OCA STATEMENT NO. 3-R

5/21/07

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BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REBUTTAL TESTIMONY OF

RICHARD A. GALLIGAN

ON BEHALF OF
OFFICE OF CONSUMER ADVOCATE

MAY 4, 2007

EXETER
ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 21044

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. I am Richard A. Galligan. My business address is 5565 Sterrett Place, Suite 310, Columbia, Maryland, 21044. I previously submitted direct testimony in this proceeding on April 6, 2007, on behalf of the Office of Consumer Advocate ("OCA"), OCA Statement No. 3.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the direct testimony of Robert D. Knecht on behalf of the Office of Small Business Advocate ("OSBA") as that testimony relates to Philadelphia Gas Works' ("PGW" or the "Company") class cost of service study and the proposed spread of any rate increase among the customer classes. I also respond to Office of Trial Staff ("OTS") witness Joseph Kubas' testimony regarding his use of an Average and Peak class cost of service study, and his class revenue recommendations.

Q. DOES MR. KNECHT ACCEPT PGW'S ALLOCATED COST OF SERVICE STUDY FOR USE IN THIS RATE PROCEEDING?

A. Yes. Mr. Knecht discusses allocation differences he has with several types of costs that are allocated in PGW's cost study, but concludes, "Thus, there is no dire need to correct PGW's cost allocation study at this stage." (Knecht, Direct Testimony, p. 15) In this case, Mr. Knecht accepts the allocation methodologies contained in the PGW cost studies, and he accepts the results of the PGW allocated cost of service studies. While accepting PGW's cost allocations, Mr. Knecht prefers to utilize a particular variant of PGW's cost study that omits gas cost rate ("GCR") costs and revenues. Mr. Knecht ties his class revenue recommendations directly to the elimination of a portion of the indicated class "cross-subsidies" based on PGW's proposed allocated costs of service.

Q. WHY DO YOU PLACE MR. KNECHT'S USE OF THE TERM "CROSS-SUBSIDY" WITHIN QUOTATION MARKS?

A. The term "cross-subsidy" is not uniquely defined. Mr. Knecht uses the term to refer to various comparisons of class revenues and fully distributed class allocated costs of service. At times, Mr. Knecht places the term within quotes, as, for example, at page 17, line 13 of his direct testimony. In discussing the limitations of fully distributed cost studies to identify subsidies, Professor Bonbright puts it this way:

> "Quite simply, the basic defect of fully distributed costs as a basis for ratemaking is that they do not necessarily measure marginal cost responsibility in a causal sense" (Kahn, 1970, p. 151). To make sure that no subsidies are involved, one must look to stand-alone or incremental costs under break-even conditions and not fully distributed costs. (Bonbright, James, C., Principles of Public Utility Rates, Public Utilities Reports, Inc., Arlington , VA, p. 513)

It is exactly those fully distributed, allocated costs of service that Mr. Knecht utilizes to measure his concept and defined use of the term "cross-subsidy."

Q. IS IT APPROPRIATE TO ACCEPT AND UTILIZE PGW'S PROPOSED COST OF SERVICE STUDY RESULTS AS A MEASURE OF THE ADEQUACY OF CLASS REVENUES?

A. No. In my direct testimony, I explained why no part of a gas distribution company's distribution mains should be classified and allocated on a customer-count basis, and why those mains should be classified and allocated partially on average demands and partially on peak demands. OTS witness Kubas agrees that no part of distribution mains investment should be classified or allocated on a customer basis and that distribution mains should be allocated partially on average demands and partially on a basis that

considers class peak demands.[1] To the extent that PGW's cost study allocates 25 percent of distribution mains investment and related costs on a customer basis, and allocates the remaining 75 percent of these costs only on what customers may demand under extreme peak conditions that have an expected periodicity of once in 10- to 20-years misallocates costs, the resulting class costs of service will not be properly stated. When costs are misallocated the adequacy of class revenues to properly allocated costs cannot be determined.

Q. WHAT CLASS REVENUES IS MR. KNECHT PROPOSING?

A. Mr. Knecht is proposing the rate increases shown in Table 1-R. For comparison, I also include PGW's recommendations, which I am endorsing.

Table 1-R

Proposed Rate Increase
$000s

Full Increase Request	Residential	Commercial	Industrial	Municipal	Housing Authority	Total
PGW Proposed	69,397	24,743	1,845	2,197	1,758	99,940
OSBA Proposed	95,641	3,682	217	267	134	99,940
Scaleback						
PGW Proposed	41,622	14,840	1,107	1,318	1,054	59,940
OSBA Proposed[1]	57,361	2,208	130	160	80	59,940
OSBA Proposed[2]	57,028	2,359	176	209	168	59,940

[1] Full Revenue Requirement Method
[2] "First Dollar" Scaleback Method

Data Source: Exhibit IEe-4, Tables 4-A, 4-B, and 4-C

The first two lines in Table 1-R compare proposed rate increases at PGW's requested $100 million rate increase. The last three lines compare proposed rate increases if PGW were to authorize increased revenues of about $60 million. Based on the purported costs contained in PGW's allocated cost of service studies, Mr. Knecht proposes a substantially

[1] I will address differences within this overall similar approach proposed by Mr. Kubas and myself later in my rebuttal testimony.

greater residential rate increase in combination with substantially smaller rate increases for the other indicated classes. Not included in OSBA's reported Table 1-R residential rate increases is another $34 million of Universal Service and Energy Conservation ("USEC") revenues that Mr. Knecht recommends be shifted from non-residential customers to residential customers.

Table 2-R below shows the resulting class rates of return and index rates of return at both PGW and OSBA proposed class rate increases, based on PGW's allocated cost results.

Table 2-R

Class Rates of Return under PGW and OSBA Proposed Class Rate Increases Totaling to $100 Million

	Residential	Commercial	Industrial	Municipal	Housing Authority	Total
Current Rate of Return	4.4%	13.5%	16.0%	13.0%	15.9%	6.0%
Index Rate of Return	73.0	225.0	267.0	217.0	265.0	100.0%
PGW Proposed Rate of Return	11.2	28.1	28.9	26.4	28.9	14.1%
Index Rate of Return	79.0	199.0	205.0	187.0	205.0	100.0%
OSBA Proposed Rate of Return	13.7	15.7	17.5	14.6	16.9	14.1%
Index Rate of Return	97.2	111.3	124.1	103.5	119.9	100.0%

Data Source: Exhibit IEc-4, Table 4-B

OSBA's proposed class rate increases are intended to make more progress toward "cost based" rates. Of course, to the extent that costs are misallocated, any progress toward basis in costs is misstated. Under OSBA's proposed base rate revenue spread, all classes would be awarded smaller rate increases than those proposed by PGW except

residential customers. Residential customers would receive $95.6 million of the proposed $100 million base rate increase, or a 41.3 percent increase, under OSBA proposals. This compare to a $69.4 million increase, or 30.0 percent, for the residential class requested by PGW. Also, under OSBA's proposed rates and its acceptance of PGW's allocated costs, residential customers would yield a 13.7 percent rate of return, as shown on Table 2-R, which would close in one rate case, not 20 percent of the difference between the residential class' indexed rate of return and unity, but would close 90 percent of that current difference. All of the rates of return shown in Table 2-R are based on the results of PGW's customer/demand cost of service study.

Q. WHEN COSTS ARE ALLOCATED ON THE BASIS OF YOUR PEAK AND AVERAGE COST OF SERVICE STUDY, HOW DO RESIDENTIAL AND COMMERCIAL RATES COMPARE TO COSTS?

A. Based on PGW's cost study, the Company testifies that residential heating and non-heating customers would progress from index rates of return of 79 percent and (42) percent at present rates to index rates of return of 86 percent and 7 percent, respectively, at PGW's proposed increase in rates.[2] Based on my Peak and Average cost study, the residential heating and non-heating index rates of return are 94 percent and 12 percent, respectively.[3] Thus, when the customer cost notion is properly limited to meters, house regulators, service lines and related expenses, and when distribution mains are properly allocated substantially on energy usage as well as peak demands, residential rates are seen to be far more consistent with allocated costs than under the progress toward unity that PGW proposes. While I discuss the OTS cost of service study later in my rebuttal

[2] PGW proposes to eliminate 20 percent of the difference between the residential heating index return and 100 percent. In fact, when PGW determined its common residential heating and non-heating rate, proposed heating *revenues closed one-third of the indicated gap.*

[3] Residential heating and non-heating customers provide an 11.4 percent rate of return on a combined basis.

testimony, I note here that the OTS agrees that the customer cost notion should not extend to the allocation of distribution mains, and that distribution mains should be allocated substantially (i.e., a recommended 50 percent in the OTS study) on energy, as well as usage at times of peak demand.

Q. IS IT APPROPRIATE TO REQUIRE THAT CLASS REVENUE RESPONSIBILITIES MUST BE SET EXACTLY EQUAL TO THE ALLOCATED, EMBEDDED, HISTORIC, ACCOUNTING COSTS OF SERVICE?

A. No. While such a prescription would lead to index rates of return equal to 100 percent, revenue-to-allocated cost ratios of 1.0, and revenue minus allocated cost differences of zero, in my opinion, this prescription is neither necessary nor desirable. First, this revenue allocation prescription would produce a slavish, mechanistic basis for the setting of rates to the exclusion of all other cost and non-cost considerations. This conflicts with the long-standing Commission policy of using allocated cost study results as a guide to the setting of rates. Second, this prescription implies a precision and a lack of allocated cost controversy that simply does not exist.

In my direct testimony at page 26-28, I discuss the existence of many different allocated cost studies and the controversies that attend such studies.[4] The very existence of numerous cost study variants and the controversial nature of various cost allocations reinforces the use of cost studies as guides to the setting of rates. Third, the wide range of allocated cost study results supports a skepticism regarding precise study results. Variations in results imply that as class revenues approach variously stated allocated costs, further precision in class revenue prescriptions may not be warranted. For

[4] Indeed, there are three cost studies in this proceeding (PGW's, OCA's, and OTS', plus a variant that OSBA discusses but did not pursue). Thus, there is little support for a finding that class revenues should be set at exactly the level of allocated costs, when the allocated costs themselves are numerous and not free from controversy.

example, it would not be unreasonable to find that very little confidence attends the exercise of fine-tuning class revenue adjustments when cost study results suggest that class revenues are in substantial agreement with costs. Residential heating customers would pay a rate of return of 94.3 percent of the PGW system average rate of return at proposed rates, when costs are allocated in accord with the peak and average methodology.

Finally, when addressing capacity related embedded cost allocations, Professor Bonbright states, "Should the capacity costs be assigned to the different ratepayers on the basis of system peak responsibility, of coincident class demand, or any one of the other thirty-odd proposed bases of assignment to be found in the literature of rate theory? 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 the costs, as butter would be spread over bread in a gourmet's sandwich." (Bonbright, James C., Principles of Public Utility Rates, Public Utilities Reports, Inc., Arlington, VA, second edition, 1988, p. 184) A standard that is best described as the wide spreading of costs as butter would be spread over bread in a gourmet's sandwich hardly supports a finding that class revenue responsibilities should be set entirely on the basis of and consistent with costs allocated in accord with the standard. Unfortunately, such is the nature of allocated, fully distributed cost of service findings.

Q. DOES YOUR FINDING THAT A PRESCRIPTION TO SET CLASS REVENUES AT RESULTING ALLOCATED COSTS IS NOT WARRANTED

MEAN THAT CLASS COST RESULTS MAY NOT BE CONSIDERED IN THE RATE SETTING PROCESS?

A. No. In this present case, for example, even though the OTS and I believe that PGW's cost of service study over-allocates costs to residential customers, PGW's study shows that its proposed rates are consistent with substantial movement toward rates based on allocated costs. These cost studies show that class revenues are sufficient to cover all allocated expenses and provide a contribution to income available for interest and surplus. At PGW's proposed rates for residential heating customers, for example, when class income available for interest and surplus is related to the investment which gives rise to the income and surplus cost (i.e., the traditional measure of the adequacy of rates), the residential rates provide an 11.02 percent rate of return (PGW Study). This represents substantial movement toward rates based on allocated costs. A greater movement toward costs is indicated under the OCA study, since PGW's proposed rates provide a 12.15 percent rate of return for residential heating customers. Both of these rates of return compare to a requested 12.89 percent system rate of return.

Q. MR. KNECHT PREFERS TO INTRODUCE AND UTILIZE THE RATIO OF CLASS REVENUES TO CLASS ALLOCATED COSTS, AND THE DIFFERENCES BETWEEN CLASS REVENUES AND ALLOCATED CLASS COSTS AS MEASURES OF REVENUE ADEQUACY. PLEASE COMMENT.

A. The traditional index rate of return method of determining the adequacy of class revenue compares the income remaining after deducting all allocated expenses from class revenues to the allocated investment necessary to the provision of service. Mr. Knecht's ratio and difference method nowhere relates class return to the allocated investment that is deemed necessary to provide service to each class. A measure of the adequacy of

PGW's total revenues is whether total income available for interest and surplus related to the investment which gives rise to this needed income is sufficient. Similarly, the adequacy of each class' revenues is determined by the ratio of resulting income available for interest and surplus related to the allocated investment required to provide service.

Class revenues minus class allocated expenses determine the residual return, which is available for interest and other capital costs related to the provision of service. That is, Total Revenue minus Expenses equals Total Return. No one is recommending that class revenues should be set at an amount that is less than allocated expenses. The adequacy of class returns is measured as the ratio of class return to class allocated rate base. If the sum of the individual class returns becomes inadequate between rate cases, the Commission may authorize a rate increase to re-establish the adequacy of returns at proposed rates. PGW's class returns will increase on a dollar-for-dollar basis for each dollar of rate increase assigned to a class. PGW is seeking a $100 million rate increase so as to increase its return available for interest and surplus by $100 million. The adequacy of class revenues is directly related to the adequacy of class returns (revenues minus allocated expenses), and the adequacy of class returns is determined by the ratio of class rates of return to class allocated rate base, and a comparison of the resulting ratios to the overall system average return-to-rate base ratio.

Mr. Knecht's revenue-to-allocated cost ratio and his revenue minus allocated costs difference analyses lead him to believe that PGW's proposed residential rates make no progress toward basis in cost. Not revealed by Mr. Knecht's proposed revenue-to-cost ratios and his proposed revenue minus cost measures of revenue adequacy is the disproportionate and relatively higher income requirement proposed for residential customers. PGW witness Gorman's Exhibit HSG-7C, revised March 30, shows a current

total residential income available for interest and surplus of $45.310 million. This would increase to $114.707 million at proposed rates, a $69.397 million, or a 1.53 times increase. The total proposed commercial income available for interest and surplus at current rates of $24.808 million would increase to $49.561 million. This is a proposed commercial income increase of $24.753 million, or a 1.00 times increase. The revenue-to-cost ratio and revenue minus cost difference methods do not reveal this substantial residential increased return responsibility compared to the increased return responsibility proposed for the commercial class. Mr. Knecht utilizes a cost study procedure that explicitly allocates net income available for interest and surplus to each class in order to define his two preferred revenue-to-cost and revenue minus cost adequacy measures, but then Mr. Knecht advises against any further consideration of net income, with its own measure of adequacy (indexed rate of return), as a tool to assist the Commission in determining the reasonableness of class revenue responsibilities. It is inconsistent to consider return costs in the determination of one's revenue adequacy measures, as Mr. Knecht does, but then to advise the Commission to omit from consideration the adequacy of class returns from a determination of how to spread any Commission-authorized increase.

Q. YOU MENTIONED EARLIER THAT THE OTS AGREES THAT THE CUSTOMER COST NOTION SHOULD NOT BE EXTENDED TO INCLUDE AN ALLOCATION OF DISTRIBUTION MAINS ON A CUSTOMER BASIS, AND THAT DISTRIBUTION MAINS SHOULD BE ALLOCATED IN LARGE PART ON COMMODITY, OR AVERAGE DEMANDS. PLEASE DESCRIBE OTS' COST OF SERVICE STUDY.

A. Mr. Joseph Kubas performed a class cost of service study on behalf of the OTS. The study Mr. Kubas performed is an "Average and Excess" study. Mr. Kubas allocated distribution mains and related expense 50 percent on the basis of commodity, or average demands, and 50 percent on the basis of the excess of peak demands over average demands. In contrast, I allocated 80 percent of distribution mains and related costs on average demands for the reasons stated in my direct testimony. While the exact weights afforded to average demands differ in Mr. Kubas' and my own cost studies, both studies recognize the importance of allocating a substantial portion of mains on the basis of average demands.

Q. HAVE YOU CAUSED TO BE PREPARED A PEAK AND AVERAGE COST STUDY BASED ON A 50 PERCENT WEIGHTING OF AVERAGE DEMANDS?

A. Yes. While I continue to believe an 80 percent weighting of average demands is proper and support an 80 percent weighting of average demands, I recognize that OTS has utilized a 50 percent weighting of average demands, and that there is precedent in Pennsylvania for weighting average demands 50 percent. Therefore, I asked PGW to re-run my 20/80 P&A study at a 50/50 weighting of peak and average demands. The results of the 50/50 Peak and Average study are included in Exhibit__ (RAG-1R). Line 18, page 5 of Exhibit ___ (RAG-1R) shows class rates of return at proposed rates. Under the 50/50 Peak and Average study, at PGW proposed rates, the rates of return show that residential customers continue to produce higher rates of return and higher index rates of return than proposed by PGW.

Q. IN THE OTS COST STUDY, THE 50 PERCENT PORTION OF COSTS THAT IS ALLOCATED ON THE PEAK DEMAND VECTOR IS ALLOCATED ON

EACH CLASS' EXCESS OF PEAK DEMAND OVER AVERAGE DEMAND, WHEREAS IN THE PEAK AND AVERAGE STUDY THE PEAK DEMAND VECTOR IS BASED ON CLASS PEAK DEMANDS. PLEASE COMMENT.

A. I have utilized peak demands because all customers requiring service at the time of peak are responsible for peak-related costs. In discussing peak demand related costs, Professor Bonbright agrees that all customers demanding service at time of peak are responsible for peak demand related costs. Discussing this concept in terms of the electric utility industry, Professor Bonbright puts it this way:

> *Because an electric company must size its system to meet the peaks, any peak period user is contributing to the peak, regardless of its off peak usage. Thus, all peak users contribute to the peak and all non-peak usage is irrelevant.* (Ibid., p. 475, *emphasis added)*

Under the Average and Excess method, when peak demands are calculated as the excess of peak demands over average demands, a 100 percent load factor customer, who is guaranteed to be demanding service whenever the peak occurs, would bear no responsibility for the costs of meeting the peak (because such a customer would have no excess of peak demand over average demand), thus violating the principle of cost causality. However, even though the OTS' cost study allocates peak demand classified costs not on peak usage but on excess of peak usage over average usage, both the OTS' cost study using excess demands and my own cost study using peak demands demonstrate higher rates of return and higher index returns for residential customers compared to PGW's customer/peak demand study results. In my opinion, the OTS' A&E study, my own P&A study, and a 50/50 P&A study support a finding that PGW's proposed rate spread is consistent with the reasonable movement of residential rates toward basis in cost.

Q. MR. KNECHT CONSIDERS ONLY NON-GAS COSTS AND REVENUES IN HIS REVENUE-TO-ALLOCATED COST RATIOS AND HIS REVENUE MINUS ALLOCATED COST MEASURES OF CLASS REVENUE ADEQUACY. PLEASE COMMENT.

A. This Commission is responsible for determining just and reasonable retail delivery and retail sales service rates. Largely for convenience, flexibility and timeliness, a separate regulatory procedure is utilized to make adjustments to the GCR, a portion of Commission-determined retail sales rates. However, PGW's gas cost rates are an important part of PGW's total regulated cost of service and PGW's customers' regulated rates. Exhibit HSG-6S shows GCR revenues of $568,861,000 out of total proposed firm revenues of $1,095,624,000, or 52 percent. On a per unit basis, gas cost rates are $10.97 per Decatherm compared to delivery charges for residential and commercial customers that are proposed in the $6.08 - $6.80 range.

Omitting regulated GCR revenues and costs from consideration provides incomplete measures of revenues and costs necessary to Mr. Knecht's reported revenue-to-allocated cost ratios. I believe that revenue-to-cost ratios that exclude essential, Commission-determined revenues and costs are not useful indicators of the impact of utility rates paid by the customer and necessary to the provision of PGW with an opportunity to recover its costs. The very measures that Mr. Knecht relies on for his increased revenue spread recommendations are influenced by the inclusion or exclusion of regulated utility costs and revenues. Additionally, Mr. Knecht's reported class revenue-to-cost ratios also omit the consideration of $131.636 million of USEC revenues and costs. GCR and USEC rates are charges that cannot be avoided under PGW's Commission-approved tariffs. Including the gas costs and USEC costs and revenues

excluded by Mr. Knecht would change his reported residential and commercial revenue-to-cost ratios at proposed rates from 91.8 percent and 144.5 percent respectively, to 96.6 percent and 112.4 percent, respectively. The difference between a revenue-to-cost ratio of 91.8 and the more accurate ratio of 96.6 eliminates 59 percent of the gap between the reported ratio (91.8) and a ratio of 100 percent.

Q. MR. KNECHT PREFERS TO UTILIZE FOR HIS CLASS REVENUE RECOMMENDATIONS A CLASS COST OF SERVICE STUDY THAT EXCLUDES GAS COSTS AND REVENUES. WOULD CLASS COST OF SERVICE STUDY RESULTS FROM A STUDY EXCLUDING GAS COSTS AND REVENUES CHANGE YOUR CONCLUSION REGARDING THE ADEQUACY OF PGW'S PROPOSED RESIDENTIAL RATES?

A. No. The combined residential customers' return goes up slightly (from $45.3 million to $45.7 million) under the cost study which includes no GCR costs, while the residential rate base goes down slightly (from) $1.109 billion to $1.031 billion). The combined residential heating and non-heating index rate of return is virtually unchanged. Utilization of the no-GCR study would not change my endorsement of PGW's proposed residential customer rate increase

Q. DOES THIS COMPLETE YOUR REBUTTAL TESTIMONY?

A. Yes.

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BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

EXHIBITS ACCOMPANYING THE REBUTTAL TESTIMONY OF RICHARD A. GALLIGAN

ON BEHALF OF
OFFICE OF CONSUMER ADVOCATE

MAY 4, 2007

EXETER
ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 21044

OCA-IX Mains 50-50
Exhibit HSG-1
Page 1 of 2

Philadelphia Gas Works
Class COS Study - 2006- OCA-IX Mains 50-50
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	17,358	311,889	12,986	62,883	2,536	5,436	1,581	5,901	6,252
Full tariff gas revenue at current rates	1,044,127	33,399	717,887	31,692	156,118	6,323	13,499	4,463	16,944	15,354
Other revenue / Adjustments	31,585	2,548	26,227	289	1,146	30	81	11	38	527
Net revenues	1,075,712	35,947	744,114	31,981	157,264	6,354	13,580	4,474	16,982	15,881
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	17,786	176,284	5,147	20,649	780	1,980	379	1,280	2,195
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	37,342	693,285	27,406	137,668	5,378	12,134	3,972	15,548	13,735
Income before Interest and Surplus	81,646	(1,395)	50,829	4,575	19,596	976	1,446	502	1,434	2,146
Interest and Surplus	81,646	4,197	57,126	2,006	9,875	318	760	257	1,020	923
Current Revenue OVER (UNDER) Total Requirements- Before Rate Increase Requirement	(0)	(5,591)	(6,297)	2,570	9,721	658	686	244	414	1,223
Rate Increase Requirement	100,000	5,140	69,968	2,457	12,095	389	931	315	1,250	1,130
Current Revenue OVER (UNDER) Total Requirements- Including Rate Increase Requirement	(100,000)	(10,732)	(76,265)	113	(2,373)	269	(245)	(71)	(836)	92
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%	32.1%	10.6%	(0.4%)	1.5%	(4.2%)	1.8%	1.6%	4.9%	(0.6%)
Rate Base	1,409,193	72,435	985,983	34,617	170,439	5,486	13,118	4,444	17,609	15,930
Return on Rate Base at Present Rates (Before All Interest and Surplus)	5.8%	(1.9%)	5.2%	13.2%	11.5%	17.8%	11.0%	11.3%	8.1%	13.5%

OCA-IX Mains 50-50
Exhibit HSG-1
Page 2 of 2

Philadelphia Gas Works
Class COS Study - 2006- OCA-IX Mains 50-50
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 A-Large-Direct RC-17	LBX A/C-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	146	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	167	8	39	27	7	0	4	1	370
Net revenues	1,075,712	5	2,661	26,485	1,119	6,090	4,116	227	30	603	174	7,626
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	221	1,381	61	295	200	13	11	38	13	5,366
Universal Service and Energy Conservation	108,546	1	0	0	0	0	0	0	0	0	0	0
Total Operating Expenses	994,066	5	2,184	24,632	1,374	6,658	4,716	261	38	690	204	6,837
Income before Interest and Surplus	81,646	(0)	477	1,853	(255)	(568)	(600)	(34)	(8)	(87)	(30)	789
Interest and Surplus	81,646	0	141	1,366	63	318	219	11	4	35	11	2,996
Current Revenue OVER (UNDER) Total Requirements- Before Rate Increase Requirement	(0)	(0)	336	487	(318)	(886)	(819)	(45)	(11)	(122)	(41)	(2,207)
Rate Increase Requirement	100,000	1	173	1,673	77	390	268	13	5	43	13	3,669
Current Revenue OVER (UNDER) Total Requirements- Including Rate Increase Requirement	(100,000)	(1)	163	(1,186)	(395)	(1,276)	(1,088)	(58)	(16)	(165)	(54)	(5,876)
AS ORIGINALLY FILED	(100,000)	(1)	216	(467)	(342)	(1,037)	(916)	(47)	(15)	(142)	(46)	(2,020)
Increase (Decrease) in Tariff Rates for Full Cost of Service with Rate Increase Requirement	9.6%	18.5%	(6.3%)	4.5%	35.5%	21.1%	26.6%	26.2%	54.2%	27.6%	31.5%	81.0%
Rate Base	1,409,193	7	2,440	23,578	1,082	5,492	3,780	185	67	612	185	51,704
Return on Rate Base at Present Rates (Before All Interest and Surplus)	5.8%	(1.2%)	19.6%	7.9%	(23.6%)	(10.3%)	(15.9%)	(18.2%)	(11.4%)	(14.1%)	(16.4%)	1.5%

OCA-IX Mains 50-50
Exhibit HSG-1A
Page 1 of 2

Philadelphia Gas Works
Class COS Study - 2006- OCA-IX Mains 50-50
Future Test Year Ended August 31, 2007 ($000s)
REVENUE REQUIREMENT BY FUNCTIONAL CLASSIFICATION

	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
SUPPLY										
Demand Costs	7,858	184	5,848	136	1,166	34	103	34	170	123
Commodity Costs	543,683	14,255	360,795	16,623	82,855	3,366	7,165	2,561	9,814	8,089
	551,540	14,438	366,643	16,759	84,021	3,400	7,267	2,595	9,983	8,212
STORAGE										
Demand Costs	41,853	934	29,697	749	6,021	181	529	174	859	629
	41,853	934	29,697	749	6,021	181	529	174	859	629
TRANSMISSION										
Demand Costs	45,990	895	34,519	746	7,003	200	625	204	1,051	747
	45,990	895	34,519	746	7,003	200	625	204	1,051	747
DISTRIBUTION										
Demand Costs	29,901	926	19,857	575	3,957	119	333	112	525	354
Commodity Costs	29,238	911	17,568	748	3,844	141	319	113	448	322
Customer Costs	189,602	12,139	139,961	4,048	18,817	613	1,560	440	1,726	1,786
	248,741	13,976	177,387	5,370	26,618	873	2,211	666	2,700	2,462
ONSITE										
Customer Costs	124,393	10,176	91,976	3,627	13,259	525	1,247	228	632	1,105
	124,393	10,176	91,976	3,627	13,259	525	1,247	228	632	1,105
USEC										
Customer Costs	131,610	3,711	93,930	4,328	21,571	876	1,865	667	2,555	2,106
	131,610	3,711	93,930	4,328	21,571	876	1,865	667	2,555	2,106
TARIFF REVENUE REQUIREMENT										
Demand Costs	125,602	2,938	89,921	2,204	18,146	534	1,589	524	2,605	1,854
Energy Costs	572,920	15,166	378,363	17,371	86,699	3,507	7,483	2,674	10,262	8,411
Customer Costs	445,605	26,026	325,868	12,003	53,647	2,013	4,672	1,336	4,913	4,997
	1,144,127	44,130	794,152	31,579	158,492	6,055	13,744	4,534	17,780	15,261
Average Customers	496	51,245	414,434	5,604	19,431	254	606	335	557	3,458
Customer Costs per Month	$74.81	$42.32	$65.52	$178.50	$230.07	$660.58	$642.80	$332.22	$735.23	$120.44

Philadelphia Gas Works
Class COS Study - 2006- OCA-IX Mains 50-50
Future Test Year Ended August 31, 2007 ($000s)
Class COS Study - 2006- OCA-IX Mains 50-50

OCA-IX Mains 50-50
Exhibit HSG-1A
Page 2 of 2

	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 Large-Direct RC-17	LBX XL-Indirect RC-18	Co-Gen InDirect RC-19	GTS / IT Trans only RC-20
SUPPLY												
Demand Costs	7,858	0	2	16	1	4	3	0	0	0	0	36
Commodity Costs	543,683	4	1,944	23,030	1,301	6,302	4,473	245	27	646	189	0
	551,540	4	1,946	23,046	1,302	6,306	4,476	245	27	646	189	36
STORAGE												
Demand Costs	41,853	0	25	285	15	75	53	3	0	8	2	1,612
	41,853	0	25	285	15	75	53	3	0	8	2	1,612
TRANSMISSION												
Demand Costs	45,990	0	0	0	0	0	0	0	0	0	0	0
	45,990	0	0	0	0	0	0	0	0	0	0	0
DISTRIBUTION												
Demand Costs	29,901	0	65	743	27	149	101	2	1	17	3	2,036
Commodity Costs	29,238	0	62	758	39	194	137	6	1	20	6	3,599
Customer Costs	189,602	1	214	2,282	104	524	359	14	8	61	20	4,924
	248,741	1	341	3,785	171	867	597	22	10	98	29	10,559
ONSITE												
Customer Costs	124,393	1	122	390	18	78	50	7	8	12	6	925
	124,393	1	122	390	18	78	50	7	8	12	6	925
USEC												
Customer Costs	131,610	1	0	0	0	0	0	0	0	0	0	0
	131,610	1	0	0	0	0	0	0	0	0	0	0
TARIFF REVENUE REQUIREMENT												
Demand Costs	125,602	0	92	1,045	43	228	157	5	1	25	5	3,684
Energy Costs	572,920	4	2,006	23,787	1,340	6,496	4,610	251	28	666	195	3,599
Customer Costs	445,605	3	336	2,672	122	602	409	21	17	73	26	5,849
	1,144,127	6	2,434	27,504	1,506	7,327	5,177	278	46	764	226	13,132
Average Customers	496	1	113	162	8	18	6	1	2	4	3	162
Customer Costs per Month	$74.81	$209.84	$248.15	$1,374.39	$1,275.73	$2,737.98	$5,586.15	$1,767.05	$687.61	$1,525.09	$657.75	$3,008.66

OCA-IX Mains 50-50
Exhibit HSG-7C
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Philadelphia Gas Works
Class COS Study - 2006- OCA-IX Mains 50-50
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	1,144,125	35,997	784,030	35,913	177,161	6,960	14,854
Full Tariff Revenues at Present Rates	1,044,127	33,399	717,887	31,692	156,118	6,323	13,499
Increase in Full Tariff Revenue	99,998	2,599	66,143	4,221	21,043	637	1,355
Income before Interest and Surplus- Present Rates	81,646	(1,395)	50,829	4,575	19,596	976	1,446
Income before Interest and Surplus- Proposed Rates	181,645	1,204	116,972	8,796	40,639	1,612	2,800
Rate Base	1,409,193	72,435	985,983	34,617	170,439	5,486	13,118
Return on Rate Base at Company's Proposed Rates (Before Interest and Surplus)							
Return on Rate Base- Proposed Rates	12.89%	1.66%	11.86%	25.41%	23.84%	29.39%	21.35%
Return on Rate Base- Present Rates	5.79%	(1.93%)	5.16%	13.22%	11.50%	17.79%	11.02%
Relative Rate of Return- Proposed Rates	100%	13%	92%	197%	185%	228%	166%
Relative Rate of Return- Present Rates	100%	(33%)	89%	228%	198%	307%	190%
Progress Toward Unity		35%	28%	24%	14%	38%	27%
Subsidy- Proposed Rates	(2)	(8,133)	(10,122)	4,334	18,670	905	1,109
Subsidy- Present Rates	(0)	(5,591)	(6,297)	2,570	9,721	658	686
% Increase in Full Tariff Revenue at Proposed Rates	9.6%	7.8%	9.2%	13.3%	13.5%	10.1%	10.0%
% Increase in Non-Gas Tariff Revenue at Proposed Rates	23.0%	15.0%	21.2%	32.5%	33.5%	25.1%	24.9%
% Increase in Distribution Revenue at Proposed Rates	33.8%	19.0%	30.3%	48.8%	50.9%	38.4%	37.9%

OCA-IX Mains 50-50
Exhibit HSG-7C
Page 2 of 3

Philadelphia Gas Works
Class COS Study - 2006- OCA-IX Mains 50-50
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	1,144,125	4,910	18,659	17,133	6	2,607	26,351	1,112
Full Tariff Revenues at Present Rates	1,044,127	4,463	16,944	15,354	5	2,597	26,318	1,111
Increase in Full Tariff Revenue	99,998	447	1,715	1,779	0	11	33	1
Income before Interest and Surplus- Present Rates	81,646	502	1,434	2,146	(0)	477	1,853	(255)
Income before Interest and Surplus- Proposed Rates	181,645	949	3,149	3,925	0	488	1,887	(254)
Rate Base	1,409,193	4,444	17,609	15,930	7	2,440	23,578	1,082
Return on Rate Base at Company's Proposed Rates (Before Interest and Surplus)								
Return on Rate Base- Proposed Rates	12.89%	21.36%	17.88%	24.64%	5.00%			
Return on Rate Base- Present Rates	5.79%	11.29%	8.14%	13.47%	(1.23%)			
Relative Rate of Return- Proposed Rates	100%	166%	139%	191%	39%			
Relative Rate of Return- Present Rates	100%	195%	141%	232%	(21%)			
Progress Toward Unity		31%	5%	31%	50%			
Subsidy- Proposed Rates	(2)	376	879	1,872	(1)	173	(1,153)	(394)
Subsidy- Present Rates	(0)	244	414	1,223	(0)	336	487	(318)
% Increase in Full Tariff Revenue at Proposed Rates	9.6%	10.0%	10.1%	11.6%	8.2%	0.4%	0.1%	0.1%
% Increase in Non-Gas Tariff Revenue at Proposed Rates	23.0%	28.3%	29.1%	28.5%	32.1%	22.7%	22.7%	22.7%
% Increase in Distribution Revenue at Proposed Rates	33.8%	48.9%	51.3%	42.9%	100.4%	22.7%	22.7%	22.7%

Philadelphia Gas Works
Class COS Study - 2006- OCA-IX Mains 50-50
Future Test Year Ended August 31, 2007 ($000s)
Results of Company's Proposed Rates

OCA-IX Mains 50-50
Exhibit HSG-7C
Page 3 of 3

	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	1,144,125	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	99,998	5	3	0	1	3	2	0
Income before Interest and Surplus- Present Rates	81,646	(568)	(600)	(34)	(8)	(87)	(30)	789
Income before Interest and Surplus- Proposed Rates	181,645	(563)	(597)	(33)	(6)	(84)	(28)	789
Rate Base	1,409,193	5,492	3,780	185	67	612	185	51,704
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	(2)	(1,271)	(1,085)	(57)	(15)	(163)	(52)	(5,876)
Subsidy- Present Rates	(0)	(886)	(819)	(45)	(11)	(122)	(41)	(2,207)
% Increase in Full Tariff Revenue at Proposed Rates	9.6%	0.1%	0.1%	0.2%	4.6%	0.5%	1.3%	0.0%
% Increase in Non-Gas Tariff Revenue at *Proposed Rates*	23.0%	22.7%	22.7%	22.6%	22.7%	22.7%	22.7%	0.0%
% Increase in Distribution Revenue at Proposed Rates	33.8%	22.7%	22.7%	22.6%	22.7%	22.7%	22.7%	0.0%

OCA STATEMENT NO. 3-S

5/21/07
Phila, PA
MS

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

SURREBUTTAL TESTIMONY OF

RICHARD A. GALLIGAN

ON BEHALF OF
OFFICE OF CONSUMER ADVOCATE

MAY 15, 2007

EXETER
ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 21044

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

SURREBUTTAL TESTIMONY OF

RICHARD A. GALLIGAN

Introduction

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Richard A. Galligan. My business address is 5565 Sterrett Place, Suite 310, Columbia, Maryland, 21044. I previously submitted direct testimony and rebuttal testimony in this proceeding on behalf of the Office of Consumer Advocate ("OCA"), OCA Statement Nos. 3 and 3-R.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of Philadelphia Gas Works witness Howard S. Gorman, and Office of Small Business Advocate witness Robert D. Knecht. In their rebuttal testimony, both of these witnesses commented on various aspects of my class cost of service testimony, and the spread of any Commission-authorized rate increase. I will first address issues raised by Mr. Gorman, then address issues raised by Mr. Knecht. Where commonality exists regarding Mr. Gorman's and Mr. Knecht's comments, I will jointly address their comments.

Response to Mr. Howard S. Gorman

Q. AT THE TOP OF PAGE 9 OF HIS REBUTTAL TESTIMONY, MR. GORMAN ASSERTS THAT THE COST OF A DISTRIBUTION MAIN IS A FUNCTION OF BOTH LENGTH AND DIAMETER AND THEREFORE, "...THE MORE CUSTOMERS THERE ARE ON THE SYSTEM, THE MORE LENGTH OF DISTRIBUTION MAINS ARE [SIC] REQUIRED, AND THE HIGHER THE COST." DOES THIS STATEMENT DEMONSTRATE THAT THERE IS A CUSTOMER COST OF DISTRIBUTION MAINS?

A. No. First it is not quite accurate to assert unconditionally that the more customers there are on the system, the greater the length of mains. As I said in my direct testimony, PGW will, at times, incur no incremental distribution mains investment to provide service to a new customer. (Direct Testimony, page 11, lines 4-7) Moreover, for PGW in particular, a mature gas distribution company, the vast majority of its budgeted distribution mains investment now relates to replacement and relocation costs, not to the extension of its system into new service areas in order to extend delivery service to new customers. (Direct Testimony, page 25, lines 20--page 21, line 3) Finally, when the extension of gas delivery service does require distribution mains costs to be incurred, those costs relate directly to both the sufficiency of annual gas volumes, which are required to warrant the extension in the first place, and to the peak gas flow requirements. Mr. Gorman's observation that distribution mains can be described as having both length and diameter does not support his proposal that the existence of PGW's customers, rather than their service requirements, causes PGW to incur gas delivery costs.

Q. AT PAGE 9, LINES 13-22, MR. GORMAN ASSERTS THAT YOUR EXAMPLE OF A BLOCK THAT HAS 10 RESIDENTIAL CUSTOMERS EACH WITH A PEAK DEMAND OF ONE MCF, OR A BLOCK THAT HAS

ONLY A SMALL PLASTICS FACTORY WITH A PEAK DEMAND OF 10 MCF, IS AN APPARENT PARADOX LOAD ONLY BECAUSE OF THE ASSUMPTION THAT ALL 10 CUSTOMERS ARE LOCATED ON THE SAME BLOCK. MR. GORMAN ASSERTS THAT THE APPARENT PARADOX DISAPPEARS IF THE 10 CUSTOMERS WERE LOCATED ON 10 DIFFERENT BLOCKS. PLEASE RESPOND.

A My example is a hypothetical, designed to illustrate an obvious point, that distribution mains investment is driven by load requirements, not by potential customers who would use no gas. My example comports with reality -- a number of residential customers on the same block. Mr. Gorman's one-residential-customer-to-a-Philadelphia-city-block example is not realistic. PGW's average footage of distribution mains per customer is 32 feet. Mr. Gorman's example of one residential customer per city block would result in one customer about every 500 feet (at a city block of about $1/10^{th}$ of a mile). I do not believe Mr. Gorman's example of one residential customer per city block comports with either reality, or with PGW's customer extension rules. Mr. Gorman's example does not describe PGW's system, is based on unrealistic assumptions and does not invalidate the point in the example I presented.

What my realistic example showed was that a city block with 10 residential houses on it, each with a peak demand of 1 Mcf, would have to have a main sized to deliver that 10 Mcf of peak demand. A city block with a small plastics factory with a demand of 10 Mcf, too, would have to have a main sized to deliver 10 Mcf. Finally, if the plastics factory were torn down and replaced with five large residences, each with a peak demand of 2 Mcf, the distribution main would, again, have to be sized to meet the 10 Mcf of peak demand. This conclusion, that distribution mains are sized to meet load requirements, not the number of customers, is not invalidated by Mr. Gorman's

unrealistic example. Of course, the very existence of the natural gas distribution service to provide for the distribution of natural gas to meet the load requirements of the customers in this example presumes that the gas loads of the customer(s) is sufficient to warrant the extension of service under PGW's Extension rules in the first place.

Q. AT PAGE 11, LINES 9-16, MR. GORMAN CITES PROFESSOR BONBRIGHT'S TEXT, WHICH EXPLAINS THAT THE HYPOTHETICAL MINIMUM-SIZED DISTRIBUTION SYSTEM IS STRICTLY UNALLOCABLE, AND MR. GORMAN CONCLUDES THAT PROFESSOR BONBRIGHT DOES NOT SUPPORT ANY ALLOCATION METHOD FOR THE ZERO-INTERCEPT COMPONENT. PLEASE COMMENT.

A. Professor Bonbright continues on from the material quoted by Mr. Gorman and says,

> But fully distributed cost analysts dare not avail themselves of this solution (that the hypothetical cost of a minimum-sized distribution system is strictly unallocable), since they are the prisoners of their own assumption that 'the sum of the parts equals the whole.' They are therefore under impelling pressure to fudge their cost apportionments by using the category of customer costs as a dumping ground for costs they cannot plausibly impute to any of their other cost categories. (Bonbright, James C., *et al.*, Principles of Public Utility Rates, Public Utilities Reports, Arlington, Virginia, 1988, *emphasis added*)

Mr. Gorman's citation of Professor Bonbright's conclusion as to the strict unallocable nature of the hypothetical costs of the minimum-sized distribution system also supports a finding of limits to which fully distributed cost study results can be reasonably relied upon to determine class cost responsibilities, especially when the cost studies contain a cost category, customer costs, which is a "dumping ground" for the significant hypothetical costs of a minimum-sized distribution system. If the portion of distribution mains costs that is not peak-related is to be allocated, or associated with a service which caused it, then which allocation makes the most sense -- an allocation on

the basis of merely connecting customers who demand delivery service only because of the natural gas deliveries they require, or an allocation which recognizes the very service demands which cause the costs to be incurred? I believe the cost-causality principle dictates the better allocation is on the basis of the service requirements which cause the costs to be incurred by PGW (*i.e.*, deliveries required throughout the year and at time of peak), not the fictitious "connection service", for which there is no demand, is a service PGW does not offer, is not tariffed, has no price, does not comport with PGW's service extension rules, is neither economically viable nor even capable of being unbundled.

Q. IF COST ALLOCATIONS CANNOT BE PRECISELY DETERMINED, AND SOME COSTS MAY BE STRICTLY UNALLOCABLE, IS THE COMMISSION LEFT WITH NO STANDARDS FOR THE WEIGHING OF DISPUTED AND CONTROVERSIAL COST ALLOCATIONS THAT ARE PUT AT ISSUE IN A RATEMAKING PROCEEDING?

A. No. In addressing cost allocation issues in a recent PJM transmission rate design case, the Federal Energy Regulatory Commission ("FERC") put it this way:

> As the Supreme Court has found, "allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science." The Commission recently articulated the same principles in Order No. 890:
>
> Our decisions regarding transmission cost allocation reflect the premise that allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science. We therefore allow regional flexibility in cost allocation and, when considering a dispute over cost allocation, exercise our judgment by weighing several factors. First, we consider whether a cost allocation proposal fairly assigns costs among participants, including those who cause them to be incurred and those who otherwise benefit from them. Second, we consider whether a cost allocation proposal provides adequate incentives to construct new transmission. Third, we consider whether the proposal is generally supported by state authorities and participants across the regions. [Opinion No. 494, Opinion and Order on Initial Decision, Docket

Nos. EL05-121-000 and EL05-121-002, April 19, 2007, footnotes omitted]

While these cost allocation standards are included in a transmission rate proceeding, these standards are not unique nor limited to transmission costs of service.

The first standard, whether a cost allocation proposal fairly assigns costs among participants, *including those who cause them to be incurred and those who otherwise* benefit from them, favors allocating a portion of distribution mains on the basis of annual delivery service requirements rather than on the basis of customer "connection" service. Customers who call upon PGW to deliver energy to their premises in the form of natural gas requirements cause PGW to incur a significant share of PGW's delivery service costs, whereas non-existent customer "connection" service, absent sustained gas demands, would not and does not cause PGW to extend delivery service and incur related costs. Moreover, customers benefit from PGW's distribution mains in proportion to their annual energy requirements delivered over that system. A volumetric allocation is directly responsive to this cost allocation standard most recently articulated by the FERC in its Opinion No. 494.

The second standard is whether a cost allocation proposal provides adequate incentives to construct new facilities. Again this standard suggests that an allocation of mains partially on volumes is appropriate, in contrast to an allocation that pretends costs are incurred to provide hookup, or connection service, through a zero-intercept minimum system that could deliver no or nominal amounts of gas. Customers need not incur the hypothetical costs of a phantom, minimum sized system that cannot deliver gas. After all, customers could receive no gas through a totally nonexistent system and incur no cost. No deliveries, no practical way to make the incurrence of costs by the customer economically viable, and no way for the utility to recover its costs. With deliveries, the incurrence of costs can be made economically viable and PGW can be afforded an

opportunity to recover its attendant costs. An opportunity to recover costs is essential to providing an incentive to construct new facilities. Indeed, PGW's Extension and Rights-of-Way service rules incorporate this principle and prohibit PGW from incurring costs to connect customers who would use little or no gas.

The third standard is whether the allocated cost proposal is generally supported by state authorities and participants across the region. Again, applying this standard supports an allocation of distribution mains costs on volumes. The Pennsylvania Commission has a long-standing use of Peak and Average cost studies with respect to natural gas distribution companies, and rejected use of a so-called distribution mains customer cost component. Finally, while I have not made a study of cost allocation disputes and their resolution among the states, I did participate in the most recent Citizens Gas & Coke Utility petition for authority to increase its rates and charges for gas utility service before the Indiana Utility Regulatory Commission ("IURC"). In its Order in that proceeding, the IURC said:

> Based upon the record evidence, this Commission concludes that the OUCC's cost-of-service study is most reflective of cost causation and possesses a high degree of objectivity upon which the Commission may place reliance in establishing the rates and charges in this proceeding ...
>
> The OUCC presented a cost-of-service study taking a middle-of-the-road approach by allocating some distribution main costs on a peak day basis (20%) and allocating the remaining distribution main costs on a volumetric basis (80%) ...
>
> For the reasons set forth above, we find 'the OUCC's cost of service study most accurately reflects the manner in which distribution main costs are actually incurred *See. In Re Citizens Gas & Coke Utility*, IURC Cause No. 39066 at 31 (Nov. 1, 1999). We therefore adopt the OUCC's cost of service study to implement the rates increase approved in this Cause. [IURC Order, Cause No. 42767, pp. 74-75]

The OUCC cost of service study adopted by the IURC in the Cause No. 42767 proceeding incorporated a 20 percent peak demand/80 percent commodity allocation of distribution mains and related costs. Citizens Gas & Coke Utility classified and allocated no distribution mains costs on a customer cost basis.

Q. AT PAGE 11, LINE 19 THROUGH PAGE 12, LINE 6 OF HIS REBUTTAL TESTIMONY, MR. GORMAN ARGUES THAT PROFESSOR BONBRIGHT WOULD BELIEVE THAT CLASSIFYING THE ZERO-INTERCEPT COMPONENT OF DISTRIBUTION MAINS CAN, UNDER CERTAIN CIRCUMSTANCES, BE THEORETICALLY JUSTIFIED. PLEASE RESPOND.

A. Mr. Gorman cites Professor Bonbright's criticisms of the zero-intercept method because that method overlooks "... the very weak correlation between the area (or the mileage) of a distribution system and the number of customers served by the system....Allocation, in whole or in part, would at least be theoretically possible if consideration of a customer-density parameter were added to the three traditional cost components." (Rebuttal Testimony, page 11, lines 26-28 and 31-33). This discussion is inapplicable with regard to Mr. Gorman's defense of the *ex post* zero-intercept analysis he prepared in this case because Mr. Gorman failed to include or consider a customer-density parameter in his zero-intercept calculations.

Q. AT PAGE 12, LINES 10-11 OF HIS REBUTTAL TESTIMONY, MR. GORMAN ASSERTS THAT, "THE AMERICAN GAS ASSOCIATES ("AGA") GAS RIGHT FUNDAMENTALS SUPPORTS THE INCLUSION OF THE ZERO-INTERCEPT COMPONENT OF DISTRIBUTION MAINS IN CUSTOMER COSTS." IS HE RIGHT?

A. Here on page 12 of his rebuttal testimony, and again on page 14 when he addresses my testimony, Mr. Gorman refers to AGA's "Gas Right Fundamentals." Mr. Gorman probably meant to refer to AGA's Gas Rate Fundamentals. Mr. Gorman testifies:

> "The customer component of distribution costs reflects the theoretical distribution system that would be needed to serve customers at nominal or minimum load conditions." (Gas Right Fundamentals (sic), 1987 Edition, p. 136)

This discussion occurs in the Embedded Cost of Service Studies section of the Cost Allocation Studies chapter in the AGA text. The quoted material is a declarative statement introducing the concept of customer costs. Nowhere does the referenced AGA text define, nor could I locate in the text even a mention of the zero-intercept method of estimating so-called customer costs or the alternative minimum system method. The AGA's Gas Rate Fundamentals index does not include a zero-intercept entry. I could find no discussion, no mention, and no endorsement of the zero-intercept calculation procedures or methodology in the AGA's Gas Rate Fundamentals text.

Q. AT PAGE 12, LINE 19 THROUGH PAGE 13, LINE 11 OF HIS REBUTTAL TESTIMONY, MR. GORMAN ADDRESSES THE CONCLUSION IN YOUR DIRECT TESTIMONY THAT SUFFICIENT VOLUMES MUST BE REQUIRED IN ORDER FOR PGW TO INCUR THE COSTS ASSOCIATED WITH THOSE DELIVERIES. PLEASE EXPLAIN MR. GORMAN'S REBUTTAL POSITION AND YOUR RESPONSE.

A. In my direct testimony at page 11, I explained that PGW's tariff Section 10, Extensions and Rights-of-Way explicitly limits the costs that PGW will incur to extend service, and that those limits relate directly to annual deliveries. The import of this portion of my direct testimony is that even if there were a demand for mere "connection service," (there isn't) that sufficient deliveries must be present before PGW will be required to incur the

costs of providing natural gas delivery service. Absent the sufficiency of delivery requirements, it would be economically irrational to extend natural gas delivery service to connect customers who would use no gas.

Mr. Gorman argues that it is really PGW's current rate design that leads to any revenue insufficiency. Mr. Gorman reasons, if a demand for "connection service" existed, and "...if the utility's rates included a customer charge to reflect the customer cost component, and a demand charge to reflect the peak demand, the utility's revenue and economic viability would not be dependent on throughput.

Mr. Gorman is wrong. His argument is like the old saw: If I had some ham, I could have some ham and eggs, if I had some eggs. Not only is there no revealed demand for incurring cost to connect to PGW's minimum sized gas delivery system that could, in fact, deliver no gas, but PGW does not have a customer charge anything like PGW's proposed $68.50 monthly residential heating customer cost [Exhibit HSG-1A, page 1, line 3], and it doesn't have a residential demand charge at all (let alone a demand charge assessed on a customer's 10-15- year estimated design day peak demand). Moreover, even if PGW's rates were based on Mr. Gorman's description, sufficient annual volumes over which the customer could amortize the costs would still be essential to result in an average delivered gas cost per unit of consumption that would make reliance on natural gas service economically viable to the customer. It is the sufficiency of deliveries that is necessary to the economic viability of gas delivery service, not a particular rate design.

Q. AT PAGES 16 AND 17 OF HIS REBUTTAL TESTIMONY, MR. GORMAN ARGUES THAT THE COSTS OF MAINS IS CAUSALLY RELATED ONLY TO PEAK DEMANDS BECAUSE THE DELIVERY SYSTEM MUST BE SIZED TO MEET PEAK DEMANDS. MR. KNECHT RAISES A SIMILAR

ARGUMENT, THAT THE COST OF A DISTRIBUTION MAIN DEPENDS ONLY ON PEAK DEMANDS, AT PAGE 22, LINES 8-15 OF HIS REBUTTAL TESTIMONY. PLEASE RESPOND.

A. PGW allocates its demand related distribution mains costs on the theory that it would not have incurred any of those costs except for the fact that its customers insist on receiving gas deliveries on the coldest day in a 10- to 15-year period. If PGW faced a demand for delivered gas only once every 10- to 15- years, it would incur no costs, as its extensive, highly capital intensive, fixed cost delivery system would not exist. One can only believe that all of PGW's demand related distribution mains costs are caused by peak demands only, if one were to find, contrary to reality, that the PGW system would exist (and costs would be incurred) if there were no demand for gas deliveries but once every 10- to 15-years. Rather than repeat my testimony on this matter, I refer to my direct testimony at pages 12-14 related to distribution mains cost-causality, and to pages 14-18 for a determination of the portion of distribution mains costs that is related to annual commodity (average demands) and the portion that is properly related to peak demands.

Q. AT PAGE 17, LINES 7-8, MR. GORMAN ASSERTS THAT YOU "... BELIEVE THAT BECAUSE UTILITIES DESIGN RATES ARE [SIC] BASED ON VOLUMES OF GAS DELIVERED, THE COSTS INCURRED ARE RELATED TO VOLUMES OF GAS DELIVERED AS WELL." DO YOU BELIEVE THAT BECAUSE A GAS UTILITY TARIFF MAY INCLUDE A VOLUMETRIC RATE, THE COSTS INCURRED ARE RELATED TO VOLUMES OF GAS DELIVERED AS WELL?

A. No. At page 15, line 22, through page 16, line 4 of his rebuttal testimony, Mr. Gorman cites my testimony as follows as the basis of his assertion:

> "Rational investment decision analysis requires 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." (OCA St. 3, p. 15, line 6)

Mr. Gorman misunderstands this testimony if he thinks that relating the delivery costs to volumes of service only holds if the delivery costs are incurred on a volumetric basis. I have earlier testified at page 10 in this surrebuttal testimony that, even if Mr. Gorman's hypothetical rate, consisting of all cost recovery through a customer charge and a peak demand charge existed, sufficient delivery volumes over which incurred cost could be amortized are necessary for economic viability. In other words, a customer could take its total gas bill, including customer charges, gas charges, delivery charges, and surcharges, and divide the total cost by volumes delivered in order to determine the average cost of delivered gas requirements. A determination of unit costs has nothing to do with cost allocation. Nowhere in my testimony do I contend that if rates are based on volumes, then costs are related to, and presumably allocated on, volumes.

Response to Mr. Robert D. Knecht

Q. AT PAGE 6 OF HIS REBUTTAL TESTIMONY, MR. KNECHT MENTIONS YOUR COST OF SERVICE STUDY RESULT SHOWING A RESIDENTIAL CLASS AVERAGE RATE OF RETURN OF 4.9 PERCENT AT PRESENT RATES COMPARED TO A SYSTEM AVERAGE RATE OF RETURN OF 5.8 PERCENT. MR. KNECHT ASSERTS THAT THIS OBSERVATION, IN CONCERT WITH YOUR ENDORSEMENT OF A 30.0 PERCENT

RESIDENTIAL RATE INCREASE COMPARED TO PGW'S OVERALL 33.9 PERCENT INCREASE IS NOT REASONABLE. PLEASE RESPOND.

A. Under the Peak and Average cost study at present rates, residential heating customers pay rates which provide a 5.38 percent rate of return compared to a system average rate of return of 5.79 percent, or an index rate of return of 92.9 percent. At proposed rates residential customers provide a rate of return of 12.15 percent compared to a system average of 12.89, or an index rate of return of 94.3 percent. This represents a closure of 21 percent of the gap between the index rate of return at present rates and the system average index rate of return of 100 percent. Residential non-heating customers would pay increased rates that close 34 percent of the gap between their index rate of return at present rates and the 100 percent system index rate of return. Using PGW's cost study, in combination with its proposed residential rate increase, shows 32 percent progress to cost-based rates for heating customers and 34 progress for non-heating customers. The residential heating customer index, at 94.3 percent under the Peak and Average study, shows these customers are essentially at cost of service at PGW proposed rates. I believe these results are reasonable.

Q. YOU MENTIONED IN YOUR REBUTTAL TESTIMONY AT PAGE 2 THAT MR. KNECHT USES THE TERM CROSS-SUBSIDY AS THE DIFFERENCE BETWEEN CLASS REVENUES AND ALLOCATED, FULLY DISTRIBUTED COSTS OF SERVICE. AT PAGES 7-8 OF HIS REBUTTAL TESTIMONY, MR. KNECHT, USING THAT DEFINITION AND YOUR ENDORSEMENT OF PGW'S RESIDENTIAL RATE INCREASE, CONCLUDES THERE IS AN "INSIDIOUS" PROBLEM WITH YOUR APPROACH. PLEASE RESPOND.

A. Mr. Knecht explains that the Peak and Average study allocates more cost to the GTS/IT customers, increasing the difference between their revenues and allocated cost, or

subsidy, as that term is used by Mr. Knecht. I do not believe it is insidious that the Peak and Average cost of service study reveals the GTS/IT class is paying rates that are below their fully allocated costs. It is standard gas utility ratemaking practice to charge discounted rates to interruptible customers and customers with competitive options, if those discounted rates are the maximum rates that can apply and they are above marginal costs. In these circumstances, the discounted rate customers' contribution toward fixed costs, albeit smaller than at non-discounted rates, benefits other customers compared to losing all contribution from the competitive-option customers if non-discounted rates could not be applied. Under these circumstances, I, like PGW and OTS and Mr. Knecht, propose no increase for the GTS/IT customers. The dollar amount of increase that is determined in this case, the disputes over the spread of that resulting increase, and the disputes over how costs are most reasonably allocated are not affected by all parties' agreement in this proceeding regarding GTS/IT rates.

Q. AT PAGE 2, LINES 7-8 OF HIS REBUTTAL TESTIMONY, MR. KNECHT CONCLUDES THAT YOU DO NOT OFFER AN ALTERNATIVE REVENUE ALLOCATION PROPOSAL FOR ALL RATE CLASSES. AT PAGE 7, LINES 15-18, AFTER ACKNOWLEDGING THAT "...PGW HAS NO REASONABLE WAY TO RAISE RATES FOR THESE [GTS/IT] CLASSES," MR. KNECHT LAMENTS THAT YOU "...DO(ES) NOT MAKE ANY SPECIFIC PROPOSAL IN THAT RESPECT, NOR (DO)ES HE (YOU) OFFER ANY EVIDENCE THAT PGW WOULD BE ABLE TO IMPOSE SUCH AN INCREASE." WHY DO YOU NOT PROPOSE TO SHIFT REVENUE RESPONSIBILITY TO OTHER CLASSES?

A. Based on the progress toward basis in cost indicated in PGW's and my own class cost of service studies, at page 28 of my direct testimony I stated, "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. At lines 20-21 on page 28, addressing all of PGW's class revenue increase proposals, I stated, "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." I found PGW's revenue allocation to be reasonable and accepted PGW's analysis that it cannot further increase the rates of the competitively situated customers without losing the contribution to margin that these customers provide.

Q. AT PAGE 9, LINES 1-2 OF HIS REBUTTAL TESTIMONY, MR. KNECHT CONCLUDES THAT YOUR ENDORSEMENT OF PGW'S RATES MUST MEAN THAT YOU DO NOT AGREE THAT COST OF SERVICE IS THE POLESTAR CRITERION FOR REVENUE ALLOCATION. PLEASE RESPOND.

A. Mr. Knecht's conclusion is not correct. Whether PGW's proposed cost study is utilized or whether the Peak and Average cost study is utilized, substantial progress toward cost based rates results at PGW's proposed rates. This is shown on Exhibit HSG-7C, page 1, line 23, of PGW's exhibits, and Exhibit RAG-1, page 5, line 23. The Peak and Average study results show residential heating customers paying proposed rates that recover all of their allocated operating costs, depreciation and taxes, and providing a rate of return that is 94.3 percent of the system average rate of return. Given the fact that fully distributed cost allocation studies are not an exact science, free from controversy, the proposed residential rates are, in my opinion, essentially cost based. Whereas Mr. Knecht believes that PGW's proposed rates are not consistent with costs of service being a polestar criterion, I believe the record evidence supports the exact opposite conclusion.

Q. AT PAGE 9, LINES 13-15, MR. KNECHT STATES THAT BECAUSE THE COST STUDIES THAT YOU AND MR. KUBAS RELY UPON CONTAIN ALLOCATED GCR-RELATED COSTS AND REVENUES, "... THE CCOSSs RELIED UPON BY MESSRS. KUBAS AND GALLIGAN ARE NOT APPROPRIATE FOR REVENUE ALLOCATION IN THIS PROCEEDING." PLEASE COMMENT.

A. I address the use of cost studies available in this record, both with and without GCR costs and revenues, at pages 13-15 of my rebuttal testimony. Here I would simply add Mr. Knecht's conclusion stated at page 3 of his rebuttal testimony, "...there is remarkably little difference in allocated costs for the major firm sales customers classes among the various cost allocation methodologies submitted in this proceeding."

Q. AT PAGE 10, LINES 21 THROUGH PAGE 11, LINE 2 OF HIS REBUTTAL TESTIMONY, MR. KNECHT COMMENTS THAT BECAUSE DISTRIBUTION MAINS HAVE LENGTH AS WELL AS SIZE THIS SUPPORTS CLASSIFYING AND ALLOCATING A SIGNIFICANT PORTION OF DISTRIBUTION MAINS ON A CUSTOMER BASIS. PLEASE RESPOND.

A. Mentioning the word length, and italicizing it as Mr. Knecht does here, does not support a conclusion that a significant portion of distribution mains costs is caused by the imaginary customer-connection service, rather than costs being caused by extending the distribution system in order to provide delivery service to meet the demand requirements of new customers. Without the new customer volumes, there would be no demand for connection service. Similarly, without new customer volumes, PGW is precluded under its tariff from incurring costs to connect customers who would use no gas. Customer volumes are absolutely essential to PGW's being required to incur costs to extend its system and provide delivery service to new customers.

Q. AT PAGES 11-12 OF HIS REBUTTAL TESTIMONY, MR. KNECHT CLAIMS THAT PGW'S ALLOCATION METHODOLOGY RECOGNIZES ECONOMIES OF SCALE. IS THIS RECOGNITION OF ECONOMIES OF SCALE UNIQUE TO PGW'S COST ALLOCATION METHODOLOGY?

A. No. Economies of scale in a gas distribution system are a function of system demands, not individual customer demands. Gas distribution systems built on the basis of least-cost principles take advantage of all available system economies. The benefits of these economies are reflected in lower total costs of service. All fully distributed cost studies recognize existing, system-wide economies of scale.

Q. AT PAGE 17 OF HIS REBUTTAL TESTIMONY, MR. KNECHT MENTIONS THAT MOST UTILITIES UTILIZE SOME FORM OF MINIMUM SYSTEM TO CLASSIFY COSTS. DOES THIS OBSERVATION ESTABLISH A CAUSAL LINK BETWEEN DISTRIBUTION COSTS AND THE NUMBER OF CUSTOMERS?

A. No. At page 17 of his rebuttal testimony, Mr. Knecht states:

> Finally, I note that Mr. Galligan excluded one observation from that section of the Bonbright text, in which the authors admit:
>
> In actual practice, the vast majority of utilities utilize some form of minimum system to classify costs, which is in line with the FERC accounts.[11]
>
> Thus, it can be inferred that most utilities believe that distribution costs are, *in fact, causally related to both peak demands and* numbers of customers on their system."

In the very next sentence following the material Mr. Knecht cites, Professor Bonbright reminds the reader of the controversial nature regarding this practice of using some form of a minimum system to classify distribution system costs as customer related:

> Sterzinger (1981) is critical of this practice and recommends that to avoid the overcollection of charges from low-use residential customers, regulators should classify distribution costs, as demand costs.

What Mr. Knecht's cited material shows is that Professor Bonbright was fully aware that the majority of utilities may use some form of minimum system to classify costs when he described the controversial nature of the practice and the impelling pressure that the cost practitioner is under to use the customer cost category as a "dumping ground" for costs they cannot impute to any of their other cost categories.

Q. AT PAGE 18, LINES 1-3 OF HIS REBUTTAL TESTIMONY, MR. KNECHT STATES THAT PGW WOULD NOT INSTALL EITHER A SERVICE LINE OR METER TO A CUSTOMER WHO USED NO GAS, YET YOU RECOGNIZE METERS AND SERVICES AS RELATED TO THE NUMBER OF CUSTOMERS. PLEASE RESPOND.

A. There is no diversity in the use of individual services and meters -- one service and one meter per customer. Each customer uses its own meter and service line; no customer uses any other customer's meter or service line. The association of meter and service line costs with customers is very much like a direct assignment. Distribution mains, however, are jointly used throughout the year and at times of peak demand. These costs must be allocated among users. An allocation in proportion to the annual and peak service requirements is an allocation on the basis of the service parameters that caused PGW to incur the costs in the first place.

Q. AT PAGE 18, LINES 4-8 OF HIS REBUTTAL TESTIMONY, MR. KNECHT PROVIDES AN AUTOMOBILE PURCHASE EXAMPLE AND CONCLUDES THAT YOUR LOGIC SUGGESTS THAT CAR PRICES SHOULD BE BASED

ON THE NUMBER OF MILES THAT THE CAR WILL BE DRIVEN, RATHER THAN ON THE COST OF THE CAR. PLEASE RESPOND.

A. Mr. Knecht's example is inapt. The purchase of a car is a purchase of a facility. PGW sells service, not facilities. Cars are in a product category that economists refer to as differentiated products, most unlike a utility's delivery service. Cars are designed to meet many basic and nuanced demands through myriad individualization techniques. Cars are not priced on a cost basis that in any meaningful way resembles utility pricing. People can buy "more" or "less" car, and people will demand new car replacements at different intervals for a litany of reasons. Mr. Knecht's car pricing example does not apply to the determination of PGW's delivery service prices.

Q. STICKING WITH CAR EXAMPLES, MR. KNECHT PRESENTS AT PAGE 22, LINE 17 THROUGH PAGE 23, LINE 2 OF HIS REBUTTAL TESTIMONY, A SPORTS UTILITY VEHICLE ("SUV") EXAMPLE. MR. KNECHT CONCLUDES FROM HIS EXAMPLE THAT YOUR LOGIC SHOULD LEAD TO A HIGHER PRICE FOR A CUSTOMER WHO WOULD USE THE CAPACITY OF PRESUMABLY A GIVEN SUV MORE THAN THE PRICE CHARGED TO A CUSTOMER WHO WOULD USE THE CAPACITY FOR ONLY RELATIVELY SHORT PERIODS OF TIME. PLEASE RESPOND.

A. Mr. Knecht presents an example of Customer A, who wants a six-passenger SUV to drive the passengers to work every day, or some 230 days per year. Customer B wants a six-passenger SUV to take his 6-person family on a two-week vacation. The rest of the year, B commutes to work by himself. Again Mr. Knecht's example is inapt regarding any implication between the sale of a facility, the SUV, and the sale of the service, delivery service, that PGW provides.

A more apt example would be an SUV leasing example, since the leasing arrangement provides the services of an SUV, similar to PGW is providing the delivery services that distribution mains make possible. Unequivocally, if Customer A presented him (or her)self at a car leasing office with a demand for the use of a 6-passenger SUV throughout an entire year, that customer would be charged more than Customer B, who wants a 6-passenger SUV for two weeks. A consumer being provided with transportation service of an SUV for a year will pay more for that service, i.e., be allocated more cost, than a customer provided with transportation service of an SUV for a short period of time.

Q. AT PAGE 18, LINES 14 TO 17 OF HIS REBUTTAL TESTIMONY, MR. KNECHT ASKS THE QUESTION:

"... WILL INCREASES IN THE NUMBER OF CUSTOMERS WITH NO INCREASE IN OVERALL DEMAND CAUSE THE NGDC TO INCUR HIGHER COSTS?" MR. KNECHT ANSWERS THE QUESTION: "... YES, SINCE THE NGDC WOULD NEED TO EXTEND THE DISTRIBUTION SYSTEM TO SERVE THE NEW CUSTOMERS."

PLEASE COMMENT.

A. There are two reasons which could explain the simultaneous existence of new customers and no increase in overall demand. One, the new customers have sufficient gas demands to warrant extension of service under PGW's tariff Section 10, Extensions and Rights-of-Way rules and regulations, and these demands exactly offset other declining demands. In this case the new demands cause PGW to incur the cost of extending its system. Two, the new customers have no demands for gas, all other things equal.[1] In this case, Mr. Knecht is wrong -- PGW would not "need to extend the distribution system to serve the new customers." In fact, if overall demand stays the same because the new customers

[1] There are intermediate cases where new customers bring various demands with them which just match decreasing other demands, but these cases reveal no different conclusions.

have no, or inadequate, demands for gas, PGW and its existing customer base is protected by its current tariff from having to incur costs in order to extend its system to such customers. In either case, it is clear from Mr. Knecht's example that costs are related to demands – if the new customers have sufficient demands, PGW will incur costs to extend its system; if new customer demands are insufficient, PGW will not incur costs of extending its system. Clearly, it is the existence of delivery service requirements which is responsible for PGW's incurrence of delivery service costs, not the possibility, or even the eventual addition, of new customers.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes.

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R-00061931
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

DIRECT TESTIMONY OF

RANDY MAGNANI

ON BEHALF OF

HESS CORPORATION

DOCKET NO. R-00061931

APRIL 6, 2007

I. Background

Q. Please state your name and business address.

A. I am Randy Magnani. My business address is One Hess Plaza, Woodbridge, NJ 07095.

Q. By whom are you employed and in what capacity?

A. I am the Director of Natural Gas Operations for the Energy Marketing Division of Hess Corporation.

Q. How long have you been employed in your current position?

A. I have been employed in my current position since 2001.

Q. Please explain the job responsibilities and duties in your current position.

A. I am responsible for the nomination and scheduling of natural gas on interstate pipelines and on the systems of Local Distribution Companies ("LDC") in seventeen states, including the operations units which handle deliveries to and operations on the PGW system. I am also responsible for the calculation of cost components associated with providing gas to retail customers.

Q. Please provide your educational background and relevant work experience prior to joining Hess.

A. I graduated from Manhattan College with a Bachelors Degree in Chemical Engineering in 1970 and worked for the Public Service Commission of the State of New York as a Junior Engineer. From 1971 to 1998, I worked for Brooklyn Union Gas Company or its affiliates. I held various positions including Manager of Rates and Gas Supply, Manager of Gas Operations and President and Chief Operating Officer of KeySpan Energy Services, Brooklyn Union's marketing affiliate. I then joined Navigant Consulting Group as a principal and consulted on several issues primarily related to natural gas. I joined Hess Corporation in 2001.

I have testified before the Federal Energy Regulatory Commission and before the Utility Commissions in New York, Massachusetts and Rhode Island.

Q. What is the purpose of your testimony?

A. I will address the state of gas competition in the retail market on the PGW system. I also will be making recommendations regarding the initial minimum systems and tariff changes that are needed to begin addressing the lack of competition in the PGW service territory.

II. State of the Competitive Gas Market on the PGW System

Q. Briefly explain the types of services that Hess provides in Pennsylvania.

A. Hess is a licensed natural gas supplier in Pennsylvania at Docket No. A-125098. Hess is licensed as an aggregator, broker/marketer and supplier of natural gas services to commercial, industrial and governmental customers in Pennsylvania, including in the PGW service territory.

Q. Is Hess currently providing service to retail customers in the PGW service territory?

A. Yes. Hess actively markets to and serves commercial and industrial customers and has been operating on the PGW system since 2004.

Q. Briefly describe the state of the competitive retail gas market in the PGW service territory.

A. Retail gas competition in the PGW service territory is scarce. The lack of robust retail competition in the PGW service territory is due primarily to: (1) operational rules that Hess and other Natural Gas Suppliers ("NGSs") must follow in PGW's service territory that serve as barriers to competitive entry and growth in the retail supply market and (2) inadequacies and inefficiencies with the current means by which NGSs communicate with PGW and with the method and format by which the NGSs and PGW exchange customer and NGS-specific information, both of

which involve manual processes that serve as barriers to competitive entry and growth.

A. Operational Rules

Q. Please identify the anti-competitive operational rules that you previously referenced.

A. The operational rules I reference include, but are not limited to: (1) nominations of natural gas supply deliveries to the PGW system by NGSs for delivery to and consumption by their customers; (2) balancing and reconciliation of NGS deliveries as compared to the volumes consumed by their customers; (3) the cash outs and penalties associated with that process and (4) the mitigation tools available to NGSs to minimize impact of the cash out process on customer rates.

Q. Please explain, generally, how the operational rules should be modified to remove competitive barriers to entry and to improve the state of retail gas competition in the PGW service territory.

A. These rules must be more reasonable in order to create a level playing field in which NGSs can meaningfully compete for retail natural gas customers. Currently, NGSs are prohibited from passing on to their customers the full benefit yielded by their position in the market place serving customers across multiple service territories in multiple jurisdictions. At the same time, these rules impose a higher standard of performance on the NGSs than the LDC, itself, could expect to meet. NGSs must have access to and operate under the same delivery performance standards under which the LDC performs.

Q. Please define the term "nomination" and explain how the nomination process should be modified to help increase retail gas competition in the PGW service territory.

A. A "nomination" is the means by which NGSs notify PGW of the physical quantity of gas for delivery to PGW's city gate as scheduled on the interstate pipelines

under specific purchase, sales and transportation agreements. PGW's current deadline for day-ahead nominations should be extended. The current deadline as per PGW's tariff is 12:00 p.m. This deadline puts NGSs at a disadvantage because it requires them to submit nominations of their deliveries 30 minutes in advance of pipeline deadlines where upstream contracts may still be provided to suppliers for nomination. The nomination deadline should be extended to at least 2:00 p.m. This will benefit NGSs, PGW and consumers because it will reduce the potential for errors and the need for nomination adjustments. Reducing errors will have a favorable impact on price. Errors, especially those that are not permitted to be corrected, result in penalties to NGSs, which can be reflected in higher customer prices. Reducing errors will also reduce PGW's risks associated with having to cover short supply imbalances on its system.

Furthermore, PGW currently does not permit NGSs to send retroactive nominations, even if a pipeline will issue one. PGW should accept retroactive nominations when a pipeline will confirm that it has issued one, particularly when the need for the retroactive nomination is the result of a simple or unintentional error or a disruption in supply that is beyond the control of the NGS. Particularly in the latter instances, permitting retroactive nominations will bolster reliability as PGW will be ensured of the delivery of gas rather than bearing the risk and financial burden associated with having to cover supply shortfalls which could have been prevented.

Q. Please explain the process associated with the balancing and reconciliation of NGS deliveries on an LDC's system.

A. Balancing addresses the reconciliation of NGS deliveries to PGW's system to the actual consumption of their customers. An imbalance occurs when an NGS delivered more than their customers actually consumed, or if the customers consumed more than their NGS actually delivered for them. When an imbalance occurs, it must be cashed out at a rate specified by the LDC, often with associated penalties imposed on the NGS. The reconciliation of these imbalances can be

done on a daily or monthly basis. Daily balancing refers to the practice of requiring NGSs to maintain the difference between the quantity of gas that their customers use and that they deliver to the LDC to within a tolerance level every day. In contrast, monthly balancing allows the NGS to be out of balance on any given day but requires them to be in tolerance for the month as a whole. Daily cash out penalties are penalties that are assessed based on the quantity by which the NGS is out of balance each and every day. Monthly cash out penalties are assessed based on the monthly imbalance quantity only.

Q. Please explain the balancing process on the PGW system and how it should be modified to help increase retail gas competition in the PGW service territory.

A. Currently, for interruptible customers, PGW performs the balancing and cash out of NGS deliveries to its system on a daily basis, structured around unreasonable tolerance levels and penalties, and then imposes a further month-end reconciliation with additional cash-outs and penalties. PGW allows a daily tolerance of 5%. Therefore, if an NGS' customers use more than 105% of the quantity delivered by the NGS, then the NGS is out of balance and must pay a penalty of $.50 per Dth outside the 5% range. At month's end, NGSs may carry over within 2.5% of their deliveries for the month, but beyond that tolerance, are cashed out at unreasonably low or high percentages of the market value of the gas, dependent on whether it was an over or under delivery, respectively.

PGW's supplier tariff should be amended such that the current practice of daily balancing is replaced with a purely monthly balanced program. In other words, instead of cashing NGSs out on a daily basis, and then again at month-end, there should be a reconciliation between delivered and consumed volumes only at the end of the month. Additionally, the rates at which the over or under delivered volumes are cashed out, or charged, should be market based with reasonable levels of penalties established on a tiered basis tied to levels of performance tolerances. The tolerances currently in place impose higher levels of performance

expectations on the NGSs than the LDC itself could expect to adhere to. If elimination of daily balancing is demonstrated to not be feasible, than the daily tolerance levels, cash-out rates and penalties, as well as the month-end cash-out rates, should be amended to more reasonable, market based levels.

Additionally, the firm transportation customer cash out rate, applied to imbalances annually, lacks transparency because it is not clearly set forth in PGW's retail or supplier tariff and is therefore unreasonable. The rate for firm transportation cash outs is supposed to be based on PGW's Weighted Average Cost of Gas ("WACOG"), but is not clearly set forth in PGW's tariffs. Therefore, the firm transportation cash out rate should be set at a reasonable, market-based rate, and for transparency purposes, the supplier tariff should be modified to specifically identify what that firm transportation cash out rate is.

Q. Please explain the mitigation tools that NGSs can use to minimize the financial impact caused by imbalances, and specify if those tools are available on the PGW system. If they are not available, please explain how the PGW program should be modified.

A. One tool that NGSs often have available to them on many LDC systems is the ability to imbalance trade with one another. Trading imbalances means that if there is one NGS who has under-delivered and another NGS on the system has over-delivered, both of whom have penalty exposure, the two NGSs would trade gas among themselves to bring their pools into balance. If one NGS is long 10 % and the other is short 10%, the PGW system is in perfect balance but both NGSs would be paying penalties on 5% of their daily delivery. Trading the imbalance would allow both NGSs to avoid penalties, which is appropriate since PGW did not incur any penalty, and can reduce costs that must be passed on to customers. The net result of imbalance trading is that there is less double charging of penalties and if executed perfectly, only NGSs that were out of balance on the same side as the overall system imbalance would pay a penalty.

Currently, PGW does not permit imbalance trading. However, permitting imbalance trading will have no net impact on PGW's systems and will help dramatically reduce costs to NGSs and customers by allowing NGSs to trade their imbalance quantities with other NGSs that have an imbalance in the other direction. This allows both NGSs to reduce the quantity by which they are out of tolerance and thus, reduces their penalty and cash out exposure. Moreover this trading, or re-allocation, which is permitted on many other LDC systems, occurs after physical deliveries to the LDC have occurred. This doesn't impact PGW because there is no physical transfer occurring – the gas has already been delivered and consumed, and PGW is not involved in the transaction other than to adjust volumes in their records. Therefore, PGW's supplier tariff should be amended to allow NGSs to imbalance trade with one another or between their own pools, if applicable.

B. Communication and Information Exchange

Q. Please identify the inadequacies and inefficiencies that exist with the communication and exchange of information between NGSs and PGW that you previously referenced.

A. The inadequacies and inefficiencies exist primarily with, but are not limited to, the means by which NGSs obtain customer information and usage data as well as the process of customer enrollment.

Q. Please explain, generally, what changes should be made to the PGW information exchange process to remove competitive barriers to entry and to improve the state of retail gas supply competition in the PGW service territory.

A. PGW does not have an automated Electronic Data Interchange ("EDI") system in place to handle the exchange of customer-related information. Therefore, the primary means by which the NGSs and PGW exchange customer and NGS data is through a manual process, which involves emailing to PGW forms and

spreadsheets that are filed out manually. In the absence of implementation of an EDI system on the PGW system, the process and means by which data is exchanged needs to be improved and stream-lined to maximize efficiencies, to facilitate customer enrollment customers, and minimize opportunities for errors.

Q. Please explain the specific changes that should be made to PGW's information exchange process to increase retail gas competition in the PGW service territory.

A. Unlike most other LDCs who have standard processes for obtaining usage, account numbers and meter information, PGW does not have EDI or any other automated systems where NGSs can obtain such information. Rather, NGSs must obtain this information directly from customers, which is unduly administratively burdensome and often yields inaccurate information. To remedy this competitive barrier to entry, PGW should provide a consistent, transparent and straightforward process by which NGSs can obtain customer information, preferably in an automated format.

Q. Please explain the specific changes that should be made to the customer enrollment process in order to increase retail gas competition in the PGW service territory.

A. Currently, customer enrollment is done via manual data entry by the 15th of the month, and there is no flexibility beyond that date to correct even minor errors, which are the normal and natural consequence of a manual process, to enrollments submitted by the established deadline. Consideration and flexibility must be given as part of any enrollment process, given the lack of an automated EDI process which would otherwise help to increase efficiencies and minimize errors.

To remedy this competitive barrier to entry, when obtaining usage information and enrolling a customer, NGSs should be required to provide only one point of information per customer (i.e. whichever identification number is unique to a customer, be it service point ID or account number). Moreover, PGW should

allow NGSs who have initially met the enrollment deadline to correct at least minor errors so that customers are not put in the detrimental position of having to take tariff gas during the first month of the term of the contract with their NGS. This causes a financial burden to both customers and marketers and can be avoided by simply providing flexibility in the enrollment process.

C. Policy Justifications

Q. From a policy perspective, please explain the importance of increased retail gas supply competition in the PGW service territory.

A. It is important for competition to grow in the PGW service territory for several reasons. First, it is my understanding that the Pennsylvania Public Utility Commission ("Commission") has made it a policy objective to improve gas competition statewide in Docket No. I-00040103. Therefore, increased competition in the PGW service territory would be consistent with the Commission's own objectives.

Second, the growth of competition will provide more options to customers both in terms of the number of NGS options to choose from as well as the number, types and prices of products and services that are available. Customers will have greater access to more efficient services and products more specifically tailored to meet their needs. Moreover, with increased competition, customers will have greater opportunities to pursue savings in their gas supply needs.

Third, with specific regards to the PGW system, the more competitive options that are available to PGW customers, the more PGW's obligations with regards to commodity procurement and supply are relieved, enabling it to focus more heavily on the provision of distribution services to its customers. Additionally, the less PGW faces the risks associated with supply procurement and sales, the more it can focus other financial issues that it faces on its system, including those identified in this proceeding.

Q. Finally why is it appropriate to address these competitive issues in this case?

A. First, as I mentioned, the Commission has set a policy of improving competition across the state, and many of the issues I address in my testimony can be addressed through tariff changes. It is entirely logical and appropriate to address such tariff changes as part of this proceeding, especially in light of the fact that all PGW tariffs are under review as part of this case. Second, also as I mentioned, the more competition grows on PGW, the more PGW will be freed up to address any other issues it faces relating to distribution service and finances. Third, the greater opportunities customers will have to minimize gas costs with NGSs, the more they can attempt to offset any distribution rate increases they may face from this case. Therefore, taking steps to ensure increased gas competition in the PGW service territory is directly related to this case.

III. Conclusion

Q. Does this conclude your testimony?

A. Yes.

Hess St. No. SR-1

R-00061931
5/21/07
Phila, PA
MS

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

SURREBUTTAL TESTIMONY OF

RANDY MAGNANI

ON BEHALF OF

HESS CORPORATION

DOCKET NO. R-00061931

DOCUMENT FOLDER

MAY 15, 2007

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

A. My name is Randy Magnani and my business address is One Hess Plaza, Woodbridge, New Jersey.

Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY IN THIS MATTER?

A. Yes. I filed direct testimony which has been designated Hess Statement No. 1.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to respond to comments made in the rebuttal testimony of PGW witnesses William C. Muntzer and Craig White, and The Office of Consumer Advocate witness Richard W. Lelash.

Q. PLEASE BEGIN BY DISCUSSING MR. MUNTZER'S REBUTTAL TESTIMONY PERTAINING TO DAILY NOMINATIONS DEADLINES.

A. Mr. Muntzer begins by responding to my direct testimony on the issue of the gas nominations deadline which PGW currently has in place at 12:00 p.m. for day ahead nominations. Mr. Muntzer suggests that Hess requires an additional half hour to "get their calculations in order," in which case, PGW would consider extending the deadline to 12:30 p.m. Mr. Muntzer misunderstands Hess' reason for requesting the change and therefore does not offer an adequate extension of the deadline. Hess does not request additional time to complete calculations, but rather to allow for the finalization of gas contracts on the upstream pipelines at 12:30 p.m., that then must be communicated between Hess and its trading partners, and finally transmitted to PGW via the electronic bulletin board ("EBB"). Even with an extension to 12:30 p.m., the natural gas suppliers ("NGSs" or "suppliers") would still be at a disadvantage because we may not be able to fully utilize the breadth of available gas contracts being traded on the pipelines, many of which are not finalized until 12:30 p.m., and still have time to provide timely nominations of those contracts to PGW. Allowing later deadlines benefits all parties involved including PGW, PGW's sales customers,

transportation customers and the NGSs. With a later deadline, fewer errors, or even the need for after-the-fact alterations of contracts, will occur. The end result is reduced penalties on NGSs, that are a component of customer pricing, as well as reduced need for PGW to balance its system when imbalances are caused by nomination errors. Moreover, PGW's rejection of retroactive nominations on its system, where an interstate pipeline serving the PGW system has permitted the supplier a retroactive nomination, completely frustrates the benefit accruing to NGSs by pipelines' willingness to allow retroactive nominations. Where an NGS can document that a pipeline has authorized a retroactive nomination, PGW should be required to permit a retroactive nomination for symmetry and to give practical effect to the pipelines' change in nomination level.

Q. PLEASE DISCUSS MR. MUNTZER'S TESTIMONY REGARDING ERROR CORRECTION.

A. Mr. Muntzer contends that allowing nomination error correction places PGW in the position of potentially showing favoritism for one NGS over another. This is not accurate. Most local distribution companies ("LDCs") provide some measure of latitude when working with NGSs to allow for the correction of errors that are clearly innocent mistakes and not meant to create some artificial advantage for the NGS. This common sense business practice is implemented even handedly among marketers, and exists with the explicit understanding that the LDC is free to deny any request for changes when the LDC suspects abuse of this flexibility. When a situation arises that clearly involves a clerical error, such as with the transposition of two numbers in a lengthy contract number, and these numbers must be manually entered each day, most LDCs will allow for correction of the contract number, particularly when the gas was in fact delivered to the gate under the correct contract number. In cases such as these, the NGS clearly made a clerical error, and no harm was imposed on the LDC since the gas was in fact delivered and was available to be consumed. Hess agrees that PGW's allowance of intraday nominations does mitigate some of the need for corrections, and that

flexibility has not been abused. Nevertheless, there are sometimes corrections that cannot be accommodated intraday, and similarly would not be abused.

Q. HOW DOES PGW RESPOND TO YOUR PROPOSAL TO INCREASE DAILY TOLERANCE BANDS, REDUCE DAILY PENALTIES, AND SET MONTHLY CASHOUTS AT MARKET BASED RATES?

A. PGW does not believe that these changes are necessary or appropriate. Mr. Muntzer argues that the tolerance bands and penalties are designed to be a disincentive to NGSs to over or under deliver in order to take advantage of economic opportunities offered in other markets. Mr. Muntzer further contends that the changes Hess proposed would reduce PGW's "control and the reliability of the system, and impose unnecessary costs on firm customers." Mr. Muntzer also states that the current penalty levels should be maintained because they were approved by the PUC as a part of a settlement. In addition, PGW suggests that NGSs could improve performance by assuming greater responsibility for its customers' actions and by forecasting more accurately.

Q. HOW WOULD YOU RESPOND TO MR. MUNTZER'S ARGUMENT THAT TOLERANCE BANDS AND PENALTIES ARE A DISINCENTIVE TO NGS MISBEHAVIOR?

A. First, Hess strongly disagrees that the tolerance band and penalties act as a disincentive to NGS misbehavior. While it makes sense to provide some restrictions in order to control the amount of swing PGW must balance from day to day, the tolerance bands and penalties currently in place are so restrictive that they go beyond deterrent and become punishment for punishment's sake. PGW appears to believe that NGSs could forecast more accurately than they do, and therefore have the ability to avoid these penalties. This is simply untrue. Customer usage can fluctuate dramatically from day to day and while NGSs have models to help predict these changes, we can be no more accurate than are the meteorologists and the customers themselves. When an NGS forecasts based on a weather forecast, and that weather forecast is 5 degrees off from the actual

temperature, usage will be vastly different than predicted. Or, when weather changes dramatically from morning to afternoon, usage patterns are significantly affected. If professional meteorologists cannot accurately predict weather, it is unrealistic to expect NGSs to do any better. In addition, Mr. Muntzer states that we can better forecast through greater communication with and responsibility placed on our customers. This argument assumes an extremely high level of natural gas sophistication on the part of the customer that is unfounded for all but the largest natural gas customers. Except in the case of these highly savvy consumers, even when suppliers are in daily communication with a customer, the customers are frequently unable to accurately determine how weather and process changes will affect their gas consumption. Therefore, these penalties do nothing but place unreasonable costs on NGSs and as a byproduct on their customers, purportedly to control behavior that cannot be appreciably improved. Mr. Muntzer also states that these penalties are meant to deter NGS from utilizing assets in territories that are more economically advantageous than the PGW territory. Once again, this assumes a level of forecasting ability that simply does not exist. If NGSs were able to forecast so accurately as to be able to arbitrage other opportunities that are more economically advantageous, we would also be able to avoid PGW's daily penalties and month end cashouts. As we are not able to avoid these penalties and cashouts, it is clear that they are no deterrent, and are simply punishing behavior that cannot be improved.

Q. HOW WOULD YOU RESPOND TO MR. MUNTZER'S CONTENTION THAT INCREASED TOLERANCE BANDS AND DECREASED DAILY PENALTIES WILL RESULT IN LOSS OF CONTROL AND INCREASED COSTS ON FIRM CUSTOMERS?

A. Hess sees no reason to believe that these results will occur. First, the difference in dekatherms ("dths") from a tolerance band of 5% to 10% is so small that it is impossible to see how it could have any real impact on PGW's swing gas buy decisions or that it would impose any additional costs on anyone. For example, if an NGS serves customers with an average daily load of 5,000 dths, with a 5%

tolerance band, the daily tolerance would be 250 dths. With a 10% tolerance, the daily tolerance would be 500 dths. Hess fails to see how an increased swing tolerance of 250 dths a day could have any appreciable impact on the entire PGW system of hundreds of thousands of dekatherms flowing daily, whether it be on reliability or costs for any customers. On the contrary, the changes Hess proposes would reduce costs for NGSs which in turn would reduce costs for transportation customers. Second, since neither marketers' customers nor PGW can accurately forecast customers' requirements, the effect of widening the band to reasonable levels will not impact the amount of gas delivered to the system or the imbalance between what customers use and what is delivered. It will, however reduce the penalties paid by marketers and flowed through to customers.

Q. DO YOU AGREE WITH MR. MUNTZER THAT THE FACT THAT THESE TOLERANCES AND RATES WERE PART OF A COMMISSION-APPROVED SETTLEMENT MEANS THAT THEY SHOULD BE MAINTAINED WITHOUT CHANGE?

A. No. Certainly Commission approved regulations must be adhered to and upheld unless and until the Commission sees fit to make changes to them. Hess would point out that much experience has been gained in serving transportation customers in the years since the settlement on PGW's current tariff was approved. It is the Commission's right and duty to re-evaluate its decisions in light of new conditions, much as it is currently working to do in the State's Natural Gas Investigation proceeding. Now that NGSs like Hess have had the opportunity to work within the rules established by the parties and approved by the Commission, we are able to explain what is not working well and how to improve on existing requirements. The Commission's order establishing this rate investigation makes it clear that PGW's current tariffs are under review, and not just the elements of those tariffs that PGW has proposed to change.

Q. PLEASE COMMENT ON PGW'S REBUTTAL TESTIMONY REGARDING IMBALANCE TRADING.

A. Mr. Muntzer states that PGW cannot implement imbalance trading because it does not have the necessary systems in place to accommodate this process. However, Hess works with other LDCs that similarly do not utilize sophisticated systems to manage imbalance trades and yet they are still able to provide this option to NGSs. All that is necessary is that PGW allow marketers to shift volume between one another. The trading activity need not, and in fact should not, be done through PGW, but rather is handled between NGSs outside the PGW system. Once a trade has been agreed to by two NGSs, they both independently notify PGW of the volume to be traded, and PGW would simply change the imbalances associated with each NGS to reflect the traded volume. A simple Excel file could be used to track these imbalances, and in fact, PGW is already using Excel to send imbalance reports to NGSs. Mr. Muntzer further objects to imbalance trading on the premise that PGW should not be made "arbitrator for disputes between suppliers."

As I have explained, all trades are conducted between NGSs without PGW involvement so that any disputes would be resolved among the NGSs. But more importantly, Hess has rarely experienced a dispute during an imbalance trade, nor are we aware that this is a frequent occurrence for others. Trade prices are negotiated up front and all trades are recorded either via instant message, on a recorded phone line, or on email so that disputes, if they were to occur, could easily be resolved. In any event, this would not be the responsibility of PGW, nor would it interfere with any system integrity. If the NGSs do not mutually agree to a trade, then PGW would take no action with imbalances.

Finally, Mr. Muntzer contends that Hess has failed to demonstrate the benefits of imbalance trading for customers. As I explained in my direct testimony, (p. 6, lines 26-29), imbalance trading allows NGSs that are on opposite sides of a position to net out certain portions of their imbalances so that the LDC does not

penalize both for being out of balance when the netted amount means the system was in balance overall. If the system was in balance, no harm came to the LDC's customers, so that penalizing both NGSs, and indirectly penalizing transportation customers, is unnecessary. Imbalance trading therefore brings no harm to LDC sales customers, and reduces costs to marketers which reduces costs to transportation customers.

Q. PLEASE DISCUSS MR. MUNTZER'S TESTIMONY WITH REGARD TO SHARING OF CUSTOMER USAGE INFORMATION WITH NATURAL GAS SUPPLIERS.

A. Mr. Muntzer points out that PGW does not have an EDI system, but instead has implemented a hybrid system utilizing EDI standards with XML systems. He further explains that 12 months of customer usage data is available on a quarterly basis as long as the customer has authorized PGW to provide such data to NGSs. He states that Hess' proposal to provide this data in an automated fashion cannot be accommodated for privacy and technical reasons.

Q. DO YOU AGREE WITH MR. MUNTZER THAT THE REASONS PROVIDED DO IN FACT PREVENT PGW FROM PROVIDING MORE TIMELY DATA IN AN AUTOMATED FASHION?

A. No. Hess is in no way advocating that PGW should install new systems to be able to provide this data in an automated fashion. Further, Hess understands that the LDC cannot release customer data without permission from the customer. Instead, Hess is suggesting first, that for customers who have already provided permission for their usage history to be released to NGSs, PGW can provide data upon request, rather than quarterly or even monthly. When an NGS is constructing a bid for a customer, it is imperative that we have the most recent usage information in order to base our quote on the customer's likely future usage patterns. It is unrealistic to expect the customer to wait until a new quarter for that usage to be available in order to be able to switch to a new supplier. With regard to the means of transmitting this data to NGSs, no elaborate system is

required. Instead, Hess is suggesting that a simple Excel spreadsheet be sent via email or provided on the EBB with password protection to ensure privacy rights are maintained. Second, in the case of customers that have not authorized PGW to supply this data to NGSs, Hess would point out that some customers simply opt out of such programs in order to avoid mass mailings and other direct marketing campaigns. However, if a customer is working with an NGS to explore the possibility of switching to NGS provided commodity service, that customer should have the right and a mechanism by which to authorize PGW to provide usage history to the NGS. In such cases, most LDCs utilize a simple authorization form that can be faxed to the LDC, after which the LDC emails an Excel file, or posts the data on the NGSs EBB. Once again, this maintains privacy rights, while also providing current usage data by request of the customer. When Mr. Muntzer postulates that NGSs may be misusing the existing Marketing File, and that this is the reason that NGSs find the file to be inadequate, he is incorrect. The Marketing File is simply inadequate in its present form, and lacks current data.

Q. TURNING TO MR. LELASH'S REBUTTAL TESTIMONY, PLEASE COMMENT ON THE NOMINATION DEADLINE.

A. Mr. Lelash states that it is "understandable that NGSs want as much flexibility in their nomination as possible..." (see page 7) but that this is in opposition to PGW's need to enforce operational requirements. Mr. Lelash misinterprets the reason that Hess is requesting an extension of the nomination deadline. Hess does not desire additional flexibility for flexibility's sake. Rather, as I have pointed out earlier in this testimony, there are logistical reasons why a 12:00 p.m. or even a 12:30 p.m. deadline is unrealistic in the context of a 12:30 p.m. interstate pipeline deadline. Hess is not requesting this change for flexibility, but instead for feasibility.

Q. PLEASE DISCUSS MR. LELASH'S COMMENTS ON YOUR BALANCING AND CASHOUT PROPOSALS.

A. Mr. Lelash expresses concern that my proposal would limit PGW's ability to control its own system and would result in costs being imposed on incumbent ratepayers. As I described above in response to Mr. Muntzer's rebuttal testimony on tolerance bands and penalties, the changes I am proposing are not designed to allow NGSs "delivery latitude" as Mr. Lelash contends, but rather are designed to correct inappropriate and overly punitive rules that punish NGS for behavior they are incapable of improving. This inability to improve is not the result of incompetence or inexperience either, but is due to the nature of the industry. LDCs themselves experience significant swing in their own customer pools. After decades of experience serving natural gas to end users, if forecasting could be done more accurately to avoid daily swings, the LDCs certainly would have been doing it by now. Moreover, the greater tolerance band and reduced penalties that Hess seeks would not impose any additional costs on LDC sales customers. As I explained above in response to Mr. Muntzer's testimony, the volume of gas that is being shipped by NGSs is so minute compared to that being flowed by the LDC overall, that even a 5% change in tolerance band would only increase swings by hundreds of dekatherms compared with hundreds of thousands on the LDC system. In addition, the increase tolerance bands would not affect the quantity of gas delivered to the system but simply reduce the unreasonable penalties that are currently assessed. The increased tolerance band and reduction in daily penalties would result in a reduced cost to transportation customers, and this plan therefore should earn the support of this proposal from the OCA.

Q. ARE MR. LELASH'S CONCERNS ABOUT IMBALANCE TRADING WELL-FOUNDED?

A. No. Mr. Lelash is concerned that various mismatches between volumes from one NGS trading partner to another and NGS disputes will result in administrative issues for PGW. As I have explained, PGW's role is simply to accept the changes that are agreed to between two marketers and as long as both marketers give PGW

the same volume there can be no dispute that would involve PGW. If the numbers do not agree, then PGW would not make the change.

Q. MR. LELASH APPEARS TO BELIEVE THAT THE COMMISSION SHOULD NOT ADDRESS SUPPLIER ISSUES IN THIS PROCEEDING AND THAT THE SUPPLIER PROPOSALS ARE REQUESTS FOR SUBSIDIES. DO YOU AGREE WITH THAT VIEW?

A. No. The low level of success NGSs have in marketing on the PGW system implicates a major issue in this proceeding which is the cash flow needs of PGW given its responsibility to buy and resell large amounts of gas supply. To the extent NGS success allows PGW to exit that role, its gas supply expenses and its cash flow needs are reduced. This is a potentially enormous benefit to PGW that should not be deferred. It is extremely shortsighted to ignore the relationship between this Company's financial needs and its gas supply function, and backburner important NGS issues on the PGW system. I also take issue with Mr. LeLash's use of the term "subsidies" to describe the NGS proposals in this case. Pennsylvania has decided that natural gas distribution systems are to be opened to natural gas suppliers so that *all* customers have the opportunity to purchase supply services from the local distribution company or a competitive supplier. Without reasonable terms under which those suppliers can operate, the local distribution systems are not truly open, and the regulatory scheme is not really being implemented.

Q. MR. WHITE ADDRESSES PGW'S DUTIES UNDER THE GAS CHOICE ACT. DO YOU HAVE ANY RESPONSIVE COMMENTS?

A. Yes. To the extent Mr. White's testimony is intended to support the notion that PGW's work is completed with respect to making robust competition an irreversible reality on its system, I disagree. Mr. White states that under the Gas Choice Act, PGW "is only required to open its distribution system to those suppliers, which it plainly has." Even if the system is *available* for suppliers to utilize, that does not mean that operation on that system is operationally or

economically feasible. And even if these conditions do exist, even when competitive suppliers make initial inroads in attracting customers, if the competitive environment is not nurtured, markets that were once open can become closed to the detriment of customers and Pennsylvania's pro-competitive policies. PGW's supplier rules must continue to be adjusted and refined to ensure that competition on the PGW system is maintained and enhanced.

Q. WHAT ARE MR. LELASH'S CONCERNS REGARDING COMPETITION OVERALL AND HESS' EMPHASIS ON THE IMPORTANCE OF PROMOTING COMPETITIVE MARKETS?

A. Mr. Lelash states that NGSs are requesting both direct and indirect subsidies to support competitive markets and that it is "certain" that customers will realize negative impacts from the changes we have proposed on balancing rules. Mr. Lelash further argues that "... successful operation should be predicated on their operating efficiency and skill and not on artificial subsidies..." (see page 10). Mr. Lelash states that NGSs may be interested in serving PGW customers because the PGW rates are so high, but that this is not a rationale for adding costs to PGW's existing rates.

Q. PLEASE COMMENT ON MR. LELASH'S STATEMENTS ON COMPETITIVE MARKETS.

A. I do not agree that the programs and rule changes we are requesting will result in any additional costs to PGW ratepayers. On the contrary, as I have explained, these proposals will result in no impact to incumbent ratepayers but will reduce costs for transportation customers. I do agree with Mr. Lelash that subsidies should not be the means by which NGSs win a successful enterprise, and Hess is not seeking such subsidies. We are seeking greater operational efficiency which cannot be achieved under the current tariff rules. These efficiencies are being hampered by overly punitive rules that do not control behavior since they punish behavior that cannot be improved. That NGSs are entering the PGW territory as a result of PGW's high rates seems unlikely since NGSs are serving natural gas

customers in almost every LDC territory on the Eastern seaboard and certainly not all of these have rates as high as those in PGW's service territory. Nevertheless, even if that is the reason for entry, the OCA should applaud NGS interest in this territory as it can only assist in bringing lower cost natural gas service to the customers in PGW's footprint. Mr. LeLash's skepticism about Hess's proposals in this case does not take into account the benefits that will accrue to customers from lower gas costs if NGSs are encouraged to pursue sales on the PGW system due to reasonable rules being in place. Mr. LeLash is properly concerned about the lack of competitive supply alternatives for residential customers. However by opposing Hess's proposals for improvements in PGW's supplier rules, he is making progress on this issue more doubtful. I agree that additional costs should not be incurred due to NGS entry, and none of the changes I have proposed would add costs to ratepayers, whether incumbent or transportation.

Q. DOES THAT CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.

Hess Corporation Hearing Exhibit No. 1

5/21/07
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Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

Docket No. R-00061931

PGW Response to Hess Set I-3
Discovery Request

RESPONSE TO HESS CORPORATION DATA REQUEST
REGARDING PGW'S BASE RATE FILING
DOCKET NO. R-00061931

Question Hess-Set I-3: Please identify the number of licenses Natural Gas Suppliers actively serving customers on the PGW system, indicating which rate class (as) they are serving, for each year dating back to 2003.

Response Provided By: Nicholas LaPergola, Director, Gas Supply & Transportation

Response: For Firm Choice participation there were no suppliers from 2003 until 2006, as of 2006 through present, there are two licensed suppliers on the Philadelphia Gas Works system.

Hess Corporation Hearing Exhibit No. 2

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Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

Docket No. R-00061931

PGW Response to Hess Set I-5
Discovery Request

RESPONSE TO HESS CORPORATION DATA REQUEST
REGARDING PGW'S BASE RATE FILING
DOCKET NO. R-00061931

Question Hess-Set I-5:	Please indicate and identify any procedures or expenditures PGW plans to implement to upgrade the process or method by which PGW provides customer usage data, customer account numbers and service point IDs to Natural Gas Suppliers.
Response Provided By:	William C. Muntzer
Response:	PGW has no formal plans at the present to implement any process or incur additional expenditures to exceed the Commission's requirements regarding the dissemination of customer information to suppliers.

Hess Corporation Hearing Exhibit No. 3

5/21/07

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Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

Docket No. R-00061931

PGW Response to Hess Set II-I
Discovery Request

RESPONSE TO HESS CORPORATION DATA REQUEST
REGARDING PGW'S BASE RATE FILING
DOCKET NO. R-00061931

Question Hess-Set II-1: RE: PGW's Rebuttal Testimony of William C. Muntzer, (p. 9, lines 7-17). Mr. Muntzer states that "...PGW does not impose a cash-out for annual imbalance penalties for firm transportation customers...We only require that the loaned gas be returned to PGW, plus a carrying charge."

PGW's tariff states (p.118),

[a]ll volumes delivered to the Company that remain unaccepted by the Customer, in excess of the allowable monthly underrun may be offered for sale to the Company or stored at the Customer's option. Gas may be purchased by the Company at a rate not to exceed the Company's avoided cost of Gas for the month of delivery. In the event that the Company does not elect to purchase volumes in excess of the allowable underrun, a service charge for all such volumes carried forward by the Company will be made..... The unit rate for this service charge will be the volumetrically weighted average of the 100% load factor unit cost of the Company's pipeline storage contracts as utilized in the Company's annual operating budget authorized by the Commission.

The tariff language seems to address underruns only, while Mr. Muntzer's testimony only addresses over deliveries. Moreover, in responses to Hess, Set I-12, Mr. LaPergola states that PGW's "tariff does not specify a cash out rate,," indicating that a cashout provision does exist but that the rate is simply unspecified in the tariff.

a) Please explain how and when a Supplier is trued up. Are suppliers trued up monthly or annually?

b) Please explain how and when a Supplier is cashed out.

c) Please indicate the rate or index at which the Supplier is cashed out.

Response Provided By: William C. Muntzer

Response: PGW believes that that Hess may have a misunderstanding of PGW's tariff regarding this issue. Further, there appears

to be a misunderstanding of what services the Company offers coupled with a mixing of terms and concepts.

First, the Company offers *Interruptible Transportation* under its various IT rate schedules. Under the IT rates the supplier provides profiling and forecasting of customer usage and schedules nominations for that quantity of commodity. Failure to deliver the nominated quantity daily results in penalties as identified in PGW's Customer Tariff, Rate Schedule DB, Section 6(d). Treatment of gas quantities forecasted and delivered by the supplier that are over or under the amount used by the customer, and fall beyond the monthly threshold limits, are addressed in Section 6(f).

Second, the Company provides *Firm Transportation* under rates GS, MS and PHA. Under these services, the Company calculates the forecasted usage for the supplier's pool(s). The supplier is responsible for delivering the forecasted quantity. If the actual quantity used exceeds the forecasted quantity, the supplier is loaned the gas to be replenished at a future date, and must pay a carrying charge.

The third group of customers are the *Gas Transportation Service* (GTS) customers. This is a group of customers that were actively transporting gas on PGW's system prior to PGW's restructuring. This service is grandfathered for those customers who used the service on or before September 1, 2003.

The cited tariff language appears on pages 122 and 128 of the current tariff (not page 118). This language is only relevant for grandfathered *customers* receiving GTS Firm and GTS Interruptible services. It does *not* deal with supplier transactions as contemplated under Gas Choice. Essentially, from the Company's standpoint, under the existing GTS rates the supplier is irrelevant. While the customer may use a supplier, or act as its own supplier when procuring supply under the GTS rate schedules, all over/under deliveries are the responsibility of the *customer*, not the supplier. The language cited above simply identifies that the Company has the option of purchasing any excess gas from the GTS customer or storing the gas for that customer based upon existing storage contract costs.

With regard to Mr. LaPergola's interrogatory response, Hess infers that because the Company's tariff does not

specify a cash out rate, we are not calculating the cash out amount. In reality, it means that the cash out rate is not stated in the tariff because it does not apply. Gas for Firm Suppliers is loaned and replenished, not cashed out.

a) Under rates GTS-Firm and GTS-Interruptible, suppliers communicate with their customers regarding the required delivery quantity. A supplier delivers gas on the customer's behalf. Any imbalance between usage and delivered quantity is the responsibility of the customer. Therefore, no supplier true up is necessary.

b) Under Gas Choice for PGW's firm tariff rates (GS, MS and PHA), the Company generates customer load profiles and forecasts to provide the supplier with a monthly Daily Deliver Quantity (DDQ) for the month. The supplier is responsible for delivering the DDQ for its customers. There are three scenarios that could occur: a supplier over delivers, under delivers, or simply delivers the correct amount. In the event that the supplier over or under delivers gas quantities necessary to meet its DDQ, steps are identified in Section 9.10 of the PGW's Supplier Tariff. The Company is not obligated to accept nominations in excess of the DDQ. Penalties for over or under deliveries are set forth in Sections 9.10 and 9.11 of the Supplier Tariff.

   If the supplier correctly delivers its DDQ, the next step is to determine if the supplier's customers utilized the amount forecasted by the Company. If the customers utilized more than the forecasted DDQ, the excess amount was provided to the customers from PGW's contracted pipeline storage and on site LNG. Such quantities would then be required to be replenished during the non-peak period. Such payback is calculated into the DDQ for those periods. Because the supplier is only allocated firm transportation, it is unlikely that it would ever be in a position of not owing the Company gas. Any excess delivery between the Company forecasted level and the actual usage would be used to credit the amount owed. Therefore, there is no cash out required.

c) As indicated in the response above and my previously provided testimony, there is no cash out for firm transportation suppliers.

Hess Corporation Hearing Exhibit No. 4

5/21/07
PhlbPD
MS

Pennsylvania Public Utility Commission

v.

Philadelphia Gas Works

Docket No. R-00061931

Hess PGW

PGW Response to Hess Set II-4
Discovery Request

RESPONSE OF HESS CORPORATION TO SET II, INTERROGATORIES NOS. 1 THROUGH 5 OF PHILADELPHIA GAS WORKS, SUBMITTED APRIL 19, 2007 BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION.

REQUEST:

II-4: Re: Hess St. No. 1 (Magnani), p.5, lines 21-22, 28-29, p.6, lines 10-13. Please provide what Hess believes are reasonable, market-based cash out rates that should be adopted in this proceeding for:

(a) interruptible customers; and
(b) firm transportation customers.

ANSWERED BY: Randy Magnani
POSITION: Director, Natural Gas Operations

RESPSONE: (a) Cash out rates and multipliers should be fair in that they should not unduly penalize behavior that cannot be improved, even with the best intentions and the highest level of expertise. Currently, PGW penalizes NGSs for delivering outside a daily tolerance band of only 5%, and then cashes out all imbalances outside 2.5% at the end of the month. NGSs are often unable to avoid both the daily penalties and monthly cash outs, due to the tight tolerance bands at both levels.

The cash out rate therefore, should be set at a transparent market index such as the Gas Daily Average ("GDA") for the month for a pipeline or multiple pipelines blended based on the delivery requirements behind PGW's city gate. Currently, PGW charges NGSs the average of the highest daily prices for the month for Transco Z6 Non-NY and Tetco M3 and pays only the average of the lowest daily prices for the month for these same pipelines. There is no reason that these most extreme prices should be used for a month end cash out that is based on imbalances that occurred throughout the month. Instead, PGW should utilize a GDA for the month for these pipelines with some blend of the two.

In addition to an unfair cashout rate, there is also an unduly punitive set of multipliers factored onto the cash out rates. On over deliveries outside the 2.5% tolerance band, NGSs are only paid 75% of an already low cash out rate. On underdeliveries, NGSs must pay 150% of an already high cash out rate. Hess sees no reason that the NGSs should be penalized twice on the monthly cash outs, particularly when NGSs are already paying daily penalties.

It would be more equitable to set a wider monthly tolerance band, such as 10%, within which the GDA price would be paid without multipliers. Outside the tolerance band, more reasonable multipliers could be instituted, for example a 90% payout on GDA for long positions outside +10%, and a 110% charge on GDA for short positions outside -10%.

(b) Because PGW's tariff requires NGSs to deliver a volume each day that is dictated by PGW, it is unreasonable to cash out any imbalances that remain at the end of the month or season at any rate other than a fair market rate. The NGS is following the rules set by the LDC in delivering the LDC's forecasted volume and has no control over imbalances as a result.

Because this is Hess' first year serving firm transportation customers in the PGW territory, we have not yet experienced the true up of the imbalance between PGW's Daily Delivery Requirement (DDR), and the customers' actual burns. In addition, since the rate is also not defined in PGW's tariff, we cannot determine whether or not PGW would cash out the firm transportation imbalances at a fair market rate.

With that said, a fair market rate would be one that is based on the indexes tied to the pipelines utilized to serve the PGW territory. NGSs are required to bring gas to PGW's city gate primarily via Transco Z6 Non-NY, with some ability to serve via Tetco M3.

PHA STMT 1
5/21/07
Phila PA
MS

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

TESTIMONY OF CARL R. GREENE

ON BEHALF OF
THE PHILADELPHIA HOUSING AUTHORITY

Docket No. R-00061931
April 9, 2007

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

A. My name is Carl R. Greene. I am Executive Director of the Philadelphia Housing Authority, ("PHA"). Our business address is 12 S. 23rd St., Philadelphia, PA 19103.

Q. HOW LONG HAVE YOU BEEN EXECUTIVE DIRECTOR?

A. I was appointed Executive Director of PHA in March 1998.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.

A. Before joining PHA, I was Executive Director of the Detroit, Michigan Housing Commission. I also served in various management positions at the Washington, DC and Atlanta, Georgia housing authorities prior to serving in Detroit.

Q. PLEASE DESCRIBE PHA'S CURRENT OPERATIONS.

A. PHA was established in 1937 and is the nation's fourth largest housing authority. PHA is the largest landlord in Pennsylvania. We develop, acquire, lease and operate affordable housing for City residents with limited incomes. Some 88 percent of PHA's households are below 30% of the area median income. Rent for these residents is based on less than 30 percent of their income, thus rent revenue to PHA is very limited.

We house more than 83,000 people in the City of Philadelphia. We offer a variety of residences, including conventional apartment buildings and town home communities ("Conventional Sites"), and apartments and houses located throughout the City ("Scattered Sites"). We currently

employ approximately 1,225 people to deliver services to our clients. Our annual revenues total $313,000,000, with a public housing operating budget of approximately $155,750,000.

Q. WHAT ARE THE PRINCIPAL SOURCES OF PHA'S FUNDING?

A. We receive virtually all of our funding from the U.S. Department of Housing and Urban Development ("HUD").

Q. ARE PHA'S ALLOTMENTS ENOUGH TO COVER THE FULL AMOUNT OF ITS BUDGET?

A. No, they are not. HUD has cut the budgets of PHA and other cities' and counties' housing authorities by more than 20 percent in the past six years. For example, in 2006, HUD funded only 86 percent of our operating budget, which caused us to reduce costs by $15,325,215.00. In 2007, our funding decreased even further, to 82% of budget, which necessitated an additional reduction of $27,018,172.00 in expenditures. The Bush administration's proposed funding for 2008 is 80% of what is necessary, and would produce a shortfall of approximately $30 million.

Q. WHAT EFFECTS, IF ANY, HAVE THE ABOVE BUDGET CONSTRAINTS HAD UPON PHA' S OPERATIONS?

The cumulative effects have been devastating. In January of this year, we were forced to lay off approximately 350 employees, about 22 percent of our workforce.

Over a period of years we had systematically reduced our workforce as we converted ourselves into a lean, efficient organization.

However, this large and unplanned reduction has placed a tremendous strain on our staff. Consider that in February 2000, PHA employed 2,508 men and women. As of April 2007 we are down to less than half of that total, with about 1225 employees. During that same period, our tenant responsibilities have increased. Our February 2000 resident population was about 50,000. Today, it is more than 83,000, an increase of more than 60 percent.

PHA's staffing reductions had a particularly significant impact on our police force and maintenance staffing, two areas with real impact on our residents' physical comfort and security.

We were forced to cut about 20 officers from PHA'S police force. This leaves us with just 52 officers. In addition, we laid off 10 lobby monitors. These security personnel reductions make it far more difficult to keep our properties and our residents safe.

The layoffs also are affecting our maintenance operations, and are forcing tenants to wait longer for routine repairs. Moreover, as tens of thousands of people remain on our waiting list for housing, we have to defer or cancel repair of vacant units instead of making them ready for occupancy. Unfortunately, these layoffs were merely a highly visible symptom of a financial crisis that impacts the quality of life for all of PHA's residents.

We are making a concerted effort to improve the energy efficiency of our properties. We are proud of the fact that we are building our new homes to meet federal ENERGY STAR standards. In fact, we were recently honored by the U.S. Department of Energy for our efforts. We have undertaken energy audits to identify new energy conservation measures and to take the greatest advantage of existing energy conservation programs. We have replaced windows, doors, gas heaters and roofing materials in a substantial number of our Scattered Site properties to make them more airtight and more energy efficient.

Despite our zealous efforts on behalf of our residents, we are reaching the limits of our demonstrated ability to do more with less. The proposed PGW rate increase adds another unwarranted burden on both PHA and its residents.

Q. PLEASE DESCRIBE PHA'S CURRENT USE OF NATURAL GAS IN ITS PROPERTIES.

A. PHA purchases natural gas from PGW in two rate classes at issue in this matter: a dedicated PHA rate for our Conventional Sites, and a GS residential rate ("GS-R") for our Scattered Site properties. The specific amounts and composition of these rates are discussed in detail in the testimony of our expert witness, Judith L. Mondre, President of Mondre Energy, Inc.

Our residents use natural gas for heat, hot water and cooking in both Conventional and Scattered Site properties. We have approximately

7,000 occupied Conventional Site units, as well as approximately 4,100 occupied Scattered Site properties, that use gas for at least one of the above three purposes, and most use gas for all three. In addition, we pay tenants a utility allowance in the 17,000 Housing Choice Voucher Program units that we administer as well as about 2,500 alternatively managed property units.

Q. HOW DOES PHA PAY PGW FOR ITS TENANTS' NATURAL GAS USES?

A. PHA pays PGW for its tenants' usage in several different ways. Our Conventional Site properties are master-metered, and we pay PGW directly for gas charges in those properties. For certain Scattered Site properties classified by PHA as "LS Accounts," PHA makes payment directly to PGW. PHA indirectly pays PGW for the balance of scattered site tenants by sending these households utility allowances.

Q. WHAT IS PHA'S PAYMENT HISTORY WITH PGW?

A. Even with all the previously mentioned fiscal and operational challenges in recent years and at the present, we have a reliable history of payment in full of our bills to PGW.

Q. HOW WILL THE RATE INCREASES AFFECT THE SCATTERED SITES UTILITY ALLOWANCES?

A. As Ms. Mondre discusses in her testimony, PHA determined that it has been overpaying PGW by more than $2.8 million per year from March 2003 to the present when compared to the MS rate. PHA has paid a higher

rate than municipal offices and even rates of residences. In addition, PHA, by means of its utility allowance, has been paying PGW more than $4 million per year in excess of what it would pay if the CAP rates were applied.

As we struggle to overcome the effects of $64 million in reductions in funding for our vital operations, we simply cannot afford to overpay any longer.

Q. PLEASE DESCRIBE PHA'S RESIDENTS' FINANCIAL SITUATIONS.

A. Our residents are no less conscious than we are of the cost of necessities, and no less harmed than we are when those costs rise. PHA's residents are low-income families who meet stated financial criteria. The average annual income of PHA households is roughly $12,000, and approximately 75% of our residents live at or below the poverty level.

PHA residents pay a portion of their monthly incomes to PHA as a form of rent. PHA pays Conventional Site residents' utility costs directly to PGW. Scattered Sites residents receive monthly utility allowances from PHA, which effectively act to fully subsidize their gas payments to PGW. As funds are cut, PHA cannot provide more funds to pay for increased energy costs at any of its properties.

Q. PLEASE DESCRIBE THE PROJECTED EFFECTS OF THE PROPOSED PGW RATE INCREASE UPON PHA RESIDENTS.

A. The typical PHA resident already faces significant challenges in making ends meet. The situation becomes worse where, as here, they are faced with increases in an important element of their household budgets that are rising faster than their incomes.

The rate increase also harms our ability to make the kinds of repairs that help our residents reduce their energy usage. For example, PHA pays for energy efficiency upgrades such as new windows and doors, replacing stoves and heating systems, and replacing roofs.

Q. PLEASE DESCRIBE THE PROJECTED EFFECTS OF THE PROPOSED PGW RATE INCREASES UPON PHA'S OPERATIONS.

A. HUD's funding reductions already threaten PHA's ability to meet current demands for its housing stock, as well as the safety of our properties and our ability to provide services to our residents. Forcing PHA to allocate further funds to increased energy costs makes the situation even more dire.

Our experts estimate that under the proposed rate increases in its current classification, PHA's natural gas costs would rise by approximately $1.9 million in the first year after the increase is approved. That increase would equal approximately 15.14 percent of our current gas expenditures.

Neither PHA's current rate nor those in the proposed rate increases reflects the intended benefit to PHA and its residents of being able to

purchase gas at a reduced cost through a dedicated rate class. On the contrary, PHA is paying a premium for its gas, and this premium damages PHA's ability to provide essential services to the people we are committed to serve.

If the rate increases affecting PHA residents are granted, PGW offers PHA the unenviable and inequitable choice of having to cut costs in one area to pay for natural gas for its residents. These cuts would almost certainly have to come from equally vital programs and services such as the various educational, job training and social programs PHA offers to help its residents improve their situations, and the already depleted resources for maintenance and security, as well as the renovation of existing units to make them more energy-efficient.

DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

VERIFICATION

I, Philip L. Hinerman, being duly sworn according to law, deposes and says that I am attorney for Philadelphia Housing Authority and that Carl R. Greene is Executive Director of the Philadelphia Housing Authority; that as such he is authorized to offer this testimony on its behalf; and that the foregoing testimony is true and correct to the best of my knowledge, information and belief.

Philip L. Hinerman

Sworn to and subscribed before me

this 9 day of April, 2007

Notary Public

NOTARIAL SEAL
JAMI M BOZZUTO
Notary Public
CITY OF PHILADELPHIA CNTY OF PHILADELPHIA
My Commission Expires Feb 5, 2008

CERTIFICATE OF SERVICE

I hereby certify that I am serving a true and correct copy of the foregoing Direct Testimony of Carl R. Greene, Executive Director of the Philadelphia Housing Authority, in accordance with the requirements of 52 Pa. Code §1.54 upon the following person(s) via First Class Mail, postage prepaid:

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JULIA A. GULDIN

Dated: April 9, 2007

School District
STMT #1
5/21/07
Pub DD
MS

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

DIRECT TESTIMONY OF JAMES LEWIS

ON BEHALF OF
THE SCHOOL DISTRICT OF PHILADELPHIA
INTERVENOR

MAY 21, 2007

BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
v.	:	Docket No. R-0006193
PHILADELPHIA GAS WORKS	:	

DIRECT TESTIMONY OF JAMES LEWIS ON BEHALF OF THE SCHOOL DISTRICT OF PHILADELPHIA, INTERVENOR

The School District of Philadelphia, Intervenor (the "School District"), submits the following Direct Testimony of James Lewis, Director of General Services, pursuant to 52 Pa. Code §5.412:

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

A. My name is James Lewis. I am Director of General Services for the School District of Philadelphia with my office at 440 North Broad Street, Philadelphia.

Q. HOW LONG HAVE YOU BEEN EMPLOYED BY THE SCHOOL DISTRICT?

A. I have worked for the School District for 28 years, all of it in maintenance of facilities and operations.

Q. PLEASE DESCRIBE YOUR JOB RESPONSIBILITIES.

A. My current responsibilities include supervision of all maintenance and operations of School District facilities, managing the School District's energy consumption and costs, as well as the operation of the energy-consuming systems and equipment in the School District's buildings. My staff and I monitor energy usage and bills from natural gas, fuel oil and electricity suppliers, arrange for payment of bills, and work with the School District's financial staff and outside consultants on budgeting matters involving energy costs.

Q. AS DIRECTOR OF GENERAL SERVICES, ARE YOU FAMILIAR WITH THE SCHOOL DISTRICT'S USE OF NATURAL GAS?

A. Yes. My staff and I have reviewed our records and files to determine the School District's consumption levels for natural gas, the effects of the proposed rate increases requested by Philadelphia Gas Works ("PGW") on

the School District's costs and operations, and PGW's compliance with the terms of the current tariff.

Q. PLEASE DESCRIBE THE DISTRICT'S USE OF NATURAL GAS IN ITS FACILITIES.

A. The School District purchases natural gas from PGW in three rate classes: BPS-L, BPS-S, and MS. The amounts of gas the School District purchases in each rate class are in the cost/comparison chart attached hereto as Exhibit A. The School District uses natural gas purchased from PGW as fuel for heat, hot water and other appliances and operations in approximately 327 schools and other facilities. The School District consumed a total of approximately 10,345, 835 ccf of natural gas during Fiscal Year 2006 (July 1, 2005 – June 30, 2006) in MS and BPS rate classes at a total cost of approximately $13,977,859. We estimate the total cost of natural gas for the current Fiscal Year 2007 (July 1, 2006 – June 30, 2007) will be $15,384,236.

I understand that PGW is not requesting an increase in the base rate for interruptible service. I am therefore discussing interruptible rate service primarily as a component of the School District's overall costs. The School District's expenditures for heat, light and power, including natural gas constituted more than 25% of the overall budget allocations for facilities and school operations for Fiscal Years 2006 and 2007.

Q. WHAT WOULD BE THE ESTIMATED INCREASE IN COST TO THE SCHOOL DISTRICT IF PGW RECEIVED AUTHORIZATION TO INCREASE THE MS SERVICE RATE?

A. The proposed rate increase would raise the MS rate from the current level paid by the School District of $1.63263 per ccf to $1.84584. When applied to the School District's 2006 MS consumption levels, the increase would generate an additional expense to the School District of approximately $1,206,127, an increase of 10.7 percent.

Q. DOES YOUR DEPARTMENT'S CURRENT BUDGET CONTAIN SUFFICIENT ALLOCATIONS TO ABSORB THE PROPOSED RATE INCREASE?

A. No, it does not. Because of the School District's financial difficulties and the current deficit, we cannot divert funds from other operations to fund the increase without causing significant damage to other equally vital programs and services.

The Facilities and Operations Department, as part of a School District-wide effort to reduce the budget deficit, laid off 24 employees as part of a central office reduction in force in December 2006, deferred or eliminated altogether planned maintenance and renovation programs to improve the energy efficiency of our facilities, and have had to defer or eliminate current maintenance programs as well.

Despite our current financial challenges, we are managing to meet our responsibility to our students, faculty and staff, and those visiting our

facilities, to keep the temperature in our buildings at safe and healthy levels.

Q. IS THE SCHOOL DISTRICT CURRENTLY MAKING EFFORTS TO CONTROL ITS NATURAL GAS COSTS?

A. Yes. The School District is working as aggressively as its financial means permit to reduce both its supply-side and demand-side costs. We have negotiated supply contracts with third-party gas vendors for both firm and interruptible service. The projected base rate savings over the two and a half year term of the firm service contract are approximately $700,000.

On the demand side, we are working to increase the number of boilers that can run either on gas or fuel oil, to allow us to purchase fuel at the most advantageous rates possible at a given time. We are finalizing a request for proposals for energy conservation measures ("ECMs"), and will engage Energy Service Contractors ("ESCOs") to perform energy audits and implement selected ECMs. We emphasize the need for energy conservation in our buildings through communications with students, faculty and staff.

Q. IN ADDITION TO COMMODITY COSTS, DOES THE SCHOOL DISTRICT MAKE OTHER PAYMENTS TO PGW IN CONNECTION WITH SERVICE TO SCHOOL DISTRICT BUILDINGS AND FACILITIES?

A. The School District pays PGW 100% of the gas main and service costs to its new facilities (those requiring a new gas load). Under the current and

proposed tariffs, the School District is entitled to receive credit for additional revenue to PGW as a result of the expansion of capacity, to be returned to the School District at the end of the initial term of the PGW service agreement. Our records do not indicate that we have ever received any such credits. The tariff is silent as to whether PGW imposes the same 100% payment requirement upon expansions to properties with existing PGW service, and as to whether the same costs and credits are applied to private entities, but the requirements and the lack of credits affect both sides of our balance sheet.

Q. WHAT ARE THE SCHOOL DISTRICT'S PAYMENT REQUIREMENTS WITH PGW

A. PGW's payment requirements also impose an unjustifiable burden upon the School District. PGW requires us to pay at least a portion of our gas service costs "up front" before commencing delivery to new facilities. It also requires the School District to pay "up front" for meter costs. We also believe we are improperly being assessed with meter charges associated with single locations for our properties, even though the District pays one monthly bill to PGW. The School District consistently pays its PGW bills in full. We have improved our accounts payable procedure to reduce the time of payment. Additionally, our existing agreements with PGW provide it with ample recourse in the event of an uncured delinquency. We believe this is inconsistent with PGW's

practices with its other customers, and causes an additional drain on our current resources.

Q. WOULD THE PGW RATE INCREASE, IF APPROVED IN FULL, CAUSE ANY OTHER DAMAGES AND BURDENS TO THE SCHOOL DISTRICT?

A. The School District is making zealous efforts to reduce its existing costs, manage future costs and make responsible use of the public trust and public funds. It is completely unfair to impose certain elements of the requested cost increase upon the School District.

For example, the vast majority of PGW's requested deficit is Attributable to residential customers, which the School District most certainly is not. If effect, PGW is asking the School District, as well as other institutional customers, to help it pay for its residential service burdens.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

Respectfully Submitted,

Miles H. Shore

Miles H. Shore
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Attorney for
The School District of Philadelphia

VERIFICATION

I, James Lewis, Director of General Services of The School District of Philadelphia, Intervenor, verify that the facts set forth in my Direct Testimony are true and correct to the best of my knowledge, information and belief, and that this verification is made subject to the penalties of 18 Pa. C.S.A., §4904 relating to unsworn falsification to authorities.

James Lewis

Dated: April 5, 2007

School District
STMT #2
5/21/07
Phila DR
MS

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

DIRECT TESTIMONY OF
PAUL G. VALLAS

ON BEHALF OF
THE SCHOOL DISTRICT OF PHILADELPHIA
INTERVENOR

MAY 21, 2007

BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
v.	:	Docket No. R-0006193
PHILADELPHIA GAS WORKS	:	

DIRECT TESTIMONY OF PAUL G. VALLAS ON BEHALF OF THE SCHOOL DISTRICT OF PHILADELPHIA, INTERVENOR

The School District of Philadelphia, Intervenor ("the School District") submits the following Direct Testimony of Paul G. Vallas, Chief Executive Officer, pursuant to 52 Pa. Code §5.412 and the Order Regarding Motion for a Continuance by The School District of Philadelphia dated April 5, 2007:

Q. PLEASE STATE YOUR NAME, YOUR OCCUPATION AND YOUR OFFICE ADDRESS.

A. My name is Paul G. Vallas. I am the Chief Executive Officer ("CEO") of the School District of Philadelphia (the "School District") with my office at 440 North Broad St., Philadelphia, PA 19130.

A. HOW LONG HAVE YOU SERVED IN THAT OFFICE?

I was appointed CEO of the School District by the School Reform Commission in July of 2002.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. I began my career as a policy advisor to the Illinois State Senate's Elementary and Secondary Education and Appropriations Committees. I was Executive Director of the Illinois Economic and Fiscal Commission. I was appointed revenue director for the City of Chicago, Illinois, in 1990, before serving as Chicago's budget director from 1993-95.

I served as the Chief Executive Officer of Chicago Public Schools from 1995-2001. During my tenure in Chicago, my staff and I restored financial stability to Chicago's schools, which, like Philadelphia's before my arrival, had been suffering from many years of deficits, declining educational outcomes, and deteriorating facilities.

Q. WHAT IS THE GOVERNING BODY OF THE SCHOOL DISTRICT?

A. The School District is now governed by a 5-member School Reform Commission,

pursuant to the distressed first class school district legislation. Three members of the Commission are appointed by the Governor and two members are appointed by the Mayor.

Q. HOW AND WHEN DID THE SCHOOL DISTRICT COME TO BE GOVERNED BY THE SCHOOL REFORM COMMISSION?

A. In December 2001, the State Secretary of Education declared the School District to be in financial and educational distress. Pursuant to state law, the School Reform Commission was appointed and replaced the former Board of Education.

Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS CHIEF EXECUTIVE OFFICER.

A. As the CEO, I oversee the management and operations of the entire School District and I directly supervise the work of the Chief Academic Officer, Chief Financial Officer and the Chief Operating Officer. My duties include supervising the learning process and educational outcomes for the City's elementary, middle, secondary and specialized schools; the safe, financially sound operation of School District-operated and charter schools; and leading a work force of more than 24,000 teachers, administrators, support and operational staff.

Q. PLEASE DESCRIBE THE SCHOOL DISTRICT'S ACTIVITIES AND FACILITIES.

A. The School District is the largest school district in the Commonwealth of Pennsylvania and the eighth largest in the United States. We serve the City of Philadelphia, the fifth-largest city in the United States, whose population is close

to 1.5 million. We have more than 207,000 students enrolled in 281 District-operated schools, as well as 55 charter schools.

The School District provides a comprehensive range of educational services, including general, special and vocational education at the elementary and secondary levels. We offer summer programs, and pre-and after-school programs. In order to support these services, we have a centralized administrative office, where the staff manages the School District's financial, legal and operational affairs. The Facilities Department oversees the operation and maintenance of more than 327 school buildings and support facilities, including, by way of example, field houses, warehouses, garages, administration buildings and a working farm.

Q. WHAT ARE THE PRINCIPAL SOURCES OF FUNDING FOR THE OPERATING BUDGET OF THE SCHOOL DISTRICT?

A. The majority of the School District's $2.04 billion operating budget funding comes from allocations from the Commonwealth of Pennsylvania. In Fiscal Year 2006, we received more than $1.4 billion in state revenue in the form of basic educational funding and allocations for specific services such as special education, vocational education, transportation and school health services. The School District receives most of its local funding from dedicated real estate taxes, non-business income taxes, liquor-by-the-drink tax, business use and occupancy and public utility real estate taxes from the City of more than $702 million in FY 2006, along with more than $80 million in local non-tax revenue from the City of Philadelphia in the form of interest on investments, stadium agreement and other

grants from the City. The School District also received approximately $188,000 in federal Impacted Area Aid in FY 2006. In short, virtually all the School District's operating revenues come from the public treasury or the people who live and work in the City.

Q. IS THE SCHOOL DISTRICT EXPERIENCING FINANCIAL DIFFICULTIES?

A. Yes, it is.

Q. WHAT EFFECTS, IF ANY, HAVE THE FINANCIAL DIFFICULTIES HAD UPON THE SCHOOL DISTRICT'S OPERATIONS?

A. Since last fall, we have been working to close more than $73 million in shortfalls in our current funding. As a result, we reduced the amounts of certain our existing contracts and renegotiated others. We eliminated 175 positions, refinanced portions of our debt, and eliminated pay raises for non-union employees. No operating or administrative department has been spared. We anticipate making significant additional reductions in spending for our FY 2008 budget as well. At the same time, we are making every possible effort to preserve our core educational programs and services to our students.

Q. WHAT CHALLENGES DOES THE SCHOOL DISTRICT FACE WITH REGARD TO ENERGY COSTS?

A. We face particular challenges in our facilities because 47 percent of our school buildings are between 41 and 80 years old, and 26 percent are between 81 and 120 years old. Although we are working diligently to improve the energy efficiency of our existing buildings and to reduce our costs through strategic

procurement initiatives, and through such energy conservation measures as improving lighting fixtures and converting boilers to dual fuel use, and emphasizing the need for energy conservation throughout our schools, our current expenditures of more than $18 million on natural gas already extend us to the limit of our financial capabilities. In Fiscal Year 2006, the School District's energy costs were approximately $274.80 per student, an increase of nearly 3% from the previous year. The School District also has increased and will continue to increase as it opens new schools. We have opened two new schools, including the High School of the Future, in the past three years. We are well into planning and design for three new high schools, two elementary schools and three primary education centers in the next few years. Whether or not we ultimately elect to use natural gas in the new buildings depends on whether we are able to purchase it at a price that does not cause a further escalation in our cost per student.

Q. WHAT DIFFICULTIES WOULD THE GAS RATE INCREASES PRESENT TO THE SCHOOL DISTRICT?

A. On a universal basis the rate increases present us with a number of issues having a substantial impact on our operation of our facilities, and therefore on the quality of our students' lives. The increases add significantly to the cost of a major component of our operating expenses. Simply stated, the extra costs to the School District generated by the proposed rate increases would provide the School District with the highly undesirable choice of reducing consumption, to the detriment of the health, safety and comfort of our students and staff, or diverting funds from other sources. We have done all we can to decrease our current

energy-related program and operating costs, and the proposed rate increases would force us to mortgage our future to pay for our present. One of our objectives in building new schools and upgrading existing ones is to permit us to control and reduce class sizes. Every dollar spent on natural gas is a dollar not being spent on security for our students and faculty, or a dollar not being spent on instructional costs to improve our students' test scores and opportunities, or on extracurricular activities and non-academic services to our students.

It is also important to remember that because our funding comes from public sources, we are answerable to the public for unwarranted increases in costs. There are no meaningful justifications presented in the proposed tariff for making the public, through the School District, pay for PGW's inefficiencies and collection problems.

Q. PLEASE DESCRIBE THE BUDGET PROCESS FOR THE FISCAL YEAR 2008.

A. The School District's proposed operating budget for Fiscal Year 2007-2008 was published on the School District's website on April 5, 2007. The School Reform Commission held a hearing for public input regarding the proposed budget on April 11, 2007, which will resume on April 25, 2007. City Council will hold hearings on the proposed budget on April 30 and May 1, 2007. The School Reform Commission expects to adopt the budget for Fiscal Year 2007-2008 on May 29, 2007.

Q. IS THE DRAFT BUDGET PRELIMINARY?

A. Yes, the draft budget detail and summary posted on the webpage are preliminary

and subject to change. No assurance can be made regarding final budget decisions by the School Reform Commission. Public hearings will take place before the final adoption of the Fiscal Year 2008 Budget. The School Reform Commission may modify or supplement any of the estimates and assumptions included in the Draft Budget Detail posted before it adopts the final School District Budget for Fiscal Year 2008.

Q. HAS THE SCHOOL DISTRICT BUDGETED FOR AN INCREASE IN THE COST OF NATURAL GAS?

A. No, the proposed Fiscal Year 2008 Budget for heat, power and light for all School District facilities does not account for an increase in the cost of natural gas.

Q. PLEASE DESCRIBE THE PROJECTED EFFECTS OF THE PROPOSED PGW RATE INCREASE, IF APPROVED, UPON THE SCHOOL DISTRICT'S OPERATIONS.

A. If the rate increase is approved as requested, the School District will have to cut costs in other areas to pay for natural gas for its school and facilities operations. These cuts would have to come from educational programs and services, which we have tried to spare in making the other cuts necessary to produce a balanced budget.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

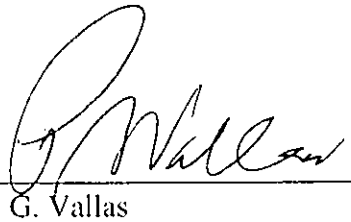
Respectfully Submitted,

Miles H. Shore
Attorney I.D. No. 03274
Assistant General Counsel
The School District of Philadelphia
440 N. Broad Street, Suite 313
Philadelphia, PA 19130
(215)400-5162
(215)400-4121 fax
mhshore@phila.k12.pa.us
Attorney for Intervenor
The School District of Philadelphia

Dated: April 12, 2007

VERIFICATION

I, Paul G. Vallas, Chief Executive Officer of The School District of Philadelphia, verify that the facts and opinions set forth in the attached Direct Testimony are true and correct to the best of my knowledge, information and belief, and that this verification is made subject to the penalties of 18 Pa. C.S.A., §4904 relating to unsworn falsification to authorities.



Paul G. Vallas

PICGUG STATEMENT NO. 1

5/21/07
Phila. PA
P/S

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	
v.	:	**DOCKET NO. R-00061931**
	:	
PHILADELPHIA GAS WORKS	:	

DIRECT TESTIMONY

AND EXHIBIT

OF

LEWIS C. COHEN

DIRECT TESTIMONY OF LEWIS C. COHEN

OF THOMAS JEFFERSON UNIVERSITY/
THOMAS JEFFERSON UNIVERSITY HOSPITAL/
ALBERT EINSTEIN HEALTHCARE NETWORK/
FRANKFORD HOSPITALS/MAGEE REHABILITATION HOSPITAL
(together, JEFFERSON HEALTH SYSTEM)/
AND
PHILADELPHIA COLLEGE OF OSTEOPATHIC MEDICINE

AS MEMBERS OF THE PHILADELPHIA INDUSTRIAL AND COMMERCIAL GAS USERS GROUP

APRIL 6, 2007

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	
v.	:	**DOCKET NO. R-00061931**
	:	
PHILADELPHIA GAS WORKS	:	

DIRECT TESTIMONY OF LEWIS C. COHEN

OF THOMAS JEFFERSON UNIVERSITY/ THOMAS JEFFERSON UNIVERSITY HOSPITAL/ ALBERT EINSTEIN HEALTHCARE NETWORK/ FRANKFORD HOSPITALS/MAGEE REHABILITATION HOSPITAL (together, JEFFERSON HEALTH SYSTEM)/ AND PHILADELPHIA COLLEGE OF OSTEOPATHIC MEDICINE

AS MEMBERS OF THE PHILADELPHIA INDUSTRIAL AND COMMERCIAL GAS USERS GROUP

Q. Please state your full name and business address.

A. My name is Lewis C. Cohen. My business address is 104 Woodside Road, Unit B104; Haverford, PA 19041.

Q. By whom are you employed?

A. I am an independent energy management and procurement consultant. I provide consulting services to a broad range of municipal, institutional, and industrial clients. In addition to Jefferson Health System ("JHS") and Philadelphia College of Osteopathic Medicine ("PCOM"), in Pennsylvania, I have provided diversified energy consulting and procurement services to the City of Philadelphia, Christiana

Care Health System, Association of Independent Colleges and Universities of Pennsylvania ("AICUP"), Pennsylvania Foundry Association, Pennsylvania League of Cities and Municipalities, Eastern Montgomery County Solid Waste Authority, Newman Paperboard Company, and the York County Solid Waste Authority.

Q. What is your educational and employment background?

A. I have a PhD from Rensselaer Polytechnic Institute, an MS from George Washington University, and a BS from the State University of New York at Albany. I have been in the energy field for over 30 years in both the governmental and private sector. A summary of my work experience is attached as Exhibit ___(LCC-1).

Q. Please describe the consulting services you provide to JHS.

A. For over 15 years, I have advised Thomas Jefferson University ("TJU") and then JHS in all areas of energy procurement and management, including negotiations related to, and the procurement of, electricity, natural gas, oil, chilled water, and steam. In addition, I have advised JHS in the selection of an Energy Services Provider who audited all 10 million square feet of JHS facilities and to date has implemented over $15 million of energy efficiency and conservation measures.

For the last 15 years, JHS has been at been at the forefront of pro-active energy management and has participated in many end-user groups such as the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG"), the Philadelphia Area Industrial Energy Users Group ("PAIEUG") and the PJM Industrial Customer Coalition ("PJMICC"). This forward-looking posture has allowed JHS to play an

important role in energy policy issues in Pennsylvania. I am proud to have assisted JHS in these regards.

Q. Please describe the consulting services you provide to PCOM.

A. I originally worked with PCOM through an electric aggregation program sponsored by AICUP in the late 1990s. Since that time, I have assisted PCOM in a number of areas, including permitting its distributed generation, selection of Curtailment Service Providers and participation in PJM Interconnection, LLC's ("PJM") demand side reduction programs, evaluation of installation of back-up propane injection system, and Philadelphia Gas Works ("PGW")-related activities, including negotiation of an Interruptible Transportation ("IT") agreement.

Q. *Dr. Cohen, are you familiar with the background of PGW's IT rates?*

A. Yes. JHS has institutions located in both the PGW and PECO Energy Company ("PECO") service territories. JHS institutions in the PECO service territory mainly utilize PECO for transportation service. Prior to PGW's Restructuring Proceeding in 2002-2003, however, PGW's transportation rates and regulations had been extremely prohibitive for JHS facilities seeking to transport. At that time, JHS's interruptible accounts were receiving service under PGW's Interruptible Sales rate schedules. As part of PGW's Restructuring Proceeding, PICGUG advanced the position that PGW should be required to implement cost-based transportation rates. I also submitted customer impact testimony supporting this argument. Specifically, I noted that PGW's pre-Restructuring transportation rates were extremely high, were not

cost-based, and were often over 350% of those paid by JHS facilities in PECO's service territory.

Per my understanding, the Pennsylvania Public Utility Commission ("PUC" or "Commission"), as part of PGW's Restructuring Proceeding, did not require PGW to implement cost-based transportation rates, but rather, allowed PGW to implement margin-based transportation rates. The maximum prices for these transportation rates are based on the average bundled interruptible service margins for the five years prior to PGW's Restructuring Proceeding. I believe, however, that PGW was required, as part of the Company's current base rate proceeding, to offer a Cost of Service Study ("COSS") analyzing these transportation rates. See Pa. PUC v. PGW; Docket No. M-00021612, Opinion and Order (Mar. 21, 2003).

Q. Dr. Cohen, has JHS been able to transport natural gas on PGW's system after the Company's Restructuring Proceeding occurred?

A. Yes, JHS and PGW negotiated multi-year IT agreements for JHS's facilities, which have allowed JHS to successfully implement an economic transport program. JHS is in the middle of these multi-year agreements. JHS is concerned that, if the Commission does not endorse a cost-based transportation rate, there will be little incentive for PGW to allow JHS to continue to transport natural gas at a reasonable rate.

Q. Has PCOM been able to transport natural gas on PGW's system during this time?

A. PCOM utilizes natural gas for both heating and air conditioning, thereby providing year-round revenues to PGW. PCOM is currently receiving firm sales service from PGW. As a result, PCOM has been faced with high gas costs, volatile natural gas pricing, and an inability to reasonably control its budget through the locking-in of more competitive natural gas costs.

In order to better control its costs, PCOM has evaluated installation of various alternative fuels, including propane injection. This would allow PCOM to become an interruptible transportation customer, comparable with other institutions of PCOM's size. Because installation of the propane injection system is expensive, PCOM is desirous of obtaining a reasonable IT rate from PGW.

If PGW's IT rates are cost-based, PCOM believes that it will be able to obtain a reasonable transportation rate; however, if the IT rate is margin-based, then PCOM will most likely **not** be offered a reasonable rate that would enable it to transport natural gas.

Ironically, PCOM is located on City Avenue with PECO natural gas service across the street. PECO's IT rates are very reasonable; however, they are unavailable to PCOM. PCOM believes that a strong endorsement by the Commission of cost-based transportation rates for PGW would lead to a reasonable IT rate for PCOM.

Q. Would PCOM consider being an interruptible sales customer?

A. If PGW fails to offer a reasonable IT rate, and PCOM nonetheless decides to invest in an alternative fuel system, PCOM would consider becoming an interruptible sales customer; however, this is not a desirable outcome for PCOM nor ironically PGW.

PGW changes the interruptible sales rates monthly. During some periods, the rates

have been both reasonable and stable. During other periods, the rates have been volatile and bear no relationship to current market conditions or, in my opinion, to the intent of PGW's own tariff. This volatility leads to large pricing uncertainty. In addition, PCOM's lack of choice with respect to obtaining natural gas service does not allow PCOM to adequately mitigate against the occurrence of natural gas price increases. PGW has indicated that it is currently subsidizing interruptible sales, and, even if PGW's proposed rates are put in place, interruptible sales provide little margin to PGW.

Q. Does this pricing uncertainty create problems for PCOM?

A. Yes. Healthcare facilities, by their nature, are conservative and do not want any budgetary surprises. If PCOM were able to transport natural gas on PGW's system, PCOM's primary advantage would be the ability to have a known price, meet budgets, and stabilize energy costs by locking-in long term prices when market conditions allow. Hospitals that I have represented have signed long-term supply agreements in order to lock-in natural gas pricing when market conditions are favorable.

Moreover, the purpose of the Natural Gas Choice and Competition Act ("Competition Act") was to provide customers, especially those on PGW's system, the opportunity for realistic choices with respect to natural gas service. As I mentioned previously, JHS's facilities on PECO's system have been transporting for a number years because PECO has a number of suppliers on its system and offers cost-based transportation rates. While the number of suppliers on PGW's system has slightly increased since the Company's Restructuring Proceeding in 2002-2003,

without competitive transportation rates, these suppliers are meaningless for many customers. For some customers, such as PCOM, who is unable to obtain a cost-based and competitive transportation rate, the options are limited to interruptible sales service and firm sales service. I do not think this was the intent of the Legislature when the Competition Act was passed.

Q. What other alternatives do JHS or PCOM have for meeting their natural gas requirements in PGW's service territory?

A. The only practical alternative to natural gas is propane or No. 2 oil. Neither of these are currently usable by PCOM absent a significant investment to upgrade its facilities for dual fuels.

Q. Does having numerous choices provide a facility with an advantage?

A. Very much so. For example, and as I mentioned previously, JHS institutions outside of PGW's service territory are mainly located in PECO's service territory. Because PECO offers cost-based transportation rates and has a multitude of suppliers on its system, these JHS facilities have had panoply of choices with respect to determining which type of fuel will provide the most cost-efficient service. In many instances, these JHS facilities have been able to almost exclusively burn natural gas at extremely competitive rates, as they have had the choice of acquiring their own supply and transporting this supply at reasonable prices. As a result, these facilities are able to meet their budgetary expectations.

Q. What is the impact on facilities that do not have such options?

A. For those facilities that have not been offered a reasonable, cost-based transportation rate on PGW's system, such as PCOM, these customers must continue to utilize non-interruptible tariff rates, or if they do have duel fuel capability, interruptible sales service, which as I mentioned previously, results in price volatility. Because of the budgetary issues facing hospitals, price volatility can result in costs exceeding budgets, resulting in significant problems.

Moreover, the level of natural gas prices can also be problematic for customers, and health care facilities must have the ability to try to mitigate these pricing levels. For example, for those JHS facilities that are able to transport, JHS is able to combine cost-based transportation rates with competitively procured natural gas supply, which offers a more competitive option. If a facility cannot mitigate these prices through such choices, it will be unable to maintain costs within the necessary budgetary parameters.

Q. Dr. Cohen, are you aware that, according to PGW's COSS provided in this proceeding, the margins for PGW's Interruptible Transportation Rates exceed costs by over $2 million?

A. Yes. PGW has indicated in this proceeding that "most" customers are charged less than maximum rates. Notwithstanding that fact, PGW's "negotiated" rates must be significantly above cost.

Q. Are you also aware that PGW's COSS indicates that the costs for PGW's Interruptible Sales rates exceed margins by $2.7 million?

A. Yes. If this is the case, then PGW should encourage Interruptible Sales customers to move to IT rates, and the most effective means to do so would be to offer a cost-based IT rate. Ironically, JHS moved all of its facilities to the IT rate (and off of Interruptible Sales rates) three years ago. Thus, instead of taking service at the Interruptible Sales rate, at a loss to PGW, JHS is able to transport natural gas via the IT rate at a gain to PGW.

Q. Without a cost-based IT rate, is it possible that customers may select options less desirable from PGW's perspective?

A. Yes, customers may elect to utilize the Interruptible Sales alternative, which PGW indicates has higher costs than revenues, or customers may choose to burn oil on a full-time basis because it is the economically efficient thing to do. In turn, however, this negates any possibility for PGW to earn any margin on these customers and increases the likelihood that the customers will stay off of natural gas for an even longer period of time. Conversely, if PGW were to focus on establishing more reasonable, cost-based transportation rates, these customers may be more likely to make investment decisions that would ensure the continued use of natural gas, thereby ensuring continued and consistent revenues for PGW. Instead, PGW is refusing to recognize this possibility by refusing to lower IT rates below the current margin. This position seems to be a lose-lose option for everyone involved.

Q. PGW suggests that if the maximum transportation rates were lowered, the burden would fall on firm customers to replace these revenues. Do you have any comment?

A. Yes, according to PGW's COSS, the firm sales rates paid by many large commercial and industrial customers are already significantly above the Company's cost to serve these customers. I certainly understand that the burden of PGW's rate increase falls on many shoulders, although I think that providing more cost-based transportation rates would provide greater opportunities for all large commercial and industrial customers on PGW's system. Regardless, I think that PGW customers have felt the crush of PGW's continual rate increases for many years, and I think these less than reasonable rates are further highlighted for those customers with facilities both inside and outside PGW's service territory. Based upon these problems, the Commission may need to examine more far reaching solutions that would ensure just and reasonable rates for all customers.

Q. Does this include your testimony?

A. Yes.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
v.	:	DOCKET NO. R-00061931
PHILADELHIA GAS WORKS	:	

EXHIBIT

OF

LEWIS C. COHEN

DIRECT TESTIMONY OF LEWIS C. COHEN

OF THOMAS JEFFERSON UNIVERSITY/
THOMAS JEFFERSON UNIVERSITY HOSPITAL/
ALBERT EINSTEIN HEALTHCARE NETWORK/
FRANKFORD HOSPITALS/MAGEE REHABILITATION HOSPITAL
(together, JEFFERSON HEALTH SYSTEM)/
AND
PHILADELPHIA COLLEGE OF OSTEOPATHIC MEDICINE

AS MEMBERS OF THE PHILADELPHIA INDUSTRIAL
AND COMMERCIAL GAS USERS GROUP

APRIL 6, 2007

LEWIS C. COHEN - EXPERIENCE SUMMARY

EMPLOYMENT HISTORY

4/91 to Present	INDEPENDENT CONSULTANT – Recent focus on municipal, institutional and industrial procurement of energy commodities and implementation of conservation/efficiency opportunities – See attached discussion.
3/90 to 3/91	O'BRIEN ENERGY SYSTEMS INCORPORATED Philadelphia, PA Vice President
5/89 to 3/90	CATALYST THERMAL ENERGY CORPORATION New York, NY Vice President
1/87 to 5/89	PHILADELPHIA THERMAL ENERGY CORPORATION Philadelphia, PA Vice President
12/85 to 12/86	MALCOLM PIRNIE, INCORPORATED White Plains, NY Project Manager
10/81 to 10/85	CSI RESOURCE SYSTEMS Boston, MA Senior Associate
9/80 to 10/81	MITRE CORPORATION Bedford, MA Energy Systems Engineer
9/79 to 9/80	NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY Albany, NY Senior Associate
1/78 to 9/79	NEW YORK STATE ENERGY OFFICE Albany, NY Energy Analyst
12/75 to 7/77	UNITED STATES ENVIRONMENTAL PROTECTION AGENCY Washington, DC Environmental Engineer

EDUCATION

5/79 Ph.D. Rensselaer Polytechnic Institute
5/76 M.S. George Washington University School of Engineering and Applied Science
6/74 B. S. State University of New York at Albany

ATTACHMENT TO L. COHEN EXPERIENCE PROFILE

For the last 15 years, Dr Cohen has focused on assisting a diverse group of end-users in coping with and taking advantage of the changes resulting from the deregulation of energy. Dr Cohen has procured electricity, natural gas, oil, energy services (i.e. conservation and energy efficiency improvements) and alternative energy sources such as wind power. Dr Cohen has extensive experience in the Mid-Atlantic and northeast regions.

Dr Cohen's clients include the Jefferson Health System, the largest health care network in the Delaware Valley, the Christiana Care Healthcare System in Delaware, and Connemaugh Health System. Furthermore, Dr Cohen represents Utility Solutions, Inc ("USI"). In Pennsylvania, USI assists a number of groups in aggregating the purchasing power of their members. These groups include over 100 municipal members of the Municipal Utility Alliance (MUA) (established by the Pennsylvania League of Cities), approximately 40 industrial members of the Pennsylvania Foundrymen's Association (PFA) and fifty colleges and university members of the Association of Independent Colleges and Universities of Pennsylvania (AICUP).

In New York, Dr Cohen and his associates, in conjunction with Tompkins and Tioga Counties, have structured an upstate energy alliance representing over five counties as well as private entities. The New York Public Service has held out this program as among the finest in New York State. Other clients in New York include over one-dozen chambers of commerce, numerous industrial customers, and non-profit nursing and elder care institutions, representing 300 facilities in every utility territory in the state.

PICGUG STATEMENT NO. 1-S

5/21/07
Phila PA
MS

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
v.	:	**DOCKET NO. R-00061931**
PHILADELPHIA GAS WORKS	:	

SURREBUTTAL TESTIMONY

OF

LEWIS C. COHEN

SURREBUTTAL TESTIMONY OF LEWIS C. COHEN

OF THOMAS JEFFERSON UNIVERSITY/
THOMAS JEFFERSON UNIVERSITY HOSPITAL/
ALBERT EINSTEIN HEALTHCARE NETWORK/
FRANKFORD HOSPITALS/MAGEE REHABILITATION HOSPITAL
(together, JEFFERSON HEALTH SYSTEM)/
AND
PHILADELPHIA COLLEGE OF OSTEOPATHIC MEDICINE

AS MEMBERS OF THE PHILADELPHIA INDUSTRIAL AND COMMERCIAL GAS USERS GROUP

MAY 15, 2007

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
v.	:	**DOCKET NO. R-00061931**
PHILADELPHIA GAS WORKS	:	

SURREBUTTAL TESTIMONY OF LEWIS C. COHEN

OF THOMAS JEFFERSON UNIVERSITY/
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PHILADELPHIA COLLEGE OF OSTEOPATHIC MEDICINE

AS MEMBERS OF THE PHILADELPHIA INDUSTRIAL AND COMMERCIAL GAS USERS GROUP

Q. Please state your full name.

A. My name is Lewis C. Cohen.

Q. Are you the same Lewis Cohen who submitted Direct Testimony in this proceeding on behalf of the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG")?

A. Yes, I am.

Q. What is the purpose of your Surrebuttal Testimony?

A. My Surrebuttal Testimony responds to the Rebuttal Testimony of Philadelphia Gas Works' ("PGW" or "Company") witness Craig White and Office of Consumer Advocate ("OCA") witness Richard LeLash regarding PGW's transportation rates.

Q. Do you have any general comments regarding Mr. White's Rebuttal Testimony?

A. Yes. Mr. White claims that, in my Direct Testimony, I have made "dire prognostications," that I "inexplicably jump to unfounded conclusions," and that I believe PGW's transportation program "will come to a screeching halt" unless PGW's current Interruptible Transportation ("IT") rate methodology is "thrown out." Mr. White's incorrect characterizations ignore the thrust of my argument, which is that PGW should be required to implement cost-based transportation rates, as other Natural Gas Distribution Companies ("NGDCs") in the Commonwealth did approximately twenty years ago, in order to ensure that all eligible customers are able to transport natural gas at just and reasonable rates.

Q. Both Mr. Lelash and Mr. White suggest that cost-based transportation rates are unnecessary in light of the "success" that Jefferson Health System ("JHS") has had in transporting natural gas on PGW's system. Do you agree with this assessment?

A. No. I agree that, since PGW's Restructuring Proceeding in 2003, more customers, including JHS, have been able to transport on PGW's system. Considering, however, that very few customers, if any, had been transporting on PGW's system prior to 2003, PGW's Restructuring should have only resulted in an increase in transporting customers.

Moreover, I think JHS's "success" must be reviewed in the appropriate context. JHS is pleased to now be able to transport natural gas on PGW's system; however, other JHS entities have been transporting on PECO Energy Company's ("PECO") system for approximately the last twenty-years. Thus, the "success" of PGW's transportation program is relative to that status of PGW's transportation program prior to its Restructuring Proceeding.

In addition, JHS's potential "success" in transporting natural gas is based upon PGW's willingness to negotiate a reasonable transportation rate with JHS. With respect to JHS's current transportation contracts, JHS was able to negotiate rates below the current maximum, margin-based rate; however, when JHS's current contracts expire, JHS will be able to transport natural gas only if PGW is willing to negotiate an IT rate that is based upon the cost to serve JHS, rather than PGW's margin.

Thus, both the OCA and PGW claims regarding the "success" of PGW's transportation rates fail to consider that the overall ability of customers to transport on PGW's system is based upon the Company's willingness to negotiate rates below the maximum rate. In other words, for customers in the service territories of NGDCs with cost-based rates, the inability to negotiate a lower rate is not necessarily an obstruction to transporting natural gas. For customers on PGW's system, however, negotiating a lower IT rate may be the only way in which these customers are able to transport natural gas on the Company's system.

Q. Mr. White claims that PGW's IT rates have not prohibited customers from transporting natural gas, and he rejects your claim that Philadelphia College of Osteopathic Medicine ("PCOM") could even negotiate such a rate with PGW. How do you respond?

A. Contrary to Mr. White's claims, PGW did negotiate with PCOM regarding a potential transportation rate based upon an alternative fuel, and PCOM has already notified PGW of the proposed installation date of an alternative fuel system. As I mentioned in my Direct Testimony, PGW provided PCOM with a proposed "negotiated" rate based upon the installation of this proposed alternative fuel. PGW's proposed rate was approximately 350% higher than the transportation rate PCOM would receive if it were on PECO's system, which is located across the street from PCOM. There is absolutely no cost-based justification for the rate offered to PCOM by PGW. Rather, PGW, as the monopoly provider, offered a non-cost based rate that would result in the Company receiving a greater margin.

Q. Mr. White argues that your comparison of PECO and PGW's transportation rates is irrelevant. Do you agree?

A. No. I would first note that I am not suggesting that PGW's IT rates be replaced with PECO's IT rates. Rather, I am using PECO's rates to note the challenge faced by many PGW customers due to PGW's margin-based rates and the Company's unwillingness, at times, to negotiate reasonable transportation rates.

Specifically, PCOM is directly across the street from PECO; however, the demarcation line places PCOM in PGW's service territory. As a result, PGW has a monopoly on its customers and is able to charge them the maximum, margin-based transportation rate if the Company so chooses. Because PCOM is unable to negotiate a lower rate with PGW, PCOM is faced with either continuing to receive firm sales service or pay a transportation rate that is 350% higher than the cost-based rate that PCOM would receive on PECO's system. While I agree with Mr. White that PGW is not responsible for guaranteeing savings to transportation customers, I do not believe that customers should pay prohibitive transportation costs simply because PGW seeks to earn a higher margin.

Q. Mr. White also argues that, if alternative fuels such as oil were a true alternative, then customers would have already switched to this fuel rather than negotiating transportation contracts with PGW. Is Mr. White correct?

A. No. I would agree with Mr. White that today, and for the past few years, including the time during which JHS negotiated its IT contract with PGW, oil was more expensive than natural gas. There were years, however, when oil was much less expensive than natural gas, and some JHS facilities burned oil exclusively. I would guess that, based upon the volatility in natural gas and oil prices, the price of oil may one day drop below the price of natural gas.

Q. Mr. White also claims that JHS decided to use Trigen for steam service for the majority of its energy needs despite the fact that JHS's annual fuel costs using

steam are more than double that of natural gas. Is Mr. White's assessment correct?

A. No. Mr. White makes general assumptions regarding JHS's use of steam that are not entirely correct. Specifically, JHS uses steam at its Center City campus because the all-in costs of building a plant that would utilize natural gas at this campus is prohibitive. Accordingly, utilizing steam at this facility is actually less expensive on an overall cost basis as compared to the costs of building a new plant and utilizing natural gas. So, while I would agree with Mr. White that price is not the only factor that transportation customers consider in determining a fuel source, I would not be so quick to discount the significance of the overall role that price plays, as confirmed by JHS's decision to utilize steam.

Q. According to Mr. White, the Commission rejected the need for cost-based transportation rates on PGW's system. Do you believe the Commission rejected cost-based rates for PGW in the Company's Restructuring Proceeding?

A. No, I believe Mr. White has misread the Commission's decision in PGW's Restructuring Proceeding. As I understand the Commission's Order, PGW was permitted to implement margin-based rates as part of its Restructuring Proceeding; however, PGW was required, as part of the Company's next base rate proceeding, to offer a Cost of Service Study ("COSS") analyzing cost-based transportation rates. I do not believe the PUC would have requested such a study if the Commission completely rejected the notion of cost-based rates for PGW.

Moreover, the PUC implemented regulations, which are still in effect today, when larger customers were first permitted to transport natural gas. According to these regulations:

> A...natural gas utility shall maintain a gas transportation program that adheres to the following terms and promotes the following objectives when providing natural gas transportation service:
>
> > (6) Transportation service shall be provided under a contract between the jurisdictional natural gas utility and the customer...The rates set shall recover, to the maximum extent possible, the fixed costs associated with the service.

52 Pa. Code § 60.2(6). Outright rejection of cost-based rates for PGW, as claimed by Mr. White, would seem to contradict the PUC's regulations.

Q. Finally, Mr. White claims that PICGUG's arguments for cost-based transportation rates ignore the negative impact that such a modification would have on PGW and the Company's firm customers. Is PICGUG ignoring these needs?

A. No; however, Mr. White seems to feel that PGW's larger customers must continue to provide a margin to the Company in order to ensure that the Company does not have to further increase firm sales customers' rates. I am not recommending that PGW's firm sales customers' rates be increased in this proceeding merely to fund cost-based transportation rates. Rather, I am suggesting that the PUC must consider whether a rate increase is truly necessary for PGW or whether other alternatives must be pursued. While Mr. White claims that PGW has raised its base rates only three times in the last thirteen years, I believe that there are other NGDCs in Pennsylvania that

have maintained the same base rates for thirteen years or more, while still offering customers cost-based transportation rates.

Q. Does this include your testimony?

A. Yes.