association - Chapter 30 Plan	P-00981425	December 1998
7.	GTE North Inc. Telephone Chapter 30 Plan	P-00981449	February 1999
8.	Pennsylvania American Water Co.	R-00994638	August 1999
9.	Philadelphia Suburban Water Co.	R-00994868	February 2000
10.	PG Energy (Gas)	R-00005119	June 2000
11.	Pennsylvania American Water - Coatesville Acquisition	A-212285-F07201	July 2000
12.	T. W Phillips Gas and Oil Company	R-00005459	October 2000
13.	Verizon North - Chapter 30 Plan	P-00001854	January 2001
14.	Philadelphia Gas Works	R-00006042	April 2001
15.	PFG Gas Inc. & Penn Fuels Gas Co.	R-00013679	July 2001
16.	Pennsylvania American Water Co.	R-00016339	August 2001
17.	Philadelphia Suburban Water Co.	R-00016750	February 2002
18.	Philadelphia Gas Works	R-00017034	May 2002
19.	PFG Gas Inc. & Penn Fuels Gas Co	R-00027389	July 2002
20.	Verizon - Pennsylvania, Inc.	P-00021973	September 2002
21.	Verizon - Pennsylvania, Inc.	P-00937105-F0002	January 2003
22.	Pennsylvania American Water Co.	R-00027982	April 2003
23.	Dominion Peoples 1307(f)	R-00038170	May 2003
24.	Verizon PA / Verizon North	C-20027195	July 2003
25.	National Fuel Gas Distribution, Inc.	R-00038168	July 2003
26.	Aqua Pennsylvania Inc.	R-00038805	February 2004
27.	Dominion Peoples 1307 (f)	R-00049153	May 2004
28.	PPL Electric Utilities	R-00049255	June 2004
29.	National Fuel Gas Distribution, Inc.	R-00049656	December 2004
30.	City of Lancaster - Sewer	R-00049862	March 2005
31.	Dominion Peoples 1307(f)	R-00050267	May 2005
32.	Verizon PA / Verizon North	C-20027195	June 2005
33.	PPL Gas Utilites Inc. 1307(f)	R-00050540	July 2005
34.	United Telephone	A-313200-F0007	February 2006
35.	Aqua Pa	R-00051030	February 2006
36.	T.W. Phillips 1307(f)	R-00051134	March 2006
37.	City of Dubois	R-00050671	May 2006

38.	T.W. Phillips	R-00051178	May 2006
39.	The Peoples Natural Gas Co. 1307(f)	R-00061301	June 2006
40.	Meted/Penelec	R-00061366	July 2006
		R-00061367	
41.	The York Water Company	R-00061322	July 2006
42.	PPL Gas Utilities Corporation	R-00061398	August 2006
43.	National Fuel Gas Distribution, Inc.	R-00061493	September 2006
44.	Pennsylvania American Water Co.	P-00062241	January 2007

OTS Exhibit No. 3
Witness: Joseph Kubas

5/21/07 hrg
Pkt. DD
MS

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

Exhibits to Accompany the
Direct Testimony

of

Joseph Kubas

Office of Trial Staff

Concerning:

Revenue
Cost of Gas Expense
Cost of Service Issues
Rate Structure

RESPONSE TO OFFICE OF TRIAL STAFF DATA REQUEST
REGARDING PGW'S BASE RATE FILING
DOCKET NO. R-00061931

Question OTS-RE-17: Provide in excel or other spreadsheet form all of the workpapers, and schedules that show the base load and temperature sensitive load for each month by customer class described by PGW witness White on page 3 of PGW Statement 5 for the most recent twelve month period.

Response Provided By: Kenneth Dybalski -- Director, Gas Planning & Rates

Response: Please see the attached spreadsheet.

Philadelphia Gas Works
Weather Normalization Calculation
Residential Heating Sales
01/01/06 - 12/31/06

Months (A)	No. of Customers BHlings (B)	Actual Sales Mcf (C)	Base Load Customers Mcf (D=B*BLoad)	Temperature Sensitive Load of Customers Mcf (E=C-D)	Cycle Deg. Days (F)	Temperature Sensitive Load Mcf/DD (G=E/F)	Normal Cycle Deg. Days (H)	Normalized Temperature Sensitive Load Mcf*DD (I=G*H)	Normalized Load (Mcf) (J=D+I)
Jan-06	421,654	5,958,757	746,729	5,212,028	781	6,674	1,069	7,134,005	7,880,734
Feb	421,943	5,543,678	747,241	4,796,437	740	6,482	941	6,099,253	6,846,494
Mar	425,725	5,736,091	753,939	4,482,152	684	6,553	713	4,672,185	5,426,124
Apr	430,821	2,991,487	762,983	2,228,524	374	5,959	499	2,973,351	3,736,314
May	427,510	1,412,092	757,100	654,992	132	4,962	181	898,133	1,655,233
Jun	422,827	988,801	748,806	239,995	35	6,857	18	123,426	872,232
Jul	421,202	787,101	745,928	41,173	0	0	0	0	745,928
Aug	416,487	680,503	737,578	0	0	0	0	0	737,578
Sep	409,608	741,299	725,396	15,903	1	0	1	0	725,396
Oct	410,931	1,061,437	727,739	333,698	72	4,635	91	421,757	1,149,496
Nov	411,968	2,511,713	729,576	1,782,137	303	5,882	363	2,135,036	2,864,612
Dec-06	419,048	3,987,169	742,114	3,165,055	454	6,971	649	4,524,495	5,266,609
Total	5,039,724	31,820,128	8,925,109	22,952,095	3,576		4,525	28,981,842	37,906,751

Avg No of Customers 419,977

Degree Day Variance (Warmer)/Colder (949)

Average Use per Customer 7.52 **Mcf per Month** 90.26 **Mcf per Year**

	Customer Billings	Mcf Sales
July	421,202	787,101
Aug	416,487	680,503
Sept	409,608	741,299
Total	1,247,297	2,208,903

Base Load (Mcf) Per Customer (BL) 1.77

OTS RE-17

2/2/2007

OTS Exhibit No. 3
Schedule 1
Page 2 of 2

Philadelphia Gas Works
Docket R-00061931

Actual Residential Heating Customers 2001-2006
OTS Projected Residential Heating Customers - 2007

		Actual Year Ending Dec 2001	Change	Actual Year Ending Dec 2006	5 Year Average	Projected Year Ending Dec 2007
	(A)	(B)	(C)	(D)	(E)	(F)
1	Residential Heating	428,946	-8,969	419,977	-1,794	418,183

RESPONSE TO OFFICE OF TRIAL STAFF DATA REQUEST
REGARDING BASE RATE PROCEEDING
DOCKET NO. R-00017034

Question OTS-RE-11: Provide in excel or other spreadsheet form all of the workpapers, and schedules that show the "two step process" the Company used to determine base and heat load for each month by customer class described by PGW witness Muntzer on pages 5 and 6 of PGW Statement 3.

Response Provided By: Kenneth S. Dybalski, Manager Gas Planning

Response: Please see attached schedules.

OTS RE-11 (revised 4-19-02)

Philadelphia Gas Works
Weather Normalization Calculation
Residential Heating Sales
01/01/01 - 12/31/01

Months (A)	No. of Customers (B)	Actual Sales Mcf (C)	Base Load Customers Mcf (D=B*BLoad)	Temperature Sensitive Load of Customers Mcf (E=C-D)	Cycle Deg. Days (F)	Temperature Sensitive Load Mcf/DD (G=E/F)	Normal Cycle Deg. Days (H)	Normalized Temperature Sensitive Load Mcf*DD (I=G*H)	Normalized Load (Mcf) (J=D+I or C)
Jan-01	429,659	9,223,256	923,144	8,300,112	1,072	7,743	1,069	8,276,884	9,200,028
Feb	431,433	6,865,925	926,956	5,938,969	849	6,995	942	6,589,528	7,516,483
Mar	430,688	6,401,676	925,355	5,476,321	739	7,410	765	5,668,993	6,594,348
Apr	429,319	4,465,773	922,414	3,543,359	521	6,801	520	3,536,558	4,458,972
May	429,830	1,751,938	923,512	828,426	161	5,146	201	1,034,247	1,957,758
Jun	436,246	1,245,486	937,297	308,189	39	7,902	26	205,460	1,142,756
Jul	433,089	1,000,570	930,514	70,056	0	0	0	0	930,514
Aug	431,500	909,643	927,100	(17,457)	0	0	0	0	927,100
Sep	433,950	879,764	932,364	(52,600)	5	(10,520)	0	0	932,364
Oct	419,374	1,352,956	901,046	451,910	101	4,474	74	331,102	1,232,148
Nov	415,120	2,405,934	891,906	1,514,028	239	6,335	337	2,134,842	3,026,749
Dec-01	427,143	3,318,625	917,738	2,400,887	344	6,979	621	4,334,159	5,251,897
Total	5,147,351	39,821,546	11,059,345	28,762,201	4,070		4,555	32,111,772	43,171,117

Avg No of Customers 428,946

Degree Day Variance (Warmer)/Colder (485)

Average Use per Customer 8.39 Mcf per Month 100.64 Mcf per Year

	Customers	Mcf Sales
July	433,089	1,000,570
Aug	431,500	909,643
Sept	433,950	879,764
Total	1,298,539	2,789,977

Base Load (Mcf) Per Customer (BL) 2.15

OTS RE-11 (rev).xls

OTS Exhibit No. 3
Schedule 2
Page 3 of 3

OTS Exhibit No. 3
Schedule 3

Philadelphia Gas Works
R - 00061931

Number of Residential Heating Customers Adjustment Present Rates

Test Year Ending August 31, 2007

		Per City	OTS Proposed Adjustment	Adjusted Revenue Per OTS
	(A)	(B)	(C)	(D)
1	Total Number of Customers	414,433	3,750	418,183
2	Total Normal Usage (Mcf)	89.3	0.0	89.3
3	Annualized sales (Mcf)	37,006,739	334,874	37,341,613
4	Customer Charge	$12.00	$0.00	$12.00
5	Present Residential Volumetric Rate $17.7875			
6	($10.9709 + $2.5387 + $0.0655 + $4.2124)	$17.7875	$0.0000	$17.7875
7	Cost of Gas ($ per Mcf) ($10.971)	$10.9709	$0.0000	$10.9709
8	Total Volumetric Revenue			
9	(Line 3 X Line 6)	$658,258,480	$5,956,574	$664,215,054
10	Customer Charge Revenue			
11	(Line 1 X Line 4)	$59,678,352	$540,029	$60,218,381
12	**Total Present Rate Revenue**			
13	**(Line 9 + Line 11)**	**$717,936,832**	**$6,496,603**	**$724,433,435**
14	**Cost of Gas**			
15	**(Line 3 X Line 7)**	**$405,997,233**	**$3,673,865**	**$409,671,098**

Philadelphia Gas Works
Docket R-00061931
Company and OTS Operating Expenses
Re-allocation by Class ($1,000)

	Class	Company Operating Expenses	OTS Adjustment	OTS Proposed Expenses	Percent Change
	A	B	C	D	E
1	Residential Non Heat	$37,938	($182)	$37,756	-0.5%
2	Residential Heat	$697,382	($862)	$696,520	-0.1%
3	Total Residential	$735,320	($1,043)	$734,277	-0.1%
4	Commercial Non Heat	$27,213	$37	$27,250	0.1%
5	Commercial Heat	$137,241	$160	$137,401	0.1%
6	Total Commercial	$164,454	$197	$164,651	0.1%
7	Industrial Non Heat	$5,338	$19	$5,357	0.4%
8	Industrial Heat	$12,085	$38	$12,123	0.3%
9	Total Industrial	$17,423	$57	$17,480	0.3%
10	Municipal Non Heat	$3,953	$10	$3,963	0.3%
11	Municipal Heat	$15,519	$23	$15,542	0.1%
12	Housing GS	$13,734	$7	$13,741	0.1%
13	Natural Gas Vehicles	$5	$0	$5	0.3%
14	Total Municipal and Housing	$33,211	$41	$33,252	0.1%
15	BPS Small	$2,154	$8	$2,162	0.4%
16	BPS Large	$24,282	$64	$24,346	0.3%
17	BPS AC	$1,350	$4	$1,354	0.3%
18	Total BPS	$27,786	$76	$27,862	0.3%
19	LBS Small	$6,548	$19	$6,567	0.3%
20	LBS Large Indirect	$4,641	$14	$4,655	0.3%
21	LBS Large Direct	$254	$1	$255	0.3%
22	LBS XL Direct	$39	$0	$39	0.4%
23	Total LBS	$11,482	$34	$11,516	0.3%
24	LBX	$678	$2	$680	0.3%
25	Co-Gen	$202	$1	$203	0.4%
26	GTS / IT	$3,507	$636	$4,143	18.1%
27	Total Other	$4,387	$639	$5,026	14.6%
28	TOTALS	$994,063	$0	$994,063	0.0%

Philadelphia Gas Works
Docket R-00061931
Rate of Return by Customer Class
OTS Present Rates and Cost Of Service Recommendations
($1,000 except R of R)

	A	B	C	D	E	F	G	H	I	J	K
	Item	Cost of Service	Residential Non Heat	Residential Heat	Commercial Non-Heat	Commercial Heat	Industrial Non Heat	Industrial Heat	Municipal Non Heat	Municipal Heat	Housing GS
1	Company Revenues from Sales	$1,044,127	$33,382	$717,864	$31,695	$156,141	$6,324	$13,501	$4,465	$16,952	$15,356
2	Additional OTS Revenue	$6,497		$6,497							
3	Other Revenues	$31,583	$2,601	$26,555	$273	$1,104	$26	$76	$9	$34	$526
4	Total Revenues	$1,082,207	$35,983	$750,916	$31,968	$157,245	$6,350	$13,577	$4,474	$16,986	$15,882
5	Less: Operating Expenses	$994,064	$37,756	$696,520	$27,250	$137,401	$5,357	$12,123	$3,963	$15,542	$13,741
6	OTS Additional Gas Cost	$3,674		$3,674							
7	Income Before Interest And Surplus	$84,469	($1,773)	$50,722	$4,718	$19,844	$993	$1,454	$511	$1,444	$2,141
8	Interest and Surplus	$84,469	$4,334	$59,730	$2,029	$10,265	$342	$837	$267	$1,080	$965
9	Net Income	$0	($6,108)	($9,008)	$2,689	$9,579	$651	$617	$243	$365	$1,175
10	Measure of Value	$1,409,191	$72,311	$996,468	$33,850	$171,251	$5,714	$13,961	$4,460	$18,012	$16,107
11	Rate of Return Percent	6.0%	-2.5%	5.1%	13.9%	11.6%	17.4%	10.4%	11.4%	8.0%	13.3%
12	Relative Rate of Return	1.00	-0.41	0.85	2.33	1.93	2.90	1.74	1.91	1.34	2.22
13	Combined R of R		Residential:	4.6%	Residential:	12.0%	Industrial:	12.4%	Municipal:	8.7%	

OTS Exhibit No. 3
Schedule 4
Page 2 of 3

Philadelphia Gas Works
Docket R-00061931
Rate of Return by Customer Class
OTS Present Rates and Cost Of Service Recommendations
($1,000 except R of R)

	A	L	M	N	O	P	Q	R	S	T	U	V
	Item	NGV Direct	BPS Small	BPS Large	BPS AC	LBS Small	LBS Large Indirect	LBS Large Direct	LBX LX Indirect	Co-Gen Indirect	GTS-IT Trans Only	GTS / IT
1	Company Revenues from Sales	$5	$2,597	$26,317	$1,111	$6,051	$4,089	$220	$30	$599	$172	$7,256
2	Additional OTS Revenue											
3	Other Revenues	$0	$62	$146	$6	$31	$21	$6	$0	$4	$1	$102
4	Total Revenues	$5	$2,659	$26,463	$1,117	$6,082	$4,110	$226	$30	$603	$173	$7,358
5	Less: Operating Expenses	$5	$2,162	$24,346	$1,354	$6,567	$4,655	$255	$39	$680	$203	$4,144
6	OTS Additional Gas Cost											
7	Income Before Interest And Surplus	($0)	$497	$2,117	($237)	($485)	($545)	($29)	($9)	($77)	($30)	$3,214
8	Interest and Surplus	$0	$152	$1,391	$61	$313	$214	$10	$4	$35	$10	$2,427
9	Net Income	($0)	$345	$726	($298)	($798)	($759)	($39)	($13)	($112)	($40)	$787
10	Measure of Value	$6	$2,543	$23,212	$1,019	$5,222	$3,570	$167	$67	$588	$174	$40,491
11	Rate of Return Percent	-0.3%	19.5%	9.1%	-23.3%	-9.3%	-15.3%	-17.3%	-13.6%	-13.1%	-17.1%	7.9%
12	**Relative Rate of Return**	**-0.05**	**3.26**	**1.52**	**-3.89**	**-1.55**	**-2.55**	**-2.89**	**-2.26**	**-2.19**	**-2.85**	**1.32**

Municipal:	10.1%

OTS Exhibit No. 3
Schedule 4
Page 3 of 3

OTS Exhibit No. 3
Schedule 5

Philadelphia Gas Works
Docket R-00061931
Company Proposed Increase By Class

	Class	Present Revenue	Increase	Proposed Revenue	Percent Increase
	A	B	C	D	E
1	Residential Non Heat	$33,382	$2,639	$36,021	7.9%
2	Residential Heat	$717,864	$66,759	$784,623	9.3%
3	Total Residential	$751,246	$69,398	$820,644	9.2%
4	Commercial Non Heat	$31,695	$4,135	$35,830	13.0%
5	Commercial Heat	$156,141	$20,609	$176,750	13.2%
6	Total Commercial	$187,836	$24,744	$212,580	13.2%
7	Industrial Non Heat	$6,324	$590	$6,914	9.3%
8	Industrial Heat	$13,501	$1,255	$14,756	9.3%
9	Total Industrial	$19,825	$1,845	$21,670	9.3%
10	Municipal Non Heat	$4,465	$454	$4,919	10.2%
11	Municipal Heat	$16,952	$1,741	$18,693	10.3%
12	Housing GS	$15,356	$1,757	$17,113	11.4%
13	Total Municipal and Housing	$36,773	$3,952	$40,725	10.7%
14	BPS Small	$2,597	$10	$2,607	0.4%
15	BPS Large	$26,317	$34	$26,351	0.1%
16	BPS AC	$1,111	$1	$1,112	0.1%
17	Total BPS	$30,025	$45	$30,070	0.1%
18	LBS Small	$6,051	$5	$6,056	0.1%
19	LBS Large Indirect	$4,089	$3	$4,092	0.1%
20	LBS Large Direct	$220	$1	$221	0.5%
21	LBS XL Direct	$30	$1	$31	3.3%
22	Total LBS	$10,390	$10	$10,400	0.1%
23	LBX	$599	$3	$602	0.5%
24	Co-Gen	$172	$3	$175	1.7%
25	GTS / IT	$7,256	$0	$7,256	0.0%
26	Total Other	$8,027	$6	$8,033	0.1%
27	TOTALS	$1,044,122	$100,000	$1,144,122	9.6%

OTS Exhibit No. 3
Schedule 6

Philadelphia Gas Works
Docket R - 00061931
Company Present and Proposed Rates

		Present Rate	Increase	Proposed Rate	Percent Increase
	Monthly Customer Charge				
1	Residential	$12.00	$0.00	$12.00	0.0%
2	Commercial	$18.00	$0.00	$18.00	0.0%
3	Industrial	$50.00	$0.00	$50.00	0.0%
	Usage Rates				
4	Residential Base	$4.2124	$1.8675	$6.0799	44.3%
5	Commercial Base	$4.3056	$2.4888	$6.7944	57.8%
6	Industrial Base	$4.3029	$1.7720	$6.0749	41.2%
7	Municipal Base	$3.1470	$1.7946	$4.9416	57.0%
8	PHA Rate 8	$4.2952	$2.3438	$6.6390	54.6%
9	PHA GS	$4.2124	$1.8675	$6.0799	44.3%
10	PHA GS Senior	$4.2124	$1.8675	$6.0799	44.3%
11	NGV	$0.0000	$0.9254	$0.9254	-
12	US Service	$2.5387	$0.0000	$2.5387	0.0%
13	Customer Education	$0.0655	-$0.0655	$0.0000	-100.0%
14	GCR	$10.9710	$0.0000	$10.9710	0.0%
	Interuptable Customer Charges				
15	BPS-Small	$35.00	$8.0600	$43.06	23.0%
16	BPS-Small	$75.00	$17.2700	$92.27	23.0%
17	BPS-AC	$35.00	$8.0600	$43.06	23.0%
18	LBS-S Indirect	$100.00	$23.0200	$123.02	23.0%
19	LBS-L-Indirect	$175.00	$40.2900	$215.29	23.0%
20	LBS-L Direct	$175.00	$40.2500	$215.25	23.0%
21	LBS-L-Direct	$250.00	$57.5400	$307.54	23.0%
22	LBS-XL-Indirect	$250.00	$57.5600	$307.56	23.0%
23	COGEN	$250.00	$57.5500	$307.55	23.0%

Philadelphia Gas Works
Docket R-00061931
Rate of Return by Customer Class
Company Proposed Rates with OTS Cost of Service Recommendations
($1,000 except R of R)

	Item	Cost of Service	Residential Non Heat	Residential Heat	Commercial Non-Heat	Commercial Heat	Industrial Non Heat	Industrial Heat	Municipal Non Heat	Municipal Heat	Housing GS
	A	B	C	D	E	F	G	H	I	J	K
1	Company Proposed Sales	$1,144,126	$36,021	$784,622	$35,830	$176,749	$6,914	$14,756	$4,919	$18,693	$17,113
2	Other Revenues	$31,204	$2,601	$26,555	$273	$1,104	$26	$76	$9	$34	$526
3	Total OTS Revenues	$1,175,709	$38,622	$811,177	$36,103	$177,853	$6,940	$14,832	$4,928	$18,727	$17,639
4	Less: Operating Expenses	$994,064	$37,756	$696,520	$27,250	$137,401	$5,357	$12,123	$3,963	$15,542	$13,741
5 6	Income Before Interest And Surplus	$181,645	$866	$114,657	$8,853	$40,452	$1,583	$2,709	$965	$3,185	$3,898
7	Interest and Surplus	$181,645	$9,321	$128,445	$4,363	$22,074	$737	$1,800	$575	$2,322	$2,076
8	Net Income	$0	($8,455)	($13,788)	$4,490	$18,377	$847	$909	$390	$864	$1,821
9	Measure of Value	$1,409,191	$72,311	$996,468	$33,850	$171,251	$5,714	$13,961	$4,460	$18,012	$16,107
10	Rate of Return Percent	12.9%	1.2%	11.5%	26.2%	23.6%	27.7%	19.4%	21.6%	17.7%	24.2%
11	**Relative Rate of Return**	**1.00**	**0.09**	**0.89**	**2.03**	**1.83**	**2.15**	**1.51**	**1.68**	**1.37**	**1.88**

12	Combined Relative R of R		Residential:	10.8%	Commercial:	24.0%	Industrial:	21.8%	Municipal:	18.5%	

OTS Exhibit No. 3
Schedule 7
Page 1 of 2

Philadelphia Gas Works
Docket R-00061931
Rate of Return by Customer Class
Company Proposed Rates with OTS Cost of Service Recommendations
($1,000 except R of R)

	Item	NGV Direct	BPS Small	BPS Large	BPS AC	LBS Small	LBS Large Indirect	LBS Large Direct	LBX LX Indirect	Co-Gen Indirect	GTS-IT Trans Only	GTS / IT
	A		B	C	D	E	F	G	H	I	J	K
1	Company Proposed Sales	$6	$2,607	$26,351	$1,112	$6,056	$4,092	$221	$31	$602	$175	$7,256
2	Other Revenues	$0	$62	$146	$6	$31	$21	$6	$0	$4	$1	$102
3	Total OTS Revenues	$6	$2,669	$26,497	$1,118	$6,087	$4,113	$227	$31	$606	$176	$7,358
4	Less: Operating Expenses	$5	$2,162	$24,346	$1,354	$6,567	$4,655	$255	$39	$680	$203	$4,144
5	Income Before Interest											
6	And Surplus	$1	$507	$2,151	($236)	($480)	($542)	($28)	($8)	($74)	($27)	$3,214
7	Interest and Surplus	$1	$328	$2,992	$131	$673	$460	$21	$9	$76	$22	$5,219
8	Net Income	$0	$179	($841)	($368)	($1,153)	($1,002)	($49)	($17)	($150)	($49)	($2,005)
9	Measure of Value	$6	$2,543	$23,212	$1,019	$5,222	$3,570	$167	$67	$588	$174	$40,491
10	Rate of Return Percent	17.3%	19.9%	9.3%	-23.2%	-9.2%	-15.2%	-16.7%	-12.1%	-12.6%	-15.4%	7.9%
11	**Relative Rate of Return**	**1.57**	**1.81**	**0.84**	**-2.10**	**-0.83**	**-1.38**	**-1.51**	**-1.09**	**-1.14**	**-1.39**	**0.72**
12	Combined Relative R of R		BPS	10.3%								

OTS Exhibit No. 3
Schedule 7
Page 2 of 2

Philadelphia Gas Works
Docket R-00061931
Rate of Return by Customer Class
OTS Proposed Rates with Targeted Scale-Back
($1,000 except R of R)

	Item	Cost of Service	Residential Non Heat	Residential Heat	Commercial Non-Heat	Commercial Heat	Industrial Non Heat	Industrial Heat	Municipal Non Heat	Municipal Heat	Housing GS
	A	B	C	D	E	F	G	H	I	J	K
1	Company Proposed Sales	$1,144,126	$36,021	$784,622	$35,830	$176,749	$6,914	$14,756	$4,919	$18,693	$17,113
2	OTS Increased Customers	$7,100		$7,100							
3	OTS Allocation of Extra Net	($3,426)			($500)	($2,491)	($71)	($152)			($212)
4	OTS First Dollar Relief	($24,919)			($3,635)	($18,117)	($519)	($1,103)			($1,545)
5	OTS Partial Dollar Relief	($1,317)							($272)	($1,045)	
6	Other Revenues	$31,583	$2,601	$26,555	$273	$1,104	$26	$76	$9	$34	$526
7	Total OTS Revenues	$1,153,147	$38,622	$818,277	$31,968	$157,245	$6,350	$13,577	$4,656	$17,682	$15,882
8	Less: Operating Expenses	$994,064	$37,756	$696,520	$27,250	$137,401	$5,357	$12,123	$3,963	$15,542	$13,741
9	OTS Increased Gas Cost	$3,674		$3,674							
10	Income Before Interest										
11	And Surplus	$155,409	$866	$118,083	$4,718	$19,844	$993	$1,454	$692	$2,141	$2,141
12	Interest and Surplus	$155,409	$7,975	$109,893	$3,733	$18,886	$630	$1,540	$492	$1,986	$1,776
13	Net Income	($0)	($7,109)	$8,190	$985	$958	$363	($86)	$200	$154	$364
14	Measure of Value	$1,409,191	$72,311	$996,468	$33,850	$171,251	$5,714	$13,961	$4,460	$18,012	$16,107
15	Rate of Return Percent	11.0%	1.2%	11.9%	13.9%	11.6%	17.4%	10.4%	15.5%	11.9%	13.3%
16	**Relative Rate of Return**	**1.00**	**0.11**	**1.07**	**1.26**	**1.05**	**1.58**	**0.94**	**1.41**	**1.08**	**1.21**
17	Increase $73,764										
18	Combined R of R		Residential:	11.1%	Commercial	12.0%	Industrial:	12.4%	Municipal:	12.6%	

OTS Exhibit No. 3
Schedule 8
Page 1 of 2

Philadelphia Gas Works
Docket R-00061931
Rate of Return by Customer Class
OTS Proposed Rates with Targeted Scale-Back
($1,000 except R of R)

	Item	NGV Direct	BPS Small	BPS Large	BPS AC	LBS Small	LBS Large Indirect	LBS Large Direct	LBX LX Indirect	Co-Gen Indirect	GTS-IT Trans Only	GTS / IT
	A		B	C	D	E	F	G	H	I	J	K
1	Company Proposed Sale:	$6	$2,607	$26,351	$1,112	$6,056	$4,092	$221	$31	$602	$175	$7,256
2	OTS Increased Customers											
3	OTS First Dollar Relief											
4	OTS First Dollar Relief											
5	OTS Partial Dollar Relief											
6	Other Revenues	$0	$62	$146	$6	$31	$21	$6	$0	$4	$1	$102
7	Total OTS Revenues	$6	$2,669	$26,497	$1,118	$6,087	$4,113	$227	$31	$606	$176	$7,358
8	Less: Operating Expense:	$5	$2,162	$24,346	$1,354	$6,567	$4,655	$255	$39	$680	$203	$4,144
9	Increased Gas Cost											
10	Income Before Interest											
11	And Surplus	$1	$507	$2,151	($236)	($480)	($542)	($28)	($8)	($74)	($27)	$3,214
12	Interest and Surplus	$1	$280	$2,560	$112	$576	$394	$18	$7	$65	$19	$4,465
13	Net Income	$0	$227	($409)	($349)	($1,056)	($935)	($46)	($16)	($139)	($46)	($1,251)
14	Measure of Value	$6	$2,543	$23,212	$1,019	$5,222	$3,570	$167	$67	$588	$174	$40,491
15	Rate of Return Percent	17.3%	19.9%	9.3%	-23.2%	-9.2%	-15.2%	-16.7%	-12.1%	-12.6%	-15.4%	7.9%
16	**Relative Rate of Return**	**1.57**	**1.81**	**0.84**	**-2.10**	**-0.83**	**-1.38**	**-1.51**	**-1.09**	**-1.14**	**-1.39**	**0.72**
17	Increase $73,764											
18	Combined R of R		BPS	9.0%								

OTS Exhibit No. 3
Schedule 8
Page 2 of 2

OTS Statement No. 3-SR
Witness: Joseph Kubas

5/21/07 hrg
Phila PD
MJ

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

Surrebuttal Testimony

of

Joseph Kubas

Office of Trial Staff

Concerning:

Revenue
Cost of Gas Expense
Cost of Service
Rate Structure

Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?

A. My name is Joseph Kubas and my business address is Pennsylvania Public Utility Commission, P.O. Box 3265 Harrisburg, PA 17105-3265.

Q. ARE YOU THE SAME JOSEPH KUBAS WHO FILED OTS STATEMENT NO. 3 ON APRIL 6, 2007?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to address the rebuttal testimony filed by Howard S. Gorman and Craig White on behalf of Philadelphia Gas Works (PGW or Company) concerning the number of residential heating customers, their corresponding usage, the allocation of main costs to the various customer classes, and the scale back of rates. I will also address the rebuttal testimony of Robert Knecht on behalf of the Office of Small Business Advocate (OSBA) concerning the proper allocation of main costs to the various customer classes.

Q. DID THE COMPANY AGREE WITH YOUR RECOMMENDATION TO REFLECT A LARGER NUMBER OF RESIDENTIAL HEATING CUSTOMERS?

A. Yes. The Company accepted my recommendation to reflect 3,750 additional residential heating customers (PGW St. 5R, p. 13).

Q. DID THE COMPANY ACCEPT YOUR RECOMMENDATION TO INCREASE NET REVENUE BY $2,822,700 AT PRESENT RATES AND $3,426,000 AT PROPOSED RATES?

A. No. While the Company agreed that revenue would increase by the amount I determined, the Company contends that the additional revenues associated with the universal service, restructuring and consumer education surcharges should have been removed to determine net revenue (PGW St. No. 5R, p. 14).

Q. DO YOU AGREE WITH THE COMPANY'S POSITION THAT THE SURCHARGE REVENUES RELATED TO THE COST OF UNIVERSAL SERVICE, RESTRUCTURING AND CONSUMER EDUCATION SHOULD BE REMOVED TO DETERMINE NET REVENUE?

A. Yes. This analysis is acceptable. These surcharges will be recalculated by the Company to collect the costs of these programs, which will not increase as a result of the additional customers and sales volumes that I proposed. Therefore, my original recommendation is modified to reflect $1,950,600 additional net revenue at present rates and $2,576,000 additional net revenue at proposed rates (PGW St. 5R, p. 15).

Q. WHAT CHANGES DID YOU RECOMMEND IN THE COMPANY'S COST OF SERVICE STUDY IN YOUR DIRECT TESTIMONY?

A. I recommended that the fixed cost and depreciation expense associated with mains be allocated to the various customer classes based on the Average and Excess (A&E) demand method (OTS St. No. 3, p. 13).

Q. DID THE COMPANY AND OTHER PARTIES SUBMIT REBUTTAL TESTIMONY DISAGREEING WITH YOUR RECOMMENDATION?

A. Yes. The Company disagrees with my recommendation to properly allocate the cost of mains to the various classes based on the A&E method (PGW St. No. 8R, p.18). The OSBA agrees that the A&E method is an accepted approach (OSBA St. No. 2. p. 20). However, after accepting the A&E method, the OSBA believes I erred in the application of the A&E and that after these errors are corrected, the resulting allocation of the cost of mains is the same as the Company originally proposed (OSBA St. No. 2, p. 21).

Q. WHAT IS THE BASIS FOR THE COMPANY'S DISAGREEMENT?

A. The Company believes that the A&E demand method does not reflect the cost causality of the investment in mains, stating that distribution mains are related to peak demand and not annual demand. The Company also states that annual usage is not considered in the design of distribution mains (PGW St. No. 8R, p. 19).

Q. IS THE CLAIM THAT MAINS ARE DESIGNED FOR "PEAK DEMAND" A PROPER BASIS FOR ALLOCATING THE COST OF MAINS TO THE VARIOUS CUSTOMER CLASSES?

A. No. The capacity of mains is shared by the various classes in varying amounts throughout the year. Since the capacity of mains is shared by the various classes, it is correct to allocate the cost of mains to the various classes on a reasonable basis. As stated in my direct testimony, the A&E method has been accepted by the Commission and, in my opinion, is a reasonable method for allocating the cost of shared assets such as mains to the various customer classes (OTS St. No. 3, p 13). The A&E method recognizes both the average use of capacity and responsibility for the capacity required to meet the maximum system load.[1] The average deliveries may not be a key design element for PGW. However according to "Gas Rate Fundamentals," fixed costs are usually assigned to the demand classification, except at the distribution level, where facilities are designed with the number of units and size of loads in mind.[2]

[1] Gas Rate Fundamentals, Fourth Edition, American Gas Association, 1987, p. 144.
[2] Id., p. 136.

Q. PLEASE ADDRESS THE COMPANY'S CLAIM THAT AVERAGE USAGE IS NOT CONSIDERED WHEN DESIGNING MAINS AND SHOULD THEREFORE NOT BE A BASIS FOR ALLOCATING THE COST OF MAINS.

A. It is the peak design criteria of the mains should not be used to allocate the cost of mains or any other plant because the system does not operate at peak usage 100 percent of the time. Also, it is an integrated system where all customers and customer classes share the use of the mains. Therefore, in my opinion, the actual use of the distribution mains should be the primary factor in determining how to allocate the cost of mains to the various customer classes. These mains are required to deliver gas to customers on a daily basis throughout the year. While it is important to design the mains based on "design day" conditions, these conditions rarely occur in practice.

Q. WHAT DID THE OSBA STATE CONCERNING YOUR RECOMMENDATION TO ALLOCATE THE COST OF MAINS?

A. The OSBA supports the Company's allocation of mains and criticizes my approach for several reasons. First, the OSBA believes the Company has followed some alleged industry practice for the allocation of main costs (OSBA St. No. 2, p. 9), Second, the OSBA believes that prior Commission Orders concerning customer costs are not relevant (OSBA St. No. 2, p. 15). Third, the OSBA claims that I

improperly applied a marginal or incremental cost allocation methodology in my support for the A&E method (OSBA St. No. 2, p. 15). Fourth, the OSBA believes that the source text used to support my recommendation was misstated (OSBA St. No. 2, p. 16). Fifth, the OSBA believes that I should have included the additional volumes associated with my recommendation to increase residential throughput (OSBA St. No. 2, p. 24). Finally, the OSBA agrees that mains cannot be assigned to one specific customer but claims that is not the issue (OSBA St No. 2, p. 16).

Q. DOES THE OSBA BELIEVE THERE IS SOME CONSISTENT INDUSTRY PRACTICE FOR ALLOCATING MAINS?

A. No. The OSBA claims that PGW's method of allocating mains based on customers and demand is consistent with industry practice (OSBA St. No. 2, p. 9). However, on page 12, the OSBA agrees that there is no standard practice for classifying mains costs, and there is some diversity among NGDCs and regulators regarding the methodologies chosen. The OSBA recognizes that PPL Gas Utilities Corporation (PPL Gas) in Pennsylvania does not include a customer component when allocating the cost of mains (OSBA St. No. 2, p. 13). There is no industry standard method for allocating the cost of distribution mains. In fact, according to the National Association of Regulatory Utility Commissioners' "Gas Distribution Rate Design Manual", the multiplicity or diversity of methods to allocate demand

or capacity costs has led many experts to express doubts about the efficacy of cost of service analyses.[3]

Q. DID THE COMMISSION RECENTLY ISSUE AN ORDER REJECTING THE OSBA PROPOSAL TO ALLOCATE THE COST OF MAINS BASED ON A CUSTOMER AND DEMAND METHOD?

A. Yes. In the most recent PPL Gas base rate case at Docket No. R-00061398, the Commission rejected the proposal by the OSBA to allocate 28% of the cost of mains to the customer component and 72% to the demand component, which is similar to 25% / 75% allocation that PGW is proposing in this case. The Commission did accept PPL Gas' allocation method which classified the distribution mains cost as 100% demand costs based on growth in demand.[4] PPL Gas then allocated 40% of demand costs based upon commodity usage and 60% based on demand in excess of average demand, or by the A & E method.[5]

Q. IS THE COMMISSION ORDER THAT YOU CITED ON PAGE 12 OF YOUR DIRECT TESTIMONY RELEVANT IN THIS CASE?

A. Yes. The results of that Commission Order determined the appropriate customer costs to be recovered in a customer charge. Those costs were clearly "customer-

[3] Gas Distribution Rate Design Manual, National Association of Regulatory Utility Commissioners, 1989, p. 26.
[4] Docket No. R-00061398, Pa. PUC v. PPL Gas Utilities Corporation, Order entered February, 8, 2007, p. 111.
[5] Id., p. 113.

related". That is, the costs changed in direct relationship with the number of customers. As I stated on page 12 of my direct testimony, it should be noted that the cost of mains were not included in any of the customer-related costs identified by the Commission in that Order. Therefore, the most important underlying ratemaking principal that mains are not customer costs as set forth by the Commission in the PPL Gas Order provides guidance in this proceeding.

Q. DID YOU IMPROPERLY APPLY A MARGINAL COST STUDY TO SUPPORT YOUR POSITION THAT MAINS ARE NOT CUSTOMER COSTS AS IMPLIED BY THE OSBA?

A. No. I simply describe the test for determining if a cost is customer related, volumetric related, or demand related within an embedded cost study. Customer-related costs are generally costs associated with the meter, the service line, meter reading, billing and collecting.[6] Customer related costs generally change if a customer joins or leaves the system. If that isn't the case, then costs are generally classified as either volumetric related, demand related or, as with mains, a combination of two of the types of costs.

[6] Electric Utility Cost Allocation Manual, National Association of Regulatory Utility Commissioners, 1992, p. 22.

Q. DID YOU ERROR IN THE APPLICATION OF THE A&E METHOD AS SUGGESTED BY THE OSBA?

A. No. My approach is the correct method for applying the A&E method. It allocates the cost of mains on a straightforward basis, giving equal weight to the average flow and excess of average flow through the mains. As I stated on page 14 of my direct testimony, mains were built to deliver volumes of gas, on a daily basis, during both average and peak times. Therefore, I gave an equal amount of weight to both of those elements of use.

Q. WHAT WAS THE PRIMARY REASON FOR RECOMMENDING THAT THE COST OF MAINS BE ALLOCATED TO THE VARIOUS CLASSES BASED ON THE A&E METHOD?

A. My primary reason for allocating the cost of mains is because the A&E method is a reasonable method that the Commission recently approved in the PPL Gas base rate case at Docket No. R-00061398.

Q. PLEASE ADDRESS OSBA'S CLAIM THAT YOU MISQUOTED THE SOURCE TEXT ON PAGE 144 AND 145 OF THE GAS RATE FUNDAMENTALS BOOK?

A. I did mischaracterize the description set forth on pages 144 and 145 of the "Gas Rate Fundamentals." However, as described above, the book was not my primary reason for recommending the A&E method. The book was used primarily as a check of the reasonableness of my recommendation and to determine a reasonable allocation ratio of 50/50. This 50/50 allocation is discussed later on page 145 where the use of several variations of the A&E method in Federal Energy Regulatory Commission (FERC) natural gas pipeline proceedings is described. FERC recognizes both a demand and commodity component when allocating fixed pipeline costs to the various customer classes. Therefore, in my opinion, since FERC believes a 50/50 allocation method is reasonable for allocating the cost of interstate pipelines, I believe that the same ratio can be used to allocate mains in this proceeding. Also, as described above, the Commission recently approved a similar 40/60 allocation method which is almost identical to the 50/50 allocation I recommend.

Q. IS THERE ANY OTHER SUPPORT IN "GAS RATE FUNDAMENTALS" FOR ALLOCATING MAINS BASED ON A COMBINATION OF DEMAND AND COMMODITY ALLOCATORS?

A. Yes. The book describes demand-related costs as costs associated with the peak usage of utility service by customers. It goes on to state that fixed costs are usually assigned to the demand classification, except at the distribution level, where facilities are designed with the number of units and size of loads in mind. Commodity-related costs are described as variable, and are those that reflect the number of units consumed or supplied during a period of time.[7]

Q. WHY DIDN'T YOU INCLUDE THE ADDITIONAL THROUGHPUT ASSOCIATED WITH THE 3,750 RESIDENTIAL HEATING CUSTOMERS THAT THE COMPANY WILL NOT LOSE IN 2007 AS SUGGESTED BY MR. KNECHT ON PAGE 24 OF HIS REBUTTAL TESTIMONY?

A. First, my goal was to provide a cost of service study that would compare to the Company's before any of the OTS recommended adjustments concerning revenues and expenses. This was done because one does not know what adjustments the Company or the Commission would accept, thereby allowing a reasonable comparison of the cost of service studies to be made. By not reflecting this additional throughput, that goal was achieved. Second, the additional throughput is less than 1% of residential heating throughput and not materially higher as alleged by the OSBA. Finally, the OSBA provided no analysis to support its claim that this small amount would even make a difference in the cost of service study.

[7] Gas Rate Fundamentals, Fourth Edition, American Gas Association, 1987, p. 136.

Q. DID THE OSBA ADDRESS YOUR STATEMENT THAT BECAUSE THE COST OF MAINS CANNOT BE ASSIGNED TO ONE SPECIFIC CUSTOMER, THEY SHOULD NOT BE CONSIDERED CUSTOMER COSTS?

A. Yes. While it appears that the OSBA admits that mains are shared by customers in the various rate classes, OSBA simply states that this is not the issue and should not be used in the determination of cost allocation. To support this claim, the OSBA states that in the Pennsylvania American Water Company (PAWC) case I cited, certain indirect costs were classified as customer-related. Therefore, the OSBA believes that somehow in this case mains must be allocated based on the number of customers (OSBA St. No. 2, p. 16).

Q. IS IT CLEAR WHAT INDIRECT COSTS THE OSBA WAS REFERRING TO?

A. Yes. Mr. Knecht was referring to certain general plant costs that were deemed to be customer-related, which did not include the cost of mains. The question was whether or not these indirect costs should be used to determine the proper customer charge for PAWC. PAWC's proposal to include these costs in the customer charge was rejected.[8] As described above, the Commission had already

[8] 82 PA PUC, 381, 429 (1994).

determined the proper way to allocate the cost of mains and limited the costs that should be allocated to the customer charge portion of a customer's bill.

Q. WHAT TYPE OF SCALE-BACK DID YOU RECOMMEND IF THE COMMISSION GRANTS AN INCREASE OF LESS THAN $100 MILLION?

A. I proposed a targeted scale-back of rates by class which is designed to move the rates of return of the various customer classes closer to the cost of providing service to that class. I achieved this by proposing a greater rate increase to 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 below the system average rate of return (OTS St. No. 3, p. 18). I further recommended that the reduction in the usage rates should be proportional to the percent increase the Company proposed for each usage rate in each class. The specific recommendation by class is shown on OTS St. No. 3, p. 24.

Q. DID THE COMPANY ADDRESS YOUR SCALE-BACK RECOMMENDATION?

A. Yes. The Company disagrees with my targeted scale-back proposal, recommending a proportional scale-back if the Commission grants less than a full increase (PGW St. 5R, pp. 15-17).

Q. WHY DOES THE COMPANY RECOMMEND A PROPORTIONAL SCALE-BACK?

A. The Company believes that the original allocation properly balances the competing goals to charge cost based rates while avoiding a large increase for the residential class. PGW states that the high level of low income customers in Philadelphia must be taken into account when allocating the proposed increase in this case. The Company also believes that the standard rule of gradualism doesn't apply (PGW St. 5R, pp. 16-17).

Q. DID THE COMPANY OR ANY OTHER PARTY PROVIDE A VALID REASON FOR NOT ACCEPTING YOUR TARGETED SCALE-BACK RECOMMENDATION?

A. No, not in my opinion. First, I believe that the standard rule of gradualism does apply to PGW. Ignoring that rule will put an undue burden on some of PGW's customers. Second, my proposal places no more of an increase on the residential class than the Company's original proposal. My targeted scale-back recommendation should be applied in this case if the Commission grants less than a full increase, because the revenue received from each class will be closer to the corresponding cost of providing service to that class (OTS St. No. 3, p. 18).

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.

OTS Exhibit No. 4
Witness: Gary L Yocca

5/21/07 hrg
Phila DD
MS

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

Exhibit to Accompany

the

Direct Testimony

of

Gary L. Yocca

Office of Trial Staff

Concerning:

Capacity Release/Off-System Sales Proposal

RESPONSE TO OFFICE OF TRIAL STAFF DATA REQUEST REGARDING PGW'S BASE RATE FILING DOCKET NO. R-00061931

Question OTS-RS-7-D: Refer to PGW Statement No. 2, page 16: Describe, in detail, the "restricted fund" that any proceeds from the Capacity Release/Off-System Sales not used to fund the capital budget will be deposited into.

Response Provided By: Joseph F. Golden, Jr., Controller

Response: PGW would open an investment account/money market account to invest these funds. The investments would be consistent with the City's investment policy.

RESPONSE TO OFFICE OF CONSUMER ADVOCATE DATA REQUEST REGARDING PGW'S BASE RATE FILING

DOCKET NO. R-00061931

Question OCA-Set I-5: Were the Company to retain all, or a portion of, such capacity related margins and credits, why shouldn't they be segregated and used solely for gas supply related projects?

Response Provided By: Steven Hershey, Vice President Regulatory and External Affairs

Response: The off-system sales/capacity release retention proposal focuses on the need to fund necessary capital improvement projects without adding to PGW's already substantial amount of outstanding debt. The funds have the potential to provide broad benefit on a range of capital projects. Thus, PGW does not believe it would make sense to limit the use of these proceeds to certain projects identified as "gas supply related". Such limitation could limit the potential benefit to customers.

RESPONSE TO OFFICE OF TRIAL STAFF DATA REQUEST
REGARDING PGW'S BASE RATE FILING
DOCKET NO. R-00061931

Question OTS-RS-1-D: Provide a history of PGW's Capacity Release / Off- System Sales for the years ended August 31, 2002 through 2006.

Response Provided By: Nicholas La Pergola, Director, Gas Control and Gas Transportation.

Response: See attached schedule.

OTS Exhibit No. 4
Schedule 3
Page 2 of 2

OTS-RS-1-D Provide a history of PGW's Capacity Release/ Off-System Sales proceeds for the years ended August 31, 2002 through 2006

Off-System Sales			
Fiscal Year	Total Revenue	Ratepayer Margin	Total Credit To GCR
2002	$95,894	$19,594	$95,894
2003	$1,236,510	$569,647	$1,236,510
2004	$0	$0	$0
2005	$4,015,920	$460,239	$4,015,920
2006	$297,750	$68,809	$297,750

Capacity Release	
Fiscal Year	Total Credits
2002	$3,346,324
2003	$2,710,398
2004	$1,592,045
2005	$2,234,937
2006	$8,897,952

OTS Statement No. 4
Witness: Gary L Yocca

5/21/07
Phila. PA
MS

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

Direct Testimony

of

Gary L. Yocca

Office of Trial Staff

Concerning:

Capacity Release/Off-System Sales Proposal

Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

A. My name is Gary L.Yocca. My business address is P.O. Box 3265, Harrisburg, PA 17105-3265.

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

A. I am employed by the Pennsylvania Public Utility Commission in the Office of Trial Staff as a Fixed Utility Financial Analyst Supervisor.

Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. My education and professional background are set forth in Appendix A, which is attached.

Q. WHAT ARE YOUR DUTIES AS A TECHNICAL SUPERVISOR IN THE OFFICE OF TRIAL STAFF?

A. My current duties include supervision of a group of engineers who are responsible for the engineering, rate structure, revenue, quality of service, rate base and other issues that come before the Office of Trial Staff's Technical Division. I also provide expert testimony as required.

Q. PLEASE DESCRIBE THE ROLE OF OTS IN RATE PROCEEDINGS.

A. OTS was established by the legislature and is responsible for protecting the public interest in rate proceedings. The OTS analysis in this proceeding is based on its responsibility to represent the public interest. This responsibility requires the balancing of the interests of ratepayers and the Company.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. The purpose of my testimony is to address Philadelphia Gas Works' ("PGW") proposal to use Off-System Sales and Capacity Release proceeds to reduce debt and fund capital improvements.

Q. WHAT IS AN OFF-SYSTEM SALE?

A. An Off-System Sale is the sale of natural gas to a customer who is not located within the Natural Gas Distribution Company's ("NGDC") service territory. An Off–System Sale is usually made by using off-peak, downstream interstate pipeline capacity that is reserved for the firm retail customers of the NGDC.

Q. DESCRIBE THE CAPACITY RELEASE MECHANISM.

A. Capacity Release is a mechanism through which a holder of firm, interstate pipeline transportation capacity can allocate, release or assign, on a permanent or temporary basis, all or part of such capacity to others. This is normally accomplished through pre-arranged transportation or through the pipeline's

electronic bulletin board. The original holder of the firm transportation capacity may recover up to the maximum tariffed rate through a bidding of the capacity.

Q. HOW DOES PGW CURRENTLY TREAT THE REVENUE DERIVED FROM OFF-SYSTEM SALES AND CAPACITY RELEASE TRANSACTIONS?

A. PGW uses Capacity Release and Off-System Sales proceeds as an additional cost saving strategy consistent with its least cost procurement obligations. The prices for these transactions are negotiated and, in both instances, all associated credits and margins are returned to customers through the PGC.

Q. WHO PROVIDES THE FUNDS THAT MAKE THESE TRANSACTIONS POSSIBLE?

A. These transactions are possible due to the fact that Purchase Gas Cost ("PGC") customers provide funds that the Company recovers through the PGC rate.

Q. IS THIS TREATMENT DIFFERENT FROM WHAT THE OTHER NGDC'S IN PENNSYLVANIA DO WITH THEIR PROCEEDS?

A. Yes. Unlike PGW, the other major NGDC's in this state are privately owned. Performance based rates have been implemented for each of these companies which generally allow them to retain a certain percentage of the proceeds from these transactions. Since these are all privately owned, for profit companies, the

Commission has permitted them to do this as an incentive to maximize the benefit to their customers from these types of transactions.

Q. DESCRIBE PGW'S OFF-SYSTEM SALES/CAPACITY RELEASE PROPOSAL.

A. PGW is proposing to change the regulatory treatment of revenue derived from the proceeds associated with Off-System Sales and Capacity Release transactions. Currently, the proceeds from these activities flow through to customers as a credit to the Gas Cost Rate ("GCR"). PGW's proposal is for the proceeds to flow through to customers by making them available to fund necessary construction projects, rather than having to fund those projects through the issuance of additional long term debt (PGW St. 1, p. 5). By doing so, none of the revenue derived from these transactions will be used as a credit against their purchased gas costs.

Q. HAS PGW EXPLAINED ITS RATIONALE FOR MAKING THIS PROPOSAL?

A. Yes. PGW claims that its situation is unique, and that by applying the revenues from the Off-System Sales and Capacity Release transactions to the GCR as a credit to gas costs does nothing to change the underlying financial structure of the Company. Any customer benefit is on a short-term basis. According to the Company, funding its construction program with these funds 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 (PGW St. 1, p. 5). This is because while the interest rate on the debt is relatively low, the transaction costs and the additional earnings necessary to meet bond ordinance coverage requirements makes the borrowing option much more expensive according to PGW witness Bogdonavage (PGW St. 2, p. 13).

Q. HOW DOES THE PROJECTED $10,000,000 IN PROCEEDS FROM THE OFF-SYSTEM SALES/CAPACITY RELEASE TRANSACTIONS FIT INTO THE COMPANY'S DEBT REDUCTION PLAN?

A. PGW has a plan which it has characterized as its "Financial Stability Plan." The goal of this plan is to seek to obtain as close to a 50/50 capital structure as reasonable while maintaining or reducing its long and short term debt service costs. To implement the plan, PGW proposes that a portion of the revenues produced by this requested base rate increase be placed in a restricted fund.[1] PGW claims that if granted the full rate request, it would be able to generate contributions of $145 million to the restricted fund over a five-year period (PGW St. 2, pp. 14-15). The $10,000,000 that PGW is projecting to be produced by permitting the Company to retain the proceeds from Off-System Sales and Capacity Release transactions are proposed to be employed to fund necessary

[1] OTS Ex. No. 4, Sch. 1 indicates that PGW would open an investment/money market account to invest these funds, and that any investments would be consistent with the City of Philadelphia's investment policy.

capital improvements and reduce outstanding debt. The Company claims that it is committing to deposit into the restricted fund 100 percent of the proceeds from these transactions not utilized to fund its approved capital budget. In this manner, it is claimed that the Commission will have the assurance that these funds will be used for their intended purposes (PGW St. 2, pp. 15-16).

Q. WHAT IS YOUR POSITION REGARDING PGW'S PROPOSAL ON OFF-SYSTEM SALES AND CAPACITY RELEASE TRANSACTIONS?

A. My position is that the Commission should reject the Company's proposal, and that PGW should be required to continue crediting 100 percent of the net proceeds from those transactions against PGC costs.

Q. WHY SHOULD THE COMMISSION REJECT THE COMPANY'S PROPOSAL?

A. The proposal should be rejected because it violates several tenets of ratemaking. First, it violates the Commission's requirement under 66 Pa. C.S.A. § 1318 that gas costs be consistent with a least cost fuel procurement requirement. Second, it grants an unreasonable advantage to a group of customers as a result of the uses to which the proceeds are proposed to be employed. Third, this proposal will violate the Commission's Regulations at 52 Pa. Code § 60.4. Rebuttable presumptions. Fourth, this proposal will set an unwanted precedent if it is approved because approval will open the mythological "Pandora's Box" for the remaining 1307(f)

NGDC's. Fifth, based on OTS's analysis, the $10,000,000 isn't needed by the Company at this time. See OTS St. No.1, the Direct Testimony of OTS witness Robert Plonski.

Q. HOW DOES THE COMPANY'S PROPOSAL VIOLATE THE COMMISSION'S LEAST COST PROCUREMENT REQUIREMENT?

A. The Public Utility Code states that no rates shall be deemed just and reasonable unless it is found that the utility is pursuing a least cost fuel procurement policy consistent with its obligation to provide safe, adequate and reliable service to its customers.[2] In my opinion, the Company's proposal deviates from this requirement to the detriment of the PGC customers. By not applying the Off-System Sales/Capacity Release credits to the total cost of gas, PGW is not pursuing a least cost procurement policy as required by the Statute. PGW has credited 100 percent of the proceeds from these activities to the PGC from the time that it was required to make 1307(f) filings before the Commission, thereby reducing the total costs to the PGC customers. This practice should continue with the current and future 1307(f) filings.

[2] 66 Pa.C.S.A. § 1318. Determination of just and reasonable gas cost rates, (a) General rule.

Q. EXPLAIN WHY THIS PROPOSAL UNREASONABLY DISADVANTAGES PGC CUSTOMERS.

A. This proposal violates the basic ratemaking tenet that no public utility shall make or grant any unreasonable preference or advantage to any person, corporation, or municipal corporation or subject any person, corporation, or municipal corporation to any unreasonable prejudice or disadvantage.[3] The money to fund Off-System Sales and the Capacity Release transactions comes from the PGC customers. Based on my understanding of PGW's proposal, the so-called benefits will be returned to all ratepayers, including transportation customers. The Company has not specified what projects that these funds will be used for (OTS Ex. No. 4, Sch. 2), and has offered no guarantees that the benefits of any plant additions, or reduction in debt will only accrue to PGC customers. Maintaining the *status quo*, however, does ensure that the PGC customers will remain the beneficiaries as a result of the funds that they are providing to the Company.

Q. HOW IS THE COMPANY'S PROPOSAL CONTRARY TO § 60.4. OF THE PUBLIC UTILITY CODE?[4]

A. The Code states that there shall be a Rebuttable presumption in rate proceedings that additional fixed costs may not be recovered from remaining retail customers due to retail customers' use of transportation service. In my opinion, PGW's

[3] 66 Pa. C.S.A. § 1304. Discrimination in rates.
[4] 52 Pa. Code § 60.4. Rebuttable presumptions.

proposal creates this exact situation. As I stated above, it is likely that any project constructed using these PGC provided funds will accrue to the benefit of all of PGW's customers, including transportation customers. The same can be said for any reduction in PGW's debt service. Certain safeguards for retail customers have been built into Chapter 60, regarding natural gas transportation service, of the Public Utility Code. The general concept is that transportation service by NGDC is in the public interest, but it has always been recognized that any shifting of costs between retail customers and transportation customers should be minimized. The Company's proposal does not guarantee that this will be the case.

Q. YOU STATED THAT THIS PROPOSAL WILL PRODUCE AN UNWANTED PRECEDENT. CAN YOU EXPLAIN WHAT YOU MEAN BY THAT?

A. Yes. As I stated above, the remaining 1307(f) NGDC's are privately owned, and have implemented performance based rates which generally allow them to retain a certain percentage of the proceeds from these transactions. Although PGC customer funds make these transactions possible, the Commission has permitted these companies to make a limited profit as an incentive to maximize the benefits to their customers. The concern that I have is that if PGW is permitted to use these proceeds as they have requested, i.e., for purposes outside the context of the 1307(f) proceeding, the remaining 1307(f) companies will see this as a precedent that can justify proposals for the use of these funds other than as a credit against

total gas costs. This would further complicate those 1307(f) proceedings, and potentially lessen benefits to all PGC customers on those systems.

Q. WHY DOESN'T THE COMPANY NEED THE USE OF THESE FUNDS AS THEY HAVE PROPOSED IN THIS PROCEEDING?

A. Based on the OTS analysis of this filing, the Company doesn't need any rate relief at this time. In fact, our analysis indicates that there is approximately a $10,000,000 cushion based on our adjustments. The testimony of the other OTS witnesses details our adjustments to PGW's claims in this proceeding. While OTS is not proposing a reduction in present rates, we believe that there are sufficient funds for projects without violating the current PGC mechanism. The bottom line is that this proposal is not necessary from a financial standpoint, and not appropriate based on the reasons that I have stated above.

Q. ARE YOU AWARE OF ANY CIRCUMSTANCE WHERE THE COMMISSION HAS PERMITTED PGW TO RETAIN A PORTION OF PURCHASED GAS RELATED FUNDS FOR PURPOSES OTHER THAN THE RECOVERY OF THOSE COSTS?

A. Yes. PGW submitted an Informational Filing to the Commission on December 12, 2001. By that filing, PGW sought permission to retain the amount of $17.58 million in GCR overcollections to enable it to meet bond ordinance covenant requirements through January, 2002. By Secretarial Letter issued on December

26, 2001, PGW was permitted to keep a $10.58 million of the reserve account funds, which constituted GCR overcollections during the 2001 period. At that time, the Commission was convinced that allowing the Company to retain those GCR overcollections was necessary to enable it to meet its debt service and cash obligations as provided for in the Interim Rate Settlement, which was approved by Commission Order adopted on February 21, 2001 at Docket No. R-00005654.[5] As I stated above, the situation is different now compared to the limited circumstances in the prior incident. According to the OTS analysis, PGW is able to meet its bond ordinance covenant requirements through the end of the future test year.[6]

Q. WHAT LEVEL OF PROCEEDS IS THE COMPANY ESTIMATING FOR PURPOSES OF THIS PROCEEDING?

A. The Company is estimating that it will see proceeds in the $10,000,000 range over the next six fiscal years (PGW Ex. JRB-1, p. 11).

Q. WHAT ADVANTAGE IS THERE IN MAINTAINING THE USE OF THESE FUNDS AS A CREDIT AGAINST GAS COSTS?

A. The advantage of keeping these dollars, which have fluctuated widely historically (OTS Ex. No. 4, Sch. 3) as a credit against total gas costs is that the actual

[5] 2002 Pa. PUC LEXIS 33.
[6] See OTS Statement No. 1, Direct Testimony of Robert Plonski.

numbers are taken into account as a result of the reconciliation of the gas costs over time. By maintaining them as a credit against gas costs, it is not necessary to isolate them into a restricted fund as PGW has proposed. If the Company is able to increase the level of the proceeds to the projected amount, so much the better for the PGC customers in terms of their total gas costs. Moreover, in a time of fluctuating gas costs, the credit provides needed rate relief to all PGC customers.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

APPENDIX A

Gary L. Yocca

P.O. Box 3265
Harrisburg, PA 17105-3265
(717)783-8084

Career Summary: *Fixed Utility Financial Analyst Supervisor* with fifteen years of experience in supervising technical experts in the Commission's Office of Trial Staff, and with thirty one years of experience in analyzing economic, engineering, financial, quality of service and rate structure data in major gas, electric, telecommunications, water, sewer and steam heat cases. I have presented expert testimony, which covers a wide range of technical issues in numerous proceedings before the Commission.

Fixed Utility Financial Analyst Supervisor **Current**
PENNSYLVANIA PUBLIC UTILITY COMMISSION
OFFICE OF TRIAL STAFF
OTS TECHNICAL STAFF
SUPERVISOR – ENGINEERING SECTION HARRISBURG, PA

As a result of the creation of the Bureau of Fixed Utility Services and the reorganization of the Office of Trial Staff, effective April 1, 1996 my supervisory responsibilities were changed to include the areas of Engineering, Revenue and Rate Structure for all fixed utility types. During the course of formal and informal investigations personnel under my direction are responsible for reviewing and presenting recommendations regarding tariff rate schedules, tariff rules and regulations, measures of value claims, revenue annualizations, depreciation claims, fuel purchasing practices and economic analyses. They are also responsible for reviewing all pertinent supporting information such as cost of service studies, bill frequency analyses, proofs of revenue, depreciation studies, water quality test results and formal complaints.

Fixed Utility Financial Analyst Supervisor **2 Years**
PENNSYLVANIA PUBLIC UTILITY COMMISSION
OFFICE OF TRIAL STAFF
TELECOMMUNICATIONS/WATER DIVISION
RATE STRUCTURE/ENGINEERING SECTION HARRISBURG, PA

From March of 1994 to March of 1996 my responsibilities included the supervision and direction of the Rate Structure/Engineering Section, and assisting the Legal Division of the Office of Trial Staff in all aspects of rate structure, rate base and quality of service litigation in water, sewer and telecommunications filings.

Fixed Utility Financial Analyst Supervisor **2 Years**
PENNSYLVANIA PUBLIC UTILITY COMMISSION
OFFICE OF TRIAL STAFF
ENGINEERING AND RATE DESIGN DIVISION
ANALYSIS SECTION HARRISBURG, PA

I was named Section Chief of the Analysis Section of the Engineering and Rate Design Division in February 1992. My responsibilities were essentially the same as those above, except that my section was responsible for the rate structure and engineering aspects of all utility types including gas, electric and steam heat.

Fixed Utility Financial Analyst 3 **5 ½ Years**
PENNSYLVANIA PUBLIC UTILITY COMMISSION
OFFICE OF TRIAL STAFF
ENGINEERING AND RATE DESIGN DIVISION HARRISBURG, PA

I performed the functions of an expert witness in major water, steam heat, gas and electric cases before the Pennsylvania Public Utility Commission from September 1986 to February 1992. My testimony covered many issues ranging from cost of service and rate design to natural gas transportation issues.

Fixed Utility Financial Analyst 3 ***3 ½ Years***
PENNSYLVANIA PUBLIC UTILITY COMMISSION
BUREAU OF RATES
ELECTRIC DIVISION HARRISBURG, PA

I was an expert witness during the period from December 1982 until August 1986. I addressed various issues including rate structure, revenues and sales levels. I was also responsible for analyzing and making recommendations on numerous electric tariff filings including economic development rates.

Bureau of Rates Liaison to the Federal Energy Regulatory Commission (FERC) **6 Months**
PENNSYLVANIA PUBLIC UTILITY COMMISSION
BUREAU OF RATES
ELECTRIC DIVISION HARRISBURG, PA

Concurrently with the above duties, for a six-month period in 1982 and 1983, I participated in hearings and settlement conferences before FERC on natural gas transmission matters.

Public Utility Analyst 3 **3 ½ Years**
PENNSYLVANIA PUBLIC UTILITY COMMISSION
BUREAU OF RATES
GAS DIVISION HARRISBURG, PA

From February 1979 to November 1982, my main role was to perform the duties of an expert witness on revenue and expense issues in major gas utility rate cases. The issues that I addressed ranged from normalized sales levels to annualizations of claimed expenses.

Fixed Utility Financial Analyst 1 and 2 **3 Years**
PENNSYLVANIA PUBLIC UTILITY COMMISSION
BUREAU OF RATES AND RESEARCH
ENERGY DIVISION HARRISBURG, PA

After joining the Pennsylvania Public Utility Commission in February 1976, I performed the duties of a Public Utility Analyst 1 and 2. For the first three years I worked mainly on major gas and electric cases with increasing levels of responsibility in the areas of revenues and expenses.

Production Analyst **5 Years**
UNITED STATES ARMY SECURITY AGENCY
USASAFS BERLIN BERLIN, GERMANY

During my final three years in the U.S. Army, I performed the duties of a Production Analyst and a Senior Voice Intercept Operator – German Language Transmissions at the Army Security Agency's Field Station in Berlin,

Germany. I prepared operational reports to the National Security Agency and developed procedures to analyze the operational efficiency of the unit. As a Senior Voice Intercept Operator, I had supervisory responsibility over thirteen other Voice Intercept Operators.

APPENDIX A

Education

Master of Science in Business Administration, Cum Laude — **1977**
BOSTON UNIVERSITY — BOSTON, MA

Major: Boston University's MBA Program focused on Business Management, and included courses in Economics, Accounting, Management and Statistics.

Bachelor of Science — **1969**
THE PENNSYLVANIA STATE UNIVERSITY — UNIVERSITY PARK, PA

Major: My major was Ceramic Science in the College of Earth and Mineral Sciences. The program focused on the engineering and chemistry of non-organic, non-metallic materials that are generally formed at and are able to withstand high temperatures.

Numerous Conferences and Seminars Concerning Public Utility Regulation, Economic and Management — **1976 to Present, Various Locations**

I have attended over 100 conferences and seminars since I began employment with the Public Utility Commission. A detailed listing is available.

Testimony

The following list provides an index of the natural gas distribution, electric power, telecommunications, steam heat, sewer and water service utility cases in which I have presented expert testimony before the Pennsylvania Public Utility Commission.

1. Docket No. A-110300F0095, Metropolitan Edison Company
2. Docket No. A-110400F0040, Pennsylvania Electric Company
3. Docket No. A-122250F5000, Equitable Gas Company and The Peoples Natural Gas Company, d/b/a Dominion Peoples
4. Docket Nos. A-211770, A-230242 and G-910255, LP Water and Sewer Company
5. Docket No. I-830374, Pennsylvania Power and Light Company
6. Docket No. I-900009, Equitable Gas Company
7. Docket No. I-00920015, Conestoga Telephone & Telegraph Company
8. Docket No. P-920567, Metropolitan Edison Company and Pennsylvania Electric Company
9. Docket No. P-00951005, Frontier Communications of Breezewood, Inc., Et. Al.
10. Docket No. P-00961024, Commonwealth Telephone Company
11. Docket No. P-00971182, Ironton Telephone Company

12. Docket No. P-0062213, Metropolitan Edison Company
13. Docket No. P-0062214, Pennsylvania Electric Company
14. R.I.D. 296, F-2, Pennsylvania Gas & Water Company – Gas Division
15. Docket No. R-78120714, Columbia Gas of Pennsylvania, Inc.
16. Docket No. R-79030781, Philadelphia Electric Company – Gas Operations
17. Docket No. R-79090956, National Fuel Gas Distribution Corporation
18. Docket No. R-79100972, Apollo Gas Company
19. Docket No. R-80111375, North Penn Gas Company
20. Docket No. R-811600, National Fuel Gas Distribution Corporation
21. Docket No. R-811719, Philadelphia Electric Company – Gas Operations
22. Docket No. R-821906, The Peoples Natural Gas Company [Not entered in record due to settlement]]
23. Docket No. R-822042, Columbia Gas of Pennsylvania, Inc.
24. Docket No. R-822250, Pennsylvania Electric Company
25. Docket No. R-842583, Duquesne Light Company
26. Docket No. R-842651, Pennsylvania Power & Light Company
27. Docket No. R-842770, Metropolitan Edison Company
28. Docket No. R-842771, Pennsylvania Electric Company
29. Docket No. R-850021, Duquesne Light Company
30. Docket No. R-850267, Pennsylvania Power Company
31. Docket No. R-860378, Duquesne Light Company
32. Docket No. R-860384, Metropolitan Edison Company
33. Docket No. R-860413, Pennsylvania Electric Company
34. Docket No. R-870666, Equitable Gas Company
35. Docket No. R-870687, Lake Latonka Water Company
36. Docket No. R-870825, Western Pennsylvania Water Company
37. Docket No. R-870840, Philadelphia Suburban Water Company
38. Docket No. R-880941, Equitable Gas – Energy Company
39. Docket No. R-880971, Equitable Gas Company
40. Docket No. R-880979, Pennsylvania Electric Company
41. Docket No. R-891238, Equitable Gas Company
42. Docket No. R-891283, Chartiers Natural Gas Company, Inc.
43. Docket No. R-901595, Equitable Gas Company
44. Docket No. R-901607, The Peoples Natural Gas Company [Not entered in record due to settlement]
45. Docket No. R-901870, Equitable Gas – Energy Company
46. Docket No. R-911909, Pennsylvania American Water Company
47. Docket No. R-911925, Equitable Gas Company
48. Docket No. R-912164, Equitable Gas Company

49. Docket No. R-00922180, The Peoples Natural Gas Company
50. Docket No. R-00922206, The Peoples Natural Gas Company
51. Docket No. R-00922319, Glen Alsace Water Company
52. Docket No. R-00922482, Pennsylvania Gas & Water Company – Scranton Water Rate Area
53. Docket No. R-00932673, Lemont Water Company
54. Docket No. R-00943008, Bell Atlantic – Pennsylvania, Inc.
55. Docket No. R-00943156, Borough of Schuylkill Haven
56. Docket No. R-00953416, North Penn Gas Company
57. Docket No. R-00038173, Philadelphia Gas Works
58. Docket No. R-00049157, Philadelphia Gas Works[Not entered in record due to settlement]
59. Docket No. R-00049255, PPL Electric Utilities Corporation
60. Docket No. R-00061297, Emporium Water Company
61. Docket No. R-00061366, Metropolitan Edison Company
62. Docket No. R-00061367, Pennsylvania Electric Company

OTS Statement No. 4-SR
Witness: Gary L Yocca

5/21/07
PhD DD
MS

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

Surrebuttal Testimony

of

Gary L. Yocca

Office of Trial Staff

Concerning:

Capacity Release/Off-System Sales Proposal

Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

A. My name is Gary L.Yocca. My business address is P.O. Box 3265, Harrisburg, PA 17105-3265.

Q. ARE YOU THE SAME GARY L. YOCCA WHO FILED OTS STATEMENT NO. 4 ON APRIL 6, 2007?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to address the rebuttal testimony filed by Steven P. Hershey on behalf of Philadelphia Gas Works ("PGW" or "Company") regarding PGW's proposal to utilize the proceeds from Off-System Sales and Capacity Release credits to fund capital projects rather than as a credit to PGW's Purchased Gas Costs (PGC).

Q. CAN YOU SUMMARIZE YOUR RECOMMENDATION REGARDING PGW'S PROPOSED USE OF PROCEEDS FROM OFF-SYSTEM SALES AND CAPACITY TRANSACTIONS?

A. Yes. In my Direct Testimony, I stated that the Commission should reject the Company's proposal, and that PGW should be required to continue crediting 100% of the net proceeds from these transactions against PGC costs.

Q. MR. HERSHEY CLAIMS, ON PAGE 11 OF HIS REBUTTAL TESTIMONY, THAT YOU CONFUSED PGW'S GAS SUPPLY POLICIES WITH THE WAY IN WHICH THE RESULTS OF SUCH POLICIES ARE RETURNED TO THE RATEPAYERS. DO YOU HAVE ANY COMMENTS ABOUT THIS CLAIM?

A. Yes. First, I am not confused by the distinction between the Company's obligation to pursue a "least cost fuel procurement policy" and the ratemaking treatment of any savings or reductions in gas costs as a result of that policy. PGW is the party that has proposed to place what has traditionally been a purchase gas cost issue pursued in §1307(f) proceedings into the ratemaking arena. My testimony recommends that the Company continue its Commission approved treatment of any Off-Systems Sales and Capacity Release credits as an offset to gas costs to the PGC customers. Based on my years of experience in dealing with 1307(f) issues at the Commission, these credits have always been considered an integral part of a company's least cost procurement policy. While the Company believes that it is striving to maximize these Off-System Sales and Capacity

Release credits, it is my opinion that taking these gas cost-related credits out of the §1307(f) process is not in the public interest for PGW and its ratepayers and for the other natural gas distribution companies (NGDCs) and their ratepayers in this state.

Q. WHAT COMMENTS DO YOU HAVE REGARDING MR. HERSHEY'S CLAIM THAT YOU MISSTATED THE ACTUAL STATUTORY STANDARD SET FORTH IN 66 PA. C.S. §1318 (PGW ST. 1R, P. 11).

A. It appears that I have quoted that standard in my direct testimony in the same manner as Mr. Hershey did in his rebuttal testimony. I am confident of what that standard is after many years of working on and supervising §1307(f)'s for all of the NGDC's in Pennsylvania. There has never been any question that the least cost obligation must be tempered by a NGDC's obligation to provide safe, adequate and reliable service. Having relatively low gas costs is no panacea if there is no gas available during a cold spell in the middle of the winter.

Q. DO YOU HAVE ANY COMMENTS ON MR. HERSHEY CLAIM THAT THE COMMISSION HAS APPROVED THE DIVERSION OF SOME OF THE CREDITS OUT OF THE GCR, DEMONSTRATING THAT THIS IS CONSISTENT WITH THE UTILITY'S PROVISION OF SAFE, ADEQUATE AND RELIABLE SERVICE, AND THAT DEVOTING 100% OF CREDITS TO THE PGC IS NOT REQUIRED?

A. Yes. I pointed out in my direct testimony that other NGDCs have performance based rates (PBRs) that have been approved by the Commission (OTS St. No. 4, p. 9). The genesis of the PBRs was to provide an incentive, in the form of a limited profit, for these privately-owned NGDCs to enhance the credits to gas costs over and above what they would do in the normal course of business. The goal was to provide an even greater benefit to the PGC customers than would otherwise be realized. These PBRs are reviewed in each §1307(f) proceeding, and are subject to change if they are not providing the projected benefits to the PGC customers. This type of review process would not take place under PGW's proposal. I also stated that my concern is that if PGW is permitted to use these proceeds as they have requested, i.e., for purposes outside the context of the §1307(f) proceeding, the remaining §1307(f) companies will see this as a precedent that can justify proposals for the use of these funds other than as a credit against total gas costs.

Q. ACCORDING TO MR. HERSHEY, PGW'S PROPOSAL TO FUND CAPITAL PROJECTS WILL BENEFIT ALL CUSTOMERS, BUT THAT THE PRIMARY BENEFIT WILL ACCRUE TO FIRM SALES CUSTOMERS (PGW ST. 1R, P. 12). DOES THIS CHANGE YOUR OPINION OF HOW THIS PROPOSAL VIOLATES THE BASIC RATEMAKING TENET YOU DESCRIBED ON PAGE 8 OF YOUR DIRECT TESTIMONY?

A. No. The basic problem still exists. That is, this proposal will admittedly grant a preference or advantage to transportation and interruptible customers that they would otherwise not receive. Since the Company has not specified how this money will be used on capital projects, it is impossible to quantify the net benefits to any particular group of customers. This also violates the safeguards built into Chapter 60 of the Public Utility Code, regarding natural gas transportation service that I described on pages 8 and 9 of my direct testimony, because there will admittedly be some shifting of fixed costs from firm to transportation customers.

Q. DO YOU HAVE ANY COMMENTS ON MR. HERSHEY'S CONTENTION, ON PAGE 13 OF HIS REBUTTAL TESTIMONY, THAT YOU DO NOT SUFFICIENTLY ACKNOWLEDGE THE KEY DIFFERENCE BETWEEN PGW AND THE OTHER NGDCS?

A. Yes. The fact that the other NGDCs are investor owned and PGW is a municipal corporation is one of the reasons that PGW does not have a PBR sharing mechanism in place. The OTS position has been that since PGW is a municipal corporation, without the profit motive, there is no need for an incentive mechanism to enhance the potential credits from Off-System Sales and Capacity Release transactions. I have already discussed the PBRs and the rationale for their existence. §1307(f) companies are permitted dollar for dollar recovery of all gas costs. In general, for natural gas customers, the cost of gas is the main factor that impacts their overall bill. This impact is especially a concern for customers situated similarly to those of PGW. The Off-System Sales/Capacity Release credits are the one offset to the overall cost of gas over which a company has limited control, unlike capital budgets which can be changed depending on the circumstances. PGC customers pay for the gas-related assets that create the credits. Therefore, any proceeds need to go back to them through the §1307(f) mechanism. In terms of PGW, it is my opinion that the *status quo* in terms of these credits should remain in effect, and that the current 1307(f) filing should reflect the projected credits that the Company is proposing in this proceeding.

Q. THE COMPANY CLAIMS YOUR CONTENTION THAT IT DOES NOT NEED THE PROCEEDS FROM THE OFF-STSTEM SALES AND CAPACITY RELEASE TRANSACTIONS TO FUND CAPITAL PROJECTS IS WRONG. HOW DO YOU RESPOND TO THAT?

A. On page 13 of his rebuttal testimony, Mr. Hershey states that the testimony of Mr. Bogdonavage and other PGW witnesses demonstrate that the argument on page 10 of my direct testimony is wrong. I stand by my testimony on the basis of the analysis of the other OTS witnesses and the overall position that we are proposing in this proceeding. My position remains that this proposal is not necessary from a financial standpoint, and not appropriate based on the reasons that I stated in my direct testimony.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.

OTS Statement No. 5
Witness: Ralph Graeser

3/21/07
Phila PD
MS

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

Direct Testimony

of

Ralph Graeser

Office of Trial Staff

Concerning:

Gas Safety

Q. PLEASE PROVIDE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Ralph Graeser. My business address is P.O. Box 3265, Harrisburg, PA 17105-3265.

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

A. I am employed by the Pennsylvania Public Utility Commission as a Gas Safety Inspector in the Bureau of Transportation and Safety. I am currently reassigned to the Technical Division of the Office of Trial Staff to provide input regarding gas safety issues in the instant proceeding.

Q. WOULD YOU PLEASE DESCRIBE THE ROLE OF OTS IN RATE PROCEEDINGS?

A. OTS was established by the legislature and is responsible for protecting the public interest in rate proceedings. The OTS analysis in this proceeding is based on its responsibility to represent the public interest. This responsibility requires the balancing of the interests of ratepayers and the Company.

Q. WHAT IS YOUR EDUCATIONAL, PROFESSIONAL AND EMPLOYMENT EXPERIENCE?

A. A summary of my educational, professional and employment experience is attached as Appendix A.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to address issues concerning Philadelphia Gas Works (PGW or Company) gas safety management. Specifically, I will be recommending the following: (1) PGW must implement a computerized leak monitoring system to ensure that information regarding leak history is readily available and easily accessed; (2) PGW must implement a schedule to repair Class 2 leaks to ensure that active leaks are repaired before they become hazardous to the public and require immediate repair; (3) PGW must continue to meet and, if possible, exceed its current replacement level of cast iron pipe.

Q. IN GENERAL, WHY DO YOU BELIEVE THE ABOVE-REFERENCED RECOMMENDATIONS ARE NECESSARY?

A. The Company must provide safe and reliable service to its customers. In my opinion, PGW's gas safety practices are a vital component of fulfilling this obligation. I believe that the recommendations listed above and discussed in greater detail below are important to improve PGW's gas safety management and will ensure that PGW ratepayers continue to receive safe and reliable service from the Company.

COMPUTERIZED LEAK MONITORING SYSTEM

Q. WHAT TYPE OF LEAK MONITORING SYSTEM DOES PGW CURRENTLY HAVE IN PLACE?

A. It is my understanding that PGW currently keeps track of leaks manually through a paper trail, and that the information is not compiled electronically.

Q. WHAT IS YOUR CONCERN WITH REGARD TO THIS SYSTEM?

A. PGW currently monitors 343 Class 2 leaks and 2,196 Class Three leaks (OTS Ex. No. 5, Sch. 1). Keeping track of existing and new leaks manually, rather than electronically, increases the likelihood of misplacing important information. Moreover, compiling the information electronically will enable the Company to keep this information in one central location so that it is readily accessible to other departments for budget purposes. The electronic spreadsheet will also allow specific information to be sorted and accessed using different criteria.

Q. WHAT DO YOU RECOMMEND?

A. I recommend that PGW implement an electronic leak monitoring system.

Q. WHY DO YOU RECOMMEND THAT AN ELECTRONIC LEAK MONITORING SYSTEM BE IMPLEMENTED?

A. The electronic leak monitoring system will enable the Company to easily access important information regarding leak history and location. This problem became

apparent when, through discovery, I asked the Company to provide information on leak detections that are over one through five years old, including a breakdown by year and by classification (OTS Ex. No. 5, Sch. 1). The Company informed me that it would take between ten days to four weeks to provide the requested information because it required a manual evaluation of all 2,539 paper records to determine the date found of each leak record. In my opinion, this timeframe is too long because the information should be easily accessible. The specific format of the electronic leak monitoring system should be left to the Company's discretion, but it can be as simple as a Microsoft Excel program. I believe that maintaining an electronic spreadsheet to track leak history will be far superior to the current filing system because it is an inexpensive way to more efficiently track leaks on its system.

LEAK REPAIR SCHEDULE

Q. HOW DOES PGW RESPOND TO LEAKS IN ITS PIPELINE SYSTEM?

A. PGW has a 90 day and 30 day schedule to pinpoint, repair, or recheck 2,575 open leaks (OTS Ex. No. 5, Sch. 2). It is my understanding that the Class 3 leaks are on a 90 day schedule and the Class 2 two leaks are on a 30 day schedule. Therefore, PGW will pinpoint, repair or recheck the 2,196 open leaks a total of 12,900 ([2,196 x 4] + [343 x 12]) in 2007 (OTS Ex. No. 5, Sch. 3).

Q. WHAT IS YOUR CONCERN WITH REGARD TO PGW'S CURRENT LEAK REPAIR SCHEDULE?

A. My concern is that PGW does not maintain a leak repair schedule for the 341 Class 2 leaks on its system. The current system ensures that the Company will continuously check the leak, but there is no set deadline of when the leak will be repaired. This can allow existing leaks to become hazardous to the public and would require immediate action to make the leak safe. Budgeting leak repairs allows the Company to eliminate leaks from the system before they become hazardous.

Q. WHAT DO YOU RECOMMEND?

A. I recommend that PGW institute a leak repair schedule for Class 2 leaks that will ensure the leak is repaired within a twelve month period.

Q. WHY DO YOU RECOMMEND THAT A LEAK REPAIR SCHEDULE BE IMPLEMENTED?

A. I believe that this recommendation is important to ensure that Class 2 leaks are repaired before they become hazardous. PGW's current system does not require that these leaks be repaired in a specific time frame, it only requires the Company to check on those leaks every 30 days. For example, in a discovery response, PGW noted that it is continuing to monitor 2 existing leaks from 2004, 15 leaks from 2005, and 153 leaks from 2006 (OTS Ex. No. 5, Sch. 1). Requiring these

leaks to be repaired within a twelve month period is beneficial because the longer a leak exist; more gas is lost and can create hazardous conditions. Moreover, a set twelve month repair schedule will reduce the number of hours PGW employees spend in the field checking on leaks because it is my understanding that the Company checks on Class 2 leaks every 30 days until some unspecified date when the leak is repaired. In 2007, these efforts are projected to result in 4,116 trips to check on 343 Class 2 leaks, some of which have remained on PGW's system since 2004 (OTS Ex. No. 5, Sch. 3). Placing Class 2 leaks on a repair schedule will eliminate the need to monitor the leak every 30 days because it will be repaired within the twelve month period.

PIPELINE REPLACEMENT PROGRAM

Q. WHAT IS PGW'S PIPELINE REPLACEMENT PROGRAM?

A. PGW must replace 1% of its pipeline per year. This mandate came from a stratified management and operations audit submitted to the Commission in January 2001. The audit recommended that 1.5%, or 27 miles, of cast iron pipe be replaced annually. PGW, in its implementation plan, agreed to replace approximately 1%, or 18 miles, of cast iron pipe annually.

Q. DO YOU BELIEVE THAT THE COMPANY HAS SATISFIED THE 1% REPLACEMENT RATE?

A. Yes. Since 2000, PGW has replaced 118 miles of cast iron pipe according to the Department of Transportation's 2000-2006 Annual Report of Gas Distribution Systems, which is an average of over 19 miles per year.

Q. WHAT DO YOU RECOMMEND?

A. I recommend that PGW continue to meet and, when possible, exceed the 1% replacement rate.

Q. WHY DO YOU RECOMMEND THAT PGW CONTINUE TO MEET AND EXCEED THE 1% REPLACEMENT RATE?

A. PGW has 1,624 miles of cast iron pipe in its system (OTS Ex. No. 5, Sch. 4). The Company should continue to aggressively replace its cast iron pipe because cast iron pipe joints are prone to leak as the caulked joints deteriorate and cast iron pipes can break during severe weather changes. In fact, since 2000, over 14,000 leaks were repaired on PGW's cast iron pipeline according to the Department of Transportation Annual Report of Gas Distribution Systems for the years 2000 through 2006. Cast iron main breaks often result in large amounts of gas being released and become hazardous to the public, and are the leading cause of leaks on mains in PGW's distribution system. While replacing pipe is expensive, the

investment would be partially offset by reductions in the cost to repair joint and main leaks and a decrease in the Company's lost and unaccounted for gas.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

Appendix A

Professional and Educational Experience of
Ralph A. Graeser

Professional Experience

September 1984 to Present: Pennsylvania Public Utility Commission, Harrisburg, Pennsylvania – Gas Safety Inspector - Responsible, primarily for the review of gas utilities to determine compliance with state and federal gas safety regulations.

June 1978 to September 1984: Heath Consultants, Belle Vernon, Pennsylvania-Supervisor-Participated in the coordination of the services provide in the leak detection field. Oversee the manpower to complete the services provided in leak detection.

Education

Bachelor of Science, Forestry, Pennsylvania State University, 1977

Various courses at the Transportation Safety Institute involving Federal Pipeline Safety Regulations 1985 to present.

Committee member in the Eastern Gas Compressor Roundtable Course and the Appalachian Underground Corrosion Short Course.

OTS Exhibit No. 5
Witness: Ralph Graeser

5/21/07
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PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

Exhibit to Accompany

the

Direct Testimony

of

Ralph Graeser

Office of Trial Staff

Concerning:

Gas Safety

RESPONSE TO OFFICE OF TRIAL STAFF DATA REQUEST
REGARDING PGW'S BASE RATE FILING
DOCKET NO. R-00061931

Question OTS-GS-3: How many leak indications are over 1 through 5 years old? Please provide a breakdown by year and by classification.

Response Provided By: Steven Groeber, Director – Field Operations and work Planning

Response: The number of total leaks reported below differ slightly from PGW's response to OTS-GS-1 because the data provided in response to OTS-GS-1 is reported as of 3/15/07 and the below data is reported as of 4/2/07.

Number of Class 2 type leaks:

2007 – 173
2006 – 153
2005 – 15
2004 – 2
2003 – 0
2002 – 0

Total – 343

Number of Class 3 type leaks:

2007 - 398
2006 – 461
2005 – 897
2004 – 174
2003 – 176
2002 (or older) 90

Total – 2,196

RESPONSE TO OFFICE OF TRIAL STAFF DATA REQUEST
REGARDING PGW'S BASE RATE FILING
DOCKET NO. R-00061931

OTS-GS-2 What is the leak monitoring schedule by leak classification?

Response Provided By: *Steven Groeber, Director – Field Operations and* Work Planning

Response: Distribution Department Bulletin #126 (attached).

S. H. VI-47

DISTRIBUTION DEPARTMENT BULLETIN #126

INVESTIGATION AND REPAIRS OF UNDERGROUND LEAKS
(Work Initiation Schedule)

The following minimum requirements shall be adhered to in scheduling investigations, repairs and rechecks of reported gas leaks from underground sources. These are minimum requirements and are not to restrict the foreman or supervisor from doing more extensive investigation or repair work which experience, safety and good judgment indicate.

1. *Conditions Requiring Immediate Investigation or Work*

When initially discovered, conditions listed below will require immediate investigation or work shall be continued until a supervisor considers the leak safe to hold. A written order shall be originated specifying what future work is required and when such work shall be scheduled.

a. A customer leak complaint

b. Combustible gas indicator readings in a sewer system, including vents at curb

c. Combustible gas indicator readings in subways, tunnels, or in vents from structures

d. Combustible gas indicator readings of 76% LEL or higher in a ductline manhole

e. Combustible gas indicator readings in a building

f. Combustible gas indicator readings along routes of natural gas supply mains

g. Combustible gas indicator readings in PGW regulator manholes (investigation by Pressure Force personnel)

h. Combustible gas indicator readings of 76% LEL or higher in gas main valve manhole (investigation by Pressure Force personnel)

i. Combustible gas indication along a Transmission main.

NOTE: A house check is compulsory whenever a reading is found in a water or gas stopbox or in a sewer vent.

S. H. VI-48

Bulletin #126

2. **Work or Recheck Schedule**

Conditions that do not require immediate work will be rechecked within 72 hours. Based on the readings obtained on the 72 hour and subsequent rechecks, the condition shall be handled as follows:

LEL Reading	Non-Conduit Type Structure*	Conduit Type Structure	Gas or Water Service Box High Pressure Drip or Test Pipe Box
25 or less	Recheck next scheduled survey	Pinpoint, repair or recheck 3 months	Repair or recheck 30 days
26 to 50	Recheck next scheduled survey	Pinpoint, repair or recheck 3 months	Repair or recheck 30 days
51 to 75	Pinpoint, repair or recheck 1 year	Pinpoint, repair or recheck 1 month	Repair or recheck 30 days
76 to 95	Pinpoint, repair or recheck 3 months	See #1 above	Repair or recheck 15 days
96 or higher	Pinpoint, repair or recheck 3 months	See #1 above	Repair or recheck 15 days

*Water valve manholes, low pressure drip boxes and other non-conduit surface boxes such as those housing buried valves, electrolysis devices, etc.

NOTE: The above table refers to readings individual manholes or boxes. Where multiple readings are found in interconnected manholes and/or in non-connected manholes in close proximity to reach other, a supervisor shall issue a written order specifying what future action is required.

S. H. VI-49

Bulletin #126

3. **Finaling Leak Orders**

Leaks will be finaled when readings are reduced to zero. On-site inspection by a supervisor will be required to "final" all leaks where readings were previously found in sewers, subways, tunnels and ductlines.

Exceptions to these minimum requirements may be made with the authorization of a General Supervisor.

STEVEN A. GROEBER

APPROVED: _____
PAUL A MONDIMORE
Vice President, Field Operations

JJJ:dls/c

cc: Ms. Janice Walsh
Distribution Department Supervisory Personnel

Original Issue: 9/22/76
Reissued: 11/8/04

RESPONSE TO OFFICE OF TRIAL STAFF DATA REQUEST
REGARDING PGW'S BASE RATE FILING
DOCKET NO. R-00061931

OTS-GS-5 How many leaks are scheduled for repair by month during 2007?

Response Provided By: Steven Groeber, Director – Field Operations and Work Planning

Response: According to PGW's Work Initiation Schedule, PGW would pinpoint, repair or recheck all 2,575 open leaks as follows (approximately):

90 day pinpoint, repair or recheck – 2,234 X 4 = 8,936
30 day pinpoint, repair or recheck - 341 X 12 = 4,092

RESPONSE TO OFFICE OF TRIAL STAFF DATA REQUEST
REGARDING PGW'S BASE RATE FILING
DOCKET NO. R-00061931

OTS-GS-7 How many miles of cast iron pipe is in the PGW system by size (below 2", 2", 3", 4", 6", 8", 10", 12" and over 12")?

Response Provided By: Steven Groeber, Director – Field Operations and Work Planning

Response:

2" and 3"	0
4"	313
6" and 8"	1,005
10" and 12"	130
Over 12"	176
Total	1,624 *miles*

OTS Statement No. 5-SR
Witness: Ralph Graeser

5/21/07
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PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

Surrebuttal Testimony

of

Ralph Graeser

Office of Trial Staff

Concerning:
Gas Safety

Q. PLEASE PROVIDE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Ralph Graeser. My business address is P.O. Box 3265, Harrisburg, PA 17105-3265.

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

A. I am employed by the Pennsylvania Public Utility Commission as a Gas Safety Inspector in the Bureau of Transportation and Safety. I am currently reassigned to the Technical Division of the Office of Trial Staff to provide input regarding gas safety issues in the instant proceeding.

Q. ARE YOU THE SAME RALPH GRAESER WHO SUBMITTED DIRECT TESTIMONY ON APRIL 6, 2007?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to address the rebuttal testimony of PGW witness Craig White, PGW St. 5R, who addressed the gas safety issues that I raised in my direct testimony.

Q. CAN YOU PLEASE SUMMARIZE YOUR RECOMMENDATIONS TO IMPROVE PGW'S GAS SAFETY PRACTICES?

A. Yes. In direct testimony, I recommended that PGW implement the following to ensure that the Company continues to provide safe and reliable service to its customers:

(1) a computerized leak monitoring system to ensure that information regarding leak history is readily available and easily accessed;

(2) a schedule to repair Class 2 leaks in twelve months to ensure that active leaks are repaired before they become hazardous to the public and require immediate repair;

(3) continue to meet and, if possible, exceed its current replacement level of cast iron pipe.

Q. DID THE COMPANY RESPOND TO YOUR RECOMMENDATIONS LISTED ABOVE?

A. Yes. On pages 10-13 of PGW Statement 5R, PGW addressed my recommendations, which are discussed in detail below.

ELECTRONIC LEAK MONITORING SYSTEM

Q. *PLEASE BRIEFLY DISCUSS WHY YOU RECOMMENDED THAT PGW IMPLEMENT A COMPUTERIZED LEAK MONITORING SYSTEM.*

A. PGW currently keeps track of leaks manually rather than electronically, which can make it difficult to easily access important information regarding leak location and history of the Company's 343 Class 2 leaks and 2,196 Class Three leaks (OTS Ex. No. 5, Sch. 1). Compiling the information electronically will allow the Company to keep this information in one central location and will be easily accessible to PGW personnel. PGW should have the discretion to implement the specific format of the electronic leak monitoring system as it is in the best position to know what format will work best for its needs.

Q. DID PGW AGREE WITH YOUR ELECTRONIC LEAK MONITORING RECOMMENDATION?

A. Yes. The Company testified that it is currently developing a leak tracking program and anticipates that it will be in use by the first quarter of fiscal year 2008.

Q. DO YOU HAVE ANY FURTHER COMMENTS WITH REGARD TO THIS RECOMMENDATION?

A. Yes. I am pleased that PGW is in the process of developing a leak tracking system, but I urge the Company to implement the new program as quickly as possible. While I am not familiar with the system the Company is developing or its degree of complexity, PGW should strive to beat the current 2008 implementation date. This recommendation is a priority because ensuring that PGW has an electronic system to efficiently and reliably track leaks is in the public interest as it will benefit the Company and its ratepayers.

LEAK REPAIR SCHEDULE FOR CLASS 2 LEAKS

Q. DOES PGW CURRENTLY REQUIRE CLASS 2 LEAKS TO BE REPAIRED IN A SPECIFIED TIME PERIOD?

A. No, PGW does not require Class 2 leaks to be repaired within a set period of time. Instead, it has a 90 day and 30 day schedule to pinpoint repair or recheck the 2,575 open leaks (OTS Ex. No. 5, Sch. 2).

Q. WHY DID YOU RECOMMEND THAT PGW IMPLEMENT A LEAK REPAIR SCHEDULE TO REPAIR CLASS 2 LEAKS WITHIN A TWELVE MONTH PERIOD?

A. I recommended that Class 2 leaks be scheduled to be repaired within a twelve month period because it is important to repair those leaks before they become hazardous and pose a threat to PGW customers.

Q. DID THE COMPANY RESPOND TO YOUR RECOMMENDATION?

A. Yes. PGW maintains that my twelve month schedule recommendation is arbitrary and detrimental to the safe and efficient management of the system (PGW St. 5-R, p. 11). In support of its position, the Company posed several arguments to counter my testimony. First, the Company claims that it manages leaks in a comprehensive manner. Second, PGW disagrees that repairing Class 2 leaks would be more economical than revisiting the leaks. Third, PGW claims that it needs flexibility to manage its leaks and that it should not be forced to divert financial resources to repair lower priority leaks. Lastly, PGW asserts that its cast iron replacement program incorporates leak repairs, but that these repairs are not necessarily completed within the time frame that I propose. Therefore, the twelve month leak repair requirement may incur additional costs, which would be unnecessary under the cast iron replacement program.

Q. CAN YOU PLEASE RESPOND TO PGW'S FIRST ARGUMENT, WHICH CONTENDS THAT IT MANAGES LEAKS IN A MORE COMPREHENSIVE MANNER THAN PROPOSED UNDER YOUR RECOMMENDATION?

A. Yes. PGW contends that its leak management is more comprehensive because a PGW employee evaluates the characteristics of the leak, the evaluation is audited by management, and this procedure is followed for each successive visit that the employee makes to the leak.

Q. IN YOUR OPINION, IS THE COMPANY'S LEAK MANAGEMENT MORE COMPREHENSIVE THAN YOUR RECOMMENDATION?

A. No, I believe that this system is archaic and poses a gas safety issue because it does not require a leak to be repaired in any specific time frame. As a result, the Company has 2 existing Class 2 leaks from 2004, 15 Class 2 leaks from 2005, and 153 Class 2 leaks from 2006 (OTS Ex. No. 5, Sch. 1). Gas is a highly flammable and dangerous commodity, and the safety threat of the leak can change dramatically at any time between the scheduled visits. Despite the Company's claims that my recommendation is arbitrary and detrimental to the safety of its system, it must be remembered that PGW is the only large (over 100, 000 customers) natural gas distribution company ("NGDC") in the Commonwealth that does not have a schedule of leak repair for Class 2 leaks. As such, my recommendation is far from arbitrary as it seeks to bring the Company up to speed with the practices of other large NGDC's under Commission jurisdiction. Moreover, the leak criteria PGW used to prepare OTS-1 and OTS-3 comes from the ASME Guide Material Appendix G-192-11. This guide defines, recommends action, and provides examples of leak criteria in order to provide NGDC's with material to comply with State and Federal Pipeline Safety Regulations. The ASME Guide Material recommends that Class 2 leaks be repaired or cleared within one calendar year, but no later than 15 months from the date the leak was reported. This is an industry guideline used by all other large NGDC's that have over 100,000 customers in the Commonwealth for leak repair scheduling.

Q. PLEASE RESPOND TO PGW'S SECOND ARGUMENT THAT REPAIRING CLASS 2 LEAKS IS UNECONOMICAL.

A. In direct testimony, based on PGW's own calculations, PGW's Work Initiation Schedule shows that it will pinpoint, repair or recheck the 343 Class 2 leaks on a 30 day basis, which is projected to result in 4,116 site visits (OTS Ex. No. 5, Sch. 3)[1]. In direct testimony, I concluded that these numerous visits would be eliminated if the Company put the Class 2 leaks on a repair schedule within a twelve month period, which would reduce the number of hours PGW employees spend in the field (OTS St. No. 5, p. 6). The cost to repair the leak must be offset against the expenses the Company incurs from the lost gas, payroll (including overtime) and benefits, transportation, equipment expenses, and materials and supplies.

The Company disagrees that repairing the Class 2 leaks is economical because it contends that I mistakenly rely on the assumption that all 343 Class 2 leaks remain static and result in 4,116 annual site visits. PGW states that I apply the worst case scenario by implying that the same 343 leaks remain constant for a 12 month period, whereas those 343 leaks continually evolve because some leaks are repaired and other new leaks are discovered (PGW St. 5-R, p. 12). Despite this claim, the fact is that PGW's own discovery responses indicate that it currently has 170 Class 2 leaks that occurred between 2004 and 2006 (OTS Ex.

[1] Note that Class 2 leaks are scheduled for 30 day pinpoint, repair, or recheck. The response to OTS-GS-5 indicates that there are 341 Class 2 leaks, which would result in 4,092 leaks to be pinpointed, repaired or rechecked. However, in an update to OTS-GS-3, attached as OTS Ex. No. 5, Sch. 1, the Company updated the 341 Class 2 leaks to 343 Class 2 leaks. This increase results in 4,116 site visits.

No. 5, Sch. 1) and those leaks have been and will continue to be subject to a 30 day pinpoint, repair or recheck until they are repaired (OTS Ex. No. 5, Sch. 3). PGW personnel clearly spend significant hours monitoring these older leaks when, in my opinion, it is in the best interest of ratepayers to ensure that the leaks are repaired in a timely manner.

Q. DO YOU HAVE ANY FURTHER COMMENT WITH REGARD TO THIS ECONOMIC ARGUMENT?

A. Yes, although PGW's testimony tries to downplay the financial impact of its current leak management, it is undeniable that allowing the leaked gas to go into the ground for an indefinite period of time is uneconomical. PGW has 343 Class 2 leaks of which 170 occurred between 2004 and 2006 and 2,196 Class 3 leaks of which 1798 occurred between 2002 (or older) and 2007. These leaks represent a significant amount of gas volume that the Company is loosing on an hourly, daily, and yearly basis.

Q. PLEASE ADDRESS PGW'S THIRD ARGUMENT THAT IT NEEDS FLEXIBILITY TO MANAGE LEAKS?

A. The Company claims that it requires flexibility in its leak management system to appropriately prioritize and economize its leak repairs (PGW St. 5-R, p. 13). The Company goes on to state that, under my twelve month scheduled repair, the Company may have to divert financial resources to repair lower priority leaks (PGW St. 5-R, p. 13).

Q. DO YOU BELIEVE THAT YOUR RECOMMENDATION REDUCES PGW'S FLEXIBILITY?

A. Yes and no. My recommendation that Class 2 leaks be repaired within twelve months from the date of discovery appropriately reduces the Company's flexibility to keep those leaks on its system for an indefinite period of time. It is simply unsafe to not have a policy that requires those leaks to be repaired in a specific time frame. No other large NGDC with over 100,000 customers regulated by the Commission has this degree of flexibility, which indicates that those NGDCs recognize that safe and efficient management requires that Class 2 leaks be scheduled for repair within a specific period of time. On the other hand, my recommendation provides the Company with plenty of flexibility to prioritize when the leak will be repaired as long as that repair is accomplished within a twelve month period. As this recommendation gives the Company a full year to repair the leak from the date of discovery, it appropriately gives PGW the flexibility to prioritize its leak repair management but sets a twelve month boundary to ensure the public remains safe.

Q. PLEASE ADDRESS PGW'S FINAL ARGUMENT THAT CONTENDS THAT YOUR RECOMMENDATION WILL UNNECESSARILY INCUR COSTS BECAUSE REPAIRS ARE MADE UNDER THE COMPANY'S PIPELINE REPLACEMENT PROGRAM.

A. PGW asserts that my recommendation is flawed because its cast iron replacement program, which replaces 18 miles of main annually, incorporates leak repairs (PGW St. 5-R, p. 13). As those repairs are not necessarily completed within the twelve month time frame that I recommend, the Company would be required to incur additional costs by repairing the leak despite the fact that such a repair is obviated by the cast iron main replacement program.

Q. DO YOU AGREE THAT YOUR RECOMMENDATION MAY REQUIRE THE COMPANY TO INCUR SUCH ADDITIONAL COSTS?

A. There is a chance that some leak repairs would be obviated by the cast iron replacement program. If that situation occurs, I believe that it would be appropriate to extend the twelve month time period so that the Company does not incur additional costs of repairing the leak twice. However, I further recommend that PGW inform the Commission's Gas Safety Bureau and the parties to this proceeding of such an occurrence so that the leak history can be examined and the length of the twelve month extension is made known to the Commission and the parties. While such construction projects may be a justification to extend the

twelve month leak repair requirement, it must be emphasized that this situation should be the exception rather than the rule as proposed by PGW.

PIPELINE REPLACEMENT PROGRAM

Q. PLEASE SUMMARIZE YOUR RECOMMENDATION THAT ENCOURAGED THE COMPANY TO MEET, AND IF POSSIBLE EXCEED, THE 1% CAST IRON PIPE REPLACEMENT RATE?

A. Cast iron pipe is prone to leak and break. The Company has 1,624 miles of cast iron pipe on its system and, since 2001, has agreed to replace approximately 1% of cast iron pipe annually. I recommend that PGW continue to meet and exceed this 1% replacement rate because cast iron main breaks are the leading cause of main leaks in PGW's distribution system and present a danger to the public if a large amount of gas is released during a main break or leak.

Q. DID THE COMPANY ADDRESS YOUR RECOMMENDATION TO MEET AND EXCEED THE 1% REPLACEMENT RATE?

A. Yes. The Company stated that its budget will continue to include the cost of 1% cast iron pipe replacement and that it will exceed that standard if possible (PGW St. 5-R, p. 10). PGW further stated that the ability to exceed this goal depends on its financial circumstances and its ability to generate internal capital.

Q. DO YOU HAVE ANY RESPONSE TO THE COMPANY'S COMMENTS?

A. Yes. I would like to reiterate my recommendation to continue to meet and exceed the 1% replacement. Replacing this infrastructure is vital to ensure the safety of PGW ratepayers because cast iron pipe is the leading cause of leaks in PGW's distribution system. While the Company's need to have internally generated funds to exceed the 1% replacement rate is outside my area of expertise, it has come to my attention that there is a possibility that the Company will be given $200 million in state funds to address problems of its aging infrastructure. If received, I urge the Company to use these funds to accelerate its cast iron pipeline replacement rate.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

OCA STATEMENT NO. 2 **(CORRECTED SCHEDULE)**

5/21/07
Phila PA
MS

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

DIRECT TESTIMONY OF

MICHAEL A. BLEIWEIS

ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

APRIL 6, 2007

TABLE OF CONTENTS

I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Michael A. Bleiweis and my business address is 243 Banks Road, Easton, Connecticut.

Q. By whom are you employed?

A. I am an independent financial and regulatory consultant. Previously, I was a principal of The Woodside Group, Inc.

Q. On what financial and regulatory subject matters do you specialize?

A. I specialize in providing financial consulting services in public utility rate cases and municipal utility budget proceedings. Over the course of my career, my services have been utilized by various consumer advocate and public interest groups, as well as by public utilities.

Q. For whom are you testifying in this proceeding?

A. I am testifying on behalf of the Office of Consumer Advocate.

Q. What is your educational background?

A. I am a graduate of Syracuse University with a Bachelor of Arts degree in Political Science and of New York University Graduate School of Business Administration with a Masters of Business Administration degree in Financial Analysis and Securities Analysis.

Q. What has been your business experience?

A. In 1973, I was employed as an economic research consultant with the firm of National Economic Research Associates (NERA) where I was involved in the

preparation of rate of return exhibits that were based upon computer modeling for various utility companies.

In 1974, I joined the firm of Citizens Utilities Company as a Revenue Requirements Analyst. My duties included the preparation of financial exhibits and testimony for various electric, water, gas and sewer company rate cases.

In 1977, I joined American Water Works Service Company as Director of Rates and Revenue of the Eastern and New England Divisions of American Water Works Company, Inc. I was charged with the responsibility of preparing financial exhibits, supporting data and testimony for use in rate hearings for a total of thirteen water companies in New England, New York and New Jersey.

From 1979 to 2002 I was a principal of The Woodside Group. In January of 2003, I became an independent consultant.

Q. Please describe further your experience in regulatory matters.

A. Attached as Appendix A, is a listing of the proceedings in which I have testified or participated concerning the proper determination of revenue requirements and other rate-related topics.

II. INTRODUCTION

Q. Please summarize the company's filing.

A. On December 22, 2006, Philadelphia Gas Works filed for a proposed overall revenue increase of $100 million, or about 9.6% over present rate revenues, based upon the future test year ended August 31, 2007. The company is also proposing to retain revenues of about $10 million from projected Off-System Sales and Capacity Release transactions to be utilized for specific construction projects and possible debt reduction, rather than flowing such revenues through the GCR, as is currently the PGW policy.

Q. What is the basis for the company's Pro Forma Income Statement for this proceeding?

A. The basis for PGW's future test year Pro Forma Income Statement is its fiscal year 2007 (FY2007) Operating Budget, as originally filed[1] before the Philadelphia Gas Commission.

Q. Mr. Bleiweis, did you participate in the company's FY2007 Operating Budget proceeding before the Philadelphia Gas Commission?

A. Yes. I was the consultant to the Philadelphia Public Advocate in that proceeding, as I have been for many prior proceedings, and provided Direct Testimony offering a number of pro forma financial adjustments.

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[1] PGW did not utilize the Philadelphia Gas Commission's Compliance Budget which recognizes Philadelphia Gas Commission adjustments to the unadjusted filed Operating Budget.

Q. Has the company proposed a number of pro forma adjustments to the Operating Budget, as filed, in this proceeding?

A. Yes. The company has proposed a number of pro forma adjustments to the originally filed budget.

Q. Please describe the major adjustments proposed by the company.

A. The major pro forma future test year present rate budget adjustments, as enumerated on the reply to the Supplemental Response to OCA-III-11, are as follows:

1) a series of Revenue (-$9,890,000), Other Operating Revenue (+$187,000) and expense adjustments (+$5,778,000 and -$5,778,000) have been made to reflect the "soft-off" program, whereby, the company has changed the accounting for gas attributed to customers for whom service has been discontinued;

2) a $56,000 reduction in postage expenses;

3) a $385,000 reduction in expenses related to PGW's meter testing and software tracking system;

4) a $30,000 reduction due to allocated facilities costs;

5) an $8,479,000 reduction in Bad Debt Expense reflecting the revenue reduction from the items listed above and the use of a 96% collection factor, rather than the 94% collection factor utilized in the Operating Budget[2];

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[2] As explained below, a 95% collection factor was used for pro forma at proposed rates;

6) a $225,000 reduction reflecting lower Marketing costs for the company's natural gas promotion program;

7) a $282,000 reduction related to tuition reimbursement;

8) a $50,000 reduction related to the outsourcing of Family & Medical Leave Act (FMLA) compliance;

9) a $550,000 reduction in corporate advertising expense;

10) a $2,518,000 reduction in pension expense due to a reduction in personnel and utilization of PGW's most recent actuarial study;

11) a $606,000 total reduction in labor and related expenses due to a reduction of 10 personnel from budgeted levels;

12) a net $217,000 increase in expense due to reductions to rate case and "normalized expenses" and an increase due to annualization of an Union wage increase;

13) a $1,585,000 increase in Other Income reflecting "additional investable cash balances".

Q. Please summarize additional pro forma future test year adjustments at both present and proposed rates[3] that you propose be recognized by the Commission for ratemaking purposes.

A. As shown on the Summary Adjustments to Pro Forma Net Earnings, Schedule MAB-1, line 6, I recommend the following pro forma future test year adjustments at present rates totaling $890,000:

---

[3] Adjustments at present rates are not affected by a revenue increase; adjustments at proposed rates, such as Bad Debt Expense, are affected by a revenue increase.

1) a reduction of $500,000 to reflect elimination of expenses related to PGW's Incentive Bonus Program;

2) a reduction of $100,000 to reflect unallowable lobbying expenses;

3) a reduction of $190,000 to reflect elimination of services related to establishment of a possible "Authority";

4) a reduction of $50,000 to reflect elimination of the amount booked for Regulatory Penalties;

5) a reduction of $50,000 to reflect elimination of the amount booked for Utility Merger Expense.

I also recommend the following pro forma future test year adjustments at the OCA proposed rate level:

6) an increase of $2,314,000 to reflect utilization of a 96% Collection Ratio to be applied to pro forma revenue at the OCA proposed rates;

7) elimination of income statement recognition of $10 million of Capacity Release/Off-System Sales.

Q. Did you base your pro forma adjustments and recommended revenue requirement utilizing a traditional future test year ratemaking methodology?

A. Yes. My pro forma adjustments and recommended revenue requirement reflect future test year revenues and expenses that are known and measurable and are representative of future periods.

Q. Based upon your utilization of a traditional future test year ratemaking methodology, is PGW's proposed $100 million rate increase justified?

A. No. As I discuss below, PGW's $100 million claim is not based upon utilization of a traditional future test year ratemaking methodology. Rather, the company's claim is dependent upon a number of financial assumptions included in a five-year forecast having the major goal of attaining a 50/50 debt/equity ratio at the end of the five-year period.

Q. What is your recommended revenue requirement increase?

A. As discussed in Mr. Lelash's testimony, we are recommending a revenue requirement increase of $22.5 million. This revenue requirement will enable the company to pay off the $45 million City Loan over a two-year period and, and based upon the traditional future test year methodology, result in debt service coverages above the 1.5 times required by the bond ordinances and a year-end cash balance above $50 million.

III. FIVE-YEAR FINANCIAL FORECAST

Q. Mr. Bogdonavage's Exhibit JRB-1 presents a five-year financial forecast for the period FY2008-FY2012 in addition to the future test year (FY2007) financial data. Why is the company presenting this forecast?

A. PGW is relying on this forecast to support a $100 million rate increase as a means of implementing its five-year forward business plan. Specifically, the company presents revenue, expense, cash flow, coverage and balance sheet data to bolster its major contention that a $100 million revenue increase plus retention of $10 million in capacity release/off-system sales revenues will ultimately result in a 47%/53% debt-to-equity ratio at the end of the five-year period, i.e., the end of FY2012. (See Exhibit JRB-1, page 10.)

Q. Is it reasonable to try to establish rates based upon a five-year forecast rather than utilizing the traditional pro forma future test year methodology?

A. No. The traditional ratemaking methodology is based upon utilization of future test year financial data that has been adjusted to reflect known and measurable changes. This methodology does not utilize forecast financial data since the test year financial data is representative of future periods.

Importantly, PGW's five-year forecast presentation and, therefore, the ultimate financial results that are generated for income, cash and debt service coverage are based upon broad financial assumptions that, in some cases, are inconsistent with the company's future test year claim. Because of the inherent problems with such a forecast, in my opinion, this forecast presentation should only be used as a very

rough representation of the company's future financial status and not be used for determining the company's revenue requirement.

Q. Did you participate in the FY2007 Operating Budget proceeding before the Philadelphia Gas Commission during which PGW's five-year forecast was first discussed?

A. Yes. Again, I was the consultant to the Philadelphia Public Advocate.

Q. Please describe how the company generally develops its five-year forecast.

A. The primary assumptions utilized in the five-year forecast are shown on the response to II.A.13 of the Filing Requirements. In general, the company utilizes broad assumptions regarding future major revenue and expense line items. For example, personnel levels are forecast to decrease by 20 employees a year. However, there is a dichotomy between the future test year and the forecast personnel levels- the FY2007 future test year is based upon a level of 1,730 employees while the forecast shows 1,740 employees for FY2007. Therefore, each year of the forecast after FY2007 reflects expenses related to at least 10 more employees than is consistent with the test year number.

Other broad assumptions utilized in the forecast include a 2% inflation factor for expenses other than those having specific departmental information and wage increases of 2% per year. Inflation factors utilized for ratemaking purposes are not generally accepted when establishing revenue requirements.

Q. Have you identified other problems regarding reliance on the five-year forecast as a basis for the company's proposed revenue increase?

A. Yes. The collection factor (discussed below) is projected at 93% for fiscal years 2008 through 2012, even though the company is utilizing a 96% collection factor for the pro forma future test year determination of Bad Debt Expense at present rates and a 95% collection factor for the pro forma future test year determination at proposed rates.

Q. What are some of the major financial variables upon which PGW's requested $100 million rate increase and the five-year forecast, discussed above, are based?

A. Some of the major financial variables include the following:

1) the $45 million interest-free City Loan is to be paid back $2 million in FY2007 and $43 million in FY2008;

2) the "grant-back" by the City of Philadelphia of the $18 million City Payment is to end in FY2010;

3) a year-end cash balance of approximately $50 million is assumed for all years of the forecast;

4) a debt reduction program over the five-year period totaling $205 million is reflected on the Cash Flow Statement;

5) an approximate 50/50 debt equity ratio is assumed at the end of the five-year period (FY2012).

Q. Why is an understanding of the major financial variables utilized in preparing the company's five-year forecast important in evaluating the company's claimed financial status?

A. Understanding these variables is important because a change in any one, or more than one major variable, can have a significant effect on the company's calculated financial position over time.

For example, if the $45 million City Loan is paid back in equal amounts of $22.5 million in both FY2007 and FY2008, rather than being paid back mostly in FY2008, then, PGW will have additional cash to utilize for capital spending and operating expense expenditures.

Also, if the $18 million annual City Payment continues to be paid by PGW but is then returned to the company by the City as capital, then the debt/equity ratio can be reduced over time with a lessened necessity of a dedicated debt reduction program.

Q. Is utilization of a five-year forecast a reasonable or reliable means to set rates?

A. No. In my opinion, the utilization of a traditional future test year ratemaking approach will provide the Commission with a better understanding of PGW's current true financial status rather than utilization of an approach encumbered by numerous inconsistent financial assumptions.

IV. REVENUE REQUIREMENT

Q. What revenue requirement increase are you and Mr. Lelash recommending?

A. As shown on the Pro Forma Income Statement, Schedule MAB-9, column 6, line 5, we are recommending a revenue requirement increase of $22.5 million. We are also recommending that PGW not retain any Capacity Release/Off-System Sales. As shown on the Debt Service Coverage schedule, Schedule MAB-11, line 22, column 7, our recommendation results in future test year debt service coverage on 1998 bonds of 2.45 times, well above the required 1.5 times. As shown on the Cash Flow Statement, Schedule MAB-10, line 31, column 7, our recommendation results in a year-end cash balance of $53.442 million.

Q. Besides utilizing your recommended pro forma future test year adjustments to the Income Statement, what are the major financial recommendations supporting your revenue requirement?

A. As discussed by Mr. Lelash, we are recommending the following:

1) As shown on the Cash Flow Statement, Schedule MAB-10, columns 5 and 7, line 8, we are recommending that the revenue requirement continue to reflect the grant-back of the $18 million City Payment to PGW, as committed to by the City through FY2010;

2) as shown on the Cash Flow Statement, Schedule MAB-10, columns 5 and 7, line 22, the $45 million City Loan will need to be paid back to the City over a two-year period, or $22.5 million per year;

3) as reflected on the Pro Forma Income Statement, Schedule MAB-9, lines 1, 3, 12 and 42, the projected $10 million to be received from Capacity

Release/Off-System Sales should be removed and the Capacity Release/Off-system sales revenues should continue to be flowed through the GCR to ratepayers, as recommended by OCA witness Lelash.

Q. Regarding debt service coverage and cash balances, would there be a future test year debt service coverage or cash problem utilizing the company's future test year claims if no rate increase is granted?

A. There would be no coverage problem. For example, as shown on the Debt Service Coverage statement, Schedule MAB-11, column 3, line 22, debt service coverage on 1998 bonds, pro forma at present rates, utilizing PGW's Income Statement adjustments (and no rate increase), would be 2.03 times, well above the required 1.5 times coverage. Further, as shown on the Cash Flow Statement, Schedule MAB-10, column 3, line 31, the pro forma year-end cash balance would be over $50 million.

Q. What is the effect on future test year coverage and cash balances at present rates when utilizing your recommended pro forma adjustments?

A. As shown on the Debt Service Coverage statement, Schedule MAB-11, column 5, line 22, pro forma test year coverage at present rates on the 1998 bonds utilizing my pro forma adjustments would be 2.05 times. This means that no rate increase is necessary to meet coverage requirements in FY2007. As shown on the Cash Flow Statement, Schedule MAB-10, column 5, line 31, the pro forma year-end cash balance would still be over $50 million

Q. If no rate increase is necessary to meet coverage for the future test year, then why is the company requesting a $100 million rate increase?

A. As I noted above, the company is requesting a $100 million rate increase in order to meet its financial goals at the end of the five-year forecast period. PGW's primary goal is attaining a 50/50 debt equity ratio for FY2012.

Q. If no rate increase is necessary to meet debt service coverage requirements for the future test year, why are you recommending a $22.5 million revenue requirement increase?

A. As I discussed, PGW has an obligation to repay the $45 million City loan in FY2008. Repaying this obligation will have a major impact on PGW's cash position. Since this is a known and certain obligation and, as OCA's witness Lelash recommends, I have reflected a two-year amortization of this obligation on the Cash Flow Statement, Schedule MAB-10, line 22, columns 5 and 7.

Q. Utilizing your recommended revenue requirement, is it possible that PGW may have to file for an additional rate increase in several years?

A. Yes, it is possible but such a filing would be dependent on many financial policies and variables such as the City's policy regarding the $18 million payment, the success of the company's collection and debt programs, as well as the success of the company's efforts to reduce capital and operating expenditures.

V. INCOME STATEMENT ISSUES

Q. What is the purpose of your five pro forma Income Statement adjustments?

A. The purpose of these known and measurable adjustments is to reflect a pro forma income statement (Schedule MAB-9) that is representative of PGW's future operating conditions. For this proceeding, the major effects of these adjustments are to increase debt service coverage and available cash. A discussion of these adjustments follows.

A. INCENTIVE BONUS PROGRAM

Q. Does PGW's pro forma Income Statement include an expense for an Incentive Bonus Program?

A. Yes. As shown on the reply to OSBA-2-70b, Schedule SD-3, Personnel & Payroll Detail, the pro forma Income Statement includes a line item entitled "Incentive Bonus" in the amount of $500,000. Mr. Bogdonavage corroborated this fact on the reply to OCA-III-35 where he states that:

> "The test year financial statements include the $500,000 management incentive compensation program."

As also shown on the reply to OCA-III-35 and below, amounts are included for this program in each year of the five-year financial forecast FY2008-FY2012 ranging from $510,000 to $552,000:

FY2008	$510,000
FY2009	$520,000
FY2010	$530,000
FY2011	$541,000
FY2012	$552,000

Q. To the best of your knowledge, has PGW ever provided a detailed description of the parameters of this incentive bonus program?

A. No. When asked to supply details of the program, the reply to PA-OB-64 in PGW's FY2007 Operating Budget proceeding before the Philadelphia Gas Commission only stated that:

> "PGW's compensation program includes employee incentives for meeting departmental goals, the achievement of savings or elimination of costs. The PFMC Board will determine upon reviewing senior management's performance whether the incentive program, on an annual basis, is applicable for any given period."

Further, in response to OTS-RE-29-D in this proceeding, PGW failed to answer a request to "provide a copy of the Company's incentive and or bonus plan for union, non-union, supervisory and management employees.

Q. Have any formal guidelines for the program been adopted to date?

A. No, again, not to my knowledge. The reply to ID-OB-8 in the FY2007 Operating Budget proceeding before the Philadelphia Gas Commission stated that:

> "Formal guidelines for an incentive bonus program **have not been adopted to date**, insofar as an incentive bonus program for FY 2007 has not been approved." Emphasis added.

Q. *Didn't the reply to OCA-III-35c in this proceeding provide examples of how payments were determined in September, 2005 for 55 management employees?*

A. Yes, but these examples are incomplete.

Q. Please explain.

A. Though the two tables that were presented showed how bonuses were determined based upon salaries and performance ratings, there was no explanation of the most important variable, that is, the basis for the performance ratings. It may be understandable for PGW to state that the evaluations, themselves are private (OCA-III-35c), but, certainly, the bases for the evaluations could be made public.

Q. Based upon the facts described above, what was your recommendation in your Direct Testimony for the PGW FY2007 Operating Budget proceeding before the Philadelphia Gas Commission regarding inclusion of an amount for the Incentive Bonus Program?

A. I stated that :

> "In the absence of formal guidelines defining the standards to be applied for such a plan, there currently is no Incentive Bonus Plan. The $500,000 that has been requested represents only a placeholder in the event that PGW management and PFMC should choose to implement a Bonus Plan in FY2007. There is, therefore, no support in this budget filing for the approval of $500,000.
>
> Further, given PGW's financial circumstances, it would be inappropriate to award management bonuses in addition to salary.... I recommend that the $500,000 budgeted for the incentive bonus program be eliminated." Emphasis added.

Q. Did the Philadelphia Gas Commission support your recommendation?

A. Yes. The Commission's Order of October 4, 2006 stated:

> "Incentive Bonuses - We grant the Public Advocate's exception to including $500,000 in the Budget for potential management incentive payments related to FY 2007 performance because clearly articulated, well-defined, quantitative goals and criteria (as are used in private industry for such "pay-for-performance" programs) are absent. During the course of FY 2007, PGW is certainly free to re-submit a specific program and projected budget for Gas Commission review and approval. Consistent therewith, we also grant the Public Advocate's request that we indicate to PGW management and the PFMC Board that no such incentive bonuses should be paid for FY 2006 performance. Not only did PGW fail to submit for the record the specific advance goals and metrics for an incentive bonus program, such expense was not included in its proposed FY 2006 Operating Budget. Accordingly, it was not included in the Gas Commission-approved FY 2006 Budget." pages 3-4

Q. To the best of your knowledge, to date, has PGW submitted a specific program to the Gas Commission?

A. No, it has not.

Q. What is your recommendation regarding this claimed expense for this proceeding?

A. Similar to my recommendation in the Operating Budget proceeding, I recommend that the claimed $500,000 pro forma expense for the Incentive Bonus Program be

excluded for ratemaking purposes. As stated above by both myself and the Philadelphia Gas Commission, to date, there are no formal guidelines that define the program. I am familiar with similar bonus programs for other utilities that specifically state how performance is to be measured. PGW must utilize similar standards for their bonus program in order to be credible.

Therefore, as shown below and on Schedule MAB-2, I recommend an expense reduction of the claimed $500,000 reflecting elimination of the Incentive Bonus program.

Schedule MAB-2

PHILADELPHIA GAS WORKS
Incentive Bonus Program
Test Year Ended August 31, 2007
($000)

	PGW (1)	Adj. (2)	O.C.A. (3)
Incentive Bonus Program	$500	($500)	$0

Source: Exhibit JRB-2, SD-3

B. LOBBYING EXPENSES

Q. Does PGW's pro forma Statement of Income include amounts for lobbying expenses?

A. Yes. When asked to detail the lobbying expenses included on the Statement of Income for Wolf Block Government Relations, the company identified $450,000 in contract costs, but stated that the contract included tasks other than Lobbying

Q. Is this amount consistent with that supplied in the PGW Operating Budget proceeding before the Philadelphia Gas Commission?

A. No. The reply to PA-OB-58 stated:

> "The Fiscal Years 2006 and 2007 include $100,000 for lobbying related activities. The firm providing this service is Wolf Block. The purpose of this expenditure is to promote regulatory issues favorable to PGW." Emphasis added.

Q. Has PGW clarified this inconsistency?

A. Yes. Regarding the amount for Wolf Block, the reply to OCA-VII-2a states that:

> "The $100,000 was for government relations work from Wolf Block Government Relations."

Q. Does the Pennsylvania Public Utility Code expressly prohibit the recovery of lobbying expenditures through rates?

A. Yes. Section 1316(a) of the Public Utility Code expressly prohibits recovery through rates of direct or indirect expenses for "political advertising." Section 1316(d) of the Public Utility Code defines "political advertising" to include "money spent for lobbying but not money spent for appearances before regulatory or other governmental bodies in connection with a public utility's existing or proposed operations." 66 Pa.C.S. §1316(d). The actions which Wolf Block Government Relations has been engaged to perform clearly include lobbying.

Further, in her decision for PGW's rate case at Docket No. R-00006042, the ALJ stated:

> "The Commission has determined in the above-referenced cases that lobbying expenses should not be paid by ratepayers. As stated in the Duquesne, Metropolitan Edison, and National Fuel cases, ratepayers do not receive a direct benefit from these costs, and therefore, the ratepayers should not be required to pay such expenses. Accordingly, OCA's recommendation to remove lobbying expenses is granted." Recommended Decision, p.66

In the rate case noted above, the PUC eliminated the claimed lobbying expense. Opinion & Order, page 66.

Q. What is your recommendation?

A. As shown below and on Schedule MAB-3, I recommend that claimed lobbying expenses in the total amount of $100,000 be disallowed for ratemaking purposes.

Schedule MAB-3

PHILADELPHIA GAS WORKS
Lobbying Expense
Test Year Ended August 31, 2007
($000)

	PGW (1)	Adj. (2)	O.C.A. (3)
1 Wolf Block	$100	($100)	$0

Source: PA-OB-58 (Operating Budget Proceeding)
OCA-III-34b

C. **AUTHORITY EXPENSES**

Q. Is there an amount included in the FY2007 budget and, therefore, the pro forma Income Statement, for what is termed "Authority"?

A. Yes. The reply to OCA-III-41a confirms that the "fiscal year 2007" includes $190,000 for this category for two law firms– $150,000 for Hangley Aronchick and $40,000 for Blank Rome.

Q. What is your understanding of the term "Authority" as utilized in the budget?

A. As I understand it, proposals have been made by various state and local officials to remove PGW from City ownership and to create a state "authority" which might also include PECO's gas division. In FY2006, PGW contracted with the law firm of Hangley Aronchick for various services related to such proposals including draft legislation or legislative provisions. I have no knowledge of the content of the written work product that was produced in FY2006 pursuant to that contract. In the reply to HE-24 in the FY2007 Operating Budget proceeding, for FY2007, PGW states that Hangley Aronchick will perform services "related to proposals made by various legislators for a state authority that would own and manage PGW."

Q. To date, has PGW contracted for these services?

A. No. The reply to OCA-III-41b states that PGW has not yet contracted for these legal services.

Q. Do you believe that these "Authority" related services to be provided by Hangley Aronchick and Blank Rome should be recognized for ratemaking purposes?

A. No. These expenditures involve the terms under which the City would be divested by the State of its ownership of PGW. The interest to be served by this expenditure is an ownership interest. Therefore, these costs should be borne by the City, not funded by PGW ratepayers.

In addition, this work is directed at influencing lawmakers to take specific action and, therefore, constitutes lobbying. Since lobbying is an ownership expense under State law, this expense should not be recognized for ratemaking purposes. Also, as stated above, the budgeted legal services have not yet been contracted. Therefore, as shown below and on Schedule MAB-4, I recommend that this $190,000 expenditure be eliminated from the pro forma Income Statement.

Schedule MAB-4

PHILADELPHIA GAS WORKS
Legal Expenses- Authority
Test Year Ended August 31, 2007
($000)

		PGW (1)	Adj. (2)	O.C.A. (3)
1	Hangley Aronchick	$150	($150)	$0
2	Blank Rome	40	(40)	0
3	TOTAL	$190	($190)	$0

Source: OCA-III-41a

D. BAD DEBT EXPENSE

Q. What amount is PGW claiming for pro forma Bad Debt Expense at present rates?

A. As shown on PGW's Exhibit JRB-1, page 1, PGW is claiming test year Bad Debt Expense at present rates of $52.258 million.

Q. How does PGW define Bad Debt Expense?

A. The reply to OSBA-II-31c states:

> "The bad debt expense is an accounting estimate of the collectibility of year end accounts receivable and is impacted by the existing balance of the reserve for bad debt."

Q. How does PGW calculate Bad Debt Expense?

A. The calculation of pro forma Bad Debt Expense is shown below:

Bad Debt Expense
($000)

Line No.	Accounts Receivable	Budget 2006-07
1	Beginning Receivable Balance	$285,039
2	Billed Gas Revenues	949,031
3	Other Operating Revenues/Adjustments	42,799
4	Total Revenues	991,830
5	Collection Ratio	96%
6	Collections Current Revenues	(952,157)
7	Net Write-Offs	(60,400)
8	Total Credit /Reductions	(1,012,557)
9	Ending Receivable Balance	$244,312
	Bad Debt Expense	
10	Current Year Net Receivable	$244,312
11	Reserve Factor	21.25%
12	Total Bad Debt Expense	$52,258

The key variable of this calculation is Line 5, Collection Ratio– 96%.

Q. What is a Collection Ratio?

A. Simply stated, the Collection Ratio is the ratio of collections to billed revenue, that is, it is a measurement of how well the company is collecting the amounts it bills to its customers.

Q. What has been the recent history of PGW's collection ratio?

A. The recent history is shown below:

Collection Ratio
($000s)

	FY2003	FY2004	FY2005	FY2006
Receipts	$690,700	$756,000	$846,600	$905,900
Billings	$797,400	$824,798	$881,800	$938,100
Ratio	86.6%	91.7%	96.0%	96.6%

Source: OSBA-2-31a

The above table shows that over the past four fiscal years, the Collection Ratio has increased from 86.6% to 96.6%. This increase has occurred even though Billings have also increased by over $140 million over this same time period.

Q. Do you agree with PGW's use of a 96% Collection Ratio for the determination of pro forma Bad Debt Expense at present rates?

A. Yes. Based on the above data, a 96% Collection Ratio is reasonable for ratemaking purposes. Use of a 96% ratio may even be considered to be a conservative approach since the most recent fiscal year ratio has been even higher.

Q. Has PGW utilized the same 96% Collection Ratio for both present and proposed rates?

A. No. The reply to OCA-III-20a confirms that PGW has utilized a 96% collection factor for pro forma at present rates and a 95% collection factor for pro forma at proposed rates.

Q. Why did PGW utilize a lower Collection Ratio at proposed rates?

A. The reply to OCA-III-20b states that:

> "PGW utilized a lower overall collection rate for the 2007 test year and five year forecast reflecting a conservative approach to projected customer payment patterns and their ability to pay as a result of the projected continued high natural gas prices and the projected increase in base rates due to the proposed rate increase."

Q. Do you agree with this rationale?

A. No, I do not. As shown on the Collection Ratio table above, even though billings increased by over $140 million or almost 18% over the four-year period, receipts increased by over 31%. Thus, the company was well able to handle the increased billings. Further, as stated above, the use of a 96% ratio is conservative in light of the 96.6% ratio attained for FY2006. Also, in my experience, I am not aware of any rate case in which Bad Debt Expense was calculated differently for Proposed Rates than for Present rates.

Q. What is your recommendation?

A. I recommend that a 96% Collection Ratio be utilized at both present and proposed rates to determine pro forma Bad Debt Expense. The company has shown that

collections will not be aversely affected by any increase in receipts that may result from a revenue increase. As shown on the Pro Forma Income Statement Schedule MAB-9, line 22, column 6, the major effects of utilizing a higher collection ratio for the OCA's proposed rates would be to decrease pro forma Bad Debt Expense at the OCA's Proposed Rates by $2.314 million and increase Net Income and available Cash.

E. REGULATORY PENALTIES

Q. Did PGW incur regulatory penalties during FY2006?

A. Yes. The reply to OTS-RE-100b states that the company incurred $104,500 in regulatory penalties during FY2006. These penalties were mainly related to two settlements of $50,000 each in which PGW had shut off service to customer premises whose occupants subsequently died as a result of hypothermia and heart disease.

Q. Has an amount been budgeted in FY2007 for Regulatory Penalties expense?

A. Yes. $50,000 has been included on Exhibit JRB-2, Exhibit D, Other Income, and is also shown on the reply to OCA-III-11n. Further, the reply to OTS-RE-94 states:

> "The fiscal year 2007 and the five year period through 2012 included a projection of $50,000 annually for the above expense category [Regulatory Penalties]..." (Also, see the reply to OCA-VII-3.)

Q. Why has this amount been included in the budget?

A. The reply to HE-10 in the FY2007 Operating Budget proceeding before the Philadelphia Gas Commission stated:

"PGW has budgeted $50,000 for FY 2007 regulatory penalties in the event of fines and penalties that may arise. Several months ago, the PUC indicated that it has "zero tolerance" for violation of winter termination rules. Given the wide range of rules and regulations involving termination of service and related matters, the possibility exists that penalties may be imposed." Emphasis added.

Q. Do you believe that the above explanation provides a sufficient reason for PGW to budget an amount for penalties?

A. No. The FY2007 Operating Budget is the first time that PGW has proposed to budget for regulatory penalties imposed by the PUC. What PGW is saying is that by budgeting this amount, it expects that the company will be fined by the PUC for failure to comply with the Public Utility Code and related regulations.

Regulatory fines are an ownership expense and, therefore, are not recoverable through rates. Customers cannot be expected to subsidize a utility's failure to comply with PUC standards of reasonable and efficient service. Similarly, PGW's Operating Budget should be based upon the assumption that PGW will provide reasonable service and avoid incurring regulatory penalties.

To allow PGW to budget for regulatory penalties is to equate such penalties with circumstances beyond PGW's control, like warmer than normal weather. However, it is within PGW's power and responsibility to take the necessary steps to avoid incurring regulatory penalties.

Q. What is your recommendation?

A. As set forth below and on Schedule MAB-5, I recommend the elimination of this $50,000 expense from the budget. The Philadelphia Gas Commission agreed with this recommendation and eliminated this expense from the FY2007 Operating Budget.

Schedule MAB-5

PHILADELPHIA GAS WORKS
Regulatory Penalties
Test Year Ended August 31, 2007
($000)

	PGW (1)	Adj. (2)	O.C.A. (3)
Regulatory Penalties	$50	($50)	$0

Source: OCA-III-11n

F. UTILITY MERGER EXPENSE

Q. Did PGW purchase legal and consulting services related to the Exelon merger in fiscal years 2005 and 2006?

A. Yes. As shown on the reply to OTS-RE-20c, C-4, Purchased Services, PGW expended $305,000 and $490,000, respectively for such services.

Q. Has an additional amount for such services been budgeted for FY2007?

A. Yes. As shown on the same reply and confirmed on the reply to OCA-VII-4, $50,000 has been budgeted for FY2007.

Q. Should this expense be recognized for ratemaking purposes?

A. No. The Exelon merger proceeding has ended and, therefore, no further expenditures are necessary. Therefore, the $50,000 amount included in the budget is not representative of future expenditures and should be eliminated for ratemaking purposes. Schedule MAB-6 and the table below reflect this adjustment.

Schedule MAB-6

PHILADELPHIA GAS WORKS
Utility Merger Expense
Test Year Ended August 31, 2007
($000)

	PGW (1)	Adj. (2)	O.C.A. (3)
Utility Merger	$50	($50)	$0

Source: OTS-RE-20c, C-4

Q. Does this conclude your Direct Testimony?

A. Yes. But I reserve the right to provide supplemental testimony as additional information becomes available.

00093416

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

APPENDIX TO THE

DIRECT TESTIMONY OF

MICHAEL A. BLEIWEIS

ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

APRIL 6, 2007

MICHAEL A. BLEIWEIS
CONSULTING EXPERIENCE

PENNSYLVANIA

Philadelphia Gas Works	1986 Rate Increase
	1988 Rate Increase
	1990 Rate Increase
	1991 Rate Increase
	2001 Rate Increase
	Docket No. R-00017034
	Docket No. M-00021612
	Docket Numbers: R-00049157 and P-00042090 (CRRC)
	1993-94 Operating and Capital Budgets
	1994-95 Operating and Capital Budgets
	1995-96 Operating and Capital Budgets
	1996-97 Operating and Capital Budgets
	1997-98 Operating and Capital Budgets
	1998-99 Operating and Capital Budgets
	1999-00 Operating and Capital Budgets
	2000-01 Operating and Capital Budgets
	2001-02 Operating and Capital Budgets
	2002-03 Operating and Capital Budgets
	2003-04 Operating and Capital Budgets
	2004-05 Operating and Capital Budgets
	2005-06 Operating and Capital Budgets
	2006-07 Operating and Capital Budgets
Philadelphia Water Department	1985 Rate Increase
	1990 Rate Increase
	1992 Rate Increase
	2001 Rate Increase
	2005 Rate Increase
Philadelphia Electric Co. (Elec. and Gas)	Docket Nos.: R-80061225
	R-811626
	R-811719
	R-822291
	R-832410
	R-842590
	R-850152
	R-860346-1307(f)
	R-880955-1307(f)
	R-891290-1307(f)
	R-911976-1307(f)
Equitable Gas Company	Docket No. R-80041169

PENNSYLVANIA

Duquesne Light Company ..... Docket Nos.: R-811470
R-832337
M-00930404C001

West Penn Power Company..... Docket Nos.: R-811836
R-901609

The Peoples Natural Gas Co. ..... Docket No. R-821906

Pennsylvania Gas & Water Co. (Gas and Water) .....
..... Docket Nos.: R-821961
R-822102
R-891261

Metropolitan Edison Company ..... Docket No. R-842770

Pennsylvania Electric Co. ..... Docket No. R-842771

UGI Corporation ..... Docket No. R-860344-1307(f)
R-00932862

Columbia Gas of Pennsylvania..... Docket Nos.: R-860527
R-87058
R-901873
R-911921-1307(f)
R-932597-1307(f)

Western Pennsylvania Water Co.-
Butler District..... Docket No. R-832381

Pennsylvania-American Water Co..... Docket No. R-880916

T.W. Phillips Gas and Oil Co. ..... Docket Nos.: R-88194
R-891566

Philadelphia Suburban Water Co..... Docket No. R-891270

Newtown Artesian Water Co. ..... Docket No. R-911977

Indian Rock Water Company..... Docket No. R-911971

Apollo Gas Company..... Docket No. R-092254

Shenango Valley Water Company..... Docket No. R-00922420

Pennsylvania Power & Light Company..... Docket No. M-00930406C0001

PENNSYLVANIA

Borough of Media Water Works ..... Docket No. R-00943098

PFG Gas, Inc./North Penn Gas, Inc. ..... Docket No. R-00953524

Pike County Light & Power Co. ..... Docket No. R-00049884

United Water Pennsylvania, Inc. ..... Docket No. R-00051186

The York Water Company ..... Docket No. R-00061322

NEW JERSEY

Commonwealth Water Company ..... Docket Nos.: 784-274
819-781
842-100
WR8503245

Elizabethtown Water Company ..... Docket Nos.: 802-76
818-735
WR8504330

Mt. Holly Water Company ..... Docket Nos.: 805-314
819-801

Monmouth Consolidated Water Company ..... Docket Nos.: 819-816
828-723
831-1113
850-3267

Public Service Electric and Gas Co. ..... Docket No. 812-76

Atlantic City Electric Company ..... Docket Nos.: 7911-9511
839-753(LEAC)
8410-1079(LEAC)
ER8504434
8609980-4981
8709-1159&1160
8809-1053
ER90091090J
ER92020253J

NEW JERSEY

Jersey Central Power and Light Co. ..... Docket Nos.: 811-25
831-110
8507698
8601121(LEAC)
ER87111295(LEAC)
ER91121820J

Rockland Electric Company ..... Docket No. 827-612

Middlesex Water Company ..... Docket Nos.: 829-707
845-402

New Jersey Natural Gas Company ..... Docket Nos.: 831-46
838-687 (LPGA)

Hackensack Water Company ..... Docket Nos.: 837-622
847-698

Elizabethtown Gas Company ..... Docket Nos.: GR86121374
GR88080913(LPGA)
GR8812-1321
GR8801-0217

Toms River Water Company ..... Docket No. WR92010081

IDAHO

Idaho Electric Company) ..... Docket Nos.: 100726)
) ..... 100727)
Idaho Water Company) ..... 100728)

INDIANA

Flowing Wells Water Company ..... Docket No. 34739

MASSACHUSETTS

Hingham Water Company ..... Docket No. 19744

American Water Company ..... Docket No. 19900

OHIO

American Utilities Co. (Water)..... Docket No.80-999-AIR

RHODE ISLAND

Bristol County Water Company.....Docket No. 1787

NEW MEXICO

Gas Company of New Mexico.....Case No. 1916

Public Service Co. of New Mexico.....Case No. 1916

DELAWARE

Delmarva Power & Light Co. ..... Docket Nos.: 86-24
91-20
92-85

Artesian Water Company..... Docket Nos.: 90-10
92-5

Wilmington Suburban Water Co. .....*Docket No. 91-1*

Delaware Electric Cooperative .....Docket No. 91-37

SOUTH CAROLINA

South Carolina Pipeline Corp. ..... Docket No. 88-652-G

South Carolina Electric and Gas Co. .....Docket Nos.: 88-695-G
92-009-G

Peoples Natural Gas Co. of SC..... Docket No. 89-12-G

Carolina Water Service..... Docket No. 93-738-W/S
2000-0207-W/S

Tega Cay Water Service, Inc. ..... Docket No. 96-137-W/S

Palmetto Utilities, Inc. ..... Docket No. 98-653-S

Harbor Island Utilities, Inc. ..... Docket No. 97-262-W/S

SOUTH CAROLINA

Sigfield Water Company, Inc. ..... Docket No. 97-131-W

United Utilities Company ..... Docket No. 2000-0210-W/S

MAINE

Central Maine Power Co. ..... Docket No. 92-345

Mr. Bleiweis has also supervised or participated in the preparation of rate cases for companies in the states of Arizona, California and New York.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

SCHEDULES TO THE

DIRECT TESTIMONY OF

MICHAEL A. BLEIWEIS

ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

APRIL 6, 2007

Schedule MAB-1

PHILADELPHIA GAS WORKS
Summary Adjustments to Pro Forma Net Earnings
Test Year Ended August 31, 2007
($000)

Line No.		O.C.A.	Schedule MAB
	Present Rates		
1	Incentive Bonus Program	($500)	2
2	Lobbying Expense	(100)	3
3	Legal Expenses-Authority	(190)	4
4	Regulatory Penalties	(50)	5
5	Utility Merger	(50)	6
6	**Adjustment to Net Earnings**	$890	
	Proposed Rates		
7	Bad Debt Expense	$2,314	9
8	**Adjustment to Net Earnings**	($2,314)	

Schedule MAB-2

PHILADELPHIA GAS WORKS
Incentive Bonus Program
Test Year Ended August 31, 2007
($000)

	PGW (1)	Adj. (2)	O.C.A. (3)
Incentive Bonus Program	$500	($500)	$0

Source: Exhibit JRB-2, SD-3

CORRECTED

Schedule MAB-3

PHILADELPHIA GAS WORKS
Lobbying Expense
Test Year Ended August 31, 2007
($000)

Line No.		PGW (1)	Adj. (2)	O.C.A. (3)
1	Wolf Block	$100	($100)	$0

Source: PA-OB-58 (Operating Budget Proceeding)

Schedule MAB-4

PHILADELPHIA GAS WORKS
Legal Expenses-Authority
Test Year Ended August 31, 2007
($000)

Line No.		PGW (1)	Adj. (2)	O.C.A. (3)
1	Hangley Aronchick	$150	($150)	$0
2	Blank Rome	40	(40)	0
3	TOTAL	$190	($190)	$0

Source: OCA-III-41a

Schedule MAB-5

PHILADELPHIA GAS WORKS
Regulatory Penalties
Test Year Ended August 31, 2007
($000)

	PGW (1)	Adj. (2)	O.C.A. (3)
Regulatory Penalties	$50	($50)	$0

Source: OCA-III-11n

Schedule MAB-6

PHILADELPHIA GAS WORKS
Utility Merger Expense
Test Year Ended August 31, 2007
($000)

	PGW (1)	Adj. (2)	O.C.A. (3)
Utility Merger	$50	($50)	$0

Source: OTS-RE-20c, C-4

Schedule MAB-7

PHILADELPHIA GAS WORKS
Capacity Release/Off-System Sales
Test Year Ended August 31, 2007
($000)

Line No.		PGW (1)	Adj. (3)	O.C.A. (4)
	Proposed Rates			
1	Non-Heating	$292	($292)	$0
2	Heating	3,708	(3,708)	0
3	Other Income	6,000	(6,000)	0
4	Total Cap. Rel.	$10,000	($10,000)	$0
5	Total Other Income	$17,131		
6	Oth. Inc. Cap. Rel.	6,000		
7	Subtotal Oth. Inc.	$11,131	$0	$11,131

Note: PGW is claiming $10 million in Capacity Release which was booked to Non-Heating & Heating Revenue and Other Income. OCA proposes to book Capacity Release 100% to the GCR and 0% to PGW.

PHILADELPHIA GAS WORKS
Bad Debt Expense
Other Operating Revenues
Test Year Ended August 31, 2007
($000)

Line No.			O.C.A. Pro Forma @Proposed Rates 2006-07
		Accounts Receivable	
1		Beginning Receivable Balance	$265,039
2		Billed Gas Revenues	$953,536
3		Proposed Rate Increase	22,500
4	33	*Other Operating Revenues/Adjustments*	43,717
5	2:4	Total Revenues	1,019,753
6		Collection Ratio	96.00%
7	5x6	Collections Current Revenues	(978,963)
		Adjustments:	
8		Net Write-Offs	(65,400)
9	7+8	Total Credit / Reductions	(1,044,363)
10	1+5+9	Ending Receivable Balance	$240,429
		Bad Debt Expense	
11	10	Current Year Net Receivable	*$240,429*
12		Prior Period Adjustments	-
13	10+11	Adjusted Net Receivable	240,429
14	15/13	Reserve Factor	22.70%
15	20	Total Bad Debt Expense	**$54,572**
16		Write Off Gas Accounts	$65,000
17		Write Off Other	$400
		Reserve Balance	
18		Beginning Reserve Balance - Gas	$190,306
19	16	Net Write-Off - Gas	(65,000)
20	21-18-19	Appropriation to Reserve - Gas	**54,572**
21		Ending Reserve Balance Gas	179,878
22		OAR Reserve	900
23		M & J Reserve	25
24	10x25	Total Reserve Balance	$180,803
25		Receivable Factor	0.7520
26	10-24	Net Accounts Receivable	$59,626
		OTHER OPERATING REVENUES	
27	2	Billed Revenue	$953,536
28	3	Rate Increase	22,500
29	27+28	New Billed Revenues	976,036
30	29x36	Other Operating Rev.	$18,545
31	29x35	Sales Tax	14,641
32		Appliance Repair & Other Revenues	10,532
33	30:32		43,717
34	29+33	Total Revenue	$1,019,753
35		Sales Tax %	0.0150
36		Other Oper Rev %	0.0190

Source: OSBA-2-70a

PHILADELPHIA GAS WORKS
Pro Forma Income Statement
Test Year Ended August 31, 2007
($000)

Line No.		PGW Budget 2006-07	PGW Adjustments	PGW Pro Forma @Present Rates 2006-07	O.C.A. Adjustments	OCA Pro Forma @Present Rates 2006-07	O.C.A. Adjustments	O.C.A. Pro Forma @Proposed Rates 2006-07	ADJ. SOURCE:
	OPERATING REVENUES	(1)	(2)	(3)	(4)	(5)	(6)	(7)	
1	Non-Heating	$115,556	($722)	$114,834		$114,834	$0	$114,834	MAB-7
2	Gas Transportation Service	7,256		7,256		7,256		7,256	
3	Heating	829,900	(9,168)	820,732		820,732	0	820,732	MAB-7
4	Weather Normalization Adjustment	0		0		0		0	
5	Proposed Base Rate	0		0		0	22,500	22,500	
6	Unbilled Gas Adjustment	(732)		(732)		(732)	1,237	505	
7	Total Gas Revenues	951,980	(9,890)	942,090	0	942,090	23,737	965,827	
8	Appliance Repair & Bill Paid Turn-Ons	10,532		10,532		10,532		10,532	
9	Other Operating Revenues	18,219	(187)	18,032		18,032	513	18,545	MAB-8
10	Total Other Operating Revenues	28,751	(187)	28,564	0	28,564	513	29,077	
11	Total Operating Revenues	980,731	(10,077)	970,654	0	970,654	24,250	994,904	
	OPERATING EXPENSES								
12	Natural Gas	630,836		630,836		630,836	0	630,836	MAB-7
13	Other Raw Material	5		5		5		5	
14	Sub-Total Fuel	630,841	0	630,841	0	630,841	0	630,841	
15	**CONTRIBUTION MARGINS**	349,890	(10,077)	339,813	0	339,813	24,250	364,063	
16	Gas Processing	15,715		15,715		15,715		15,715	
17	Field Services	29,391	5,307	34,698		34,698		34,698	
18	Distribution	16,566	(30)	16,536		16,536		16,536	
19	Collection	7,944		7,944		7,944		7,944	
20	Customer Service	14,125		14,125		14,125		14,125	
21	Account Management	7,625		7,625		7,625		7,625	
22	Bad Debt Expense	60,737	(8,479)	52,258		52,258	2,314	54,572	MAB-8
23	Marketing	3,217	(225)	2,992		2,992		2,992	
24	Administrative & General	50,623	(6,660)	43,963		43,963		43,963	
25	Health Insurance	37,884	(100)	37,784		37,784		37,784	
26	Capitalized Fringe Benefits	(11,261)		(11,261)		(11,261)		(11,261)	
27	Capitalized Administrative Charges	(7,950)		(7,950)		(7,950)		(7,950)	
28	Amortization of Restructuring Costs	0		0		0		0	
29	Pensions	17,593	(2,518)	15,075		15,075		15,075	
30	Taxes	6,574	(89)	6,485		6,485		6,485	
31	Labor/Cost Savings	(5,798)	(476)	(6,274)		(6,274)		(6,274)	
32	Pro Forma Adjustments (PGW)	0	217	217		217		217	
33	Pro Forma Adjustments (OCA)				(890)	(890)		(890)	MAB-1
34	Sub-Total Other Oper.& Maintenance	242,985	(13,053)	229,932	(890)	229,042	2,314	231,356	
35	Depreciation	38,213		38,213		38,213		38,213	
36	Cost of Removal	3,200		3,200		3,200		3,200	
37	To Clearing Accounts	(3,217)		(3,217)		(3,217)		(3,217)	
38		38,196	0	38,196	0	38,196	0	38,196	
39	Sub-Total Other Oper.& Maint. & Depreciation	281,181	(13,053)	268,128	(890)	267,238	2,314	269,552	
40	***TOTAL OPERATING EXPENSES***	*912,022*	*(13,053)*	*898,969*	*(890)*	*898,079*	*2,314*	*900,393*	
41	**OPERATING INCOME**	68,709	2,976	71,685		72,575	21,936	94,511	
42	Other Income	9,627	1,585	11,212		11,212	(81)	11,131	MAB-7
43	**INCOME BEFORE INTEREST**	78,336	4,561	82,897	890	83,787	21,855	105,642	
	INTEREST								
44	Long-Term Debt	56,437		56,437		56,437		56,437	
45	Other	13,186		13,186		13,186		13,186	
46	AFUDC	(1,202)		(1,202)		(1,202)		(1,202)	
47	Loss From Extinguishment of Debt	5,557		5,557		5,557		5,557	
48	Total Interest	73,978	0	73,978	0	73,978	0	73,978	
49	**NET EARNINGS**	$4,358	$4,561	$8,919	$890	$9,809	$21,855	$31,664	

Source: Col.1- Exhibit JRB-2, Exhibit A-1
Col. 3- Exhibit JRB-1, page 1

PHILADELPHIA GAS WORKS
Cash Flow Statement
Test Year Ended August 31, 2007
($000)

Line No.		PGW Budget 2006-07	PGW Adjustments	PGW Pro Forma @Present Rates 2006-07	O.C.A. Adjustments	O.C.A. Pro Forma @Present Rates 2006-07	O.C.A. Adjustments	O.C.A. Pro Forma @Proposed Rates 2006-07
	SOURCES	(1)		(3)		(5)		(7)
1	Net Income	$4,358	$4,561	$8,919	$890	$9,809	$21,855	$31,664
2	Depreciation & Amortization	46,007		46,007		46,007		46,007
3	Earnings on Restricted Funds	38		38		38	(419)	(381)
4	Elimination of Accrued Interest on Refunded Debt							
5	Increased/(Decreased) Other Assets/Liabilities	911		911		911		911
6	Available From Operations	51,314	4,561	55,875	890	56,765	21,436	78,201
7	Funds Required for Capital	72,000		72,000		72,000		72,000
8	Grant Income	18,000		18,000	0	18,000		18,000
9	Capital Leasing Funds Debt Service	0		0		0		0
10	Capitalized Interest Debt Service	0		0		0		0
11	Release of Sinking Fund Asset	0		0		0		0
12	Temporary Financing		*20,000*	*20,000*	*20,000*	*40,000*	*(20,000)*	*20,000*
13	**TOTAL SOURCES**	$141,314	$24,561	$165,875	$20,890	$186,765	$1,436	$188,201
	USES							
14	Net Construction Expenditures	$75,152		$75,152		$75,152		$75,152
15	*LNG & BCCS*							
	Funded Debt Reduction:							
16	Revenue Bonds	36,675		36,675		36,675		36,675
17	PMA Lease/Subordinate Debt	1,370		1,370		1,370		1,370
18	Capital Lease	0		0		0		0
19	Debt Reduction Funding	0		0		0		0
20	Post Retirement Benefit Funding	0		0		0		0
21	Temporary Financing Repayment	0		0		0		0
22	City Loan Repayment/Status	2,000		2,000	20,500	22,500		22,500
23	Distribution of Earnings	18,000		18,000		18,000		18,000
24	Additions To (Reductions of)							
25	Non-Cash Working Capital	2,900	(11,018)	(8,118)		(8,118)		(8,118)
26	Cash Needs	136,097	(11,018)	125,079	20,500	145,579	0	145,579
27	Cash Surplus (Shortfall)	5,217	35,579	40,796	390	41,186	1,436	42,622
28	**TOTAL USES**	$141,314	$24,561	$165,875	$20,890	$186,765	$1,436	$188,201
29	Cash - Beginning of Period	$10,820	0	$10,820	0	$10,820	0	$10,820
30	Cash - Surplus (Shortfall)	5,217	35,579	40,796	390	41,186	1,436	42,622
31	**ENDING CASH**	**$16,037**	$35,579	**$51,616**	$390	**$52,006**	$1,436	**$53,442**
32	**Outstanding Commercial Paper**	$70,000	$20,000	$90,000	$40,000	$130,000	$20,000	$150,000
33	**City Loan Outstanding**	$43,000	$0	$43,000	($20,500)	$22,500	$0	$22,500

Source: Col.1- Exhibit JRB-2, Exhibit A-2
Col. 3- Exhibit JRB-1, page 2

PHILADELPHIA GAS WORKS
Debt Service Coverage
Test Year Ended August 31, 2007
($000)

Line No.		PGW Budget 2006-07 (1)	PGW Adjustments (2)	PGW *Pro Forma* @Present Rates 2006-07 (3)	O.C.A. Adjustments (4)	O.C.A. *Pro Forma* @Present Rates 2006-07 (5)	O.C.A. Adjustments (6)	O.C.A. *Pro Forma* @Proposed Rates 2006-07 (7)
	FUNDS PROVIDED							
1	Total Gas Revenues	$951,980	($9,890)	$942,090	$0	$942,090	$23,737	$965,827
2	Other Operating Revenues	28,751	(187)	28,564	-	28,564	513	29,077
3	Total Operating Revenues	980,731	(10,077)	970,654	-	970,654	24,250	994,904
4	Other Income Incr. / (Decr.) Restricted Funds	9,665	1,585	11,250	-	11,250	(500)	10,750
5	City Grant	18,000	-	18,000	-	18,000	-	18,000
6	AFUDC (Interest)	1,202	-	1,202	-	1,202	-	1,202
7	TOTAL FUNDS PROVIDED	1,009,598	(8,492)	1,001,106	-	1,001,106	23,750	1,024,856
	FUNDS APPLIED							
8	Fuel Costs	630,841	-	630,841	-	630,841	-	630,841
9	Other Operating Costs	281,181	(13,053)	268,128	(890)	267,238	2,314	269,552
10	Total Operating Expenses	912,022	(13,053)	898,969	(890)	898,079	2,314	900,393
11	Less: Non-Cash Expenses	41,887	(0)	41,887	-	41,887	-	41,887
12	TOTAL FUNDS APPLIED	870,135	(13,053)	857,082	(890)	856,192	2,314	858,506
13	Funds Available to Cover Debt Service	139,463	4,561	144,024	890	144,914	21,436	166,350
14	1975 Ordinance Bonds Debt Service	35,748	-	35,748	-	35,748	-	35,748
15	**Debt Service Coverage 1975 Bonds**	**3.90**	**0.13**	**4.03**	**0.02**	**4.05**	**0.60**	**4.65**
16	Net Available after Prior Debt Service	103,715	4,561	108,276	890	109,166	21,436	130,602
17	Other Capital Leases	-	-	-	-	-	-	-
18	Net Available after Prior Capital Leases	103,715	4,561	108,276	890	109,166	21,436	130,602
19	1998 Ordinance Bonds Debt Service	53,313	-	53,313	-	53,313	-	53,313
20	New Proposed Bond Debt Service	-	-	-	-	-	-	-
21	Total New Debt Service	53,313	-	53,313	-	53,313	-	53,313
22	**Debt Service Coverage 1998 Bonds**	**1.95**	**0.09**	**2.03**	**0.02**	**2.05**	**0.40**	**2.45**
23	Net Available after 1998 Debt Service	50,402	4,561	54,963	890	55,853	21,436	77,289
24	1998 Ordinance Subordinate Bond Debt Ser	1,987	-	1,987	-	1,987	-	1,987
25	**Debt Service Coverage Subordinate Bonds**	**25.37**	**2.30**	**27.66**	**0.45**	**28.11**	**10.79**	**38.90**
26	**Net Available To Service Aggregrate Debt Serv**	**117,734**	**4,561**	**122,295**	**890**	**123,185**	**21,855**	**145,040**
27	**Aggregrate Debt Service**	**91,048**	**-**	**91,048**	**-**	**91,048**	**-**	**91,048**
28	**S&P Fixed Coverage Charge**	**1.29**	**0.05**	**1.34**	**0.01**	**1.35**	**0.24**	**1.59**

Source: Col.1- Exhibit JRB-2, Exhibit A-3
Col. 3- Exhibit JRB-1, page 3

OCA STATEMENT NO. 2-S

5/21/07
PLS PD
MS

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

SURREBUTTAL TESTIMONY OF MICHAEL A. BLEIWEIS

ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

MAY 15, 2007

Q. Please state your name and address.

A. My name is Michael A. Bleiweis and my business address is 243 Banks Road, Easton, Connecticut.

Q. Are you the same Michael Bleiweis who previously filed Direct Testimony in this proceeding?

A. Yes.

Q. What is the purpose of your Surrebuttal Testimony in this proceeding?

A. My Surrebuttal Testimony responds to the testimony of two witnesses. First, I will respond to the testimony of PGW witness Joseph Bogdonavage regarding Mr. Bogdonavage's five year forecast; the City Loan payback; the cash that would be available to PGW at the year end as a result of Mr. Bogdonavage's and the OCA's proposals; and the bad debt collection ratio at proposed rates. Second, I will respond to the testimony of PGW witness Albert D'Attilio regarding the Incentive Compensation Program.

Q. Please comment on some of the major ratemaking themes offered by Mr. Bogdonavage in his rebuttal testimony.

A. Mr. Bogdonavage argues that his total proposed $110 million revenue requirement is not entirely based on his five-year forecast scenario. (Rebuttal, page 3.) However, all of his Exhibit JRB-1 schedules presented in his Direct Testimony, which are the major supporting schedules, show financial data for the FY2007 test year and forecast data for fiscal year

periods 2008-2012. It is, therefore, evident that PGW has structured its proposed rate relief based upon this forecast period and has not utilized the traditional future test year ratemaking methodology that was the basis for the recommended revenue requirement of OCA, as well as that of OTS.

It must be emphasized that Exhibit JRB-1 presents just one of an infinite number of financial scenarios that could have been utilized by PGW. These schedules are based upon the assumption of the following major financial variables, which are stated on page 10 of my Direct Testimony: 1) the $45 million interest-free City Loan is to be paid back $2 million in FY2007 and $43 million in FY2008; 2) the "grant-back" by the City of Philadelphia of the $18 million City Payment is to end in FY2010; 3) a year-end cash balance of approximately $50 million is assumed for all years of the forecast; 4) a debt reduction program over the five-year period totaling $205 million is reflected on the Cash Flow Statement; and 5) an approximate 50/50 debt equity ratio is assumed at the end of the five-year period (FY2012).

If any one or multiple major financial variables are changed, the financial results of the forecast period would be quite different. For example, OCA has included in its recommended future test year Cash Flow Statement (Schedule MAB-10) a two-year payback of the $45 million City Loan, as compared to PGW's Scenario of a $2 million payment in FY2007 and a $43 million payment in FY2008 (Exhibit JRB-1, page 7). Obviously, any

lengthening of the payback period beyond even the two years recommended by OCA would result in substantial additional cash to PGW and less reliance on the commercial paper program in the test year and forecast periods.

Another major effect on cash would result if PGW were to pare down what it has termed its Debt Reduction Funding program. This funding, which totals $205 million for the period FY2007-FY2012, is part of PGW's program to attain an approximate 50/50 debt/equity ratio at the end of the five-year forecast period. For argument's sake, if the Debt Reduction program was reduced by $100 million over the five-year period, then an additional $100 million in cash would be available to PGW. In general, any significant change in the five major financial variables would have a considerable effect on the scenario presented by PGW and on the proposed revenue requirement.

Q. Please comment on the financial schedules prepared by Mr. Bogdonavage for the test year and subsequent five years (Exhibit JRB-7) on what he terms a "realistic" basis (Rebuttal, page 5.)

A. Exhibit JRB-7 reflects the fact that actual rates from this proceeding will not become effective until FY2008. However, the problem here is that the Exhibit JRB-1 schedules of the original filing for the test year and five ensuing years were prepared utilizing the traditional ratemaking basis. That is, the revenue increase was reflected as if it had been in effect for the entire rate year FY2007. This traditional ratemaking methodology is

used in all other base rate cases, and was used in PGW's prior base rate cases, because the test year is supposed to be representative of future operating conditions. Mr. Bogdonavage's attempt to now show financial results in a manner divorced from the traditional ratemaking process is not a sound basis for setting rates.

Of course, the Exhibit JRB-7 schedules, as well as the Exhibit JRB-1 schedules, also show financial data for the five-year forecast period. Though PGW may regularly employ a "five year planning horizon for operating and capital budget purposes", (Bogdonavage, page 5), the PUC has consistently utilized the future test year concept for ratemaking purposes.

Q. Do you agree with Mr. Bogdonavage's contention that OCA's *position of proposing a two-year payback of the City Loan "can be considered the same as accounting for a 'known and definite' change"*? (Bogdonavage, page 6)

A. Yes. The schedules in my Direct Testimony (Schedules MAB 9-11) do reflect a proposed "known and measurable" change that is representative of future conditions, that is, the payment of the City Loan over two years. However, as discussed above, Exhibit JRB-1 is <u>not</u> presented on a future test year basis because the FY2007 future test year shows only a small $2 million payment of the City Loan with the remainder being paid during the

next fiscal year (FY2008). Therefore, the test year, as presented by PGW, is not reflective of this known and measurable change.

Q. Even though Exhibit JRB-8 does not recast the company's claim by reflecting a two-year payback of the City Loan, does it present some interesting financial data regarding one possible revenue requirement scenario?

A. Yes. As I understand it, the Exhibit JRB-8 scenario reflects PGW's pro forma test year expense position, a $25 million test year rate increase and a test year payment of $22.5 million for the City Loan. Utilizing this scenario, the Cash Flow Statement for the test year 2007 shows a year-end cash balance of approximately $50 million and $95 million of Outstanding Commercial Paper while the test year Debt Service Coverage Statement shows coverages on 1998 bonds of 2.47 times. Thus, even excluding any further expense adjustments as proposed by OCA and OTS, or any additional capital contributions by the City, the pro forma test year financial results provide PGW with the financial means to continue into the short-term future.

Q. Please comment on Mr. Bogdonavage's statement that "Mr. Bleiweis points to the $53 million of "cash" at year end as evidence that a $25 million rate increase is reasonable but does not state any standard or basis for the claim." Rebuttal, page 10

A. As stated in my Direct Testimony (page 10) and above, one of the major financial variables utilized by PGW in developing its five-year forecast was an assumption of year-end cash in the amount of approximately $50 million. It must be understood that this assumption has a major effect on the financial model, especially as it regards the outstanding Commercial Paper balance. For example, as shown on Exhibit JRB-8 described above, if the financial goal had been to have a $40 million year-end cash balance rather than a $50 million balance, then, all other things being equal, the FY2007 commercial paper balance would have been $10 million less, that is, $85 million instead of $95 million. Essentially, any reduction in the required year-end cash balance or reduction in uses of cash (for example, in order to pay back the City Loan), would reduce reliance on the commercial paper program for everyday cash needs.

There is nothing magical about utilizing a $50 million year-end balance in the financial model. But for ease of presentation, I utilized the same balance as the company for determining cash flow on Schedule MAB-10. In fact, my historical financial data base shows that PGW has not had a fiscal year-end actual cash balance of at least $50 million since at least FY1995.

Q. Please comment on Mr. Bogdonavage's statements regarding your recommendation that the bad debt collection ratio at proposed rates should be 96% rather than the company's proposal of 95%. Rebuttal, page 27

A. Though it is probable that a substantial increase in base rates would have some effect on the collection ratio and the resultant Bad Debt Expense, OCA's $22.5 million revenue increase recommendation should not have a substantial effect. As shown on page 25 of my Direct Testimony, even though company billings increased by over $140 million (17.6%) over the four-year period FY2003-FY2006, the collection ratio increased from 86.6% to 96.6% over the same period.

Further, though the actual 12-month rolling average collection ratio through March, 2007 is 95.5% (Rebuttal, page 27), this figure compares to an actual collection ratio for the 12-months ended March, 2006 of 93.7%. Thus, if this 1.8% differential continues throughout the remainder of FY2007, then the FY2007 collection ratio could very well be above last year's figure of 96.6%.

Q. Please comment on Mr. Bogdonavage's statement that:

> **"In my view, civil fines and penalties assessed by regulatory agencies are legitimate operating expenses for a municipal natural gas utility." Rebuttal, page 35**

A. As I stated in my Direct Testimony (page 28), by including an amount for Regulatory Penalties in rates, PGW is stating that "it expects that the company will be fined by the PUC for failure to comply with the Public Utility Code and related regulations" and further, that customers will be the

ultimate source for such payments. The test year amount of $50,000 should be eliminated for ratemaking purposes.

Q. Please comment upon Mr. D'Attilio's contention that formal guidelines do exist for the Incentive Compensation Program. (Rebuttal, page 9)

A. I do not agree with Mr. D'Attilio that the Company's replies to interrogatories sufficiently set forth the Incentive Compensation Program. As I stated in my Direct Testimony, PGW did not provide a copy of the program in response to an OTS request because such a document does not exist. It has been my experience in many rate proceedings that utilities provide each eligible employee with a document detailing exactly how bonuses are determined. Such is not the case with PGW.

Further, to the best of my knowledge, no formal guidelines for the program exist even today. Since there are no formal guidelines, it is logical to conclude that there is no formal bonus program. The informality of the program can be shown by Mr. D'Attilio's admission that there is no written support for the calculation of the actual bonuses since these would have to be "replicated". Thus, any costs associated with the "bonus program" should be eliminated for ratemaking purposes.

Q. Does that complete your surrebuttal testimony?

A. Yes, it does.

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OCA STATEMENT NO. 3

5/21/07

Phila Gas
#15

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

DIRECT TESTIMONY OF

RICHARD A. GALLIGAN

ON BEHALF OF
OFFICE OF CONSUMER ADVOCATE

APRIL 6, 2007

EXETER
ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 21044

TABLE OF CONTENTS

I. Introduction

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Richard A. Galligan. I am a principal with Exeter Associates, Inc., a firm of consulting economists specializing in utility economics. My business address is 5565 Sterrett Place, Suite 310, Columbia, Maryland, 21044.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I have two degrees from the University of Wisconsin, including a Master's degree in economics and, in addition, I completed two years of graduate study at the University of Minnesota, where I fulfilled all of the course work requirements for the Ph.D. degree.

Q. WHAT IS YOUR PROFESSIONAL EXPERIENCE?

A. I have taught economics at the University of Minnesota, the University of Wisconsin, Mankato State University, and Webster College. In these positions, I taught a wide range of courses covering all aspects of economics.

In January 1975, I joined the staff of the Minnesota Public Service Commission at the commencement of that commission's responsibility over gas and electric utility operations in the State of Minnesota. From 1976 to 1984, I was an economic consultant specializing in public utility rate regulation of gas, electric and telephone utilities.

From 1984 until 1987, I was Director of Utilities Division at the Iowa State Commerce Commission and Executive Director of the Texas Public Utility Commission. At Iowa, my responsibilities included the management and administration of all Utilities Division activities regarding the regulation of gas, electric and telephone utilities operating in the State of Iowa under Iowa State Commerce Commission jurisdiction. At the Texas Public Utility Commission, I was responsible for the management and day-to-day administration of that Commission's regulatory activities regarding all aspects of its jurisdictional responsibilities. I also served briefly as General Manager of Rates &

Regulatory Affairs at Gas Company of New Mexico before assuming my present position at Exeter Associates, Inc. in October 1987.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY PROCEEDINGS ON UTILITY RATES?

A. Yes. I have previously presented testimony on more than 100 occasions before the Federal Energy Regulatory Commission ("FERC") and the public utility commissions of Alabama, California, Connecticut, Delaware, the District of Columbia, Florida, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Missouri, Montana, Nevada, New Hampshire, New Jersey, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, and Virginia.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of the Pennsylvania Office of Consumer Advocate ("OCA").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. Philadelphia Gas Works ("PGW" or the "Company") has filed a base rate increase request for its gas delivery rates. PGW's proposed rates would result in a total gas revenue delivery rate increase of $100 million annually. This $100 million increase is a 23 percent increase in non-gas tariff revenue, and a 9.6 percent overall increase. PGW proposes to achieve its approximate $100 million revenue increase, in part, by increasing its residential customers' rates as follows:

Table 1

Proposed Rate Increase
Philadelphia Gas Works
Total Company and Residential Service

	Revenue Increase ($)	Percentage Increase
Residential Heat	66,758,000	21.4
Residential Non-Heat	2,639,000	15.2
Total Company	100,000,000	23.0

PGW arrived at this proposed revenue spread among the classes by essentially adjusting each class' revenues so as to make progress toward basing rates on its average embedded class cost of service study results, while also considering the principle of gradualism.

Exeter Associates, Inc. was retained by the OCA to review the cost of service study, revenue allocation and rate design proposals included in PGW's application. My testimony presents my findings, conclusions and recommendations concerning the Company's cost of service study, revenue allocation, and rate design proposals.

Q. WHAT CONCLUSIONS HAVE YOU REACHED AS A RESULT OF YOUR REVIEW AND ANALYSIS?

A. Based on the results of my review and analysis, I have reached the following conclusions:

- Typical of local gas distribution companies, the lion's share of PGW's plant, accounting for more than 80 percent of its plant, is comprised of distribution mains and services investment;
- PGW's class cost of service study misallocates its distribution mains plant investment and related costs, producing study results that do not reasonably reveal an accurate indication of class allocated cost responsibilities;

- Mr. Howard, PGW's witness who performed PGW's class cost of service study, erroneously believes that PGW would have incurred 25 percent of its actual distribution mains investment costs to install a system incapable of delivering any gas to customers who would use no gas;
- PGW erroneously concluded that all of its non-customer-related distribution mains investment is caused by its customers' peak demands, leading the Company to allocate all of its distribution demand-related mains costs on class peak demands;
- PGW's gas distribution system exists to meet its customers' demands for gas each day of the year;
- Because peak demands exceed average demands, some additional costs relate to providing service at times of peak demands;
- Distribution mains costs that are incurred because PGW's annual demands are sufficient to warrant its provision of delivery service through its extensive investment in its capital intensive, fixed delivery assets should be allocated on the basis of those annual, or average, demands, and the additional costs related to serving peak demands should be allocated on peak demands;
- When viewed through the alternative Peak and Average cost study, PGW's proposed residential rate increases result in residential customers' rate of return on fixed assets required to provide their service significantly closer to system average rate of return than reflected in PGW's cost study;
- PGW's proposed residential class revenue responsibility is not unreasonable; and
- PGW's proposed residential rate design is reasonable.

Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?

A. Following this introductory section, my testimony is divided into three additional sections. In the first additional section, I detail the reasons that support a finding that

PGW's recommended class cost of service study produces an inaccurate indication of the allocated costs of serving the various customer classes. The second additional section addresses class revenue requirement determinations. The final section of my testimony addresses PGW's proposed Residential rate design.

II. Cost Allocation

Q. PLEASE BRIEFLY DESCRIBE THE COST OF SERVICE STUDY SUBMITTED ON BEHALF OF PGW IN THESE PROCEEDINGS.

A. PGW submitted an average embedded allocated class cost-of-service study performed by its witness, Mr. Howard Gorman. Sometimes an average embedded allocated cost of service study is referred to as a fully distributed cost study. The performance of such a study requires that every cost included in the total cost of service be ascribed, somehow, to the customers who allegedly, or to the best ability of the cost practitioner performing the study to determine, have "caused" the utility to incur such costs. Customers cause the utility to incur costs by demanding the services for which the Company incurs costs.

When performing an average, embedded, allocated class cost of service study, the cost practitioner's task is not done until each and every embedded cost, which comprises the total costs of providing service, is either directly assigned or allocated to the customer classes. In performing its cost of service study, PGW first functionalized its total costs of service into categories including production, storage, and distribution. Fixed costs are generally classified as being related to number of customers and to average and peak demands.[1] Variable costs are generally classified as throughput related. Generally, customer related costs were allocated in a manner related to number of customers; throughput related costs were allocated on volumes; and distribution demand related costs were allocated on customer class maximum coincident demands. The allocation of fixed or capacity related costs is the most controversial aspect of performing an allocated cost of service study.

[1] PGW relates some demand classified costs to peak season requirements.

Q. HOW DID PGW ALLOCATE ITS DISTRIBUTION MAINS PLANT AND ITS DISTRIBUTION SERVICES PLANT INVESTMENT?

A. PGW allocated its distribution mains plant investment seventy-five percent on the basis of customer class coincident peak demands, and twenty-five percent on the basis of number of customers. Services were allocated essentially on the basis of number of customers. Distribution mains investment and distribution services investment, at $1 billion of gross plant, represent about two-thirds of PGW's total plant investment. While it is customary to allocate services investment on the basis of number of customers, the allocation basis for distribution mains is much more controversial. If PGW's proposed allocation of total distribution mains cost is to be consistent with the principle of cost causation, then PGW's total distribution mains investment and related costs would necessarily have to be caused by the mere existence of customers and the non-customer portion of costs would have to be caused entirely by the fact that customers demand gas only under the design day conditions that produce peak demands for gas.

Customer Component of Distribution Mains

Q. PLEASE EXPLAIN HOW PGW DETERMINED THAT 25 PERCENT OF ITS DISTRIBUTION MAINS INVESTMENT IS A CUSTOMER COST.

A. At page 10 of his prefiled direct testimony, Mr. Gorman states, "For example, Account 376, Mains, was classified as both customer and demand related due to their dual function of connecting customers and meeting peak demand." Mr. Gorman explains that a zero-intercept study, which estimates the costs that would be incurred to install pipes of zero-inch diameter, would produce an estimated cost of mains that is classified as the customer component of mains. Further explaining that PGW did not have the data required to perform a zero-intercept study, and based on R. J. Rudden Associates' experience, an estimate of 25 percent was used. That is, 25 percent of PGW's actual

distribution mains investment was determined by Mr. Gorman to be a customer cost. Mr. Gorman later submitted a data response to OSBA-Set II-20 which indicated that the customer component of distribution mains would be 21.1 percent when estimated on a zero-intercept basis, or 46.7 percent when measured on the basis of performing a minimum system study.

Q. DO YOU AGREE WITH PGW'S CLASSIFICATION OF A PORTION OF ITS DISTRIBUTION MAINS AS A CUSTOMER COST?

A. No. Mr. Gorman claims at page 9 of his prefiled testimony that, "Customer costs are a function of the number of customers served ...," and that, "Customer related costs are the costs incurred to attach a customer to the distribution system ..." In fact, the so-called customer cost component of distribution mains is not a function of the number of customers. Unlike services investment, which is a cost required to connect customers to the distribution system (and each customer requires one services investment[2]), distribution system investment is a function of the diversified and coincident loads that the distribution system must provide.

Q. PLEASE COMMENT ON PGW'S DETERMINATION OF THE ALLEGED CUSTOMER COST COMPONENT OF DISTRIBUTION MAINS IN THIS PROCEEDING.

A. After simply assuming a PGW customer cost component of mains at 25 percent of all the mains costs that PGW has incurred since its inception, Mr. Gorman, as indicated above, later determined that customer costs of mains is 21.2 percent when estimated on a zero-intercept basis, or 46.7 percent when estimated on a minimum system basis. Both the zero-intercept and minimum system methods attempt to measure the same thing -- the

[2] Since each customer must be served through the services line (essentially, the pipe that runs from the distribution main to the meter), there is a direct relationship between the number of customers and the number of services.

customer component of distribution mains. That customer costs could differ by so much, $138.4 million[3], depending upon how they are determined by Mr. Gorman, raises significant concerns with the validity of these customer cost determinations.

Q. WHEN A PORTION OF DISTRIBUTION MAINS INVESTMENT COST IS ALLOCATED ON THE BASIS OF THE NUMBER OF CUSTOMERS, HOW DOES A COST MISALLOCATION RESULT?

A. Customer meter and service line costs are customer-related costs. The costs associated with investment in mains is misallocated due to PGW's introduction of a cost of service study variant that extends the customer cost notion, through the minimum system concept, into the allocation of mains investment. Mains are not sized for the number of customers served from them, but for the loads placed upon them. This is made clear in the following example: along one city block are located 10 residential customers with a coincident peak demand of one Mcf each. The main running down the street would have to be capable of delivering 10 Mcf at peak. On another city block is only a small plastics factory that exhibits a maximum demand of 10 Mcf. The main for that one customer has to be sized to deliver 10 Mcf when the plastics factory demand peaks. It is clear that the mains investment is driven by the loads placed upon it -- not by the number of customers served from it. Finally, imagine that the plastics factory is torn down to make room for five large residences, each of which exhibits a demand at time of coincident peak of 2 Mcf. Again, the main which is sized to deliver 10 Mcf is adequate. One customer, five customers, or ten customers do not determine the amount of mains investment; rather, mains investment is a function of the loads to be served.

[3] ($540,564,000 x .467) -- ($540,564,000 x .211) = $138,384,000.

Q. DOES ANY RECOGNIZED AUTHORITY AGREE WITH YOUR CONCLUSION THAT IT IS IMPROPER TO ALLOCATE A PORTION OF THE MAINS DISTRIBUTION SYSTEM ON THE BASIS OF BEING CUSTOMER-RELATED?

A. Yes. Professor Bonbright, at pages 347 and 348 of his Principles of Public Utility Rates, utilizing an example from the electric industry, states:

> But the really controversial aspect of customer-cost imputation arises because of the cost analyst's frequent practice of including, not just those costs that can be definitely earmarked as incurred for the benefit of specific customers but also a substantial fraction of the annual maintenance and capital costs of the secondary (low voltage) distribution system -- a fraction equal to the estimated annual costs of a hypothetical system of minimum capacity. This minimum capacity is sometimes determined by the smallest sizes of conductors deemed adequate to maintain voltage and to keep from falling of their own weight. In any case, the annual costs of this phantom, minimum-sized distribution system are treated as customer costs and are deducted from the annual costs of the existing system, only the balance being included among those demand-related costs to be mentioned in the following section. Their inclusion among the customer costs is defended on the ground that, since they vary directly with the area of the distribution system (or else with the lengths of the distribution lines, depending on the type of distribution system), they therefore vary indirectly with the number of customers.
>
> What this last-named cost imputation overlooks, of course, is the very weak correlation between the area (or the mileage) of a distribution system and the number of customers served by this system. For it makes no allowance for the density factor (customers per linear mile or per square mile). Indeed, if the Company's entire service area stays fixed, an increase in number of customers does not necessarily betoken any increase whatever in the costs of a minimum-sized distribution system.
>
> While, for the reason just suggested, the inclusion of the costs of a minimum-sized distribution system among the customer related costs seems to me clearly indefensible, its exclusion from the demand-related costs stands on much firmer ground.

Professor Bonbright clearly agrees that distribution costs, except for those costs that can be definitely earmarked to benefit specific customers, are not properly classified as customer costs. It is conceptually wrong to consider distribution mains as being customer

related. This is so because mains investment is undertaken when annual gas consumption is high enough to warrant the investment, and mains are sized to meet elevated demands, independent of the number of customers.

Q. DOES PGW ALWAYS INVEST IN DISTRIBUTION MAINS TO ATTACH A NEW CUSTOMER TO ITS SYSTEM?

A. No, it does not. At times, no incremental distribution mains investment is required to extend service to a new customer.

Q. IS PGW REQUIRED TO INCUR COSTS TO SIMPLY CONNECT A CUSTOMER?

A. No. PGW, like virtually all natural gas delivery companies, is not required to incur costs simply to connect customers who would use little or no gas. Specifically, PGW's tariff, Section 10, Extensions and Rights-of-Way, explicitly limits that the amount of cost that PGW will incur to extend service to an Applicant based on the Applicant's annual Delivery Charge. In short, no deliveries, no Delivery Charges, and no extension of service to "connect" the Applicant. Only when the Applicant has sufficient anticipated annual requirements, which produce Delivery Charge revenues to justify the extension, will PGW incur costs up to five times the annual Delivery Charge to extend service.

It would be economically irrational to extend natural gas delivery service to a customer who would use no gas. PGW is not in the business of connecting customers who would use no gas. There is no observed demand for connection service on PGW's system. PGW has no obligation under its tariff to incur costs to simply connect a potential customer who would use no gas. No part of PGW's distribution mains investment is incurred and related to "connecting" customers who would use no gas.

Clearly, it is its gas usage requirements, both annual and peak demands, which are the cause of PGW's distribution mains costs, not the imaginary costs of connecting

customers who would use no gas. I conclude that 100 percent of PGW's distribution mains costs are related to the gas delivery demands, both annual and peak demands, that are responsible for the existence of the delivery system in the first place. This contrasts to Mr. Gorman's view that 75 percent of PGW's distribution mains investment is caused by demand requirements, and 25 percent is caused by the need to install mains that are so small (zero-diameter or minimum size) that they are incapable of delivering any gas to customers who would use no gas.

Q. TURNING NOW TO THE DISTRIBUTION INVESTMENT COSTS THAT ARE CLASSIFIED AS DEMAND RELATED, IS PGW CORRECT THAT 100 PERCENT OF ITS DISTRIBUTION DEMAND RELATED COST IS CAUSED BY ITS PEAK DESIGN DAY DEMANDS?

A. No. Mr. Gorman, who performed the class cost of service study that PGW sponsors, is only about 10 percent right when he allocates 100 percent of demand related distribution mains cost on class contributions to design day peak demands. That is, I will show later in this section of my testimony, that about 10 percent of the distribution mains cost should be allocated on peak demands.

If Mr. Gorman's allocation of 100 percent of PGW's distribution demand related mains cost on the basis of design day peak demands were in accord with the principle of cost-causality,[4] then demands for natural gas deliveries only under design day weather conditions would be the only cause of the existence and utilization of the demand related portion of the distribution mains system. Design Day demands represent the maximum demands that are expected under the most severe weather assumptions used for planning purposes. Generally, gas distribution companies, like PGW, utilize demands associated with design day conditions that are expected to occur infrequently, say, on one day in a

[4] The principle of cost-causality requires costs to be allocated to customers on the basis of the customers' relative use of the service units that gave rise to the costs in the first place.

10- or 15-year period. While a portion of PGW's distribution mains cost is associated with, and hence, should be allocated on peak demands, it is obviously wrong to profess that all demand related distribution mains cost is caused by what consumers do on one day in a 10- to 15-year period. Quite simply, if PGW's customers had a demand for gas only at the time of peak, there wouldn't be a PGW gas distribution system. The costs of delivered gas supplies on that one peak day would be prohibitively high, and the cost of delivering gas through a local, in-ground, gas distribution system on that one day simply could not compete with alternative energy costs.

Q. IF LOCAL GAS DISTRIBUTION SYSTEMS ARE NOT BUILT TO MEET DESIGN DAY LOADS THAT OCCUR, PERHAPS, ONLY ONE DAY IN EACH 10-15-YEAR PERIOD, WHY DO GAS DISTRIBUTION COMPANIES INCUR DISTRIBUTION MAINS INVESTMENT COSTS?

A. The basic reason, of course, why LDC's invest monies in their distribution systems is to meet the annual demands for gas by end-use customers. This is the *raison d'etre* for the existence of the LDC in the first place. Without sufficient annual gas usage over which to amortize the annual costs of providing service, there would be no gas distribution system. Additionally, as I will describe later, a small amount of the total cost of distribution service is related to installing a system with enough throughput capacity to meet peak demands as well as annual demands. Because distribution mains exist and are related to both annual demands and peak demands, both annual and peak demands must be recognized in the allocation of distribution mains costs, if the allocation is to be in accord with the principle of cost-causality.

Q. WHY IS IT PROPER TO ALLOCATE MAINS INVESTMENT ON THE BASIS OF ANNUAL AS WELL AS PEAK DEMANDS?

A. The allocation of mains investment costs on the basis of both annual and peak demands is in accord with the principle of allocating costs on the basis of cost causality. Natural gas is of little or no value to an end user if that gas cannot be delivered to the location of the gas burning equipment. PGW's distribution system imparts locational value to the natural gas delivered across that system by allowing for the movement of that gas from its acquisition source to each customer's location. PGW's distribution system exists, and related costs are incurred, to deliver gas to its customers whenever, over the course of each year, its customers demand gas. In other words, PGW's system was built and costs were incurred to deliver gas both at the time of peak system demand and generally throughout the year. Because costs are incurred to deliver gas generally throughout the year, and additional costs are incurred to meet peak demands, PGW's delivery costs must be allocated on the basis of both annual and peak demands if those costs are to be allocated in accord with the principle of cost causality. PGW's failure to recognize the importance of annual demands as well as peak demands, and PGW's allocation of 100 percent of its demand related mains investment costs on peak demands only, violates the principle of cost-causality.

Q. PLEASE EXPLAIN YOUR STATEMENT THAT COSTS ARE INCURRED TO MOVE BOTH ANNUAL AND PEAK VOLUMES ACROSS PGW'S SYSTEM.

A. PGW's customers are projected to move approximately 70,369,397 Mcf across PGW's system during the test period. This equates to an average demand of about 192,793 Mcf each day. PGW's estimated design day peak demand is 723,500 Mcf. PGW could not have met its customers' annual gas demands with a system capability any smaller than 192,793 Mcf. In other words, if there were no variance in the daily demands on PGW's

system, the capacity of that system would have to be designed to accommodate the daily movement of 192,793 Mcf just to meet the annual demands. To meet peak demands, PGW's system capacity must be 3.75 times larger than 192,793 Mcf. Thus, some costs are related to the average deliveries each day on PGW's system, and some costs are related to the movement of gas when demands are above the average demand.

Rational investment decision analysis requires the consideration of annual volumes delivered across a natural gas distribution company's system. A gas distribution system would not exist if all demand related costs were the responsibility of peak demands. A viable gas market is dependent upon the ability to amortize delivery costs over a sufficient volume of service so as to result in a unit cost that can be recovered from the price at which gas can be sold and still compete with other energy sources. The association of costs with annual as well as peak demands, and the allocation of costs on the basis of both annual and peak demands for gas is absolutely essential to the economic feasibility of a gas delivery system. To ignore annual demands and allocate total demand related mains costs on peak demands only, as Mr. Gorman proposes, is inconsistent with the consideration of annual demands which are essential to the economic justification of the very costs being allocated.

Q. HOW DO THE COSTS OF PROVIDING FOR THE MOVEMENT OF PEAK DEMANDS COMPARE TO THE COSTS OF PROVIDING FOR THE MOVEMENT OF LESSER DEMANDS?

A. Many of the costs associated with the distribution delivery system do not depend upon pipe sizes. These costs would include planning, surveying, excavation, hauling, pipe bed preparation, unloading and stringing of pipe, municipal inspection, backfill, and pavement and sidewalk replacement. Since a portion of total costs does not vary with pipe size, or are fixed costs, total costs do not increase at a one-to-one ratio with increases

in maximum demands. The additional costs associated with meeting elevated demands are largely related to the cost of the pipe itself.

Moreover, throughput capability increases not at a one-to-one ratio with the size of the pipe, but at a rate equal to the square of the pipe's diameter. Doubling the diameter of a pipe, for example, increases its capacity by four times the original capacity. Thus, the additional costs of providing additional capacity are lower than the average costs of providing capacity. This means that the costs associated with providing capacity for the movement of average demands are greater on a unit basis than are the costs associated with providing capacity for additional demands. PGW's distribution system exists to deliver annual system requirements. There are costs that are uniquely associated with meeting peak demands, and as such peak demands should bear some cost responsibility. But the additional costs incurred to meet peak demands tend to be small.

Q. ARE GAS FLOWS DURING THE DESIGN PEAK SO IMPORTANT THAT MOST OF PGW's TOTAL DISTRIBUTION MAINS COSTS ARE DIRECTLY RELATED TO, AND CAUSED BY, DESIGN DAY DEMAND REQUIREMENTS?

A. No. Peak demands are not the major cause of PGW's demand related mains cost, and it is wrong therefore to allocate total demand related costs on the basis of peak demands, as PGW has done. Only the additional costs incurred to meet peak distribution demands above other demands are caused by, or directly related to, peak requirements. The PGW gas distribution system simply would not be viable and simply would not exist if the only demand for gas was the demand associated with extreme weather conditions, or peak demands each year or each 10- to 15-years. The PGW distribution system exists because the total annual demand for gas is sufficient to warrant its existence. It is an extreme and erroneous view that total demand costs associated with PGW's distribution network are

caused by peak day demands. Because PGW's system exists to deliver annual gas requirements, but some additional costs are related to the delivery of gas during periods of elevated demand, it is appropriate to allocate distribution mains costs on both annual and peak demands. The allocation on peak demands of all distribution system demand related costs, as PGW has done, misallocates substantial costs.

Q. TO WHAT EXTENT DO THE COSTS OF MEETING PEAK GAS FLOW REQUIREMENTS EXCEED THE COSTS OF MEETING AVERAGE GAS FLOW REQUIREMENTS?

A. PGW's design day peak demand is about four times its average demand. A pipe's cross-sectional area, and correspondingly its capacity, varies with the square of its radius. Therefore, doubling the size of a pipe's radius (or diameter), increases the capacity of the pipe four-fold. For example, doubling the diameter of a two-inch pipe to four inches, increases the capacity by four times the capacity of the two-inch pipe. The costs of meeting increased flow requirements that are caused by, or associated with, elevated demands is answered by the relationship of the change in total capacity costs to the change in capacity.

I have earlier explained that, since many capacity costs are essentially fixed, the increased costs associated with meeting increased capacity requirements is expected to be small. Indeed, it is largely these economies of scale that lead to falling average costs of service and the provision of gas distribution service more economically by one monopoly provider, like PGW, rather than by many competing providers.

Considering the many costs which remain essentially fixed, and that pipe costs are a small portion of installed pipeline project costs, the result is a favorable relationship between the costs associated with increased capacity and increasing pipe size. Were a doubling of the pipe sizes (and hence, a quadrupling of capacity) to increase capacity

related costs by as much as 40 percent, the result would be that increased demands above the average can be accommodated at increased distribution mains costs that are about 10 percent of the costs of meeting average demands. Thus 10 percent of distribution mains costs is associated with meeting peak demand requirements and should be allocated on peak demands, and 90 percent of mains cost relates to customers' annual demands for natural gas and should be allocated on average demands.[5]

Q. PLEASE COMPARE YOUR VIEWS ON HOW DISTRIBUTION SYSTEM DEMAND RELATED COSTS SHOULD BE ALLOCATED WITH PGW'S VIEWS.

A. PGW argues that 25 percent of its distribution mains investment, or $135 million, is customer related, whereas I have shown that the customer component is zero. PGW asserts that the demand classified share of its distribution mains is the remaining 75 percent of its total mains costs. I am recommending that a portion of PGW's distribution mains investment be allocated on the basis of average demands, and a portion on the basis of peak demands.

PGW believes that peak demands that occur on one day each 10- to 15- years are the demands that cause all of PGW's demand related distribution mains costs. Based on this belief, PGW argues that 100 percent of its total distribution system demand related costs should be allocated on a peak demand related basis. This is wrong. I have shown that there are additional costs, small though they may be, associated with building a gas distribution system with sufficient capacity to meet peak demands, which are higher than average demands. Mr. Gorman erroneously concludes that all of PGW's distribution demand costs are caused by peak demands. Ironically, the upshot of Mr. Gorman's allocation proposal is that under his assumption no distribution mains costs are allocated

[5] Class annual demands bear the same relationship as class average demands. Therefore, an allocation on annual demands is identical to an allocation on average demands.

on the basis of customer average demands, which is the basic service that PGW provides and the very reason PGW exists in the first place. PGW's proposed cost allocation, which in fact allocates no costs on the basis of the primary service (annual delivery of gas) that PGW provides, and without which the PGW distribution system would not exist, violates the principle of allocating costs in accord with cost-causality. On the other hand, my recommendation to allocate a portion of distribution mains costs on the basis of average demands that cause those costs, and the allocation of a portion of distribution mains costs on the basis of the peak demands that cause the peak-related distribution costs, certainly comports with the principle that costs should be allocated to the service units that cause the costs.

Q. HOW CAN DISTRIBUTION MAIN INVESTMENT COSTS BE PROPERLY ALLOCATED?

A. The additional costs of providing capacity in order to meet peak demands, as opposed to lesser demands, should be allocated on a peak demand basis. I earlier mentioned that about 10 percent of a gas utility's distribution mains cost is associated with meeting increased demands, and hence, 10 percent of mains costs should be allocated on the basis of peak demands. I conservatively recommend that fully 20 percent of PGW's distribution mains costs, instead of only 10 percent, be allocated on the basis of peak demands. The remainder of PGW's distribution mains cost, being related to, or caused by, PGW's annual gas requirements, should be allocated on annual, or average demands.

Q. HAVE YOU CAUSED TO BE PREPARED A CLASS COST OF SERVICE STUDY ON THE PGW SYSTEM THAT ALLOCATED DISTRIBUTION MAINS INVESTMENT AND RELATED COSTS PARTIALLY ON THE BASIS OF AVERAGE DEMANDS AND PARTIALLY ON THE BASIS OF PEAK DEMANDS?

A. Yes. Because PGW's witness Gorman asserts that the Rudden Gas Cost of Service study he relies on is proprietary, I requested a run which allocates 20 percent of distribution mains and related costs on peak demands, and 80 percent on average demands. Exhibit RAG-1 is a copy of the cost of service study summary pages. By allocating 80 percent of mains investment costs on the basis of average demand in this study, I have recognized the critical fact that PGW's existence as a viable business entity relies upon, and thus, its distribution mains investment costs are caused by, end-user annual gas requirements. I have also recognized that some additional costs are incurred to install pipe that can flow peak demand requirements by allocating a large, 20 percent portion of mains investment costs on the basis of peak demands. Allocating fully 20 percent of PGW's distribution mains costs on the basis of peak demands, rather than the 10 percent of mains costs that are reasonably associated with accommodating demands that exceed the average as discussed earlier at pages 15 and 16 of my testimony, results in a conservative recognition of volumetric cost responsibility. These changes to PGW's cost study correct significant misallocations of major cost components of PGW's total cost of service, and produce a cost study that is consistent with the principle that costs should be allocated to the service units that cause the costs to be incurred.

Q. HOW DO THE RESULTS OF YOUR PEAK AND AVERAGE COST OF SERVICE STUDY COMPARE TO THE RESULTS OF PGW'S CUSTOMERS/PURE PEAK STUDY?

A. Table 2 below shows the results of both the PGW's cost of service study and my cost of service study at present rates.

Table 2

Total Allocated Costs and Rate of Return at Present Rates ($000's)

	Residential Heating		Residential Non-Heating		Total Company	
	Index Return	Rate of Return	Index Return	Rate of Return	Index Return	Rate of Return
1. Results per PGW's Study	78.6%	4.6%	(41%)	(2.4%)	100%	5.8%
2. Results per OCA Study	93.0%	5.4%	(33%)	(1.9%)	100%	5.8%

Line 1 of the table shows each class' resulting rate of return and index return based on PGW's view that it incurs its total distribution mains costs because it has customers and those customers have an estimated one-day demand for gas each 10- to 15-year period, when PGW may face its design day weather conditions. Line 2 of the table shows each class' resulting rate of return and index return when a more reasonable 20 percent of PGW's distribution mains cost is associated with peak demands, and 80 percent of main costs is associated with PGW's primary service – the delivery of gas each day throughout the year consistent with its customers' requirements.

III. Class Revenue Requirements

Q. PLEASE EXPLAIN HOW PGW DETERMINED ITS PROPOSED SPREAD OF ITS REQUESTED $100 MILLION REVENUE INCREASE TO THE SEVERAL CUSTOMER CLASSES.

A. In a two-step process, PGW first determined its progress toward cost-based distribution rates that it deemed reasonable in this proceeding. Next, PGW developed rates for subject groups that would retain historic rate relationships between heating and non-heating customers. For example, in step-one of its process, PGW determined that a twenty percent movement toward cost-based rates as measured by its indexed rate of return for its residential heating customers, using its proposed cost of service study results as the standard, would reasonably balance the concepts of costs and gradualism. PGW then combined the residential heating customers with residential non-heating customers and with Housing Authority customers to determine a common delivery rate. The resulting proposed increased revenues for residential heating customers in step-two would be such that residential heating customers would actually make thirty-two percent progress in reducing this difference between their rate of return compared to system average rate of return.

Table 3 below shows the residential heating customer rates of return, and system average rates of return at present and PGW-proposed rates, using PGW class cost of service study results.

Table 3

Residential Heating Customers
Financial Indicators Based On PGW Class Cost of Service
Study Results

	Present Rates		Step-One Revenues		Step-Two Revenues	
	Rate of Return	Index	Rate of Return	Index	Rate of Return	Index
Residential Heating	4.59%	79.2%	10.74%	83.3%	11.07%	85.6%
Residential Non-Heating	(2.4%)	(42.1%)	5.00%	38.8%	.87%	6.7%
Total PGW	5.79	100%	12.89	100%	12.89%	100%

The 10.74% residential heating, step-one rate of return represents a twenty percent movement of the class to the system average. The actual movement of residential heating customers at PGW proposed rates represents a 32% movement to the system average. The Step-1 and Step-2 results shown in Table 3 are based on PGW's proposed $100 million rate increase, PGW's proposed spread of that requested amount, and PGW's proposed class cost of service study.

Q. PLEASE EXPLAIN THE RELATIONSHIP BETWEEN CLASS REVENUES AND COSTS WHEN COSTS OF SERVICE ARE DETERMINED BASED ON YOUR AVERAGE AND PEAK STUDY RESULTS.

A. PGW proposes that residential heating customers should pay rates that provide sufficient revenues to yield an 11.07 percent rate of return. At this proposed rate increase, and using PGW's cost study results, residential heating customers close 32% of the difference between their index return and the PGW system average rate of return. When PGW's proposed residential heating rate increase is used and the cost results of the P&A cost of service study are substituted for PGW's cost study, residential heating customers are seen

to be providing a 12.15 percent rate of return at proposed rates. This 12.15 percent rate of return represents a 94.3 percent index return rather than the 86 percent index return based on the peak demand/customer study proposed by PGW. Thus, residential customers are seen to be paying rates that yield higher rates of return and higher index returns when PGW's proposed residential rates are compared to the more cost based P&A allocation of PGW's total costs of service.

Another way of comparing PGW's results under its proposed study with results under the P&A study is to compare the residential heating customer rate increase required to produce a class rate of return of 11.07 percent, PGW's proposed class rate of return. Because of the costs misallocated to residential heating customers under Mr. Gorman's peak/customer study, PGW proposed a $66.762 million rate increase for this class. Utilizing the P&A study results, a rate increase of $55.202 million would be required to cover all costs allocated to the residential heating class and leave enough leftover to provide an 11.07 percent rate of return. These results are shown in Table 4 below.

Table 4

Comparison of Class Financial Indicators When PGW-Proposed Rates Are Compared to PGW's Customer/Peak Cost Study Results and to OCA's Peak and Average Cost Study Results

	Total	PGW Customer/Peak Study		OCA Peak and Average Study	
		Heating	Non-Heating	Heating	Non-Heating
Rate of Return	12.89%	11.07%	0.87%	12.15%	1.58%
Index Rate of Return	100%	85.9%	6.7%	94.3%	12.26%
Increase Required to Achieve PGW-Proposed Class Rate of Return	N/A	$66,758,000	$2,639,000	$54,511,000	$2,686,000

Q. ARE YOU RECOMMENDING A CHANGE IN THE REVENUE INCREASE ALLOCATED TO RESIDENTIAL CUSTOMERS?

A. No. I am endorsing PGW's proposed residential rate increase. Residential heating customers account for over 95 percent of PGW's total residential revenues. Residential heating customers would yield a 94.3 index return at PGW proposed rates, or essentially cost-based rates, when costs are allocated in accord with the P&A methodology.

Q. SHOULD THE COMMISSION BE AWARE OF ANY FURTHER ALLOCATION MATTERS?

A. Yes. PGW has utilized estimated design day demands associated with the most extreme weather expected over a 10-to-15 year period to allocate its major demand classified costs. Because residential gas demands are greatly affected by weather, the use of design day demands is particularly burdensome to residential customers. Because design day weather is experienced infrequently, design day demands do not comport with the allocation of costs on the basis of how the PGW distribution system is actually used during all the days and years that are not typified by extreme design day weather conditions. The Commission should be aware that PGW's utilization of design day demands does not allocate its major demand related costs on the basis of delivery demands that are typical of most years of operation that PGW experiences, again, to the detriment of its residential, weather-sensitive customers.

Moreover, PGW is a mature gas distribution company, whose demands are not subject to ongoing, systematic increases. PGW's FY Budget 2007 investment reveals that only about 20 percent of the Company's new mains investment relates to new customer service. Review of PGW's 10 largest distribution mains investment projects reveals that only 7 percent of this investment relates to new service -- the remaining 93 percent relates to the replacement or relocation of existing pipe. Replacements and relocations

are not caused by either actual peak demands or design day peak demands, yet, under PGW's proposed costing methodology, demand classified replacement and relocation costs are allocated on peak demands only. In short, as the Commission deliberates the extent to which it should move classes toward average cost based rates by spreading whatever rate increase results from this proceeding, it should recognize that PGW's proposed cost of service study results are based on the Company's use of estimated design day demands. Moreover, it is questionable whether most of PGW's distribution mains costs it currently incurs as a mature company are even related to its peak demands. PGW's study allocates all demand classified distribution costs on a theoretical weather event based on expected frequency of once each 10-to 15-years. Unlike PGW's study, the P&A study tempers this extreme view by weighting actual usage of PGW's system, yet still allocates peak demand related costs, but only peak demand related costs, on extreme peak demands.

Q. ARE AVERAGE, EMBEDDED, ALLOCATED, CLASS COST OF SERVICE STUDIES CAPABLE OF YIELDING RESULTS THAT ARE SO PRECISE THAT THEIR RESULTS SHOULD BE DEEMED DEFINITE?

A. No. The bulk of PGW's costs are fixed costs. The allocation of fixed costs is controversial, largely because in the short-run, these costs may not change with the provision of a little more or less service. Regarding the allocation of fixed customer costs, Bonbright puts it this way:

> The really controversial aspect of customer-cost computation arises because of the cost analyst's frequent practice of including, not just the costs than can be definitely earmarked as incurred for the benefit of specific customers, but also a substantial fraction of the annual maintenance and capital costs of the secondary (low-voltage) distribution system - a fraction equal to the estimated annual costs of a hypothetical system of minimum capacity. [Bonbright, James C., et. al, Principles of Public Utility Rates, Public Utility Reports, Inc., Arlington, Virginia, Second Edition, 1988, p.491, emphasis added.]

Also, regarding capacity related costs, the NARUC Manual, at page 23 states:

Dr. James Bonbright, whose Principles of Public Utility Rates is the classic examination of regulation and ratemaking, wrote:

> Of all of the many problems of rate making that are bedeviled by unresolved disputes about issues of fairness, the one that deserves first rank for frustration is that concerned with the apportionment among different classes of consumers of the demand costs or capacity costs....Here, notions of 'fair apportionment' are almost sure to conflict with economists' convictions as to the relevant cost allocations. But these notions are themselves, neither stable nor uniform, although they reveal a general tendency in favor of a fairly wide spreading out of costs, as butter would be spread over bread in a well-made sandwich. Awareness of these unresolved conflicts about 'fair' cost apportionment has lead the British economist Professor W. Arthur Lewis to exclaim that, in rate determination, 'equity' is the mother of confusion,'

Dr. Bonbright also includes the following regarding the allocation of capacity, or demand related costs:

> We come now to that category of costs, capacity, ready to serve, or demand costs, the treatment of which has made a nightmare of utility cost analysis (for two masterly theoretical treatments see Boiteux, 1960, and Crew and Kleindorfer, 1986). As the FERC *Handbook* (1983, p. 139) states: "For the problem which it presents is that of imputing joint costs to joint products or byproducts, and not merely that of distributing those common, but nonjoint, costs (See Chapter 2) which vary more or less continuously with number of consumers or with rates of output....
>
> Here, as with the other two categories of cost, there is no general agreement as to what items or portions of total costs should be included among the demand-related costs, perhaps because cost functions are far too complex to be reflected by the arbitrary, three-way classification of customer, energy, and demand....
>
> In attempting to assess these relative responsibilities, the analyst is offered a wide variety of alternative formulas of apportionment, each of which has received support from some rate experts. Testifying before the ICC in Illinois (1953) in a rate case, Corey noted the existence of twenty-nine such formulae; in their textbook Garfield and Lovejoy (1964, p. 159) mention "20 or more allocation methods"; and Grainger (1972), 1976) discusses several methods of allocating the ready-to-serve costs. Most of them have no claim whatever to validity from the standpoint of cost determination and only a

> dubious claim to acceptance as compromise measures of reasonable rates. A harsher critic might use the metaphor of Bentham that these claims are "nonsense upon stilts". [Ibid., pp. 494-495]

I conclude that allocated cost of service study results based on often controversial cost allocations are themselves controversial. Allocated costs of service are one component of information available for the Commission as it considers its affirmative responsibility to set just and reasonable rates. The controversial aspect of fixed cost allocations reinforces the general regulatory principle that cost of service results are often used as a guide to the setting of rates.

Q. WHAT DO YOU CONCLUDE FROM YOUR ANALYSIS OF PGW'S PROPOSED RESIDENTIAL HEATING CUSTOMER RATE INCREASE AND ALLOCATED COSTS?

A. I conclude that no more than PGW's proposed residential rate increase should be approved by the Commission, if PGW is authorized its full, $100 million requested rate increase.

Q. IF THE COMMISSION AUTHORIZES A SMALLER RATE INCREASE THAN PGW HAS REQUESTED, HOW SHOULD THE SCALE-BACK IN CLASS REVENUE RESPONSIBILITIES BE ALLOCATED?

A. If a cost study is not required in the compliance phase, each class' responsibility for the additional revenues should be scaled back in proportion to PGW's original proposal. For example, if the Commission were to authorize, say, 75 percent of PGW's request, then PGW's proposed class revenue increases would be scaled back to 75 percent of the originally requested amounts.

IV. Rate Design

Q. PLEASE DESCRIBE PGW'S PRESENT RESIDENTIAL DELIVERY SERVICE RATES.

A. PGW's current residential delivery service rates consist of a $12.00 monthly customer charge and a $4.2124 per Mcf delivery charge (a universal service surcharge of $2.5387 also applies). PGW proposes to retain this rate design at the $12.00 monthly customer charge and a $6.0799 per Mcf delivery charge (plus a universal service surcharge of $2.5387 per Mcf).

Q. DO YOU AGREE WITH PGW'S PROPOSED RESIDENTIAL RATE DESIGN?

A. Yes. Meaningful price signals result when prices are based on marginal costs. Marginal customer costs can be estimated as avoidable customer costs -- those costs which are avoided should a customer leave the system. An estimate of residential heating customer avoided costs is PGW's customer accounts expense and overheads, which is in range of $7 per customer per month.

PGW's current $12 per month residential customer charge significantly exceeds estimated residential avoided customer costs. Because PGW has substantial fixed costs, all billing elements are set above marginal, or avoided, costs. I recommend that PGW's current $12 per month customer charge be retained, as PGW proposes.

PGW's current residential volumetric delivery rate design consists of a single, constant charge per Mcf of metered gas usage. This is consistent with PGW's proposed use of an average, embedded, allocated class cost of service study, which is designed to produce total allocated class costs of service, but is not designed to provide class costs of service by usage level. PGW's single block rate design is also consistent with principles of conservation that would increase rates for all levels of consumption by at least the

same amount. I recommend that PGW's current, single-block, residential rate design be retained.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes.

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BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

EXHIBITS ACCOMPANYING THE

DIRECT TESTIMONY OF

RICHARD A. GALLIGAN

ON BEHALF OF
OFFICE OF CONSUMER ADVOCATE

APRIL 6, 2007

EXETER
ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 21044

Philadelphia Gas Works
Class COS Study - 2006- REVISED (Mar30) Mains
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
Revenues at Current Rates										
Gas Full Tariff Revenue	609,786	16,040	405,998	18,706	93,235	3,788	8,063	2,882	11,043	9,102
Non-Gas Full Tariff Revenue	434,342	17,369	311,903	12,984	62,869	2,535	5,435	1,580	5,896	6,251
Full tariff gas revenue at current rates	1,044,127	33,409	717,901	31,690	156,104	6,323	13,498	4,462	16,939	15,353
Other revenue / Adjustments	31,585	2,551	26,111	298	1,135	31	80	11	33	525
Net revenues	1,075,712	35,960	744,011	31,988	157,239	6,354	13,577	4,473	16,972	15,878
Operating Expenses										
Supply, Storage and Transmission	651,439	16,495	439,531	18,690	99,228	3,875	8,616	3,043	12,161	9,804
Other Operating expenses	234,080	17,824	174,889	5,250	20,512	791	1,964	377	1,220	2,169
Universal Service and Energy Conservation	108,546	3,061	77,470	3,569	17,791	723	1,538	550	2,107	1,737
Total Operating Expenses	994,066	37,380	691,889	27,510	137,531	5,389	12,119	3,970	15,487	13,709
Income before Interest and Surplus	81,646	(1,419)	52,122	4,479	19,708	965	1,459	502	1,484	2,168
Interest and Surplus	81,646	4,224	56,172	2,078	9,783	326	749	256	979	905
Current Revenue OVER (UNDER) Total Requirements- Before Rate Increase Requirement	**0**	**(5,643)**	**(4,050)**	**2,401**	**9,925**	**639**	**709**	**246**	**506**	**1,263**
Rate Increase Requirement	100,000	5,173	68,799	2,545	11,982	399	918	314	1,199	1,109
Current Revenue OVER (UNDER) Total Requirements- Including Rate Increase Requirement	**(100,000)**	**(10,816)**	**(72,848)**	**(144)**	**(2,057)**	**240**	**(209)**	**(68)**	**(693)**	**154**
AS ORIGINALLY FILED	**(100,000)**	**(12,257)**	**(86,038)**	**594**	**(1,203)**	**377**	**(111)**	**(18)**	**(730)**	**113**
Increase (Decrease) in Tariff Rates for Full Cost of Service with Rate Increase Requirement	9.6%	32.4%	10.1%	0.5%	1.3%	(3.8%)	1.5%	1.5%	4.1%	(1.0%)
Rate Base	1,409,193	72,898	969,504	35,865	168,849	5,621	12,935	4,424	16,894	15,624
Return on Rate Base at Present Rates (Before All Interest and Surplus)	5.8%	(1.9%)	5.4%	12.5%	11.7%	17.2%	11.3%	11.4%	8.8%	13.9%

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

	Total	NGV Direct RC-10	BPS Small RC-11	BPS Large RC-12	BPS A/C RC-13	LBS Small RC-14	LBS Large-InDirect RC-15	LBS Large-Direct RC-16	LBS XLarge-Direct RC-17	LBX XL-InDirect RC-18	Co-Gen InDirect RC-19	GTS / IT Trans only RC-20
Revenues at Current Rates												
Gas Full Tariff Revenue	609,786	4	2,549	26,172	1,108	6,029	4,076	218	24	587	162	0
Non-Gas Full Tariff Revenue	434,342	1	48	147	3	22	13	2	6	12	10	7,256
Full tariff gas revenue at current rates	1,044,127	5	2,597	26,318	1,111	6,051	4,089	220	30	599	172	7,256
Other revenue / Adjustments	31,585	0	64	166	8	41	28	7	0	4	1	490
Net revenues	1,075,712	5	2,660	26,484	1,120	6,092	4,117	227	30	603	174	7,746
Operating Expenses												
Supply, Storage and Transmission	651,439	4	1,963	23,250	1,314	6,362	4,516	247	27	652	191	1,471
Other Operating expenses	234,080	1	217	1,369	68	319	219	15	11	40	15	6,810
Universal Service and Energy Conservation	108,546	1	0	0	0	0	0	0	0	0	0	0
Total Operating Expenses	994,066	6	2,180	24,620	1,381	6,681	4,735	263	38	692	206	8,281
Income before Interest and Surplus	81,646	(0)	480	1,865	(262)	(590)	(618)	(36)	(8)	(88)	(32)	(535)
Interest and Surplus	81,646	0	139	1,358	68	335	232	12	4	37	12	3,977
Current Revenue OVER (UNDER) Total Requirements- Before Rate Increase Requirement	0	(1)	341	507	(329)	(924)	(850)	(48)	(12)	(125)	(44)	(4,512)
Rate Increase Requirement	100,000	1	170	1,664	83	410	284	15	5	45	15	4,871
Current Revenue OVER (UNDER) Total Requirements- Including Rate Increase Requirement	(100,000)	(1)	171	(1,157)	(412)	(1,335)	(1,134)	(63)	(17)	(170)	(59)	(9,384)
AS ORIGINALLY FILED	(100,000)	(1)	216	(467)	(342)	(1,037)	(916)	(47)	(15)	(142)	(46)	(2,070)
Increase (Decrease) in Tariff Rates for Full Cost of Service with Rate Increase Requirement	9.6%	21.0%	(6.6%)	4.4%	37.1%	22.1%	27.7%	28.7%	56.2%	28.4%	34.0%	129.3%
Rate Base	1,409,193	8	2,401	23,446	1,166	5,782	4,006	212	70	635	206	68,648
Return on Rate Base at Present Rates (Before All Interest and Surplus)	5.8%	(1.8%)	20.0%	8.0%	(22.4%)	(10.2%)	(15.4%)	(16.9%)	(11.2%)	(13.9%)	(15.5%)	(0.8%)

Philadelphia Gas Works
Class COS Study - 2006- REVISED (Mar30) Mains
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	Housing Auth. GS RC-9	NGV Direct RC-10
Tariff Revenue at Present Rates											
Customer Charge	73,990	7,379	59,678	1,210	4,197	152	364	72	120	554	0
Delivery Charge / RCEC	221,459	6,278	158,276	7,445	37,097	1,506	3,206	841	3,220	3,590	0
USEC	131,636	3,712	93,949	4,329	21,575	877	1,866	667	2,555	2,106	1
Gas Revenue / Transport	617,042	16,040	405,998	18,706	93,235	3,788	8,063	2,882	11,043	9,102	4
Full tariff gas revenue at current rates	1,044,127	33,409	717,901	31,690	156,104	6,323	13,498	4,462	16,939	15,353	5
Tentative Revenue Allocation											
Customer Charge	74,051	7,379	59,678	1,210	4,197	152	364	72	120	554	0
Delivery Charge / RCEC	321,401	11,342	221,342	12,168	58,084	1,990	4,767	1,378	4,878	5,450	1
USEC	131,636	3,712	93,949	4,329	21,575	877	1,866	667	2,555	2,106	1
Gas Revenue	617,042	16,040	405,998	18,706	93,235	3,788	8,063	2,882	11,043	9,102	4
Full tariff gas revenue at proposed rates	1,144,129	38,473	780,967	36,413	177,092	6,807	15,059	4,999	18,597	17,212	6
Rate Base	1,409,193	72,898	969,504	35,865	168,849	5,621	12,935	4,424	16,894	15,624	8
Distributin Revenue (Delivery Charge and Customer Charge)											
Tentative Revenue Allocation	395,451	18,721	281,021	13,378	62,282	2,143	5,131	1,450	4,998	6,004	1
Revenue at Present Rates	295,449	13,657	217,954	8,655	41,294	1,658	3,570	913	3,340	4,144	0
Tentative Increase	100,002	5,064	63,067	4,723	20,987	484	1,561	537	1,658	1,860	1
Interest Before Income and Surplus- Present Rates											
Present Rates	81,646	(1,419)	52,122	4,479	19,708	965	1,459	502	1,484	2,168	(0)
Tentative Revenue Allocation	181,649	3,645	115,189	9,202	40,696	1,449	3,020	1,040	3,142	4,028	0
Return on Rate Base											
Present Rates	5.79%	(1.95%)	5.38%	12.49%	11.67%	17.17%	11.28%	11.36%	8.79%	13.88%	(1.81%)
Tentative Revenue Allocation	12.89%	5.00%	11.88%	25.66%	24.10%	25.78%	23.35%	23.50%	18.60%	25.78%	5.00%
Relative Ratees of Return on Rate Base											
Present Rates	100.0%	(33.6%)	92.8%	215.5%	201.5%	296.3%	194.6%	196.0%	151.7%	239.5%	(31.2%)
Tentative Revenue Allocation	100.0%	38.8%	92.2%	199.0%	187.0%	200.0%	181.1%	182.3%	144.3%	200.0%	38.8%
Progress Toward Unity		54.2%	-8.6%	14.3%	14.3%	49.1%	14.3%	14.3%	14.3%	28.3%	53.4%
Constraint		Min. 5% Return	20% Progress Toward Unity	Max. Progress Toward Unity	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

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

	Tentative Revenue Allocation	Annual Sales (mcf)	Proposed Delivery Charge Rate ($ / mcf)
Residential:			
Residential Non-Heating	11,342	1,387,356	
Residential Non-Heating-Senior		74,732	
Residential Heating	221,342	32,855,506	
Residential Heating-Senior		4,151,233	
PHA/GS (a)	1,853	270,534	
PHA/GS- Senior (a)		10,840	
	234,537	38,750,201	$6.0525
Commercial:			
Commercial Non-Heat	12,168	1,705,062	
Commercial Heat	58,084	8,498,417	
	70,252	10,203,479	$6.8851
Industrial:			
Industrial Non-Heat	1,990	345,261	
Industrial Heat	4,767	734,898	
	6,758	1,080,159	$6.2562
Municpal:			
Municpal Non-Heat	1,378	262,687	
Municpal Heat	4,878	1,006,599	
	6,256	1,269,286	$4.9285
NGV	0.541	367	$1.4742
PHA Rate 8 (a)	3,597	548,297	$6.5601

(a) Tentative Revenue Allocation of $5,450 split based on sales volumes.

Philadelphia Gas Works
Class COS Study - 2006- REVISED (Mar30) Mains
Future Test Year Ended August 31, 2007 ($000s)
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
Income (before Interest and Surplus)- Company's Proposed Rates							
Full Tariff Revenues at Proposed Rates	1,144,126	35,981	783,608	35,985	177,520	6,977	14,889
Full Tariff Revenues at Present Rates	1,044,127	33,409	717,901	31,690	156,104	6,323	13,498
Increase in Full Tariff Revenue	99,999	2,572	65,708	4,295	21,416	654	1,392
Income before Interest and Surplus- Present Rates	81,646	(1,419)	52,122	4,479	19,708	965	1,459
Income before Interest and Surplus- Proposed Rates	181,646	1,153	117,830	8,773	41,124	1,619	2,850
Rate Base	1,409,193	72,898	969,504	35,865	168,849	5,621	12,935
Return on Rate Base at Company's Proposed Rates (Before Interest and Surplus)							
Return on Rate Base- Proposed Rates	12.89%	1.58%	12.15%	24.46%	24.36%	28.80%	22.04%
Return on Rate Base- Present Rates	5.79%	(1.95%)	5.38%	12.49%	11.67%	17.17%	11.28%
Relative Rate of Return- Proposed Rates	100%	12%	94%	190%	189%	223%	171%
Relative Rate of Return- Present Rates	100%	(34%)	93%	216%	201%	296%	195%
Progress Toward Unity		34%	21%	22%	12%	37%	25%
Subsidy- Proposed Rates	(1)	(8,244)	(7,140)	4,150	19,359	894	1,183
Subsidy- Present Rates	0	(5,643)	(4,050)	2,401	9,925	639	709
% Increase in Full Tariff Revenue at Proposed Rates	9.6%	7.7%	9.2%	13.6%	13.7%	10.3%	10.3%
% Increase in Non-Gas Tariff Revenue at Proposed Rates	23.0%	14.8%	21.1%	33.1%	34.1%	25.8%	25.6%
% Increase in Distribution Revenue at Proposed Rates	33.8%	18.8%	30.1%	49.6%	51.9%	39.4%	39.0%

Philadelphia Gas Works
Class COS Study - 2006- REVISED (Mar30) Mains
Future Test Year Ended August 31, 2007 ($000s)
Results of Company's Proposed Rates

	Total	Municipal Non-Heat RC-7	Municipal Heat RC-8	Housing Auth. GS RC-9	NGV Direct RC-10	BPS Small RC-11	BPS Large RC-12	BPS A/C RC-13
Income (before Interest and Surplus)- Company's Proposed Rates								
Full Tariff Revenues at Proposed Rates	1,144,126	4,916	18,680	17,062	6	2,607	26,351	1,112
Full Tariff Revenues at Present Rates	1,044,127	4,462	16,939	15,353	5	2,597	26,318	1,111
Increase in Full Tariff Revenue	99,999	454	1,741	1,710	1	11	33	1
Income before Interest and Surplus- Present Rates	81,646	502	1,484	2,168	(0)	480	1,865	(262)
Income before Interest and Surplus- Proposed Rates	181,646	956	3,225	3,878	0	491	1,898	(261)
Rate Base	1,409,193	4,424	16,894	15,624	8	2,401	23,446	1,166
Return on Rate Base at Company's Proposed Rates (Before Interest and Surplus)								
Return on Rate Base- Proposed Rates	12.89%	21.62%	19.09%	24.82%	5.00%			
Return on Rate Base- Present Rates	5.79%	11.36%	8.79%	13.88%	(1.81%)			
Relative Rate of Return- Proposed Rates	100%	168%	148%	193%	39%			
Relative Rate of Return- Present Rates	100%	196%	152%	240%	(31%)			
Progress Toward Unity		29%	7%	34%	53%			
Subsidy- Proposed Rates	(1)	386	1,048	1,864	(1)	181	(1,124)	(411)
Subsidy- Present Rates	0	246	506	1,263	(1)	341	507	(329)
% Increase in Full Tariff Revenue at Proposed Rates	9.6%	10.2%	10.3%	11.1%	9.7%	0.4%	0.1%	0.1%
% Increase in Non-Gas Tariff Revenue at Proposed Rates	23.0%	28.7%	29.5%	27.4%	38.5%	22.4%	22.4%	22.4%
% Increase in Distribution Revenue at Proposed Rates	33.8%	49.7%	52.1%	41.3%	120.8%	22.4%	22.4%	22.4%

Philadelphia Gas Works
Class COS Study - 2006- REVISED (Mar30) Mains
Future Test Year Ended August 31, 2007 ($000s)
Results of Company's Proposed Rates

	Total	LBS Small RC-14	LBS Large-InDirect RC-15	LBS Large-Direct RC-16	LBS XLarge-Direct RC-17	LBX XL-Indirect RC-18	Co-Gen InDirect RC-19	GTS / IT Trans only RC-20
Income (before Interest and Surplus)- Company's Proposed Rates								
Full Tariff Revenues at Proposed Rates	1,144,126	6,056	4,092	221	31	602	175	7,256
Full Tariff Revenues at Present Rates	1,044,127	6,051	4,089	220	30	599	172	7,256
Increase in Full Tariff Revenue	99,999	5	3	0	1	3	2	0
Income before Interest and Surplus- Present Rates	81,646	(590)	(618)	(36)	(8)	(88)	(32)	(535)
Income before Interest and Surplus- Proposed Rates	181,646	(585)	(615)	(35)	(6)	(86)	(30)	(535)
Rate Base	1,409,193	5,782	4,006	212	70	635	206	68,648
Return on Rate Base at Company's Proposed Rates (Before Interest and Surplus)								
Return on Rate Base- Proposed Rates	12.89%							
Return on Rate Base- Present Rates	5.79%							
Relative Rate of Return- Proposed Rates	100%							
Relative Rate of Return- Present Rates	100%							
Progress Toward Unity								
Subsidy- Proposed Rates	(1)	(1,330)	(1,131)	(63)	(15)	(167)	(56)	(9,384)
Subsidy- Present Rates	0	(924)	(850)	(48)	(12)	(125)	(44)	(4,512)
% Increase in Full Tariff Revenue at Proposed Rates	9.6%	0.1%	0.1%	0.2%	4.5%	0.5%	1.3%	0.0%
% Increase in Non-Gas Tariff Revenue at Proposed Rates	23.0%	22.4%	22.4%	22.4%	22.4%	22.4%	22.4%	0.0%
% Increase in Distribution Revenue at Proposed Rates	33.8%	22.4%	22.4%	22.4%	22.4%	22.4%	22.4%	0.0%