

21

OTS Statement No. 1

Witness: Robert Plonski

5-23-07

Phila

TC

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

**DOCUMENT
FOLDER**

Direct Testimony

of

Robert Plonski

Office of Trial Staff

Concerning:

Debt Service Coverage

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JUN 23 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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

2 A. My name is Robert Plonski. My business address is P.O. Box 3265, Harrisburg,
3 Pa. 17105-3265.

4
5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. I am currently employed by the Pennsylvania Public Utility Commission
7 (Commission) as a Fixed Utility Financial Analyst. I am assigned to the Office of
8 Trial Staff (OTS) as an expert witness.

9
10 **Q. PLEASE DESCRIBE THE ROLE OF OTS IN RATE PROCEEDINGS.**

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

15
16 **Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL
17 BACKGROUND?**

18 A. I have prepared this information in Appendix A attached to my direct testimony.

1 **Historical Presentation**

2 **Q. HOW WAS THE PHILADELPHIA GAS WORKS (PGW) CLASSIFIED**
3 **BEFORE COMING UNDER THE JURISDICTION OF THE**
4 **COMMISSION?**

5 A. PGW was classified a municipal gas distribution utility that is owned by the City
6 of Philadelphia (City).

7
8 **Q. PLEASE DESCRIBE HOW RATES WOULD BE SET FOR A TYPICAL**
9 **MUNICIPAL UTILITY.**

10 A. Generally, a municipal utility would fall outside the jurisdiction of the
11 Commission. As a result, the municipality would decide what level of rates are
12 required and set rates appropriately.

13
14 **Q. HOW DID PGW SET RATES?**

15 A. PGW was allowed to set rates as needed based on the budget it presented before
16 the Philadelphia Gas Commission.

17
18 **Q. HAVE THERE BEEN INSTANCES WHEN A MUNICIPAL UTILITY HAS**
19 **FALLEN WITHIN THE JURISDICTION OF THE COMMISSION?**

20 A. Yes. When a municipal utility provides service to customers outside its municipal
21 service territory, those customers would come under the jurisdiction of the

1 Commission. The utility would come before the Commission and present their
2 case as to the appropriate level of rates to charge those customers.

3
4 **Q. IS THIS HOW PGW CAME UNDER THE JURISDICTION OF THE**
5 **COMMISSION?**

6 A. No. After the General Assembly of the Commonwealth of Pennsylvania passed
7 the Natural Gas Choice and Competition Act of 1999, PGW came under the
8 jurisdiction of the Pa PUC.

9 On July 1, 2000, the Commission assumed jurisdiction over the public
10 utility services being furnished by PGW within the City of Philadelphia. Prior to
11 the passage of the Act of 1999, PGW's rates, terms and conditions of service were
12 exempt from the jurisdiction, regulation and control of the Commission. Instead,
13 PGW was regulated by the Philadelphia Gas Commission.

14
15 **Q. CURRENTLY, DOES THE PHILADELPHIA GAS COMMISSION OR**
16 **ANY OTHER AGENCY WITHIN THE CITY OF PHILADELPHIA HAVE**
17 **AUTHORITY OVER SETTING RATES FOR PGW?**

18 A. No.

1 **Q. HOW ARE RATES DETERMINED ON THE BUDGETARY PROPOSALS**
2 **PRESENTED BY PGW?**

3 A. The Commission determined that the rates for PGW are to be set based on the cash
4 flow methodology and must be just and reasonable. The Commission made this
5 determination in accordance with Section 1301 of the Public Utility Code and
6 2212(c) of the Gas Choice Act.

7
8 **Q. WHAT ARE THE TWO METHODS OF DETERMINING RATES FOR**
9 **UTILITIES?**

10 A. They are the rate base rate of return revenue requirement and the cash flow
11 methodology revenue requirement.

12
13 **Q. PLEASE EXPLAIN THE RATE BASE RATE OF RETURN**
14 **METHODOLOGY.**

15 A. Simply put, the rate base rate of return method is the primary method used for
16 most utilities regulated by state agencies. In most cases, the revenue requirement
17 includes operating and maintenance expenses, depreciation expense and a rate of
18 return on rate base (identified as net operating income), which provide for capital
19 expenditures and debt service coverage. The revenue requirement is established
20 based on the formula:

1 $RR = E + D + T + (V-d) \times R$

2 Where:

3 RR = Revenue Requirement

4 E = Operating Expense

5 D = Depreciation Expense

6 T = Taxes

7 V = Gross Rate Base

8 d = Accrued Depreciation

9 R = Overall Rate of Return

10

11 **Q. PLEASE EXPLAIN THE CASH FLOW METHODOLOGY.**

12 A. The cash flow approach assumes revenues must be sufficient to cover all cash
13 needs, including debt obligations which will become due in the test period. The
14 basic components considered under the cash flow revenue requirement approach
15 generally include: operating and maintenance expenses; debt service coverage and
16 a margin expressed as a percent of debt service. The margin provides for capital
17 expenditures not financed by debt, debt pay down, equity build up and dividends
18 to the municipality. The revenue requirement for a cash flow utility is established
19 based on the formula:

1 RR = E + DS +M

2 Where:

3 RR = Revenue Requirement

4 E = Operating Expense

5 DS = Debt Service

6 M = Margin

7

8 **Q. HOW IS THE CASH FLOW METHODOLOGY DIFFERENT FROM THE**
9 **RATE OF RETURN METHODOLOGY?**

10 A. *The rate base rate of return methodology differs from the cash flow methodology*
11 *in how the return of and return on capital are provided for. When referring to*
12 *recovery of capital, in the most simple of terms, there are two components for rate*
13 *base rate of return; depreciation expense and a rate of return on rate base*
14 *(identified as net operating income). The cash flow methodology provides for the*
15 *return of and the return on capital in two components: the debt service and the*
16 *margin.*

17

18 **Q. PLEASE IDENTIFY THE ISSUES THAT ARE ADDRESSED IN YOUR**
19 **TESTIMONY.**

20 A. The first issue to be addressed in my direct testimony is debt service coverage.
21 The second issue is the appropriate level of rate increase that PGW is entitled to
22 receive.

1 **Q. DOES YOUR DIRECT TESTIMONY INCLUDE AN EXHIBIT THAT**
2 **SUPPORTS YOUR RECOMMENDATION AS TO THE LEVEL OF DEBT**
3 **SERVICE COVERAGE FOR PGW?**

4 A. Yes. OTS Ex. No. 1 presents the analyses that I have conducted regarding the
5 adequate level of debt service coverage for PGW.

6

7 **Q. PLEASE EXPLAIN WHAT DEBT SERVICE ENTAILS.**

8 A. Debt service is the annual amount of principal and interest due on outstanding
9 loans.

10

11 **Q. PLEASE DEFINE DEBT SERVICE COVERAGE.**

12 A. Debt service coverage is a ratio of annual funds available to cover annual debt
13 service divided by the annual debt service requirement (principal and interest).

14

15 **Q. HOW DOES PGW CALCULATE ITS DEBT SERVICE COVERAGE**
16 **REQUIREMENTS?**

17 A. The Company's filing calculates debt service coverage using two different
18 methods: 1) aggregate debt service coverage ratio, which is defined as total funds
19 available divided by total debt service, and 2) debt service coverage ratio for each
20 debt issue ranked according to subordination¹.

¹ This method is required by the City's bond ordinances.

1 Q. IS PGW REQUIRED TO SATISFY THE DEBT SERVICE COVERAGES
2 SET FORTH IN THE CITY ORDINANCE?

3 A. Yes.

4
5 Q. WHAT ARE PGW'S SPECIFIC DEBT SERVICE REQUIREMENTS?

6 A. The City's ordinance, Article IV, Section 4.02A, sub-sections (i & ii) states that
7 after all the Operating Expenses are paid, the debt service coverage for the 1975
8 bonds is set at 1.5x. For the 1998 bonds, Article VI, Section 5.03, states that the
9 senior 1998 debt will have debt service coverage of 1.5x. Additionally, the City
10 ordinance states that the 1998 subordinate debt will have debt service coverage of
11 1.0x.

12
13 Q. WHAT SOURCES DID YOU USE AS AN INDICATOR FOR THE
14 MINIMUM AGGREGATE DEBT SERVICE COVERAGE TO MAINTAIN
15 INVESTMENT GRADE FOR A MUNICIPAL UTILITY?

16 A. I used information located in the Handbook of Fixed Income Securities and
17 PGW's own testimony.

1 Q. PLEASE EXPLAIN WHAT IS STATED IN THE HANDBOOK OF FIXED
2 INCOME SECURITIES.

3 A. The Handbook of Fixed Income Securities, published by Dow Jones-Irvin,
4 provides a perspective of the municipal bond investor in terms of what factors a
5 potential investor should examine before investing in municipal bonds. This
6 handbook's recommendation to prospective investors is to examine the potential
7 of a municipality to pay its operating expenses and cover its annual debt service
8 charges at 1.2x. Moreover, PGW has acknowledged this standard in its own
9 testimony. (PGW Statement No. 2, p. 6)

10

11 Q. WHAT IS THE DEFINITION OF A TEST YEAR?

12 A. The calculation of rates is founded in the device of a test year. It is a period of
13 measurement for a recent, consecutive 12-month period consisting of a full year
14 operations where data is readily available. The ultimate objective of the rate-
15 setting process is to predict the operating results of the utility during the period.
16 It can be deemed a historic test year or future test year.

17

18 Q. WHICH TEST YEAR HAS PGW SELECTED?

19 A. PGW has selected to use a future test ending August 31, 2007 in this proceeding.

1 **Company Position**

2 **Q. WHAT IS THE AMOUNT OF INCREASE PGW IS REQUESTING IN THE**
3 **PRESENT PROCEEDING?**

4 A. PGW is seeking an increase in base rates of \$100,000,000. Additionally, PGW is
5 requesting to transfer \$10,000,000² from its 1307(f) mechanism (off system sales
6 and capacity release) into base rates for a total increase of \$110,000,000.

7
8 **Q. BRIEFLY SUMMARIZE PGW'S REASONS FOR THE RATE INCREASE**
9 **IN THIS PROCEEDING.**

10 A. The following reasons have been indicated by PGW for its requested increase:

- 11 • Debt service coverage for 2008 and beyond
12 • A 50/50 capital structure by year 2012
13 • Need for 200 days of cash on hand
14 • Ongoing O&M expense increases³
15

16 **Q. PLEASE ELABORATE ON THE SPECIFIC NATURE OF THESE ISSUES.**

17 A. PGW claims that without rate relief by fiscal year 2008 it will fall below the
18 minimum investment grade for municipal utilities of 1.2x debt service
19 requirements. The Company additionally claims that, at that time, it will not meet
20 its ordinance requirements of 1.5x debt service requirements (PGW Statement No.
21 2, page 6, lines 11-23 and page 7, lines 1-3).

² To be addressed in OTS Statement No. 4.

³ To be addressed in OTS Statement No. 3.

1 The Company also alleges that there is a danger of it not meeting the
2 required 1.5x debt service coverage, mandated by its 1975 and 1998 bond
3 ordinances, by fiscal year 2009 if a rate increase is not granted (PGW Statement
4 No. 3, page 14, lines 4-10).

5
6 **Q. WHAT IS THE BASIS FOR THE \$100,000,000 INCREASE REQUEST BY**
7 **PGW?**

8 A. PGW indicates that the \$100,000,000 increase will help develop a “50/50” capital
9 structure by fiscal year ending 2012 (PGW Statement No. 2, page 12, PGW
10 Statement No. 3, page 15).

11 PGW also indicates that the increase will enable it to have 200 days of cash
12 on hand and claims that “it is not unusual for A-rated utilities to have in excess of
13 200 days of unrestricted cash on hand” (PGW Statement No. 3, page 10).

14
15 **Q. ARE THE COMPANY’S FIVE-YEAR PROJECTIONS APPROPRIATE IN**
16 **THIS PROCEEDING?**

17 A. No. The Company’s five-year projections are outside the 2007 test year. The
18 Commission does not set rates based on five-year projections. Going beyond the
19 scope of the test year will improperly allow the recovery of expenses that are not
20 known and measurable. Furthermore, the cash flow method does not utilize
21 budgetary projections. The Company is not precluded from filing a base rate case
22 should its coverages become inadequate.

1 **Q. PLEASE ADDRESS THE COMPANY'S GOALS TO ATTAIN A "50/50"**
2 **CAPITAL STRUCTURE BY FYE 2012.**

3 A. Although a 50/50 capital structure may be representative of an investor owned gas
4 distribution utility, PGW has provided no evidence to support the claim that the
5 rating agencies require a similar standard of a municipality. In general, rating
6 agencies hold municipalities to a different standard due to the municipalities good
7 faith and credit backed by their taxing authority. If PGW wants to improve its
8 capital structure, the City has the option to forgive repayment of the City loan.

9
10 **Q. PLEASE ADDRESS THE COMPANY'S CLAIM TO HAVE 200 DAYS OF**
11 **UNRESTRICTED CASH ON HAND.**

12 A. The Company's request is arbitrary and is not supported by relevant information.
13 In response to OTS-RR-6, OTS Ex. No. 1, Sch. No. 1, PGW supplied statistics
14 that were applied to A-rated water utilities. There is no correlation between A-
15 rated water utilities and a municipal gas company.

16
17 **Q. DO YOU AGREE WITH PGW'S ALLEGATION THAT THERE IS A**
18 **FINANCIAL CRISIS?**

19 A. No. Currently there is no financial crisis at PGW. First, a review of past debt
20 service coverage shows that PGW has not missed its required debt service
21 coverage (OTS Ex. No. 1, Sch. No. 2). Second, since the extraordinary rate relief
22 application, Docket No. R-00017034F0002, banks have granted an increase of

1 \$50,000,000 in commercial paper to PGW. This would indicate that creditors are
2 not worried about PGW's ability to repay any outstanding short-term debt (OTS
3 Ex. No. 1, Sch. No. 3). Third, PGW has indicated that it intends to pay off the
4 \$149,500,000 balance of its short term debt by April or May of this year (OTS Ex.
5 No. 1, Sch. No. 4). Fourth, Fitch Ratings removed a "negative watch" due to
6 PGW's ability to collect receipts from its customers despite higher gas prices
7 (OTS Ex. No. 1, Sch. No. 5). Lastly, fiscal year 2009 is two years away. As
8 stated above, should it be necessary, PGW has the opportunity to seek a rate
9 increase before that period to avoid the possibility of not meeting its required debt
10 service coverage. Going beyond the test year will bring in elements that are
11 currently not known and measurable.

12
13 **OTS Position**

14 **Q. PGW HAS REQUESTED A \$100,000,000 RATE INCREASE IN THIS**
15 **PROCEEDING. IN YOUR PROFESSIONAL OPINION, IS THIS**
16 **REQUEST APPROPRIATE?**

17 **A. No.** My analysis indicates that PGW, as a cash flow company, does not need a
18 base rate increase at the present time.

1 **Q. DOES THE COMPANY MEET THE MINIMUM INVESTMENT GRADE**
2 **CRITERIA BASED ON AGGREGATE DEBT SERVICE COVERAGE?**

3 A. Yes. Based on the Company's future test year claim of August 31, 2007 presented
4 in Ex. JRB-1, page 3, the aggregate debt service coverage is 1.34x, which is in
5 excess of the 1.2x discussed earlier in my testimony (OTS Ex. No. 1, Sch. No. 6).

6

7 **Q. DOES THE COMPANY HAVE SPECIFIC COVERAGE**
8 **REQUIREMENTS?**

9 A. Yes. As I described above, the Company is required by the City ordinance to
10 satisfy debt service requirements on each individual debt issue.

11

12 **Q. BASED ON THE COMPANY'S TEST YEAR AUGUST 31, 2007, WHAT**
13 **ARE THE COVENANT DEBT SERVICE COVERAGES?**

14 A. From the information provided in Ex. JRB-1, page 3, the Company calculated the
15 debt service coverage for each issue.

16 Presented in OTS Ex. No. 1, Sch. No. 7 is a calculation of debt service
17 needed for Philadelphia Gas Works. This amount totaled \$91,048,000, for fiscal
18 year 2007.

19 OTS Ex. No. 1, Sch. No. 6 indicates without an increase PGW will have
20 \$144,024,000 of funds available for debt service coverage. To properly calculate
21 debt service coverage, I would add in capital leases. In this instance there were no
22 capital leases to add in. According to OTS Ex. No. 1 Sch. No. 7, the debt service

1 due for the 1975 bonds equaled \$35,748,000. I then divided the \$144,024,000 by
2 \$35,748,000 to calculate the debt service coverage for the 1975 bonds to be 4.0x.
3 This coverage is well in excess of the covenant requirement of 1.5x.

4 Next, I subtracted the \$35,748,000 applied to the 1975 bonds from the
5 \$144,024,000 to calculate the funds available to meet the debt service for the 1998
6 senior debt, which resulted in an available amount of \$108,276,000. I calculated
7 the debt service coverage of 2.03x by dividing the \$108,276,000 by \$53,313,000.
8 This coverage, again, is in excess of the required coverage of 1.5x.

9 After calculating the 1998 senior debt coverage, I calculated the coverage
10 on the 1998 subordinate debt. From the \$108,276,000 I subtracted \$53,313,000 to
11 arrive at \$54,963,000 left available to cover the subordinate 1998 debt. Dividing
12 the funds available by the debt service due, I calculated the debt service coverage
13 to be at 27.7x. Again, this coverage is well in excess of what is required by the
14 Company's covenant of 1.0x.

15
16 **Q. WHAT HAVE YOU CONCLUDED FROM YOUR REVIEW OF THE**
17 **FUTURE TEST YEAR INFORMATION PRESENTED IN PGW'S EX. JRB-**
18 **1, PAGE 3?**

19 **A.** The data presented by the Company indicates that, without the increase, it has
20 sufficient funds to meets its debt service ordinance requirements for fiscal year
21 2007. As a result, a rate increase is not warranted at this time.

1 **Q. WHAT IS THE IMPACT OF REVENUE AND EXPENSE ADJUSTMENTS**
2 **ON DEBT SERVICE COVERAGE RATIOS?**

3 A. Should revenues increase and expenses decrease as a result of ratemaking
4 adjustments, the debt service coverage ratios will be greater than those presented
5 in the test year information. The converse is also true.

6
7 **Q. WHAT IMPACT WILL THE OTS ADJUSTMENTS HAVE ON THE DEBT**
8 **SERVICE COVERAGE RATIOS?**

9 A. *OTS adjustments will increase all of the debt service coverage ratios. With OTS*
10 *adjustments, the Company's rate increase request is even less justified.*

11
12 **Q. BASED ON THE CASH FLOW METHODOLOGY HAS THE COMPANY**
13 **DEMONSTRATED A NEED FOR ADDITIONAL REVENUE?**

14 A. No. From a regulatory standpoint, the Company's financial position is adequate to
15 meet its future test year obligations.

16
17 **Q. IS IT YOUR FINAL RECOMMENDATION THAT PGW NOT RECEIVE A**
18 **RATE INCREASE FROM THIS PROCEEDING?**

19 A. No. My final recommendation would be that PGW receive an increase of
20 \$25,000,000.

1 **Q. WHY ARE YOU RECOMMENDING A \$25,000,000 INCREASE?**

2 A. I am making this recommendation based on a loan payment due to the City in
3 fiscal year 2008 in the amount of \$43,000,000. This is in conjunction with a
4 \$2,000,000 payment due to the City in 2007. This would produce a total outlay
5 due by 2008 of \$45,000,000. The sole reason for this recommended increase is to
6 extinguish the City loan due in fiscal years 2007 - 2008. If this recommendation is
7 accepted by the Commission, the Company should be prohibited from claiming
8 the \$45,000,000 in any future base rate filing.

9
10 **Q. WHY ARE YOU RECOGNIZING THE \$45,000,000 CITY LOAN?**

11 A. I have two reasons for recognizing the City Loan. First, it is a known and
12 measurable amount. Second, due to the unique nature of PGW's cash flow
13 methodology, the funds to extinguish the identified City loan must be built into
14 rates prior to repayment of the loan.

15
16 **Q. WILL THE \$25,000,000 ALLOW PGW TO HAVE ADEQUATE DEBT
17 SERVICE COVERAGE?**

18 A. Yes. Based on Company's own projections, PGW will have adequate debt service
19 coverage several years beyond the test year. (See OTS Ex. No. 1, Sch. No. 8)

20
21 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

22 A. Yes.

APPENDIX A

Robert J. Plonski

Educational and Professional Background

Education

M.S., Finance, King's College, 1998-2001

B.S., Accounting, Marywood University, 1995-1998

Training

NARUC Utility Rate School, Clearwater, FL, October 24-29, 2004

Fundamentals of Utility Finance, Arlington, VA, April 18-19, 2005

Sox 101, Orlando, FL, December 12-14, 2006

Professional

Currently- Fixed Utility Financial Analyst
Pa. PUC-Office of Trail Staff 2004 – Present

Previous- Adjunct Professor
McCann Business School-Scranton, PA 2003 – 2004
Instructed students in a wide range of Business subjects including
Investments and Intermediate Accounting I & II

Case History

I have submitted testimony on behalf of the Office of Trail Staff in the following cases:

Application to change control of American Water Works Through issuance of IPO	A-212285F0136
Duquesne Light Co.	R-00061346
T.W. Phillips Gas & Oil Co.	R-00051178
City of Dubois	R-00050671
City of Lancaster – Water	R-00051167

City of Lancaster – Sewer R-00049862

I have been involved in the following cases for the Office of Trial Staff:

Little Washington Wastewater R-00040189
R-00040191
R-00040192

National Fuel Gas Company R-00050216

Pike County Gas R-00049884

Falls Township Sewer R-00049557

Buss Water Company R-00049559

Myers Gas Company R-00050259

City of Dubois-Water R-00050671

T.W. Phillips Gas and Oil Co. R-00051178

UGI acquisition of Southern Co. A-1200F2000

City of Bethlehem-Water R-00050680

CMV Sewage Company, Inc. R-00050677

Duquesne Light Company R-00061346

TW Phillips Gas and Oil Co. R-00051178

National Fuel Gas Distribution Corp R-00061246

Aqua Pennsylvania, Inc. R-00051030

Pocono Water Works R-00050673

Exit 11 WWTP R-00050679

Meadows Sewer Company R-00050672

Southern Union Company 1307(f) R-00050538

National Fuel Gas Dist 1307(f)	R-00050216
NRG Energy Pgh.	R-00061435
PPL Gas Utilities	R-00061519
B.E. Rhodes Sewer Co.	R-00061559
Utilities Inc.-Westgate	R-00061592

OTS Exhibit No. 1
Witness: Robert Plonski
5-23-07
Phila
TC

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

**DOCUMENT
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Exhibit to Accompany

the

Direct Testimony

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Concerning:

Debt Service Coverage

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JUN 22 2007

**PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU**

OTS RR-6

Government - Owned Utility Ratios

UtilityName	Days of Liquidity	LTD/(Total Equity + Total Liabilities)
Alameda County Water District	2,052	9.36%
Anchorage Water and Wastewater Utility	462	24.53%
Austin Water Utility	146	80.65%
Azusa Light & Water	1,221	35.07%
Bay Area Water Works Board	249	92.96%
Boston Water and Sewer Commission	325	37.34%
Bucks County Water and Sewer Authority	408	55.79%
Burbank Water and Power	820	20.32%
Burlington Public Works	386	51.00%
Cambridge Water Department	N/A	57.14%
Cedar Rapids Water Department	518	41.62%
Central Arkansas Water	1,526	8.23%
Central Lake Cty Joint Action Water Agency	249	0.00%
Central Texas WSC	2,744	66.95%
Chesapeake Bay Water Utilities	541	59.33%
Chester Water Authority	689	17.93%
chesterfield county department of utilities	3,300	4.00%
Cheyenne Board of Public Utilities	1,203	25.36%
Chicago Department of Water	583	50.97%
City Corporation	3,118	0.00%
City of Akron; Public Utilities Bureau	545	31.06%
City of Albuquerque Public Works Department	139	40.29%
City of Allentown	264	48.53%
City of Ames Water and Pollution Control	611	1.25%
City of Ann Arbor Water Utilities	504	39.47%
City of Arlington Water Utilities	1,155	18.51%
City of Arvada	6,980	17.30%
City of Asheville - Water Resources Dept.	626	43.27%
City of Bismarck	794	0.00%
City of Canton Water Department	15,026	29.25%
City of Casper Public Utilities	4,182	1.80%
City of Charlottesville	1,830	51.90%
City of Chesapeake Public Utilities	749	26.07%
City of Columbia Water Department	189	38.84%
City of Concord	819	0.00%
City of Concord	819	0.00%
City of Corvallis	3,440	0.00%
City of Dayton, Department of Water	5,551	10.97%
City of Duluth	1,029	20.99%
City of Durham, Env. Res. Dept.	6,178	53.59%
City of Escondido	2,312	45.43%
City of Evanston)	154	14.54%
City of Flagstaff	1,160	13.85%
City of Frederick	1,604	19.81%

**Historic Debt Service Coverage Ratios for Philadelphia Gas Works
for 1994 - 2000**

**OTS Exhibit No. 1
Schedule No. 2**

	[1]	[2]	[3]	[4]	[5]	[6]	[7]
	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
[1] 1975 Ordinance Bonds	1.50	1.50	1.67	1.50	1.52	1.53	1.72
[2] 1998 Ordinance Bonds						1.58	1.59
[3] 1998 Ordinance Subordinate Bond							6.48

Source: Philadelphia Gas Works, Docket No. 00006042
OTS Exhibit No. 5, Schedule No. 1

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

Question OTS-RR-18: In reference to Mr. Bogdonavage's statement of 2/27/07, please verify that the current level of Commercial Paper is \$149,500,000.

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

Response: The balance of commercial paper outstanding on February 27, 2007 was \$149,500,000.

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

Question OTS-RR-19: In reference to Mr. Bogdonavag's statement of 2/27/07, please verify that it is the intention of Philadelphia Gas Works to pay down the entire current level of commercial paper by April of 2007.

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

Response: PGW intends to pay down the entire current level of commercial paper in April or May of 2007 to comply with the related IRS regulations. It is PGW's intent to then reissue the amount of commercial paper PGW needs to meet working capital requirements on a going forward basis.



Search Results for Google

OTS Exhibit No. 1
Schedule No. 5

Print this Release

March 28, 2007 11:41 AM Eastern Daylight Time

Fitch Rates Philadelphia, Pennsylvania's Gas Works Revs 'BBB/BBB-'; Stable Outlook

NEW YORK--(BUSINESS WIRE)--Fitch Ratings assigns a 'BBB-' rating to the City of Philadelphia, PA's \$220 million gas works revenue bonds, seventh series (1998 ordinance) and a 'BBB' rating to \$14.8 million gas works revenue bonds, nineteenth series (1975 ordinance). The bonds are scheduled to price via negotiation with a syndicate led by Goldman Sachs and Co. on April 11, 2007.

Approximately \$200 million of the seventh series bonds will be used to fund capital projects of the Philadelphia Gas Work (PGW). The balance of the proceeds of the seventh series will be used to refund outstanding 1998 ordinance bonds, while the nineteenth series bonds will be used to refund outstanding 1975 ordinance bonds. Savings on the refundings will be equal to at least 3% of the refunded par. The Rating Outlook on all bonds is Stable.

In addition, Fitch upgrades the following ratings:

--\$302 million gas works revenue bonds (1975 ordinance) to 'BBB' from 'BBB-';

--\$12.9 million subordinated gas works revenue bonds (1998 ordinance) to 'BBB-' from 'BB+'.

Fitch affirms the following rating:

--\$740 million senior lien gas works revenue bonds (1998 ordinance) 'BBB-';

The upgrade of the rating on the 1975 ordinance bonds reflects the stronger security provisions of the indenture. The 1975 bonds have a lien on pledged revenues that is senior to the 1998 bonds; in addition, the 1975 lien is closed, additional bonds on this lien are limited to refunding of outstanding 1975 lien bonds. The upgrade of the rating on the 1998 subordinate lien bonds reflects improvement in the credit quality of PGW; Fitch now believes that all liens reflect investment grade quality credit.

The ratings on PGW are constrained by the utility's tight liquidity position. The fulfillment of operating commitments, including debt service, relies heavily on external liquidity, including cash flow support from the city and a commercial paper letter of credit. However, this risk is mitigated by sustained improvement in collection rates since fiscal 2003, which has resulted in a stabilization of the utility's liquidity position. In particular, Fitch views favorably financial improvement achieved in fiscal 2006 despite a sharp increase in gas commodity costs. Credit strengths include the utility's strong management team and well-maintained system assets. In addition, a strengthening of the city's financial position in recent years bodes well for the future fiscal health of the city owned utility (Philadelphia's general obligation (GO) bonds rated 'BBB+' with a Stable Outlook by Fitch).

Fitch would view favorably a positive ruling by the Public Utility Commission (PUC) on PGW's December 2006 rate filing, requesting an increase of \$100 million in the base rate. The PUC must rule on the rate filing by September 2007, allowing PGW to implement the rate increase for the fiscal 2008 winter heating season. An increase in the base rate of the magnitude requested by PGW will allow the utility to reduce its dependence on financial support from the city and its commercial paper letter of credit. In addition, it would allow PGW to fund portions of its capital plan with cash resources, thereby limiting future debt issuance.

Collection rates have been volatile historically, with lower rates of collection correlating with colder winter heating seasons. After hitting a 15-year low of 86.6% in fiscal 2003, collection rates have rebounded to a solid 96.6% for fiscal 2006. Although collection rates were bolstered by warmer than normal winters since fiscal 2003, PGW management has made significant progress in implementing

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

	ACTUAL 2006-06	ESTIMATE 2006-06	BUDGET 2006-07	FORECAST 2007-08	FORECAST 2008-09	FORECAST 2009-10	FORECAST 2010-11	FORECAST 2011-12
FUNDS PROVIDED								
Total Gas Revenues	\$630,560	\$658,662	\$642,000	\$670,961	\$637,130	\$677,079	\$672,629	\$664,454
Other Operating Revenues	32,807	28,634	28,584	29,151	28,770	27,855	27,961	28,054
Total Operating Revenues	663,367	687,296	670,584	1,000,142	665,900	704,934	700,590	692,508
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,097	11,260	11,343	9,820	7,723	7,820	7,160
City Grant	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000
AFUDC (Interest)	907	1,168	1,202	1,002	1,036	1,006	985	956
TOTAL FUNDS PROVIDED	683,777	1,016,381	1,001,106	1,030,487	694,565	731,665	709,415	700,627
FUNDS APPLIED								
Fuel Costs	509,704	630,185	630,841	658,482	623,366	562,401	558,248	590,884
Other Operating Costs	283,308	278,189	288,128	278,151	280,407	283,136	288,083	290,653
Total Operating Expenses	793,012	917,374	898,969	936,633	903,773	845,537	846,331	881,537
Less: Non-Cash Expenses	39,338	40,554	41,887	43,300	44,612	45,907	47,385	47,604
TOTAL FUNDS APPLIED	753,674	878,820	857,062	883,343	859,163	790,630	797,658	794,143
Funds Available to Cover Debt Service	130,103	139,541	144,024	137,144	135,402	132,035	111,559	108,484
1975 Ordinance Bonds Debt Service	38,808	41,849	35,748	34,368	32,368	30,155	30,745	32,184
Debt Service Coverage 1975 Bonds	3.35	3.33	4.83	3.98	4.18	4.38	3.63	3.31
Net Available after Prior Debt Service	91,297	97,582	108,278	102,776	103,034	101,880	80,814	74,320
Other Capital Leases	1,988	-	-	-	-	-	-	-
Net Available after Prior Capital Leases	89,299	97,582	108,278	102,776	103,034	101,880	80,814	74,320
1986 Ordinance Bonds Debt Service	45,989	32,487	53,313	67,813	71,727	84,111	85,579	92,016
New Proposed Bond Debt Service	-	-	-	-	-	-	-	-
Total New Debt Service	45,989	32,487	53,313	67,813	71,727	84,111	85,579	92,016
Debt Service Coverage 1986 Bonds	1.94	3.81	2.03	1.52	1.44	1.21	0.94	0.81
Net Available after 1986 Debt Service	43,300	65,125	54,963	34,963	31,307	17,769	(4,765)	(17,696)
1986 Ordinance Subordinate Bond Debt Ser	1,967	1,968	1,967	1,968	1,960	1,968	1,968	1,964
Debt Service Coverage Subordinate Bonds	21.78	32.79	27.88	17.80	15.73	8.95	(2.48)	(8.82)
Net Available To Service Aggregate Debt Serv	111,075	114,154	122,295	115,298	113,838	118,182	107,044	102,683
Aggregate Debt Service	82,780	78,402	81,848	104,187	108,085	118,232	118,312	126,184
Fixed Coverage Charge	1.25	1.48	1.34	1.11	1.07	0.95	0.91	0.81
Fixed Coverage Charge Including \$18.8 City Fee	1.94	1.21	1.12	0.94	0.82	0.82	0.78	0.71

Debt Service
Philadelphia Gas Works
Test Year Ended August 31, 2007
'000s Omitted

OTS Exhibit No. 1
Schedule No. 7

	Interest 2007	Principal 2007	Total Debt Service
1975 Ordinance			
[1] 11th C TECA	0	0	0
[2] 12th A TECA	0	0	0
[3] 15th	777	0	777
[4] 16th	2,320	8,525	10,845
[5] 17th	8,837	10,715	19,552
[6] 18th	2,784	1,780	4,574
			<u>35,748</u>
1998 Ordinance			
[7] 1st A	6,181	11,080	17,261
[8] 1st B	0	0	0
[9] 2nd	1,166	2,315	3,481
[10] 3rd	901	985	1,886
[11] 4th	6,010	1,285	7,295
[12] 5th	6,000	0	6,000
[13] 5th Variable	1,050	0	1,050
[14] 6th	11,485	0	11,485
[15] 7th	4,875	0	4,875
			<u>53,313</u>
Subordinate Debt			
[16] 1st C Subordinate	817	1,370	1,987
			<u>1,987</u>
			<u>91,048</u>

Source: Philadelphia Gas Works Docket No. R-00061931
Volume II, Exhibits E1 and G1

PHILADELPHIA GAS WORKS
DEBT SERVICE COVERAGE
(Dollars in Thousands)

OCA-Set III-17
\$25.0M

	ACTUAL 2004-05	ESTIMATE 2005-06	BUDGET 2006-07	FORECAST 2007-08	FORECAST 2008-09	FORECAST 2009-10	FORECAST 2010-11	FORECAST 2011-12
FUNDS PROVIDED								
Total Gas Revenues	\$ 830,550	\$ 856,562	\$ 942,090	\$ 1,000,306	\$ 966,138	\$ 906,078	\$ 901,627	\$ 893,451
Other Operating Revenues	32,807	28,534	28,564	29,732	29,321	28,406	28,532	28,605
Total Operating Revenues	863,357	985,096	970,654	1,030,038	995,459	934,484	930,159	922,056
Other Income Incr. / (Decr.) Restricted Funds	1,513	12,097	11,250	17,343	14,967	11,368	8,868	8,868
City Grant	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000
AFUDC (Interest)	907	1,168	1,202	1,002	1,036	1,008	985	959
TOTAL FUNDS PROVIDED	883,777	1,016,361	1,001,106	1,066,383	1,029,462	964,860	940,012	931,883
FUNDS APPLIED								
Fuel Costs	509,704	639,185	630,841	658,492	623,368	562,401	558,248	550,894
Other Operating Costs	283,308	278,189	268,128	285,895	288,252	290,014	292,068	295,153
Total Operating Expenses	793,012	917,374	898,969	944,387	911,620	852,415	850,316	846,047
Less: Non-Cash Expenses	39,338	40,554	41,887	43,300	44,612	45,907	47,385	47,404
TOTAL FUNDS APPLIED	753,674	876,820	857,082	901,087	867,008	806,508	802,931	798,643
Funds Available to Cover Debt Service	130,103	139,541	144,024	165,296	162,454	158,352	137,081	133,240
1975 Ordinance Bonds Debt Service	38,806	41,949	35,748	34,368	32,368	30,155	30,745	32,164
Debt Service Coverage 1975 Bonds	3.35	3.33	4.03	4.81	5.02	5.25	4.46	4.14
Net Available after Prior Debt Service	91,297	97,592	108,276	130,928	130,086	128,197	106,336	101,076
Other Capital Leases	1,988	-	-	-	-	-	-	-
Net Available after Prior Capital Leases	89,299	97,592	108,276	130,928	130,086	128,197	106,336	101,076
1998 Ordinance Bonds Debt Service	45,999	32,467	53,313	67,813	66,852	67,966	65,143	60,885
New Proposed Bond Debt Service	-	-	-	-	-	-	-	-
Total New Debt Service	45,999	32,467	53,313	67,813	66,852	67,966	65,143	60,885
Debt Service Coverage 1998 Bonds	1.94	3.01	2.03	1.93	1.95	1.89	1.63	1.68
Net Available after 1998 Debt Service	43,300	65,125	54,963	63,115	63,234	60,231	41,193	40,191
1998 Ordinance Subordinate Bond Debt Ser	1,987	1,986	1,987	1,986	1,990	1,986	1,988	1,984
Debt Service Coverage Subordinate Bonds	21.79	32.79	27.66	31.78	31.78	30.33	20.72	20.26
Net Available To Service Aggregate Debt Serv	111,075	114,154	122,295	143,450	140,690	136,509	133,216	129,319
Aggregate Debt Service	88,790	76,402	91,048	104,167	101,210	100,107	97,876	95,033
Fixed Coverage Charge	1.25	1.49	1.34	1.38	1.39	1.38	1.38	1.36
Fixed Coverage Charge Including \$18.0 City Fee	1.04	1.21	1.12	1.17	1.18	1.18	1.15	1.14

32

OTS Statement No. 1-SR
Witness: Robert Plonski

5-23-07
Phila
TC

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

Surrebuttal Testimony

of

Robert Plonski

Office of Trial Staff

**DOCUMENT
FOLDER**

Concerning:

Debt Service Coverage

Working Capital

RECEIVED

JUN 23 2007

**UTILITY COMMISSION
OFFICE'S BUREAU**

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

2 A. My name is Robert Plonski. My business address is P.O. Box 3265, Harrisburg,
3 Pa. 17105-3265.

4

5 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS**
6 **PROCEEDING?**

7 A. Yes, I have. Please refer to OTS Statement No. 1 and OTS Exhibit No. 1.

8

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

10 A. The purpose of this surrebuttal testimony is to address the rebuttal testimony of
11 Mr. Joseph Bogdonavage, PGW St. 2R, and the rebuttal testimony of Ms. Barbara
12 Bisgaier, PGW St. 3-R.

13

14 **SURREBUTTAL OF PGW WITNESS BOGDONAVAGE, PGW ST. 2R**

15 **Q. ON PAGES 3 THROUGH 5, MR. BOGDONAVAGE LISTS FOUR**
16 **CRITICISMS IN THE OVERALL APPROACH THE INTERVENORS**
17 **TOOK IN THIS PROCEEDING AND THE OTS RECOMMENDATION**
18 **OF A \$25,000,000 BASE RATE INCREASE. WOULD YOU PLEASE**
19 **COMMENT ON THESE?**

1 A. Yes. The four criticisms Mr. Bogdonavage articulated in his rebuttal testimony
2 are as follows:

3 A. PGW claims that OTS has not recognized that it has shown that the future
4 test year presented a substantial need for a rate increase because of the
5 need to have internally generated funds and liquidity and to deal with the
6 excessive debt in its capital structure.

7 B. PGW claims that the recommended \$25,000,000 base rate increase falls far
8 short of the allowed revenues in the Company's prior base rate
9 proceedings.

10 C. PGW claims that the parties fail to recognize that PGW's debt crisis is a
11 test year problem.

12 D. PGW asserts that it was inappropriate for the parties to suggest that any
13 contributions come from the City of Philadelphia ("City").

14 I will address each of these contentions in my discussion below.

15

16 A. **LIQUIDITY AND INTERNALLY GENERATED FUNDS**

17 Q. **PLEASE DEFINE THE CASH FLOW METHOD?**

1 A. As stated in my Direct Testimony, the cash flow method requires that the
2 Company have sufficient revenues to cover all cash needs, including debt
3 obligations which will become due in the test period (OTS St. No. 1, p. 5). The
4 basic components considered under the cash flow method generally include:
5 operating and maintenance expenses and debt service which includes principal
6 and interest payments.

7

8 **Q. HOW HAS THE COMMISSION INTERPRETED THIS DEFINITION?**

9 A. In the case of PGW, the Commission has determined that the cash flow method is
10 to enable PGW to meet its minimum debt service coverage and operating and
11 maintenance expenses (Pa PUC v PGW, R-00006042, p. 15). The Commission, in
12 addition to allowing debt service coverage, will take into consideration other
13 ratemaking principles. By doing so, rates established under this methodology
14 comply with PGW's obligation to provide service to its ratepayers at just and
15 reasonable rates.

16

17 **Q. MR. BOGDONAVAGE STATES THAT THE COMMISSION'S ORDER OF**
18 **2001 SETS FORTH A SPECIFIC FORMULA FOR DETERMINING**
19 **INCREASES IN CASH WORKING CAPITAL AS REQUIRED BY THE**
20 **MANAGEMENT AGREEMENT ORDINANCE, PGW ST. 2R, PAGE 12,**
21 **LINES 4-38. IS HE CORRECT?**

1 A. No. He is mischaracterizing the Commission Order. In the Order, the
2 Commission acknowledged the Company's Management Agreement Ordinance
3 methodology as the one to establish rates. Part of the Management Agreement
4 Ordinance provides that PGW's rates must include "reasonable additions to the
5 working capital". However, as shown below, the Commission did not explicitly
6 endorse this formula:

7 We note that PGW's Management Agreement sets forth
8 specific categories of expenses and revenues that are to be
9 included in PGW's rate setting process. The Commonwealth
10 Court has determined that this Agreement specifies the cash
11 flow method as the ratemaking formula for establishing
12 PGW's rates. The Commonwealth Court in *Action Alliance*
13 *v. Philadelphia Gas Commission*, 406 A.2d 1155, 1157 (Pa.
14 Cmwlth. Ct. 1979) has deemed the above process of fixing
15 rates as the cash flow method. Also, the Commonwealth
16 Court accepted the cash flow method as set forth in
17 Section VII of the Management Agreement as an acceptable
18 ratemaking method for PGW at a time when PGW was not
19 regulated by the Commission. (*Id.*, p. 1158).

20
21

22 For the purposes of this ratemaking issue, the General
23 Assembly clearly directs the Commission, in Section 2212(e)
24 of the Act, to set rates in a base rate proceeding for PGW in
25 accordance with its previous ratemaking methodology and
26 requirements rather than by other ratemaking methods
27 traditionally employed in reviewing public utility rate filings.
28 In this instance, the previous ratemaking methodology, as
29 contained in PGW's Management Agreement and affirmed by
30 the Pennsylvania courts, is the cash flow method.

31
32 By adopting this ratemaking methodology in accordance with
33 Section 2212(e) of the Act, the Commission is simply
34 utilizing a different methodology than the traditional rate
35 base/rate of return regulation. **At the same time, the**
36 **adoption of this ratemaking methodology to set rates for**
37 **PGW allows the Commission's other statutory directives,**

1 **such as minimum debt service coverage and just and**
2 **reasonable rates, to be fulfilled in accordance with**
3 **Sections 1301 of the Code and 2212(c) of the Act.**
4

5 As discussed below, in following the cash flow method, the
6 Commission is free to examine PGW's rates under the just
7 and reasonable standard. The Commission is not required to
8 accept the level of expense claimed by PGW or approved in a
9 PGW budget by the PGC. If PGW fails to prove that a given
10 expense item was prudently incurred and reasonable in
11 amount, the Commission will make an appropriate adjustment
12 in its rates chargeable to customers.

13
14 Accordingly, this Commission must, and intends to, exercise
15 its discretion to determine a just and reasonable level of rates
16 for PGW while balancing the interests of PGW's customers,
17 as it does in all other rate cases before us. Only through the
18 exercise of this authority is the Commission in conformity
19 with all the provisions of the Code, namely Sections 1301 and
20 2212, and sound ratemaking principles.
21

22 Pa. PUC v PGW, Docket No. R-00006042 pp. 14-16 (Order Entered
23 October 4, 2001)(Emphasis added).

24
25 **Q. WHAT IS YOUR INTERPRETATION OF THIS SECTION OF THE**
26 **COMMISSION ORDER?**

27 **A.** As shown above, the Commission must regulate PGW under the cash flow
28 methodology. The Commission has indicated that this methodology allows for
29 the use of minimum debt service coverage in establishing just and reasonable
30 rates. Because working capital is contained in the Management Agreement
31 Ordinance, the Commission may consider a reasonable level of working capital in
32 setting rates under the cash flow method.

1 Q. DID THE COMMISSION LATER CLARIFY ITS ACCEPTANCE OF A
2 REASONABLE LEVEL OF WORKING CAPITAL?

3 A. Yes. In a Petition for Reconsideration, the Commission issued the following
4 statement at Public Meeting dated December 5, 2001.

5 The Agreement clearly states that only a reasonable amount
6 of working capital is to be included in rates. **The**
7 **Management Agreement does not assume that customer**
8 **rates will cover all PGW's capital and cash needs as if no**
9 **other sources of capital or revenues are available to**
10 **PGW.** In our October 4th Order, we specifically found that
11 a \$39 million increase in base rate revenues (later corrected
12 to \$33.5 million in our October 12th Order) will provide
13 PGW with adequate revenues "to ensure that PGW is able to
14 maintain an adequate level of financial health require to fund
15 operations and meet debt service requirements." (October
16 4th Order, pp. 43-44). Our Order specifically found that the
17 approved revenue requirement, which includes a reasonable
18 amount of cash working capital, results in rates that are just
19 and reasonable in accordance with the statutory directives set
20 forth in the Public Utility Code. (October 4th Order, pp. 26-
21 27). We find that the Management Agreement does not
22 require a greater increase, nor does the just and reasonable
23 standard.

24 (Emphasis added).

25
26
27 Q. DO YOU AGREE WITH MR. BOGDONAVAGE'S USE OF THE TERM
28 CASH WORKING CAPITAL?

1 A. No. The term in PGW's Management Agreement Ordinance is "working
2 capital". However, Mr. Bogdonavage uses the term cash working capital in his
3 testimony. These terms should not be used interchangeably as the definitions are
4 not the same.

5
6 **Q. PLEASE DEFINE CASH WORKING CAPITAL?**

7 A. Cash working capital is an element of rate base valuation and is measured by
8 those funds needed to bridge the gap between the rendition of service to
9 customers and the receipt of payment for those services.

10
11 **Q. PLEASE DEFINE WORKING CAPITAL?**

12 A. Working capital is defined as current assets (cash, accounts receivable, inventory)
13 minus current liabilities. Positive working capital means the company is able to
14 pay off its short-term liabilities. Whereas, negative working capital means that a
15 company currently is unable to meet its short-term liabilities with its current
16 assets.

17
18 **Q. WHY IS THE COMPANY'S USE OF CASH WORKING CAPITAL**
19 **INCORRECT?**

20 A. I have two reasons for rejecting PGW's narrow definition of working capital in
21 this proceeding. First, the concept of cash working capital is only relevant in
22 proceedings using the rate base/rate of return method. In these proceedings, cash

1 working capital is clearly defined as a component of determining a utility's total
2 rate base. It is not relevant in the context of a cash flow proceeding because rate
3 base is not an element of the cash flow method. Second, the contention that cash
4 working capital is mandated in the Management Agreement Ordinance is in error.
5 The Management Agreement Ordinance states that PGW must have reasonable
6 working capital (cash, accounts receivable, inventory, etc.), but it does not state
7 that it requires cash working capital.
8

9 **Q. MR. BOGDONAVAGE STATES ON PAGE 7 THAT YOUR**
10 **RECOMMENDED RATE INCREASE OF \$25,000,000 DOES NOT GIVE**
11 **PGW ADEQUATE LIQUIDITY. DO YOU AGREE?**

12 A. No, I do not agree. His conclusion is dependent on his reference to "free cash" as
13 the sole indicator of liquidity (PGW St. 2R, p. 10).
14

15 **Q. IS "FREE CASH" THE ONLY INDICATOR OF LIQUIDITY?**

16 A. No.
17

18 **Q. WHAT IS THE PROPER DEFINITION OF LIQUIDITY?**

19 A. Liquidity is defined as the ability to turn an asset into cash or cash equivalents.
20 Therefore, I would consider cash, gas inventories, money markets, commercial
21 paper, and short-term treasury bonds as examples of liquid assets.

1 **Q. USING THE “FREE CASH” CONCEPT, CAN THE ISSUE OF A**
2 **COMPANY’S INADEQUATE LIQUIDITY BE MANIPULATED?**

3 A. Yes. The “free cash” variable can be manipulated by changing any other variable
4 in the Company’s cash flow statement.

5
6 **Q. HAS SUCH A MANIPULATION OCCURRED IN THE INSTANT**
7 **PROCEEDING?**

8 A. Yes. As evidenced by the series of updated schedules attached to Mr.
9 Bogdonavage’s Rebuttal Testimony, the Company has presented a series of
10 scenarios that alter the cash flow statement demonstrated in JRB Ex. 7, 8, 13.

11
12 **Q. ON PAGE 6, MR. BOGDONAVAGE CLAIMS YOUR**
13 **RECOMMENDATION OF A \$25,000,000 RATE INCREASE PRODUCES**
14 **NO INTERNALLY GENERATED FUNDS. IS HE CORRECT?**

15 A. No. Mr. Bogdonavage is confusing the definition of internally generated funds
16 with internally generated cash.

17
18 **Q. WHAT IS THE DEFINITION OF INTERNALLY GENERATED FUNDS?**

19 A. The definition of internally generated funds is net income plus depreciation.

20
21 **Q. DOES YOUR RECOMMENDED \$25 MILLION INCREASE PROVIDE**
22 **PGW WITH INTERNALLY GENERATED FUNDS?**

1 A. Yes. Based on our \$25,000,000 rate increase, we are providing internally
2 generated funds of \$90,000,000 (\$52,000,000 of net income plus \$38,000,000 of
3 depreciation). The computation of the OTS position is presented on page 13 of
4 my surrebuttal testimony.

5
6 **B. RATES NOT SET ON REVENUE ALLOWANCES GRANTED IN PRIOR**
7 **COMMISSION ORDERS**

8
9 **Q. MR. BOGDONAVAGE CLAIMS THAT THE OTS RECOMMENDED**
10 **\$25,000,000 INCREASE DOES NOT PRODUCE AS MUCH NET INCOME**
11 **AS WAS ALLOWED IN PRIOR BASE RATE PROCEEDINGS. PLEASE**
12 **EXPLAIN.**

13 A. PGW asserts that a large part of its \$100 million request will simply put PGW in
14 the same financial position as it was in after the Commission's prior base rate
15 Orders, which permitted the Company to increase its rates by \$36 million in 2002
16 and \$33.6 million in 2001 (PGW St. 2R, p. 16). The Company maintains that to
17 put PGW back in the position that it was in after these proceedings, it must
18 receive an increase of \$79.3 million. According to PGW's analysis, the PUC
19 approved rates in its two prior base rate proceedings produced a net income of
20 approximately \$88 million. The Company maintains that the OTS recommended
21 \$25 million increase is unreasonable because operating and maintenance expense,
22 interest expense and depreciation expenses have increased since the last
23 proceedings while the Company's net margin contribution has decreased due to

1 the significant increase in natural gas expenses (PGW St. 2R, p. 17). According
2 to PGW's analysis, its rates must be increased by \$65.8 million to allow PGW the
3 same level of net income that the Commission permitted in the two prior rate
4 cases and maintains that this should be the minimum level of increase that the
5 Commission can award.

6
7 **Q. DO YOU AGREE THAT COMPARING RESULTS FROM PRIOR BASE**
8 **RATE PROCEEDINGS IS A VALID BENCHMARK OF AN**
9 **APPROPRIATE RATE INCREASE IN THIS PROCEEDING?**

10 A. No. I disagree with the Company's analysis for two reasons. First, from a basic
11 ratemaking standpoint, the revenue received in prior base rate proceedings is not
12 an indication of what is an appropriate level of increase in subsequent base rate
13 proceedings. Second, to the extent that the Company believes that such a
14 comparison is appropriate, its calculations are in error.

15
16 **Q. PLEASE ADDRESS YOUR FIRST CONTENTION THAT PRIOR BASE**
17 **RATE PROCEEDINGS ARE NOT AN APPROPRIATE INDICATION OF**
18 **REVENUE REQUIREMENT IN SUBSEQUENT BASE RATE**
19 **PROCEEDINGS.**

20 A. An appropriate level of rate increase is determined by the Commission on a case
21 by case basis. As always, the starting point for this determination is the
22 company's filing as this is where the company presents its case and provides

1 supporting documentation and information necessary to review all the ratemaking
2 components to determine an appropriate increase. Examining the unique
3 circumstances of the utility at the time of the base rate filing is necessary every
4 time the company makes such a filing because the law requires that all rates be
5 just and reasonable. Therefore, relying on a comparison between the net income
6 and revenue arrived at in prior base rate proceedings is an improper way to
7 establish rates for PGW ratepayers.

8
9 **Q. SECONDLY, YOU CONTEND THAT, TO THE EXTENT PGW**
10 **BELIEVES SUCH A COMPARISON IS INSTRUCTIVE, THEIR**
11 **CALCULATION IS IN ERROR. PLEASE EXPLAIN.**

12 A. PGW indicates that the PUC approved rates in the two prior base rate proceedings
13 produced a net income of approximately \$88 million. However, after reviewing
14 the Commission Orders in the prior base rate cases, the \$88,000,000 is a
15 mischaracterization of the results of the rate proceedings because the results of
16 the two rate cases cannot be cumulative.

17
18 **Q. WHY CAN'T THE NET INCOME RESULTS BE CUMULATIVE?**

19 A. As mentioned earlier, each case must stand on its own merits and is not
20 dependant on results in previous cases. The rate increase and resulting net
21 income from the first rate case are subsumed in the historical test year data of the
22 second rate case. The Company's notion that these net income results are

1 cumulative is just another attempt to give credence to an unsupported revenue
2 claim.

3
4 **Q. WHAT LEVEL OF NET INCOME WILL THE OTS RECOMMENDED**
5 **\$25,000,000 RATE INCREASE PRODUCE?**

6 A. The OTS recommended \$25,000,000 rate increase with OTS adjustments would
7 produce a net income of \$51,726,000:

8	Adjustments:	\$6,467,000	Revenue Adjustment
9		\$4,546,000	Expense Adjustment
10		\$13,315,000	Bad Debt Adjustment
11		\$2,491,000	Various Cost Savings Adjustment
12		\$50,000	Other Income Adjustment
13		\$25,000,000	OTS Rate Increase
14			
15		\$114,000,000	Operating Income
16			
17		\$51,726,000	Net Income

18 I will explain the OTS adjustments. There are two adjustments to revenue
19 proposed by OTS Witness Kubas that the Company has accepted. This is a
20 \$6,467,000 increase adjustment to heating income and has a corresponding
21 increase to expenses of \$4,546,000. OTS Witness Markovich has proposed
22 decreases of \$13,315,000 to bad debt expense and \$2,491,000 to various cost
23 savings. Additionally, Ms. Markovich proposes a \$50,000 increase to other
24 income. The OTS adjustments to the Company's claim along with the OTS
25 recommended \$25,000,000 base rate increase will produce an operating income

1 of \$114,000,000 for the test year. With no other changes to the Company's
2 expenses, the net income result for the test year will be \$51,726,000.

3
4 **Q. WHAT IS THE SIGNIFICANCE OF THE NET INCOME**
5 **CALCULATION?**

6 A. According to my analysis, the OTS recommended \$25 million rate increase with
7 OTS adjustments would produce net income of approximately \$52 million.

8 Therefore, to the extent that the Company believes a comparison is appropriate, it
9 appears that the Company's \$52 million in net income would be greater than the

10 \$44 million net income from the prior base rate proceeding (Docket No. R-

11 ¹⁷~~0007~~034F0002, Table 1)(Order entered April 12, 2002).

12
13 **C. TEST YEAR**

14 **Q. MR. BOGDONAVAGE HAS CLAIMED THAT PGW HAS**
15 **DEMONSTRATED ITS FINANCIAL NEED BOTH IN THE SHORT**
16 **TERM (TEST YEAR) AND THE LONGER TERM (THROUGH 2012).**
17 **HOW DO YOU RESPOND?**

18 A. Mr. Bogdonavage's assertion as to short term needs of the Company is not
19 supported by its own filing. As demonstrated in Exhibit ^{SRB-1, pg. 3}~~JRB-3~~, filed with the
20 Company's Direct Testimony, PGW has demonstrated that it will produce
21 sufficient revenue to satisfy its debt service coverage while retaining an adequate
22 amount of working capital to provide for short term needs. Mr. Bogdonavage's

1 continued misapplication of the definition of working capital underscores the
2 problem. As discussed earlier in my Surrebuttal Testimony, working capital
3 consists of more than just cash. Any liquid assets will provide the Company with
4 working capital. As has been demonstrated by the Company's own evidence, it
5 has sufficient revenue to cover its debt service and retain a reasonable amount of
6 working capital. Furthermore, attached to my Direct Testimony as Exhibit No. 1,
7 Sch. 8 is an Interrogatory response showing the Company's financial position
8 including the \$25 million allowance contained in the OTS recommendation. This
9 evidence in my exhibit was supplied by the Company's witness and does not
10 support its dire financial straits claim. Mr. Bogdonavage's claims regarding the
11 Company's need through 2012 serve nothing more than to distort the needs of
12 this proceeding.

13
14 **Q. HAS THE COMPANY PROVIDED ANY UPDATED EXHIBITS IN ITS**
15 **REBUTTAL TESTIMONY?**

16 **A.** It appears that the Company has attempted to update its cash flow analysis that
17 was contained in its Direct Testimony through its submission of JRB-7.

18 However, there are numerous unexplained changes that render this exhibit
19 meaningless in this proceeding. My recommendation is based on the Company's
20 exhibits in its original filing as well as the above referenced Interrogatory
21 response attached as an exhibit to my Direct Testimony. These documents

1 provide the basis for any analysis. The Company's rebuttal exhibits are
2 unreliable.

3 **Q. WHY ARE YOU NOT CONCERNED WITH THE COMPANY'S**
4 **PERCEIVED NEEDS THROUGH 2012?**

5 A. Public utility regulation in Pennsylvania is based on the concept of a test year. As
6 explained in my Direct Testimony on page 9, a test year is a period of
7 measurement for a recent, consecutive 12 month period consisting of a full year
8 operations where data is readily available. In this case, the Company has elected
9 to use a future test year as the basis for analyzing its needs. Mr. Bogdonavage's
10 representations as to the Company's financial situation through 2012 include
11 claims that are outside of the test year. Except under extremely limited
12 circumstances, utility regulation in Pennsylvania does not recognize activities
13 falling outside the test year.

14
15 **Q. WHY IS A TEST YEAR IMPORTANT IN THIS REGULATORY**
16 **PROCEEDING?**

17 A. A test year is important as it provides the foundation for the calculation of the
18 rates to be established at the conclusion of a base rate case. One of the goals of a
19 base rate case is to accurately represent the revenue requirement of the utility
20 during the time in which the rates will be in effect. Utilization of a test year is the
21 best way to accurately represent the operating revenue of the utility and to match
22 the appropriate level of expenses.

1 **Q. WHY ISN'T A LONGER PLANNING PERIOD APPROPRIATE?**

2 A. Trying to plan beyond a future test year yields unreliable results. The estimate of
3 expenses, revenues and other factors influencing the proper setting of rates
4 becomes less reliable the further away from the source time period one goes. In
5 other words, one year predictions or estimates are more accurate than five year
6 estimates. While the Company can file several base rate cases over a five year
7 span, it is inappropriate under the current regulatory framework to set rates in this
8 proceeding to meet goals that are five years away.

9
10 **Q. WHAT HAS THE COMPANY DONE IN THIS PROCEEDING?**

11 A. While claiming that its current financial situation represents a test year problem,
12 it continues to include data and scenarios through 2012. The Company refers to
13 its procedure as utilization of a "planning horizon."

14
15 **Q. WHAT IS YOUR UNDERSTANDING OF THE COMPANY'S**
16 **"PLANNING HORIZON"?**

17 A. In this proceeding, the Company's planning horizon is nothing more than its 5
18 year budget as approved by the Philadelphia Gas Commission (PGW St. 2R, p.
19 15).

1 **Q. WHAT IS THE DIFFERENCE BETWEEN THE COMPANY'S**
2 **"PLANNING HORIZON" AND A FUTURE TEST YEAR?**

3 A. Utility regulation in Pennsylvania is based on a test year. As I've discussed
4 earlier, a test year provides a more accurate picture of the Company's operating
5 finances than a five-year plan. Because of the numerous uncertainties in
6 projecting out five years, it makes more sense to utilize a test year to create a
7 more accurate and reliable position. Moreover, use of a test year is a statutory
8 requirement. Planning horizons may be appropriate when dealing with the
9 Philadelphia Gas Commission or the Company's parent, the City of Philadelphia,
10 but it has no use in a base rate proceeding.

11
12 **Q. DOESN'T LIMITING YOUR ANALYSIS TO A TEST YEAR DEPRIVE**
13 **THE COMPANY OF RECOVERING FUTURE EXPENSES?**

14 A. No, not at all. Ratemaking is not an exact science. What must be accomplished
15 as a result of this proceeding is that PGW be allowed to recover, in rates, what it
16 needs to provide safe and reliable service based on its known and measurable
17 operating needs. Anything beyond that is not justifiable. The cash flow method
18 requires the Company to recover what it needs to operate. This methodology
19 contains no provisions for granting what the Company may want.
20 *Should the Company's financial position continue to improve, rate increases can*
21 *be delayed. If the Company's operating revenues threaten its ability to provide*
22 *safe and reliable service, it should file for rate relief.*

1 **D. CONTRIBUTION FROM THE CITY OF PHILADELPHIA**

2 **Q. THE CITY STATES THAT YOU SUGGESTED THAT PGW'S HIGH**
3 **DEBT CAN BE ADDRESSED BY THE CITY OF PHILADELPHIA.**
4 **PLEASE EXPLAIN.**

5 A. PGW witness Bogdonavage states that it is not practical or legal to look to the
6 City to resolve PGW's debt and liquidity issues (PGW St. 2R, p. 5). The
7 Company asserts that, with the OTS recommended \$25 million increase, it would
8 require the City to contribute \$325 million to reduce PGW's debt ratio to 57% by
9 FY 2012.

10
11 **Q. DID YOU SUGGEST THAT THE CITY CONTRIBUTE SIGNIFICANT**
12 **FUNDS TO THE COMPANY TO IMPROVE ITS CAPITAL**
13 **STRUCTURE?**

14 A. No. In Direct Testimony I commented that PGW could improve its capital
15 structure if the City forgave repayment of the \$45 million City loan. I did not,
16 however, recommend that the City contribute any funds to the Company. By
17 forgiving the loan, the City would assist PGW in reducing its debt. Therefore,
18 my testimony recommended that the City forgive a current debt, not contribute
19 additional funds to PGW.

1 **Q. WHY SHOULD THE CITY HELP PGW REDUCE ITS DEBT?**

2 A. Throughout this proceeding, PGW claims that it has a debt and liquidity crisis.

3 The City is the parent of PGW and, as a parent, it has the responsibility to help its

4 subsidiary in troubled times, which was noted by the Commission in the

5 following Order (Docket No. R-00006042):

6 However, we urge the City of Philadelphia, as owner of
7 PGW, to continue to take measures to insure the financial
8 health of PGW. It is the expectation of this Commission that
9 the City of Philadelphia, as owner of PGW, continue to assist
10 PGW in its cash flow requirements so that a financial crisis
11 does not take place. One way of insuring PGW's overall
12 financial health is to grant back or waive, in part or in total,
13 the City payment when necessary. We hope that the City of
14 Philadelphia will be as diligent in its concern for the
15 financial health of PGW as the Commission is in granting
16 the rate relief described herein.

17
18
19 **Q. DO YOU HAVE ANY FURTHER COMMENT ABOUT WHO**
20 **SHOULD BEAR THE RESPONSIBILITY TO ADDRESS PGW'S**
21 **CAPITAL STRUCTURE ISSUE?**

22 A. Yes. The Company contends that it needs to be "fixed" because of its high debt
23 and low liquidity (PGW St. 1R, p. 8; PGW St. 2R, p. 15). It must be emphasized
24 that the Company, through its requested \$100 million increase, is looking solely
25 to its ratepayers to bear the cost of this "fix". In my opinion, requiring only
26 ratepayers to do so within the proposed five year period violates the public
27 interest. Ratepayers can do their part to balance PGW's debt to equity ratio. The
28 OTS recommended rate increase of \$25 million will provide coverage well in

1 excess of the Company's required debt service requirements and will produce
2 approximately \$52 million in net income, which indicates that, based on the
3 recommended \$25 million increase, the Company's equity account should
4 strengthen. While a slow rise in the equity ratio can be expected, it will not rise
5 to the 50% level requested by the Company in the filing. If the City forgives
6 repayment of the \$45 million loan, the Company's debt will continue to be
7 reduced. Additionally, if PGW implements the operating efficiencies identified
8 in OTS St. No. 2 and 2-SR, the Company can do its share to achieve its desired
9 capital structure. Unlike the Company's view, there is more than one way that
10 PGW's debt can be reduced. While PGW looks solely to its ratepayers, OTS
11 maintains that the City, as the parent, and the Company, in conjunction with the
12 ratepayers, can do their part to achieve PGW management's goal of a more
13 balanced capital structure.

14
15 **Q. ON PAGE 20, LINES 20-25, MR. BOGDONAVAGE CLAIMS THAT YOU**
16 **ASSUMED THAT PGW'S BONDS ARE BACKED BY THE FULL FAITH**
17 **OF THE CITY OF PHILADELPHIA. IS THIS A CORRECT**
18 **INTERPRETATION OF YOUR TESTIMONY?**

19 **A.** No. It is a mischaracterization of my testimony. As provided in an interrogatory
20 response to the Company, I noted that the statement in my testimony was a general
21 observation that rating agencies recognize that municipalities have taxing
22 authority resulting in different rating criteria compared to investor owned utilities.

1 However, I did not testify about the specific relationship between the City and
2 PGW's bonds. I informed the Company that I understand that the City does not
3 have an obligation to back PGW bonds, but I have no knowledge of the City's
4 policy in the event of a default. Therefore, while I recognize that the City does not
5 have an obligation to back PGW's bonds, I do believe that the City, as the
6 Company's parent, should do its part to help PGW management achieve its goal of
7 a more balanced capital structure which is consistent with the prior Commission
8 Order, Docket No. R-00006042, noted above.

9
10 **SURREBUTTAL OF PGW WITNESS BISGAIER, PGW ST. 3-R**

11 **Q. MS. BISGAIER, AT PAGE 5, INDICATES THAT THE OTS**
12 **RECOMMENDED \$25 MILLION INCREASE IS INADEQUATE**
13 **BECAUSE IT WILL PROVIDE ONLY \$86.5 MILLION OF LIQUID**
14 **ASSETS BY THE END OF FISCAL YEAR 2008. WOULD YOU PLEASE**
15 **COMMENT?**

16 **A. Yes. Ms. Bisgaier's criticism concerning liquidity does not merit consideration**
17 **for two reasons. First, Ms. Bisgaier's analysis extends well beyond the test year.**
18 **The amount of cash projected to be on hand at the end of FY 2008 cannot be**
19 **determined with any degree of certainty. Calculations beyond the test year are**
20 **speculative and should not be considered. As I've stated earlier in my response to**
21 **PGW witness Bogdonavage, utility regulation in Pennsylvania is based on test**

1 year representations. Basing a recommendation on data extending beyond the test
2 year is improper and must be rejected.

3
4 **Q. WHAT IS YOUR SECOND REASON FOR REJECTING MS. BISGAIER'S**
5 **LIQUIDITY ANALYSIS?**

6 A. Ms. Bisgaier's definition and ultimate determination of liquid assets is too narrow
7 and does not provide an adequate indication of PGW's true liquidity position.

8
9 **Q. AT LINES 15 AND 16 OF PAGE 5, MS. BISGAIER DEFINES LIQUIDITY**
10 **AS ONLY CASH AND AVAILABLE SHORT-TERM BORROWING. DO**
11 **YOU AGREE WITH THIS DEFINITION?**

12 A. No, not entirely. Liquidity does include cash and short term borrowing, however,
13 liquidity measurement must also include all items easily converted to cash such as
14 gas inventories and capital projects funds. Any liquidity analysis that does not
15 include these items is meaningless and must be disregarded.

16
17 **Q. DO THE RATING AGENCIES ACKNOWLEDGE THESE ITEMS IN A**
18 **LIQUIDITY ANALYSIS?**

1 A. Of course. PGW Exhibit BB-2 demonstrates this. At page 2 of 4 (second
2 attachment) of that exhibit, S&P states “unspent proceeds of bonds previously
3 issued to fund capital projects represent a liquidity tool.” At page 3 of the same
4 exhibit, they also state “Gas storage deferral contracts enhance PGW’s short-term
5 liquidity by delaying cash outlays in summer months when liquidity is tight.”
6

7 **Q. PGW’S WITNESS HAS OPINED THAT 200 DAYS OF LIQUIDITY IS**
8 **NECESSARY. DO YOU AGREE WITH THIS RECOMMENDATION?**

9 A. No, I do not. Based on her limited definition of liquidity as including only cash
10 and short term borrowing, the resulting recommendation is clearly excessive.
11

12 **Q. WHAT HAS THE COMPANY WITNESS OFFERED AS SUPPORT FOR**
13 **HER RECOMMENDATION?**

14 A. Ms. Bisgaier provided a list of municipal companies showing days of liquidity
15 that she claims provides support for her 200 days cash proposal (PGW St. 3R, Ex.
16 BB-3).
17

18 **Q. DOES THIS EXHIBIT SUPPORT HER CLAIM?**

19 A. No, it does not. This exhibit and her related conclusions are suspect for two
20 reasons.

1 Q. **WHAT IS YOUR FIRST REASON?**

2 A. First, Ms. Bisgaier's list is not representative of the subject utility in this
3 proceeding. In order to be representative of PGW the list should only include
4 municipal gas companies. From reviewing the list, it appears that the majority of
5 the companies represented are either municipal electric or municipal water
6 companies.

7
8 Q. **WHY ARE MUNICIPAL ELECTRIC AND WATER COMPANIES NOT**
9 **REPRESENTATIVE OF PGW?**

10 A. Municipal electric and water companies do not have to store large amounts of
11 inventory during the summer for use during peak winter demand. As such, their
12 liquidity needs are different compared to a gas utility since they don't have gas
13 inventories available as current assets.

14
15 Q. **WHAT IS YOUR SECOND REASON FOR REJECTING HER**
16 **LIQUIDITY ANALYSIS?**

17 A. Ms. Bisgaier's statistical analysis is skewed by the data. Several companies are
18 sample outliers which results in a large influence on the overall average. For
19 example, the City of Newark has 100,075 days (274 years) of liquidity. Simply
20 deleting that one company from the analysis lowers the average from 2124 days
21 to 1650 days. A good statistician would not only have picked a more
22 representative sample but would have thrown all outliers out of the sample. Ms.

1 Bisgaier has done neither. As a result, the analysis is meaningless and should be
2 rejected.

3
4 **Q. HAS OTS MADE A RECOMMENDATION AS TO AN APPROPRIATE**
5 **LEVEL OF LIQUID ASSETS?**

6 A. No. As presented in my Direct Testimony, the cash flow method is not fixated on
7 the concept of days of liquidity. Regulation under the cash flow method requires
8 adequate debt service coverage combined with reasonable working capital.
9 By way of analogy, a rate base/rate of return analysis uses the one-eighth method,
10 or 45 days, in the calculation of a cash working capital allowance. This method is
11 an alternative to a lead/lag study. These comments are not meant as an
12 endorsement of this methodology in this proceeding. It merely underscores the
13 unsupported nature of Ms. Bisgaier's excessive 200 day recommendation.

14
15 **Q. CAN THE NUMBER OF DAYS OF LIQUIDITY BE ACCURATELY**
16 **CALCULATED AT THIS TIME?**

17 A. No. Because of the number of variables that must be included in the analysis of
18 liquidity, a definitive calculation is not possible at this time. However, a cursory
19 review of the current assets that can readily be converted into cash would likely
20 produce a calculation in excess of the Company's recommended 200 days.

1 **Q. MS. BISGAIER, AT PAGE 13, REFERS TO THE FORGIVENESS OF**
2 **THE \$45 MILLION CITY DEBT AS A SUBSIDY AND FURTHER**
3 **BELIEVES THAT FUNDS RECEIVED BY PGW FROM THE CITY**
4 **WOULD NOT ALLEVIATE RISK. IS SHE CORRECT?**

5 A. No. The forgiveness of the \$45 million City debt is incorrectly labeled a subsidy.
6 The correct term for this act is an equity infusion. Corporate parents do this kind
7 of transaction routinely.

8
9 **Q. HOW WOULD AN EQUITY INFUSION BE REFLECTED ON THE**
10 **COMPANY'S BALANCE SHEET?**

11 A. PGW's balance sheet would simultaneously show a decrease of \$45 million to the
12 debt account and a \$45 million increase to the equity account. Ms. Bisgaier's
13 analysis continues to assume that the capital structure of PGW can only be
14 adjusted by increased funds from ratepayers.

15
16 **Q. WOULD YOU PLEASE RESPOND TO MS. BISGAIER'S COMMENTS**
17 **WITH RESPECT TO RISK?**

18 A. Ms. Bisgaier's conclusion that risk would not change is also incorrect. Any
19 equity infusion would alter the risk characteristics of this utility. The resulting
20 capital structure after the debt forgiveness would show less leverage. Less
21 leverage is indicative of lower financial risk. To suggest otherwise is
22 fundamentally incorrect.

1 **Q. ON PAGE 6, LINES 18-20, MS. BISGAIER STATES THAT BY 2011 PGW**
2 **WILL DEFAULT ON SOME OF ITS PAYMENT OBLIGATIONS. DO**
3 **YOU AGREE WITH HER CONCLUSION?**

4 A. No. I disagree with her conclusion for several reasons. First, her conclusion was
5 based on a zero increase and did not reflect the OTS recommended \$25,000,000
6 addition to rates. Also, her conclusion ignores the operating efficiencies
7 presented in Ms. Markovich's testimony. Furthermore, her conclusion fails to
8 acknowledge the impact of the Company's parent's capabilities. By the City of
9 Philadelphia merely waiving the \$45 million loan repayment obligation, PGW's
10 financial circumstances will improve dramatically. Finally, 2011 is four years
11 beyond the test year that was selected by the Company. PGW will have the
12 opportunity to request rate relief should its ability to provide safe and reliable
13 service become compromised.

14
15 **Q. ACCORDING TO MS. BISGAIER, PAGE 7, LINES 16-18, PGW WILL BE**
16 **IN TECHNICAL DEFAULT OF ITS BOND ORDINANCES BY 2009. DO**
17 **YOU AGREE WITH CONCLUSION?**

18 A. No. According to the information presented by the Company in its test year it has
19 ample debt service coverage within the confines of the test year. Any amount of
20 increase granted at the present time will give PGW additional debt service
21 coverage for the test year. Again, Ms. Bisgaier's prediction goes beyond the test

1 year and does not recognize the operating efficiencies identified by OTS, nor
2 does it consider PGW's option of seeking additional rate relief.

3
4 **OTS SUMMARY POSITION**

5
6 **Q. DO YOU BELIEVE THAT PGW'S REQUESTED \$100,000,000 RATE**
7 **INCREASE IS APPROPRIATE?**

8 A. No. Under the cash flow method, PGW's filing has not demonstrated a need for
9 rate relief at this time. Based on PGW's future test year claim, the Company
10 exceeds its debt service requirements and has a reasonable amount of working
11 capital. Because PGW's financial position is adequate to meet its future test year
12 obligations, a rate increase is not warranted from a ratemaking standpoint.

13
14 **Q. DO YOU RECOMMEND THAT PGW RECEIVE NO RATE INCREASE?**

15 A. No. Despite the fact that a rate increase is not justified based on the Company's
16 future test year, the OTS recommendation is that PGW receive a \$25,000,000 rate
17 increase. As discussed in Direct Testimony, I believe that a \$25,000,000 rate
18 increase is appropriate because, absent the Company's parent waiving repayment,
19 PGW has a loan payment due to the City in fiscal year 2008 in the amount of
20 \$43,000,000 and a \$2,000,000 payment to the City in 2007 (OTS St. No. 1, p.
21 17). The \$25,000,000 increase is intended to extinguish the loan due in the 2007-
22 2008 fiscal years. Because this payment is known and measurable and because

1 PGW is regulated under the cash flow methodology, I believe that the OTS
2 recommended increase of \$25,000,000 is appropriate.

3
4 **Q. DOES THE OTS RECOMMENDATION TAKE INTO ACCOUNT THE**
5 **IMPACT OF THE OTS REVENUE AND EXPENSE ADJUSTMENTS?**

6 A. No. My recommended \$25,000,000 increase does not take into account the
7 expense adjustments presented in OTS St. No. 2 and 2-SR, or the revenue
8 adjustment presented in OTS St. No. 3 and 3-SR.

9
10 **Q. WHAT IMPACT DO THE OTS ADJUSTMENTS HAVE ON DEBT**
11 **SERVICE COVERAGE RATIOS?**

12 A. The OTS adjustments will increase the Company's debt service coverage ratios,
13 which even further demonstrates that the Company's requested rate increase is
14 unsupported by the filing.

15
16 **Q. WHY DID OTS NOT FACTOR ITS ADJUSTMENTS INTO THE**
17 **PROPOSED \$25,000,000 RATE INCREASE?**

18 A. OTS, the party charged with representing the public interest, did not reflect the
19 adjustments in the recommended increase because OTS believes that a modest
20 level of rate relief will assist the Company in addressing its operational needs.
21 From a ratemaking standpoint, it is entirely appropriate to make these
22 adjustments, which would clearly reduce the OTS recommended \$25,000,000 rate

1 increase. However, in order to recognize that PGW must, at this point, make
2 known and measurable loan payments to the City, OTS determined that the
3 interests of the Company and its ratepayers would be served from the
4 recommended \$25,000,000 rate increase. The OTS recommendation allows this
5 cash flow Company sufficient revenue to satisfy its loan obligations, but avoids
6 the rate shock of a \$100,000,000 increase to the Company's ratepayers.

7

8 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

9 **A. Yes.**

OTS Statement No. 2
Witness: Janet M. Markovich

5-23-07
Phila
TC

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

**DOCUMENT
FOLDER**

Direct Testimony

of

Janet M. Markovich

Office of Trial Staff

DOCKETED
AUG 20 2007

Concerning:

Operation & Maintenance Expenses

RECEIVED

JUN 22 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

1 **Q. STATE YOUR FULL NAME, EMPLOYER AND BUSINESS ADDRESS.**

2 A. My name is Janet M. Markovich. I am employed by the Pennsylvania Public
3 Utility Commission, P.O. Box 3265, Harrisburg, PA 17105-3265.

4
5 **Q. WHAT IS YOUR POSITION WITH THE PENNSYLVANIA PUBLIC
6 UTILITY COMMISSION?**

7 A. I am a Fixed Utility Financial Analyst in the Office of Trial Staff (OTS).

8
9 **Q. PLEASE DESCRIBE THE ROLE OF OTS IN RATE PROCEEDINGS.**

10 A. OTS was established by the Pennsylvania Legislature in 1986 and is responsible
11 for representing the public interest in rate proceedings. The OTS analysis in this
12 proceeding is based on its responsibility to represent the public interest. This
13 responsibility requires the balancing of the interests of the ratepayers and the
14 Company.

15
16 **Q. WHAT ARE YOUR DUTIES AS AN ANALYST IN OTS?**

17 A. My duties as an OTS Analyst include participation in formal base rate proceedings
18 as an expert witness. In that capacity, I prepare and present OTS testimony and
19 exhibits. My education and professional background are set forth in the attached
20 Appendix A.

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

2 A. Based upon my review of the Philadelphia Gas Works (Company or PGW) base
3 rate filing, I am recommending adjustments to the Company's claims for operation
4 and maintenance (O&M) expenses claimed for the test year ended August 31,
5 2007.

6
7 Q. **PLEASE SUMMARIZE YOUR PROPOSED ADJUSTMENTS.**

8 A. I am recommending the following adjustments:

9	<u>Issue</u>	<u>Reduction</u>
10		
11	Management Incentive Compensation	\$ 500,000
12	Benefits – Rx coverage	\$ 460,787
13	Bad Debt Expense	\$ 21,553,000
14	Marketing - Promotions	\$ 500,000
15	Lobbying –	
16	Outside Services	\$ 230,000
17	Dues and subscriptions	\$ 15,200
18	Injuries and Damages	\$ 475,000
19	Special legal services	\$ 250,000
20	Advertising	
21	Marketing	\$ 35,000
22	Corporate communication	\$ 175,000
23	Merger Activity	\$ 50,000
24	PUC Fines and Penalties	\$ <u>50,000</u>
25		
26	Total	<u>\$ 24,293,987</u>

1 **MANAGEMENT INCENTIVE COMPENSATION**

2 **Q. WHAT IS PGW'S MANAGEMENT INCENTIVE COMPENSATION**
3 **EXPENSE?**

4 A. Management Incentive Compensation expense consists of payments made under a
5 one time or "at risk" program developed by the Philadelphia Facilities
6 Management Corporation to reward PGW's top management team, after years in
7 crisis, and in lieu of an annual merit increase for those years. The management
8 team consists of 55 to 57 management employees.

9
10 **Q. WHEN DID PGW BEGIN THIS PROGRAM?**

11 A. PGW began the "at risk" payments September 5, 2005. The payments were based
12 on the manager's performance in the fiscal year ended August 31, 2005. The
13 payments totaled \$518,953 and were expensed in the fiscal year ended August 31,
14 2006.

15
16 **Q. WHAT IS THE COMPANY'S TEST YEAR CLAIM FOR MANAGEMENT**
17 **INCENTIVE COMPENSATION EXPENSE?**

18 A. The Company's claim in the test year ending August 31, 2007 is \$500,000. In
19 addition PGW has forecasted future expenses as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2008	\$510,000
2009	\$520,000
2010	\$530,000
2011	\$541,000

1 a reduction of 50% to 0% if the performance rating was "3" (proficient).
2 Managers rated "5" (of which there were none) would receive 100% and managers
3 rated lower than "3" did not receive bonuses. Since the incentive amount received
4 was not added to the managers base salary, this portion of the managers
5 compensation was "at risk" if the manager did not continue to perform at a
6 proficient or higher level. Additionally, future base salary increases and pension
7 payments would not be compounded by these payments.

8
9 **Q. DO YOU AGREE WITH THE COMPANY'S CLAIM FOR**
10 **MANAGEMENT INCENTIVE COMPENSATION EXPENSE?**

11 A. No.

12
13 **Q. WHAT IS YOUR RECOMMENDATION FOR MANAGEMENT**
14 **INCENTIVE COMPENSATION EXPENSE?**

15 A. I recommend that the Company's claim for management incentive compensation
16 be denied. Therefore, \$500,000 should be deducted from PGW's test year
17 expenses. Although this incentive payment was originally scheduled for payment
18 on September 5, 2006, the Company indicated during discovery conference on
19 March 21, 2007 that it had not implemented payments as of that date because the
20 Gas Commission did not approve it in the PGW 2007 budget.

1 **Q. WHAT IS THE BASIS OF YOUR RECOMMENDATION FOR**
2 **MANAGEMENT INCENTIVE COMPENSATION EXPENSE?**

3 A. The recommendation to deny the Company's claim for management incentive
4 compensation expense is based on the conclusion that it is not in the best interest
5 of either the customers or the owners of PGW as it results in an expense that is
6 excessive without direct correlation to implementation of improvements in the
7 operational, service level and/or financial condition of PGW.

8
9 **Q. CONTINUE YOUR DISCUSSION CITING SPECIFIC ISSUES WITH THE**
10 **MANAGEMENT INCENTIVE PAYMENTS.**

11 A. I will explain several specific issues that support my recommendation. First, the
12 plan is not documented. For instance, the Company stated that these bonuses were
13 in lieu of merit increases, yet in a discovery conference I was informed that
14 management did receive an average merit increase of 4½ % on September 5, 2006.
15 Since this was an average merit increase (all management was eligible) and not an
16 adjustment to base salary or promotional increase, it has not been documented
17 whether the amount of this increase will be deducted from the 10% to 20% of
18 salary eligible for an incentive payment. In addition, the Company stated that
19 these payments would not impact future pension payouts. However, in a
20 discovery conference on March 21, 2007 it was explained that the pension impact
21 would depend on whether the employee was in his or her last ten years of
22 employment because the pension benefit is based on the highest five years gross

1 salary out of the last ten years of that employee's career. Again, this situation is
2 not clearly documented. Second, the evaluations that determine the final payment
3 are based on subjective core competencies or skills instead of clearly defined and
4 measurable Company or individual performance measures or objectives. In a
5 discovery conference, on March 21, 2007, I was informed that the 2005
6 performance evaluations which resulted in the 2006 payments were based on a
7 weighted score of ten core competencies which include general competencies such
8 as leadership, organization, decision making, customer focus, etc. Third, the
9 incentive plan results in payments that are excessive compared to normal merit
10 increases without any additional demands of measurable objectives. Of the four
11 examples included in the Company's response to OTS-RE-29, the two employees
12 that received promotional increases in 2005 of 4.8% and 15.84% received
13 additional payments of 10.43% and 2.9% respectively as incentive payments.
14 Both employees had a performance rating of "4". The remaining two employees
15 were not promoted and they received payments of 6.2 % and 9%. Each had a
16 performance rating of "3". Fourth, the maximum payment percentage or eligible
17 payment is escalated not only by the base salary of a manager's pay-grade but also
18 by the pay-grade itself rather than by a greater level of performance. The lowest
19 three pay grades have a maximum payment of 10% and the four highest pay
20 grades have a maximum payment of 12%, 16%, 18%, and 20% respectively (see
21 OTS Ex. No. 2, Sch. 3, p. 1-3). Therefore an employee at a higher pay-grade can
22 be rated lower and receive a higher percentage incentive payment. An

1 achievement based incentive plan would tie higher eligible payments to a higher
2 level of performance or greater percentage of objectives achieved.

3
4 **PRESCRIPTION PLAN EXPENSE**

5 **Q. WHAT IS PRESCRIPTION PLAN EXPENSE?**

6 A. Prescription plan expense includes that part of employee and retiree health
7 benefits which includes the Company's portion of prescription drug costs.

8
9 **Q. WHAT IS THE COMPANY'S CLAIM FOR PRESCRIPTION PLAN
10 EXPENSE?**

11 A. The Company's test year ending August 31, 2007 includes a claim of \$37,784,000
12 for health insurance (see JRB -1). In response to OTS-RE-48 Part A, the
13 Company includes a breakdown of this claim identifying \$13,649,529 as Rx or
14 prescription plan expenses before any Medicare Part D subsidy (see OTS Ex. No.
15 2, Sch 4).

16
17 **Q. WHAT IS THE BASIS FOR THE COMPANY'S PRESCRIPTION PLAN
18 EXPENSE CLAIM?**

19 A. During a discovery conference on March 21, 2007, Company representatives
20 explained that they employ an outside consultant to forecast health insurance
21 benefit costs. However, my calculations show that the Company's test year claim
22 is a 15.98% increase over fiscal 2006 prescription plan expenses.

1 Q. DO YOU AGREE WITH THE COMPANY'S CLAIM FOR
2 PRESCRIPTION PLAN EXPENSE?

3 A. No.

4
5 Q. WHAT IS YOUR RECOMMENDATION FOR PRESCRIPTION PLAN
6 EXPENSE?

7 A. I recommend an allowance of \$13,188,742 before the Medicare Part D subsidy.
8 This recommendation results in a reduction of \$460,787 to the Company's claim
9 for health benefits that include the prescription drug benefit. Therefore, the OTS
10 allowance for all health insurance is \$37,323,213.

11

12 Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION FOR
13 PRESCRIPTION PLAN EXPENSE?

14 A. The OTS recommendation is based on the Company's actual experience in the
15 most recent year. OTS Ex. No. 2, Sch 2, shows a comparison of the most recent
16 two fiscal years. The prescription plan expenses increased 12.06% in fiscal 2006
17 over fiscal 2005. Therefore, the OTS recommendation includes a 12.06% increase
18 for fiscal 2007 over the actual fiscal 2006 expenses rather than the Company
19 claimed 15.98%. In addition, I compared this recommendation to two independent
20 sources to verify its fairness. First, the 2006 annual Consumer Price Index for
21 Medical Care Commodities, which includes retail prescription drug prices,

1 increased 3.42%¹. Second, an AARP study of manufacturer's prices for the top
2 twenty five brand name prescription drugs sold to consumers over fifty
3 documented an average of 6.2%² increase. Finally, the Company provided a copy
4 of their consultant Brown and Brown's recommendation projecting 2007
5 prescription rates at 12% and 10% for years after 2007 (see OTS Ex. No. 2, Sch.
6 1).

7
8 **BAD DEBT EXPENSE**

9 **Q. IN THIS PROCEEDING THE COMPANY HAS MADE A CLAIM FOR**
10 **UNCOLLECTIBLE ACCOUNTS EXPENSE. WOULD YOU BRIEFLY**
11 **DEFINE WHAT IS MEANT BY UNCOLLECTIBLE ACCOUNTS?**

12 **A.** Uncollectible accounts, or what PGW refers to as bad debts, are specific
13 receivables that are determined to be uncollectible in whole or in part, either
14 because the debtors do not pay or because the creditor finds it impracticable to
15 enforce payment. Those accounts deemed uncollectible are charged against
16 income.

¹ Bureau of labor statistics data <http://data.bls.gov> 121.1/117.1=3.42%

² AARP Public Policy Institute <http://www.aarp.org/ppi>

1 **Q. HOW DO UTILITIES GENERALLY RECOGNIZE UNCOLLECTIBLE**
2 **ACCOUNTS FOR RATEMAKING PURPOSES?**

3 A. Generally, for rate making purposes, utilities compute uncollectible accounts
4 expense on an annual prospective basis. While the uncollectible accounts expense
5 is a prospective claim, the proper calculation begins with an historic analysis.

6
7 **Q. HOW WAS THE COMPANY'S CLAIM FOR UNCOLLECTIBLE**
8 **ACCOUNTS EXPENSE DEVELOPED?**

9 A. The Company's claim for bad debt expense is based on funding the bad debt
10 reserve balance. The Company projects the ending accounts receivable balance by
11 assuming that 95% of billed revenues will be collected and by estimating the
12 amounts that will be written-off during the year. The Company then takes the
13 estimated ending accounts receivable balance multiplied by the reserve factor of
14 23.38% to determine its claimed bad debt expense for the future test year. The
15 Company's bad debt expense claim is the amount needed to adjust the bad debt
16 reserve balance to the Company's desired level. The bad debt expense claim is
17 not based on a projection of uncollected amounts.

18
19 **Q. WHAT IS THE COMPANY'S CLAIM FOR UNCOLLECTIBLE**
20 **ACCOUNTS OR BAD DEBT EXPENSE IN THIS PROCEEDING?**

21 A. The Company's claim for bad debt expense is \$59.546 million at proposed rates
22 and represents approximately 5.68% of total gas revenues (\$1,047,327 million).

1 **Q. WHAT DO YOU RECOMMEND AS THE APPROPRIATE ALLOWANCE**
2 **FOR UNCOLLECTIBLE ACCOUNTS EXPENSE?**

3 A. I recommend an uncollected percentage of 4% based on the Company's most
4 recent collection rate experience of over 96%. PGW's collection rate in Fiscal
5 Year 2005 was 96.01% and in Fiscal Year 2006 the collection rate was 96.57%
6 (see PGW Statement No. 6, Exhibit RG-1). The two-year average collection rate
7 is 96.3%. When the write-off percentage of 4% is multiplied by the OTS projected
8 total revenues of \$949,824 million the result is an allowance of \$37,993 million
9 (\$949,824 x 4%). The reduction to the Company claim is \$21,553 (\$59.546 -
10 \$37,993).

11
12 **Q. WHAT IS YOUR RATIONALE FOR BASING A PROSPECTIVE**
13 **UNCOLLECTIBLE ACCOUNTS ALLOWANCE ON HISTORIC**
14 **EXPERIENCE?**

15 A. OTS proposes the application of a two year historic analysis to project
16 uncollectible accounts or bad debt expense because a company's historic ability to
17 collect receivables is the only documented basis for future performance. In
18 addition, OTS does not support the Company's use of a reserve appropriation as a
19 substitute for write-off amount because companies can set the amount of a reserve
20 balance on various criteria. The reserve amount is not the amount written off.

1 **Q. WHY IS THE OTS PROPOSAL BASED ON ONLY TWO YEARS OF**
2 **EXPERIENCE?**

3 A. The OTS proposal is based on only the most recent two-year period because this is
4 a period in which PGW implemented numerous organizational, process and
5 system improvements. The principal components of PGW's collection
6 improvement efforts as detailed in witness Gyory's testimony, PGW Statement
7 No. 6, page 3, include: (1) the full implementation of a Billing, Collections and
8 Customer Service ("BCCS") system; (2) improvements in its Customer service
9 and Credit Collection Call Centers; and , (3) implementation of the Collections
10 Renewal Initiative ("CRI"). In addition, the Company experienced the collection
11 enhancements associated with the enactment of Chapter 14. In fact, as PGW
12 witness Gyory testified in PGW Statement No. 6, page 2, the twelve month
13 collection rate improved from a rate of 91.24% in Fiscal 2004 to the 96.01% in
14 Fiscal 2005 and 96.57% in Fiscal 2006. Additionally, Mr. Gyory continues by
15 pointing out that this improvement occurred as PGW experienced a 7% increase in
16 billings due to the increase in wholesale gas costs.

17
18 **Q. HAS THE COMMISSION ACCEPTED THE HISTORIC WRITE OFF**
19 **METHOD TO DETERMINE BAD DEBT EXPENSE TO BE INCLUDED IN**
20 **RATES?**

21 A. Yes, the Commission in PGW's most recent base rate cases at Docket No.
22 R-00017034, determined that a historical analysis of prior years uncollectible

1 accounts expense is an accurate method of determining the level of bad debt
2 expense. The Company has continued to ignore the Commission's most recent
3 orders and insists on arguing its funding of the bad debt reserve as bad debt
4 expense. The Commission has consistently rejected the funding of the reserve
5 balance.

6
7 **MARKETING – PROMOTION**

8 **Q. WHAT IS MARKETING-PROMOTION EXPENSE?**

9 A. Promotional expenses are associated with the marketing department initiatives to
10 expand the use of natural gas in all market segments by providing customer
11 incentives.

12
13 **Q. WHAT IS THE COMPANY'S CLAIM FOR PROMOTION EXPENSE?**

14 A. PGW has included \$500,000 in the future test year ending August 31, 2007 for
15 customer incentives.

16
17 **Q. WHAT IS THE BASIS FOR THE COMPANY'S CLAIM FOR
18 PROMOTION EXPENSE?**

19 A. The Company's claim is based on a marketing plan to expand the use of natural
20 gas in all market segments by paying customers some type of incentive to use
21 natural gas. In response to OTS-RE-99 (see OTS-Ex. No. 2, Sch. 13, p1-3), the
22 Company outlined a plan to provide customers with conversion incentive

1 payments. These payments are intended to be used by the customer to purchase
2 plant equipment for the purpose of converting from steam, electric and/or oil to
3 gas. In some cases the customer will have capability for dual fuel usage. PGW
4 applies rules 2.3 and 10 of their Tariff as justification for these incentive
5 payments. The Tariff is included in Volume I of the Company's filing. The
6 Company states that these incentives offset incentives offered by competitors.
7

8 **Q. DO YOU AGREE WITH THE COMPANY'S CLAIM FOR PROMOTION**
9 **EXPENSE?**

10 A. No.
11

12 **Q. WHAT DO YOU RECOMMEND FOR PROMOTION EXPENSE?**

13 A. I recommend that the Company claim be denied. Therefore, the Company's test
14 year expenses should be reduced by \$500,000.
15

16 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDED PROMOTION**
17 **EXPENSE?**

18 A. The basis for my recommendation is that payments for incentives only increase the
19 overall cost of service for all utilities as each utility attempts to include these costs
20 in rates. Incentive payments of this nature are not in the public interest and are not
21 necessary to provide safe and reliable service. Therefore, ratepayers should not
22 bear these costs. Additionally, the public interest would dictate that in an era of

1 deregulation a level playing field for all forms of energy should be paramount.
2 Any costs incurred in the promotion of markets and customer growth should be
3 below the line. To allow companies to recover these costs in base rates creates an
4 uneven competitive environment to the Company's advantage. Advertising and
5 promotions of this nature simply escalate the cost of service for all utilities to the
6 detriment of all energy customers.

7
8 **Q. PLEASE ADDRESS CONCERNS WITH THE SPECIFIC PROGRAM**
9 **THAT PGW HAS OUTLINED IN OTS-RE-99.**

10 A. First, the Company lacks the proper Tariffs or prior Commission approval to
11 institute such a program. Tariff sections 2.3 and 10 do not apply to purchasing
12 plant for customers. The Company is applying section 2.3, which allows for
13 negotiated non-scheduled rates and/or terms of service between the customer and
14 the Company if the Company deems the rates or terms of service are economically
15 advantageous to the Company. It does not address purchasing plant by ratepayers.
16 Section 10 of the Company's tariff provides for the extension of service by
17 installing new mains and service lines. These mains and service lines are owned
18 by PGW not the customer. Ratepayers are paying for PGW's plant not the
19 customers. Second, the Company has not demonstrated that there will be a net
20 benefit to ratepayers if the plant conversions are subsidized by ratepayers. The
21 same standards that the Commission established for flexing rates for competitive
22 reasons should also apply here. There should be a demonstrated net benefit in

1 rates for ratepayers.

2

3 **Q. WHAT OTHER CONCERNS DO YOU HAVE REGARDING THIS**
4 **PROGRAM?**

5 A. Undoubtedly, this program will result in some customers having dual fuel
6 capabilities. Historically, the Commission has allowed utilities to negotiate a
7 lower rate when facing the risk of losing the load to an alternative fuel, as long as
8 there was a documented net benefit to ratepayers. It would be unconscionable to
9 ask ratepayers to subsidize the creation of a dual fuel situation and then let the
10 customer leverage that dual fuel capability into a lower negotiated rate.

11

12 **Q. ARE YOU OFFERING AN ADDITIONAL RECOMMENDATION**
13 **RELATIVE TO THIS PROGRAM?**

14 A. Yes. If the Commission approves the subsidization of these conversions, I
15 recommend to the Commission that these customers be prohibited from receiving
16 a lower negotiated rate.

17

18 **LOBBYING EXPENSE-OUTSIDE SERVICES - DUES AND**
19 **SUBSCRIPTIONS**

20 **Q. WHAT IS LOBBYING EXPENSE?**

21 A. Lobbying expenses include the costs for services that attempt to influence
22 governmental units in matters that affect the company and or the industry.

1 **Q. WHAT IS THE COMPANY'S CLAIM FOR LOBBYING ACTIVITIES?**

2 A. Although the Company does not make a specific claim for lobbying, these
3 activities are included in the outside services contracted with Wolf Block,
4 \$450,000 and with Mardi Enterprises, \$130,000 (see OTS Ex. No. 2, Sch.5).
5 During a discovery conference on March 21, 2007 the Company provided a
6 breakdown of the Wolf Block expenses for government relations of \$100,000. No
7 further monetary breakdown has been provided by the Company for activities not
8 considered lobbying by these two contractors. Therefore, I will attribute \$230,000
9 (\$100,000 + \$130,000) of outside services to lobbying. In addition, the Company
10 has included in the test year expenses for dues or subscriptions to three trade
11 associations; the American Gas Association, \$285,000, the Energy Association of
12 Pennsylvania, \$85,000, and the American Public Gas Association, \$25,000 (see
13 OTS Ex. No. 2, Sch. 6, p. 1-4). The Company has provided an invoice from the
14 Energy Association of Pa. that estimates that 10% of dues are attributable to
15 lobbying activities. The other invoices just alert that a portion of the dues is used
16 for lobbying activities. I contacted the American Gas Association and the
17 American Public Gas Association. They reported that 2% and 4% respectively of
18 dues were used for Lobbying activities. Therefore, \$15,200 ($\$285,000 \times .02$) +
19 ($\$85,020 \times .10$) + ($\$25,000 \times .04$) of PGW's dues and subscription claim can be
20 attributable to Lobbying activities.

1 Q. DO YOU AGREE WITH THE COMPANY'S CLAIM?

2 A. No.

3

4 Q. WHAT IS YOUR RECOMMENDATION FOR LOBBYING EXPENSE?

5 A. Lobbying expense is found in two separate accounts. My recommendation for
6 lobbying expense is to reduce the Company's claim for outside services by
7 \$230,000 and reduce the Company's claim for dues and subscriptions by \$15,200.

8

9 Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION CONCERNING
10 LOBBYING EXPENSES?

11 A. My recommendation is based on the premise that lobbying expenses are not
12 necessary for the utility to provide safe and reliable service and therefore should
13 not be paid by the ratepayers. These activities are considered below the line and
14 should not be paid by ratepayers.

15

16 **INJURIES AND DAMAGES**

17 Q. WHAT IS INJURIES AND DAMAGES?

18 A. This account includes the cost of insurance or reserve accruals to protect the utility
19 against injuries and damages claims of employees or others, losses not covered by
20 insurance, and expenses incurred in settlement of injuries and damages claims.

1 **Q. WHAT IS THE COMPANY'S CLAIM FOR INJURIES AND DAMAGES?**

2 A. The Company's test year claim for injuries and damages is \$6,424,000. Part of
3 this expense is a provision for an appropriation for reserves and other losses of
4 \$2,847,000. In this appropriation, the Company included \$475,000 for a projected
5 contingent liability for legal fees associated with a class action suit that is
6 currently being litigated (see OTS Ex. No. 2, Sch 7).

7

8 **Q. DO YOU AGREE WITH THE COMPANY'S CLAIM FOR INJURIES AND**
9 **DAMAGES?**

10 A. No. I do not agree with the inclusion of the \$475,000 for the settlement of the
11 class action suit.

12

13 **Q. WHAT IS YOUR RECOMMENDATION FOR INJURIES AND**
14 **DAMAGES?**

15 A. My recommendation is to reduce the Company's test year claim for injuries and
16 damages by \$475,000.

17

18 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION?**

19 A. The basis for this recommendation is that this expense is a one time, non-recurring
20 expense. A test year is usually based on expenses that are recurring. In a
21 discovery conference on March 21, 2007 the Company stated that they have not
22 had any other class action suits and did not expect any future class action suits.

1 Additionally, this expense is a projected liability if and when the case settles and
2 may be speculative. In the discovery conference, the Company expressed
3 uncertainty as to when the liability would occur.
4

5 **Q. WHAT IS THE PROPER RATE MAKING TREATMENT FOR NON-**
6 **RECURRING EXPENSES?**

7 A. If the expenses are known and measurable, the expense should be considered for
8 amortization.
9

10 **Q. DO THE EXPENSES FOR THIS CLASS ACTION SUIT MEET THE**
11 **REQUIREMENTS FOR THE RATE MAKING TREATMENT OF**
12 **AMORTIZATION?**

13 A. Pending further investigation of the circumstances, I would recommend
14 amortizing these costs over a 5 year period.
15

16 **Q. DID THE COMPANY HAVE ANY OTHER EXPENSES IN THE TEST**
17 **YEAR ASSOCIATED WITH THIS ISSUE?**

18 A. Yes. During a discovery conference on March 21, 2007, the Company stated that
19 the services of the firm Manko, Gold, Katcher & Fox, LLP were employed to
20 represent PGW in this case. The Company included \$250,000 in special legal
21 expenses in the test year (see OTS Ex. No. 2, Sch 8, p. 1-2).

1 Q. DO YOU HAVE A RECOMMENDATION WITH REGARDS TO THE
2 LEGAL EXPENSES INCURRED FOR THIS CLASS ACTION SUIT?

3 A. Yes. I recommend that the Company's test year claim for special legal expenses
4 be reduced by \$250,000 for the same reasons stated above. Upon further
5 investigations, these expenses could be recommended for amortization.

6

7 ADVERTISING

8 Q. WHAT IS ADVERTISING EXPENSE?

9 A. Advertising expense includes the costs to use various media outlets such as
10 newspaper, television, radio, magazines, bill inserts and brochures to make public
11 announcements by a company for various purposes which may include but is not
12 limited to the following:

- 13 • Public health and safety
- 14 • Conservation of energy
- 15 • Explain billing practices
- 16 • Provide education
- 17 • Recruitment activities
- 18 • Regulatory activities

19

20 Q. WHAT IS THE COMPANY'S CLAIM FOR ADVERTISING EXPENSE?

21 A. The Company's test year claim for advertising is \$1,427,000.

1 **Q. WHAT IS THE BASIS FOR THE COMPANY'S CLAIM FOR**
2 **ADVERTISING EXPENSE?**

3 A. The Company's claim is based on a program of spending that is broken down in
4 the Company's filing in Volume IV, Part 2 of 2, Ex.A-III.A25.

5
6 **Q. DO YOU AGREE WITH THE COMPANY'S CLAIM FOR ADVERTISING**
7 **EXPENSE?**

8 A. No.

9
10 **Q. WHAT IS YOUR RECOMMENDATION FOR ADVERTISING EXPENSE?**

11 A. I recommend an allowance for advertising of \$1,217,000. This would result in a
12 reduction of \$210,000 to the Company's claim.

13
14 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION?**

15 A. The Company's claim includes two items that determined the adjustment. The
16 first is a marketing expense of \$35,000 that relates to customer satisfaction,
17 education and promotion. The Company provided an example of this type of
18 advertising in its response to OTS-RE-83 (see OTS Ex. No. 2, Sch.9, p 1-2). The
19 second is a corporate communication expense of \$175,000 for PGW's corporate
20 awareness program (see OTS Ex. No. 2, Sch.10, p. 1-2). Both of these programs
21 are used to promote the Company and include forms of image advertising. These
22 types of advertising are not necessary to provide safe and reliable utility service to

1 the customers and therefore should not be paid for by the ratepayers.

2
3 **MERGER ACTIVITY EXPENSE**

4 **Q. WHAT IS MERGER ACTIVITY EXPENSE?**

5 A. Merger activity expense includes the costs to hire legal or consultant expertise to
6 assist the Company in handling a merger of PGW with another utility.

7
8 **Q. WHAT IS THE COMPANY'S CLAIM FOR MERGER ACTIVITY?**

9 A. The Company has included a claim of \$50,000 in the test year for services related
10 to merger activities (see OTS Ex. No. 2, Sch. 11).

11
12 **Q. WHAT IS THE BASIS FOR THE COMPANY'S CLAIM?**

13 A. The Company has experienced expenses for merger activities in the past.

14
15 **Q. DO YOU AGREE WITH THE COMPANY'S CLAIM FOR MERGER
16 ACTIVITY?**

17 A. No.

18
19 **Q. WHAT IS YOUR RECOMMENDATION CONCERNING THE EXPENSES
20 FOR MERGER ACTIVITY?**

21 A. I recommend that the Company's claim for merger expense be denied. This will
22 result in a \$50,000 reduction to the Company's test year claim for purchased

1 services.

2

3 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION CONCERNING**
4 **THE EXPENSES FOR MERGER ACTIVITY?**

5 A. The basis for my recommendation regarding the expenses for merger activity is
6 that the Company stated in a discovery conference on March 21, 2007 that they
7 are not currently involved in merger activity and do not expect that there will be
8 any merger activity. Therefore, this expense does not exist and therefore should
9 be denied.

10

11 **REGULATORY FINES AND PENALTIES**

12 **Q. WHAT ARE REGULATORY FINES AND PENALTIES?**

13 A. The uniform system of accounts defines "account 426.3 Penalties" as payments by
14 a company for penalties or fines for violation of any regulatory statutes by a
15 company or its officials.

16

17 **Q. WHAT IS THE COMPANY'S CLAIM FOR REGULATORY FINES AND**
18 **PENALTIES?**

19 A. In response to interrogatories by both the Office of Trial Staff OTS-RE-94 and the
20 Office of Consumer Advocate OCA-Set VII-3 (see OTS Ex. No. 2, Schedule 12,
21 p. 1-2), the Company stated that an adjustment of \$50,000 reducing other income
22 is included in the Company's claims for the test year ending August 31, 2007.

1 **Q. WHAT IS THE BASIS FOR THE COMPANY'S CLAIM?**

2 A. The Company stated in response to OTS-RE-94 that "PGW did pay \$104,500 in
3 fiscal year 2006 for actions taken by the PaPUC" (see OTS Ex. No. 2, Sch.12).
4 Therefore, the Company included \$50,000 as an ongoing expense for regulatory
5 penalties in the proposed test year as well as each year forecasted in the filing
6 through 2012.

7
8 **Q. WHAT WAS INCLUDED IN THE \$104,500 IN FINES AND PENALTIES**
9 **THAT PGW PAID IN FISCAL 2006?**

10 A. The Commission Orders at Docket No. M-00041859 and Docket No. R-00041858
11 required PGW to pay two civil penalties in the amount of \$50,000 each, a total of
12 \$100,000, as a result of settlements in the Commission's investigations regarding
13 cold weather deaths.

14
15 **Q. DO YOU AGREE WITH THE COMPANY'S CLAIM?**

16 A. No, I do not agree with the Company's claim.

17
18 **Q. WHAT IS YOUR RECOMMENDATION FOR REGULATORY FINES**
19 **AND PENALTIES?**

20 A. I recommend that the Company's claim of \$50,000 be removed and that other
21 income be increased by \$50,000 to reflect the denial of this expense for rate
22 making purposes.

1 Q. WHAT IS THE RATIONALE FOR YOUR RECOMMENDATION
2 CONCERNING REGULATORY FINES AND PENALTIES?

3 A. My recommendation is based on the premise that claims for expenses resulting
4 from penalties or fines for violation of regulatory statutes by the Company or its
5 officials should not be included in rates. Only expenses that are reasonably and
6 prudently incurred as well as expenses that are necessary to the rendition of utility
7 service should be included in rates. Therefore, the Office of Trial Staff
8 recommends that PGW not be allowed to recover costs of this nature from
9 ratepayers.

10

11 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

12 A. Yes. However, I reserve the right to submit supplemental testimony as the
13 Company and other parties provide interrogatory responses during the course of
14 this proceeding.

Janet M. Markovich

Applicable Educational and Professional Background

Education:

Master of Science in Business Administration, Concentration in Finance,
St. Joseph's University, Philadelphia, Pa. 1994

Bachelor of Science in Business Administration, Elmhurst College, Elmhurst Ill. 1981

Additional Education:

NARUC Utility Rate School - October 2004

The Many Voices of Wall Street – October 2004

Telephony and Telecommunications – December 2004

Business Experience:

Commonwealth of Pennsylvania

Public Utility Commission

Office of Trial Staff

Fixed Utility Financial Analyst 2004 - Present

Responsible for performing studies and analysis of revenues and expenses and other related financial and economic data as required to process rate increase requests, 1307 (f) purchased gas cost filings and general tariff revisions.

Commonwealth of Pennsylvania

Department of Corrections

Budget Analyst I and II 2003-2004

Responsible for coordinating the General Fund section of the business office as required to monitor spending, collect data and generate budgets, re-budgets and various projections.

Borough of Minersville

Borough Manager 1997-2000

Responsibilities under the direction of the Borough Council included the supervision of the business office, and the coordination of the activities of the following departments:

Streets, Sewer Treatment Plant and Collection System, Code, Health, and Grant Administration. Addition responsibilities included the development and administration of budgets for the General, Water, and Sewer Funds.

Pepperidge Farm, Inc
Plant Manager 1982-1991

As Resident Executive, my responsibilities included all activities related to the manufacture and distribution of fresh and frozen bakery, cookie and cracker products at facilities in Downers Grove, Illinois and Lakeland, Florida. Major responsibilities included the development and administration of plant operating and capital budgets and the coordination of the following functions: Engineering, Maintenance, Production, Distribution, Accounting, Purchasing, Human Resources, and Information Systems.

Assisted in the following Cases :

Borough of Quakertown – Rate Case – R-00049555
National Fuel Gas Distribution – Rate Case – R-00049656
TW Phillips Gas and Oil Co. – 1307(f) – R- 00040059
Myers Gas Company – Rate Case – R-00050259
PECO Energy Company – 1307(f) – R – 00050537
UGI Utilities, Inc. Gas Division – 1307(f) – R – 00050539
Trigen- Philadelphia Energy Corporation – R – 00050781

Participated in the following Cases:

City of Bethlehem Water Fund – Rate Case - R-00050671
Wonderview Water Inc. – Rate Case - R-00050659
Meadows Sewer Co. – Rate Case – R-00050672
Wilcox Water Co. – Rate Case – R-00050781
Lancaster Water Fund – Rate Case – R-000501167
City of Dubois – Water Bureau – R-00050671

Testified in the following Cases:

City of Lancaster Sewer Fund – Rate Case – R-00049862
Mesco Inc. – Rate Case – R- 00050678
TW Phillips 1307(f) – R-00051134
Aqua Pa – Rate Case – R-00051030
Equitable Gas Company 1307 (f) – R-00061295
Duquesne Light Company – R-00061346
National Fuel Gas Distribution – Rate Case – R-00061493

OTS Exhibit No. 2

Witness: Janet M. Markovich

5-23-07
Phila TC

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

**DOCUMENT
FOLDER**

Exhibit to Accompany

the

Direct Testimony

of

Janet M. Markovich

Office of Trial Staff

**Concerning:
Operations & Maintenance Expenses**

RECEIVED

JUN 22 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU



**Brown & Brown
Consulting**

Formerly Doyle Consulting Group

March 22, 2007

Mr. William J. Ambrose, Jr.
Director, Employee Services
Philadelphia Gas Works
800 W. Montgomery Avenue
Philadelphia, PA 19122

Re: Medical and Rx budget projections

Dear Bill:

We prepare estimates of healthcare and prescription drug costs for PGW's five year budget projection purposes. For medical care, we use the known premium rates for the plan year multiplied by the eligible participants. The premium rates are trended to future periods for budget projection purposes using a trend of 10% for 2007 and 2008, and 8% thereafter.

To develop the prescription drug estimate, we review actual claims experience over the most recent period available, develop a per capita claim cost for the experience period, and trend the per capita cost to the budget projection periods. The per capita rates are multiplied by the current eligible participants to estimate the dollar cost. We do not project changes in the number of eligible participants in our calculations.

For the period 9/1/06 to 8/31/07, following are the monthly per capita rates used for the Rx projections:

Union Active	\$210.
Management Active	\$200
Retirees	\$390

For future projections periods, these rates are trended 12% for 2007, and 10% per year for years after 2007.

Please call if you need further detail.

Cordially yours,

Samuel M. Kikla F.S.A.
Consulting Actuary

**PHILADELPHIA GAS WORKS
COMPUTATION OF PRESCRIPTION DRUG EXPENSE*
PER OFFICE OF TRIAL STAFF**

OTS Exhibit No. 2
Schedule 2

PGW -R-00061931

Caremark	Budget 2007	Caremark Invoices	Actual 2006	Caremark Invoices	Actual 2005		
Req. No.	Inv. No.	Inv Date	Payment	Req. No.	Inv No.	Inv Date	Payment
9-11-91540	84264115	09/07/05	170,090	9-11-91432	84216714	09/07/04	184,902
9-11-91543	84265048	09/15/05	282,374	9-11-91433	84217568	09/15/04	221,528
9-11-91547	84265875	09/23/05	244,541	9-11-91436	84218593	09/23/04	241,960
9-11-91548	84266879	09/30/05	225,611	9-11-91440	84219539	09/30/04	208,108
9-11-91549	84267832	10/07/05	196,068	9-11-91441	84220597	10/07/04	208,839
9-11-91550	84268638	10/15/05	196,979	9-11-91447	84221461	10/15/04	217,169
9-11-91553	84269581	10/23/05	229,428	9-11-91446	84222476	10/23/04	229,438
9-11-91557	84270917	10/31/05	273,494	9-11-91453	84224449	11/07/04	194,184
9-11-91558	84271747	11/07/05	197,725	9-11-91454	84223405	10/31/04	230,191
9-11-91559	84274300	11/15/05	294,372	9-11-91456	84225297	11/15/04	254,687
9-11-91565	84275330	11/23/05	258,864	9-11-91457	84226297	11/23/04	249,422
9-11-91566	84276343	11/30/05	220,911	9-11-91458	84227227	11/30/04	185,906
9-11-91571	84277297	12/07/05	237,448	9-11-91459	84228271	12/07/04	224,929
9-11-91573	84278093	12/15/05	272,269	9-11-91465	84229129	12/15/04	234,808
9-11-91574	84279145	12/23/05	250,884	9-11-91466	84230138	12/23/04	228,284
9-11-91575	84280229	12/31/05	242,089	9-11-91467	84231067	12/31/04	210,047
9-11-91576	84280230	12/31/05	383	9-11-91468	84232202	01/07/05	207,139
9-11-91579	84281220	01/07/06	217,384	9-11-91472	84232615	01/15/05	210,406
9-11-91580	84282007	01/15/06	240,097	9-11-91475	84234634	01/23/05	219,024
9-11-91584	84283089	01/23/06	272,354	9-11-91476	84236029	01/31/05	276,643
9-11-91585	84284234	01/31/06	312,520	9-11-91477	84236771	02/07/05	188,077
9-11-91586	84285121	02/07/06	230,446	9-11-91479	84237602	02/15/05	253,443
9-11-91587	84286125	02/15/06	281,048	9-11-91485	84238660	02/23/05	254,531
9-11-91593	84286941	02/23/06	272,686	9-11-91486	84240752	02/28/05	184,389
9-11-91594	84288086	02/28/06	148,625	9-11-91487	84241592	03/07/05	219,730
9-11-91595	84288951	03/07/06	247,561	9-11-91488	84242391	03/15/05	232,003
9-11-91596	84289916	03/15/06	296,197	9-11-91494	84243498	03/23/05	237,825
9-11-91602	84290738	03/23/06	256,437				
9-11-91604	84292720	04/07/06	174,148	9-11-91495	84245494	04/07/05	180,512
9-11-91607	84293699	04/15/06	255,969	9-11-91496	84246282	04/15/05	176,606
9-11-91613	84296917	05/07/06	256,177	9-11-91502	84247314	04/23/05	260,838
9-11-91608	84294500	04/23/06	268,069	9-11-91503	84248430	04/30/05	239,549
9-11-91611	84295481	04/30/06	233,560	9-11-91505	84249265	05/07/05	221,595
9-11-91612	84296295	04/30/06	15,380	9-11-91506	84250068	05/15/05	205,408
9-11-91614	84297689	05/15/06	262,809	9-11-91511	84251120	05/23/05	254,789
9-11-91615	84298711	05/23/06	279,432	9-11-91512	84252250	05/31/05	241,888
9-11-91621	84299799	05/31/06	301,645	9-11-91513	84253068	06/07/05	213,258
9-11-91622	84302562	06/07/06	223,200	9-11-91514	84254034	06/15/05	254,112
9-11-91623	84303566	06/15/06	284,139	9-11-91520	84254864	06/23/05	250,779
9-11-91624	84304380	06/23/06	290,193	9-11-91521	84255856	06/30/05	223,682
9-11-91625	84305504	06/30/06	263,892	9-11-91526	84256792	07/07/05	181,567
9-11-91631	84306559	07/07/06	197,520	9-11-91527	84257532	07/15/05	250,409
	84307566	07/15/06	253,854	9-11-91529	84258552	07/23/05	216,743
9-11-91638	84308372	07/23/06	256,228	9-11-91530	84259505	08/01/05	169,834
9-11-91639	84309403	07/31/06	295,185	9-11-91531	84260476	08/07/05	176,726
9-11-91640	84310424	08/07/06	235,568	9-11-91537	84261179	08/15/05	259,923
9-11-91645	84311399	08/15/06	268,268	9-11-91538	84262196	08/23/05	259,749
9-11-91647	84312191	08/23/06	282,332	9-11-91539	84263164	08/31/05	256,164
9-11-91648	84313241	08/31/06	302,906				

2007 Budget	\$ 13,649,529	11,769,357	10,502,755
2007 % Increase	15.98%	12.06%	
OTS allowance	\$ 13,188,742		
2006 % Increase	12.06%		
OTS Adjustment	\$ 460,787		

*Prior to any Medicare Part D Subsidy

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

Question OTS-RE-29-D: Provide a copy of the Company's incentive and or bonus plan for union, non-union, supervisory and management employees. In addition provide the following information:

A. Identify the amount of payroll expense by department or category of operating expense that was paid out as a bonus or incentive.

B. Identify the amount of payroll expense in part A by union and non-union-supervisory/management.

C. Provide several actual examples of employee evaluation that resulted in a bonus or incentive being paid.

Response Provided By: A, B: Joseph F. Golden, Jr., Controller
 C: Albert D'Attilio, VP – Human Resources

Response: A. Please see the below schedule:

<u>DEPARTMENT</u>	<u>DEPT #</u>	<u>BYPASS BONUS</u>	<u>INCENTIVE PAY</u>	<u>DEPT TOTALS</u>
Corp Communications	03		\$6,000.00	\$6,000.00
Officers	04		278,942.00	278,942.00
Sr. VP-General Counsel & Legal	05		11,040.00	11,040.00
Gas Control & Acquisition	09		12,852.00	12,852.00
VP - Customer Affairs	10	\$15.00	7,340.00	7,355.00
VP - Human Resources	11		11,788.00	11,788.00
Exec VP - Chief Operating Officer	13		26,698.00	26,698.00
Office of Sr. VP – Finance	17		6,273.00	6,273.00
Engineering	30		6,616.00	6,616.00
VP Compliance, Tech & Bus Transform	38		16,830.00	16,830.00
Dir - Policies & Compliance	39		6,652.00	6,652.00
Risk Management	41		7,912.00	7,912.00
Customer Service	44		14,032.00	14,032.00
Information Services	47		29,858.00	29,858.00
Credit Collection	49	57,515.00		57,515.00
Field Services	50	82,050.00	5,934.00	87,984.00
Distribution	52	675.00	26,256.00	26,931.00
Gas Processing	53	145.00	22,383.00	22,528.00
Director - Internal Audit	54		8,280.00	8,280.00
Sales & Marketing	60		3,956.00	3,956.00
VP Labor, Safety, Preparedness	65		5,355.00	5,355.00
Director – Procurement	74		3,956.00	3,956.00
Total Bypass and Incentive Payments Paid FY 2006		\$140,400.00	\$518,953.00	\$659,353.00

B.	Union	\$140,400.00
	Non-Union:	<u>518,953.00</u>
	Total Bypass and Incentive Payments Paid FY 2006:	\$659,353.00

C. **Bypass Bonus** – The bypass bonus program provides a bonus to field personnel who report, investigate, and terminate gas service at locations where gas service is obtained without PGW’s authorization. Bonuses are provided in the following manner:

- **Meter Diversion** – (commonly known as a bypass) per incident bonuses are paid as follows: a \$30.00 bonus is paid for one employee and \$15.00 each for two or three employees. Not more than two employees from the same department may receive the bonus.
- **Unauthorized User** – A \$10.00 bonus is paid per incident to a maximum of three employees. Not more than two employees from the same department may receive the bonus.

Management Incentive Payments – In September 2005, PGW provided a One-Time, At-Risk payment to 55 top managers in lieu of a base wage increase. The group of 55 managers is referred to as PGW’s Management Team.

PGW set the Maximum One-Time Payment based on each Management Team member’s pay grade (see Table “A”, below). The actual amount of the One-Time, At-Risk Payment was primarily based upon the individual manager’s performance in the prior fiscal year, as documented in the employee’s performance evaluation. In some circumstances, a manager may have received a base wage adjustment because he or she had been promoted, had assumed new duties, or was paid below the minimum salary established for their position. In those situations, the manager’s One-Time payment was reduced accordingly (see Table “B”, below).

Grade	Minimum Salary	Maximum Payment
64	\$154,400	20%
63	\$131,200	18%
62	\$108,800	16%
61	\$92,000	12%
60	\$79,120	10%
59	\$71,400	10%
58	\$59,840	10%

At-Risk Payment	BASE SALARY INCREASE	PERFORMANCE RATING				
		5	4	3	2	1
	0-5%	100%	100%	75%	0%	0%
	5-10%	100%	75%	50%	0%	0%
	10-15%	100%	50%	25%	0%	0%
	>15%	100%	25%	0%	0%	0%

Only 55 Management Team members were eligible for the At-Risk program. Since they would be easily identifiable from the comments contained in their performance evaluations, it is not possible to provide copies of their actual performance evaluations without impacting their privacy. PGW can however, provide the following actual examples to further illustrate how the individual At-Risk payments were determined.

Employee "A" had a base salary of \$73,400 and was in a Grade 6 pay grade. Since Employee A's salary was above the minimum of the Grade 6, Employee "A" did not receive a base wage increase. At a Pay Grade 6, Employee A was eligible for a Maximum 10% One-Time Payment. Employee A's overall Performance Rating was a "3". Referring to Table B, based on the 0% base wage adjustment and the "3" rating, Employee A received 75% of his or her Maximum 10% One-Time Payment or \$4,578.

Employee "B" had a base salary of \$75,480 and was in a Grade 8 pay grade. Since Employee B's was below the minimum of the Grade 8, Employee "B" received a base wage increase of \$3,640 or 4.8%. At a Pay Grade 8, Employee B was eligible for a Maximum 10% One-Time Payment. Employee B's overall Performance Rating was a "4". Referring to Table B, based on the 4.8% base wage adjustment and the "4" rating, Employee B received 100% of his or her Maximum 10% One-Time Payment or \$7,912.

Employee "C" had a base salary of \$105,000 and was in an E1 pay grade. Since Employee C's salary was above the minimum of the E1 pay range, Employee "C" did not receive a base wage increase. At an E1 pay grade, Employee "C" was eligible for a Maximum 12% One-Time Payment. Employee C's overall Performance Rating was a "3". Referring to Table B, based on the 0% base wage adjustment and the "3" rating, Employee "C" received 75% of his or her Maximum 12% One-Time Payment or \$9,450.

Employee "D" was promoted from a manager to a director (Grade 8) and received a base wage increase of \$10,821 for assuming a greater level of duties and responsibilities. Employee D's new base salary was \$79,120, which was the minimum salary for a Grade 8 position. At a Pay Grade 8, Employee "D" was eligible for a Maximum 10% One-Time Payment. Employee D's overall Performance Rating was a "4". Because Employee D's base salary increase as a result of his promotion exceeded 15%, Employee "D" received 25% of his Maximum 10% One-Time Payment or \$1,978.

PGW Health and Welfare Costs

OTS-RE-48-part A

PGW Healthcare Budget for FYE 2007

Union	Gross	Employee	Employer
Personal Choice	\$ 2,424,982.00	\$ 508,648.00	\$ 1,916,334.00
Keystone	\$ 6,983,166.00	\$ -	\$ 6,983,166.00
Aetna	\$ 1,406,277.00	\$ 128,854.00	\$ 1,277,423.00
Rx	\$ 3,376,128.00	\$ -	\$ 3,376,128.00
Dental	\$ 757,583.00	\$ 284,051.00	\$ 473,532.00
Vision	\$ 34,704.00	\$ 10,762.00	\$ 23,942.00
Total:			\$ 14,050,525.00

Management	Gross	Employee	Employer
Personal Choice	\$ 1,297,544.00	\$ 312,677.00	\$ 984,867.00
Keystone	\$ 2,492,027.00	\$ -	\$ 2,492,027.00
Aetna	\$ 478,498.00	\$ 72,415.00	\$ 406,083.00
Rx	\$ 1,014,518.00	\$ -	\$ 1,014,518.00
Dental	\$ 257,532.00	\$ 92,138.00	\$ 165,394.00
Vision	\$ 17,376.00	\$ 4,708.00	\$ 12,668.00
Total:			\$ 5,075,557.00

Early Retiree	Gross	Employee	Employer
Personal Choice	\$ 3,383,620.00	\$ 439,428.00	\$ 2,944,192.00
IBC	\$ 1,458,999.00	\$ -	\$ 1,458,999.00
Keystone	\$ 611,454.00	\$ -	\$ 611,454.00
Aetna	\$ 504,683.00	\$ 21,036.00	\$ 483,647.00
Rx	\$ 3,086,294.00	\$ -	\$ 3,086,294.00
Vision	\$ 13,302.00	\$ -	\$ 13,302.00
Total:			\$ 8,597,888.00

Regular Retiree	Gross	Employee	Employer
Personal Choice	\$ 339,293.00	\$ -	\$ 339,293.00
IBC	\$ 4,499,304.00	\$ -	\$ 4,499,304.00
Keystone	\$ 67,632.00	\$ -	\$ 67,632.00
Aetna	\$ 29,510.00	\$ (15,069.00)	\$ 44,579.00
Rx	\$ 6,172,589.00	\$ -	\$ 6,172,589.00
Dental	\$ 675,079.00	\$ 189,025.00	\$ 486,054.00
Vision	\$ 206.00	\$ -	\$ 206.00
Total:			\$ 11,609,657.00

\$13,649,529

Medicare Subsidy: \$ (1,450,000.00)

Grand Total: \$ 37,883,627.00

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

Question OCA-Set VII-2: Regarding the reply to OCA-III-34a:

- a) please reconcile the \$450,000 expense figure provided for Wolf Block with the \$100,000 expense figure provided in the FY2007 Operating Budget proceeding;
- b) please provide a breakdown of the \$450,000 expense figure as shown in part a) by services to be provided
- c) please reconcile the \$130,000 expense figure provided for Mardi Enterprises with the \$135,000 expense figure contained in the contract provided under OCA-III-34b.

Response Provided By: Joseph R. Bogdonavage, Senior Vice President – Finance

- Response:**
- a) PGW's original fiscal year 2007 operating budget filing detailed certain expense categories. General regulatory work associated with the PaPUC was projected at \$350,000 with an additional \$100,000 associated with governmental relations work. Also, \$350,000 was provided for PGW's base rate proceeding. The \$100,000 was for government relations work from Wolf Block Government Relations.
 - b) As discussed in the above response, the fiscal year 2007 approved operating budget provides funds for the two categories of work (legal (\$350,000) and government relations (\$100,000)). There is no further breakdown.
 - c) The fiscal year 2007 operating budget included a \$130,000 purchased service expense for consulting services. This was an estimate that was developed prior to the execution of a contract.

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

Question OTS-RE-91: Reference Volume IV Exhibit A-III.A.28, Account 930.2, Miscellaneous General Expense.

- A. Provide an explanation and a detailed breakdown of the expenses expected in the fiscal year 2007 of \$585,000 and the per book amounts for fiscal 2006 and 2005 of \$571,058 and \$550,578 respectively for dues and subscriptions.
- B. Include documentation in the form of copies of invoices, contracts, accounting reports, etc.

Response Provided By: Joseph R. Bogdonavage, Senior Vice President – Finance

Response: A. The following schedule details the expenditures for fiscal years 2005, 2006 and a projection for 2007

	<u>FY2005</u>	<u>FY2006</u>	<u>FY2007</u>
Utility Emergency Service Fund	\$158,628	\$169,400	\$180,000
American Gas Association	265,811	275,870	285,000
Energy Association of PA	76,539	74,591	85,000
American Public Gas Association	19,600	21,200	25,000
APGA Research Foundation	30,000	30,000	-
Miscellaneous	-	-	10,000
Total	<u>\$550,578</u>	<u>\$571,061</u>	<u>\$585,000</u>

B. Please see the attached FY2006 invoices.

File # 390140

AMERICAN GAS ASSOCIATION

Invoice # 5-000004481

Invoice
for
Philadelphia Gas Works

June 22, 2006

Mr. Thomas E. Knudsen
President & CEO
Philadelphia Gas Works
800 West Montgomery Avenue
Philadelphia, PA 19122-2806

DESCRIPTION	AMOUNT
Dues for 2006 membership year: \$278,383.00	
Third Quaterly Payment	\$69,595.75

REMIT PAYMENT WITH DUPLICATE COPY OF INVOICE TO:

AMERICAN GAS ASSOCIATION
Post Office Box 79226
Baltimore, MD 21279-0226
Telephone (202) 824-7256
Fax (202) 824-9156

IMPORTANT IRS REQUIRED NOTICE

Federal regulations require us to advise you that contributions or gifts to the American Gas Association are not deductible as charitable contributions for federal income tax purposes. Dues payments are usually deductible by members as an ordinary and necessary business expense. The American Gas Association expects that a portion of your dues may be used to influence legislation. The Association will pay directly the federal tax that is due on lobbying activities.

Dues include a one-year subscription to *American Gas*, the normal subscription rate for which is \$59.00 per year for U.S. and Canadian subscribers and \$110.00 per year for international subscribers.

#96313



800 North Third Street, Suite 301 • Harrisburg, Pennsylvania 17102
Telephone (717) 901-0600 • Fax (717) 901-0611 • www.energypa.org

INVOICE DATE: December 2, 2005

Mr. Tom Knudsen
President & CEO
Philadelphia Gas Works
800 West Montgomery Avenue
Philadelphia, PA 19122

**INVOICE
MEMBER COMPANY DUES FOR 2006**

Dues paid in 2005	\$76,539
Total Gas Dues Owed for 2006	\$149,181

to be paid in 2 installments @ \$74,590.50 ea

Please make check payable to Energy Association of Pennsylvania

Return one copy with your remittance.
Retain second copy for your records.

PLEASE REMIT PAYMENT BY JANUARY 5, 2006

IMPORTANT TAX INFORMATION

Pursuant to the Omnibus Budget Reconciliation Act of 1993, the Energy Association estimates that 10% of your 2006 dues are not deductible due to the Association's lobbying activities on behalf of its members.

** TX STATUS REPORT **

AS OF JAN 30 '06 14:13 PAGE.01

DATE	TIME	TO/FROM	MODE	MIN/SEC	PGS	CMDH	STATUS
02	01/30	14:13 215 684 6163	EC--S	00'25"	001	168	OK

REQ #18450



**AMERICAN PUBLIC
GAS ASSOCIATION**
201 Massachusetts Avenue, NE, Suite C-4
Washington, DC 20002

202-464-2742 (tel)
202-464-0246 (fax)

Craig White, Chief Operating Officer
PHILADELPHIA GAS WORKS
800 W. Montgomery Avenue
Philadelphia, PA 19122-2512

Date: 01/19/06
Mem. ID: O001679
Invoice No: 023480

DUES INVOICE

SECOND NOTICE

Description

Amount Due

2006 APGA Membership Dues

\$21,200.00

Includes APGA biweekly newsletter, annual Directory of Publicly Owned Natural Gas Systems, the Public Gas Voice in Congress and at the Federal regulatory agencies, pipeline safety updates, training workshops and conferences, special mailings, and Members Only Access to the APGA website.

Your dues are calculated based on the following number of customers we show in our database:
498219

If this number needs to be adjusted, please do so below on your remittance.

Please return the bottom portion with your payment. Thank you

AMERICAN PUBLIC GAS ASSOCIATION
201 Massachusetts Avenue, NE, Suite C-4, Washington, DC 20002

Craig White, Chief Operating Officer
PHILADELPHIA GAS WORKS
800 W. Montgomery Avenue
Philadelphia, PA 19122-2512

Date: 01/19/06
Mem. ID: O001679
Invoice No: 023480

Description

Amount Due

2006 APGA Membership Dues

\$21,200.00

Our current customer count should be: _____

We also accept payments with Mastercard and Visa. Call the APGA office for information.
Please note: Federal Tax Identification Number 52-0805605

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

- Question OTS-RE-101:** Reference the Company's response to OTS-RE-20-D, Part C and PGW Exhibit C-4, page 2, Appropriation for Reserves and Other Losses.
- A. Provide an explanation and detailed breakdown for each of the three categories included in the 2007 Fiscal Year budgeted amount of \$2,847,000.
 - B. Include documentation of the need for these reserves and/or losses.
 - C. Identify the expense accounts expected to be charged.
 - D. Provide the same information as requested in Part A, Part B and Part C above for the actual amounts expended in fiscal year 2005 and 2006 of \$3,083,000 and \$4,900,000 respectively.

Response Provided By: Joseph R. Bogdonavage, Senior Vice President – Finance

- Response:**
- A. The \$2,257,000 is associated with PGW's reserve for losses associated with suits and claims that may arise and for workers' compensation settlements. PGW has a self-insured retention of \$500,000 per incident for damages and workers' compensation. The \$115,000 represents the increase in the outstanding liability for employees' vacation earned but not yet utilized at the end of PGW's fiscal year. Vacation is calculated on an annual basis. The \$475,000 in corporate settlements represents a projected contingent liability for legal fees associated with a class action suit. PGW is currently in litigation regarding this matter.
 - B. The injuries and damages reserve and the current liability for employees' compensated absences are established pursuant to generally accepted accounting practices. Attached are the detailed calculations for both of the above mentioned items. The \$475,000 associated with corporate settlements is a projected liability and may be paid upon settlement of the case which was projected to be settled during the 2007 fiscal period.

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

Question OCA-Set VII-5: Regarding the reply to OTS-RE-20(c), C-4, Purchased Services, please provide a detailed breakdown of the following line items for FY2005, 2006 and 2007

- a) Special Legal
- b) Administrative Consultants

Response Provided By: Joseph R. Bogdonavage, Senior Vice President - Finance

Response: Please see the attached schedule.

OCA Set VII-5

PHILADELPHIA GAS WORKS
ADMINISTRATIVE & CONSULTING EXPENSES

<u>Admin. Consulting</u>	<u>FY 2007</u>	<u>FY 2006</u>	<u>FY 2005</u>
Accenture, LLP	\$150,000	\$150,000	\$0
Aon Consulting, Inc.	25,000	14,438	11,461
Blank Rome, LLP	90,000	76,000	51,000
Bond Resource Partners, LP	25,000	22,800	22,700
Cusip Service Bureau	1,000	130	-
Digital Assurance, LLC CAFR	40,000	1,750	1,500
Duane Morris, LLP	20,000	-	39,151
Fitch, Inc.	10,000	2,500	-
Hangley Aronchick	150,000	174,999	-
KPMG, LLP	395,000	294,998	435,000
Kryos Energy Inc.	-	15,350	9,345
Nicholas A. Legatos PE	-	-	7,250
Moody's Investor Service	60,000	49,850	22,103
Public Fin'l Mgt. Inc	50,000	25,000	80,279
PriceWaterhouse & Coopers LLP	25,000	-	-
Black & Veatch Corporation	-	-	25,125
Standard & Poor's	70,000	74,500	66,000
Wachovia Bank	30,000	-	26,876
Miscellaneous	200,000	340	(4,731)
Total	\$1,341,000	\$902,655	\$793,060

SPECIAL LEGAL EXPENSES

<u>Special Legal</u>	<u>FY 2007</u>	<u>FY 2006</u>	<u>FY 2005</u>
Andre C. Dasent PC	\$150,000	\$87,541	\$83,923
Austin J. McGreal, Esq.	-	9,156	-
Autherine B. Smith, Esq.	-	1,550	-
Ballard, Spahr, & Ingersoll, LLP	100,000	60,620	56,873
Booth & Tucker, LLP	-	21,882	200
City of Phila Law Department	-	-	644
Deposition Services	-	3,005	-
Dilworth & Paxson, LLP	-	7,015	-
Grant & Liebowitz, LLC	100,000	98,240	50,544
Klehr, Harrison, Harvey, Branzburg & Ellers, LLP	10,000	8,480	-
Klett, Lieber, Rooney & Schorling	40,000	51,243	24,358
Manko, Gold, Katcher & Fox, LLP	250,000	58,203	-
Nasuti & Miller	-	-	7,100
Obermayer, Rebmann, Maxwell & Hippel	100,000	1,320	122,372
Saul Ewing, LLP	-	58,953	-
Adjustments	-	-	(65,090)
Total	\$750,000	\$467,208	\$280,924

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

Question OTS-RE-83: Reference the Company's filing, Volume IV, Part 2 of 2, Exhibit A. III.A.25.

- A. Provide a detailed breakdown and respective dollar amounts for the items included in the other Advertising programs listed under each type of advertising for the period ending 8/31/2007.
- B. Include samples of each type of advertising.
- C. Identify all Co-op advertising expenses.

Response Provided By: Joseph R. Bogdonavage, Senior Vice President – Finance

- Response:**
- A. Please refer to the below schedule.
 - B. Please refer to the attached samples.
 - C. The Philadelphia Gas Works does not participate in Co-op advertising programs.

PHILADELPHIA GAS WORKS
OTHER ADVERTISING PROGRAMS

8/31/2007

OTHER NEWSPAPER ADVERTISING PROGRAMS

a) Job Vacancies and Recruitment Events	\$68,196
b) PGW's Parts and Labor Repair Plan	322,553
c) Construction and Service Bid Proposals	34,000
d) Regulatory Activities Relating to Tariff Changes, Meeting Notices and Public Hearings.	10,000

OTHER TELEVISION ADVERTISING PROGRAMS

a) PGW's Parts and Labor Repair Plan	\$54,447
--------------------------------------	----------

OTHER RADIO ADVERTISING PROGRAMS

a) Job Vacancies and Recruitment Events	\$21,102
---	----------

OTHER MAGAZINES & MISCELLANEOUS

a) Job Vacancies and Recruitment Events	\$20,702
b) Telephone Listings	11,000
c) Marketing Activities Relating to Customer Satisfaction, Education and Promotion.	35,000

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

Question OTS-RE-102: Reference the Company's response to OTS-RE-20-D, Part C and PGW Exhibit C-4, page 2, advertising.

A. Explain the difference between the fiscal year budgeted amount of \$1,977,000 stated in this schedule and the amount of \$1,427,000 stated in PGW Exhibit A-III.A.25. Which amount is included the requested revenue requirement in this proceeding?

B. Provide an explanation and detailed breakdown for the items included in the 2007 fiscal year budget for advertising in the following areas:

1. Corporate communications	\$725,000
2. Field services	377,000
3. Collection and revenue recovery	350,000
4. VP Customer affairs	300,000
5. Human Resources	110,000
6. Marketing	35,000

C. Include samples of the various types of advertising detailed in Part B. above.

Response Provided By: Joseph R. Bogdonavage, Senior Vice President -- Finance

Response: A. The difference between the fiscal year budget stated in PGW's Exhibit C-4, page 2, and the amount stated in PGW's Exhibit A-III.A.25 consists of a reduction of \$550,000 of advertising expenditures related to the Corporate Communication Department's corporate awareness advertising program.

PGW included \$1,427,000 stated in PGW Exhibit A III.A.25 as part of the requested revenue requirement in this proceeding.

B. The major components of the advertising expenditures in the 2006-2007 Budget Year are related to corporate campaigns to inform eligible customers of the availability of Low Income Heating Assistance Programs, \$300,000; collection activities related to customer bill payment, \$350,000; PGW's Parts and Labor Repair Plan, \$377,000; marketing activities relating to customer satisfaction, education, and promotion, \$35,000; the announcement of job vacancies and recruitment events, \$110,000; and, activities relating to PGW's awareness campaign program, \$175,000.

C. Refer to the response to question OTS-RE-83.

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

Question OCA-Set VII-4: Please clarify whether \$50,000 for Utility Merger is or is not included in pro forma Purchased Services expense.

Response Provided By: Joseph R. Bogdonavage, Senior Vice President – Finance

Response: A \$50,000 expense item for services related to utility merger activities was included in PGW's pro-forma fiscal year 2007 purchased services expense.

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

Question OTS-RE-94: Provide an explanation and identify by item all reserves that have been set up in the event the company should be fined or penalized by any agency or entity. Include the corresponding expense account that was charged to set up the reserve. Provide this information for the test year, for the previous 2 fiscal years and for the forecasted years included in JRB-1, page 6.

Response Provided By: Joseph R. Bogdonavage, Senior Vice President – Finance

Response: PGW does not set up a reserve for fines or penalties assessed by regulatory agencies. However, PGW did pay \$104,500 in fiscal year 2006 for actions taken by the PaPUC. The F.E.R.C. account charged was 426.3 – penalties. The fiscal year 2007 and the five year period through 2012 included a projection of \$50,000 annually for the above expense category. Fiscal year 2005 had no expense activity.

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

OTS-RE-99

Reference the Company's filing Volume II, part I of 2, Exhibit JRB-2, the Direct Testimony of Joseph R. Bogdonavage before the Philadelphia Gas Commission, page 30, lines 1 through 7.

- A. Provide an explanation for the budget amount of \$500,000 for customer incentives in the 2006-2007 budget year.
- B. Include a detail breakdown of the customers that are targeted to receive these incentives along with an explicit description of the criteria needed to earn the incentives.
- C. Provide a copy of the marketing plan for customer incentives.

Response provided by: Mary E. Galasso
Manager, Economic Development
Marketing Department

Response:

- A. In order to promote conversions from district steam, electric and/or oil, PGW offers incentives to defer a portion of the customer's capital costs related to the installation of gas utilization equipment. Capital costs are the number one obstacle in persuading a customer to convert to natural gas.

B. The following is a breakdown of the customers.

	Job Description	Incentive \$ in thousands
Customer A	2 nd phase of steam to gas conversion for heating. Contracted load increase is 9,900 MCF. Total adjusted cost of \$52,717 includes the \$12,000 CIP with a 28% IRR, and 3.3 year simple payback. Estimated customer conversion costs are approximately \$200,000. Rules 2.3 & 10 of the Tariff and Discounted Cash Flow ("DCF") are applied in this calculation.	12
Customer B	Oil to natural gas boiler conversion for process steam. Will be used for process applications in addition to heating and water heating. Contracted load increase is 142,660 MCF. Total adjusted cost of \$908,925 includes \$250,000 CIP with 18% IRR and 4.5 year simple payback. Estimated customer conversion costs are \$1,000,000. Rules 2.3 & 10 of the Tariff and DCF are applied in this calculation.	250
Customer C	Conversion of oil to natural gas boiler plant. Will be used for process applications in addition to heating and water heating. Contracted new load increase is 28,493 MCF. Total adjusted cost of \$233,905 includes \$45,000 CIP with a 16% IRR and 4.8 year simple payback. Estimated customer conversion costs are \$900,000. Rules 2.3 & 10 of the Tariff and DCF are applied in this calculation.	45
Customer D	Steam loop conversion. Installing central heating plant with dual fuel capabilities using oil and natural gas. Estimated customer conversion costs are approximately \$1,000,000.	225
Total		532

C. Below is a customer incentives excerpt from a 5-year Marketing Plan.

The Marketing Department has a number of product offerings geared towards increasing natural gas sales and increasing net margin for PGW.

- **Rule 10 Allowance** – Reduction in construction costs commensurate with the anticipated non-fuel margins for that customer for a predefined period of time. This credit serves to defray the customer's capital outlay at the beginning of a project in order to get this customer onto PGW's system and is based upon the anticipated load to be generated.
- **Conversion Incentive Programs** – This incentive is used to assist customers with equipment purchases and to offset incentives provided by competing alternate fuel. PGW offers reliable, dependable natural gas service and energy information to help customers maintain efficient business operations.
- **Technical Expertise and Industry Information** – An important added-value that the Marketing Department offers its customers is technical expertise to help customers develop energy solutions that provide operational and economic advantages.

OTS Statement No. 2-SR
Witness: Janet M. Markovich

5-23-07
Phila
TC

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

DOCUMENT
FOLDER

Surrebuttal Testimony

of

Janet M. Markovich

Office of Trial Staff

Concerning:

Operation & Maintenance Expenses

PROPRIETARY VERSION

RECEIVED

JUN 2 2 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

1 **Q. STATE YOUR FULL NAME, EMPLOYER AND BUSINESS ADDRESS.**

2 A. My name is Janet M. Markovich. I am employed by the Pennsylvania Public
3 Utility Commission, P.O. Box 3265, Harrisburg, PA 17105-3265.

4
5 **Q. HAVE YOU PREVIOUSLY SUBMITTED DIRECT TESTIMONY IN THIS**
6 **PROCEEDING?**

7 A. Yes, I have submitted OTS Statement No. 2 and OTS Exhibit No. 2.

8
9 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

10 A. The purpose of my surrebuttal testimony is to respond to PGW's rebuttal
11 testimony of Joseph R. Bogdonavage (PGW Statement 2R) and Albert L.
12 D'Attilio (PGW Statement 12) submitted in this instant rate case proceeding. My
13 surrebuttal testimony will address the following items:

- 14 • Management Incentive Compensation
- 15 • Bad Debt Expense
- 16 • Marketing Promotions
- 17 • Lobbying
- 18 • Injuries and Damages
- 19 • Advertising
- 20 • PUC Fines and Penalties

1 I will not address the issues of prescription plan expense because Mr. D'Attilio
2 accepted the OTS adjustment in his rebuttal testimony and merger expense
3 because Mr. Bogdonavage accepted the OTS adjustment in his rebuttal testimony.
4

5 **MANAGEMENT INCENTIVE COMPENSATION**

6 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATION FOR**
7 **MANAGEMENT INCENTIVE COMPENSATION.**

8 A. I recommended that the Company's claim for management incentive
9 compensation be denied thereby reducing PGW's test year expenses by \$500,000.
10 This recommendation is based on the conclusion that it is not in the best interest of
11 either the customers or the owners of PGW to pay the management incentives.
12 These incentive payments result in an expense that is excessive without direct
13 correlation to implementation of improvements in the operation, service level
14 and/or financial condition of PGW.

15
16 **Q. DID THE COMPANY SUBMIT REBUTTAL TESTIMONY BASED ON**
17 **THE OTS RECOMMENDATION FOR MANAGEMENT INCENTIVE**
18 **COMPENSATION?**

19 A. Yes. Mr. D'Attilio addressed this issue.
20

21 **Q. MR. D'ATTILIO CONTENDS THAT THE PLAN IS WELL**
22 **DOCUMENTED. DO YOU AGREE?**

1 A. No. Mr. D'Attilio provided the same interrogatories that I provided in OTS Ex.
2 No. 2, Sch. 3 and a copy of the City's ordinance that describes the PGW pension
3 plan as documentation of the plan. He contends that the incentive payments were
4 calculated based on a formula developed in conjunction with the Hay Group and is
5 easily replicated. This documentation is woefully inadequate. It does not identify
6 who determines if the Company's performance is adequate to fund the plan and at
7 what funding level. It does not identify who administers the plan. It does not
8 identify the parameters necessary to achieve the Company and individual
9 performance objectives, such as measurable objectives and performance goals
10 with timetables and a predetermined hierarchy of completion percentage. It does
11 not document the idea that all future merit and other types of salary adjustments
12 will be subtracted from the total eligible payment amount. It does not document
13 the procedure to be used if the payments achieved exceed the budget for incentive
14 payments. The documentation must provide for these issues in addition to the
15 payment calculation.

1 **Q. MR. D'ATTILIO DISAGREES WITH YOUR CRITICISM THAT THE**
2 **INCENTIVE COMPENSATION PROGRAM IS BASED ON SUBJECTIVE**
3 **CRITERIA. PLEASE COMMENT.**

4 A. Although he defended the 2005 payments, they were still based on the same skill
5 criteria as the normal PGW annual evaluation that is used for merit based
6 increases. Mr. D'Attilio must agree that the evaluation system used in
7 determining the 2005 payments was inadequate because as he continues his
8 testimony he explains that the appraisal process is evolving and improving to
9 include the establishment of goals, a process for determining whether the goals
10 were achieved and a review to insure that the individual goals are in alignment
11 with the goals of the Company. However, this process must be documented to
12 insure that the focus of evaluations for incentive payments is based on these
13 meaningful measurable goals with measurable timetables. Mr. D'Attilio did not
14 present that documentation.

15
16 **Q. MR. D'ATTILIO DISAGREES THAT THE INCENTIVE PROGRAM**
17 **RESULTS IN EXPENSE THAT IS EXCESSIVE WITHOUT DIRECT**
18 **CORRELATION TO IMPLEMENTATION OF IMPROVEMENTS IN THE**
19 **OPERATION, SERVICE LEVEL, AND FINANCIAL CONDITION OF**
20 **PGW AND EXCESSIVE PAYMENTS COMPARED TO TRADITIONAL**
21 **MERIT INCREASES WITHOUT ADDITIONAL DEMANDS OF**
22 **MEASURABLE OBJECTIVES. PLEASE COMMENT.**

1 A. Mr. D'Attilio offers no further justification or support of the program through
2 documentation of the performance criteria that the incentive bonuses will be based
3 on over and above an annual merit based increase system. He stated that the
4 average increase was around 10% which is more than double the amount given in
5 2006 as an average merit based system increase. He does not state that the
6 maximum at risk amount that PGW might have had to pay the management group
7 was approximately \$700,000 instead of the \$518,000 that was actually paid. He
8 does not state that the total increase percentage for this group of managers was
9 almost 14% due to the additional \$204,262 in salary adjustments made prior to the
10 incentive payments and that those salary adjustments lowered the incentive
11 payment percentage for this one year.

12
13 **Q. DID MR. D'ATTILIO ADDRESS ANY OTHER ISSUES CONCERNING**
14 **THE MANAGEMENT COMPENSATION PROGRAM?**

15 A. Yes, in addition, Mr. D'Attilio presented a synopsis of an assessment completed in
16 2005 by the Hay Group concerning PGW's non-union pay grades. Mr. D'Attilio
17 states that this assessment revealed an unfavorable compensation relationship,
18 compared to the mid-point of salaries, between the compensation levels of non-
19 union management and non-union lower level managers/supervisors as well as an
20 unfavorable compensation relationship with managers in the industry. Mr.
21 D'Attilio concludes that the unfavorable compensation relationship has prevented
22 PGW from retaining competent management. He also states that under the Hay

1 Compensation System, proficient employees should be paid at the midpoint of
2 their pay grade and that PGW's non-union management employees are not being
3 paid at the mid-point.
4

5 **Q. DID MR. D'ATTILIO PROVIDE PROOF THAT THE MANAGEMENT**
6 **TEAM RECEIVING THE INCENTIVE BONUS ACTUALLY**
7 **EXPERIENCED A HIGH RATE OF TURNOVER?**

8 A. No. Mr. D'Attilio did not provide any turnover statistics for the Company's 485
9 non-union employees or statistics pertaining to the group of fifty-four or fifty-five
10 of those non-union employees referred to as the "management team" that were
11 eligible to receive incentive bonus payments.
12

13 **Q. PLEASE ADDRESS THE STATEMENT CONCERNING MANAGEMENT**
14 **SALARIES BELOW THE MIDPOINT OF PAY GRADES.**

15 A. Mr. D'Attilio states that PGW engaged the Hay Group in March of 2005 to
16 develop the management incentive program. However, they initially focused on
17 aligning PGW's pay grades with the market. The exact results of this process
18 were not revealed by Mr. D'Attilio in terms of the changes to each pay grade and
19 the specific dollar value of the ranges. However, based on confidential
20 information that PGW provided in informal discovery, 55.5% or thirty of the fifty-
21 four "management team" employees received salary adjustments on 9/5/2005 as a
22 result of this study. The salary adjustments ranged from 2.06% to 22.66% and

1 averaged 4.05% of the total salaries for all the fifty-four management team
2 members or \$204,262. Twenty-eight or 51.85% of the salary adjustments brought
3 PGW managers to the minimum of the new salary range. One salary adjustment
4 brought a manager to 12.1% above the minimum of the new salary range and one
5 salary adjustment brought a manager to 5.44% above the minimum. Therefore,
6 not knowing the mid-point of the ranges, I can determine that at least 51.8% of the
7 fifty four management employees that were eligible to receive incentive bonus
8 payments are under the mid-point of their pay grade without incentive bonus
9 payments as of 9/5/2006.

10
11 **Q. DID THE HAY GROUP RECOMMEND PAY GRADE RANGES THAT**
12 **ARE TOO HIGH?**

13 **A.** It is impossible for anyone to make that judgment without much more information.
14 However, the results of this type of study can vary depending on the sample
15 groups a compensation consultant uses in their analysis, the number of years since
16 the previous ranges were adjusted and the amounts of wage increases both the
17 sample and the company has had in the intervening years. If the sample group
18 included highly profitable investor owned utilities, the pay grade ranges could be
19 high. Additionally, a compensation package should be comparing all fringe
20 benefits, such as pensions, medical, retiree medical, etc.

1 **Q. PLEASE COMMENT ON THE HAY GROUP IDEA THAT PROFICIENT**
2 **EMPLOYEES SHOULD BE PAID AT THE MID POINT OF THE RANGE**
3 **FOR THEIR SALARY.**

4 A. First of all that is one consultant's opinion. Secondly, I do not know how the Hay
5 Group evaluates "proficient". Third, a rule of that nature does not take into
6 consideration the employee's time in that position.

7

8 **Q. HOW WOULD THIS RULE EFFECT PGW?**

9 A. According to the blank performance appraisal forms that I received from PGW,
10 the Company evaluates its managers on a five point grading system. Three is
11 considered "Proficient".

12

13 **Q. HOW MANY OF PGW'S MANAGEMENT TEAM THAT WERE**
14 **ELIGIBLE TO RECEIVE INCENTIVE BONUS PAYMENTS WERE**
15 **RATED PROFICIENT?**

16 A. Based on the confidential information that PGW provided in informal discovery
17 and the responses the Company provided for OTS Ex. No.2, Sch. 3, all but two
18 were evaluated with a rating of proficient or higher. Twenty-five managers were
19 rated "Commendable" (4) and twenty-seven managers were rated "Proficient" (3).
20 Therefore, if PGW follows the Hay Compensation System, then 96.3% of PGW's
21 management team should be compensated at the mid-point of their pay grade or
22 above. Given PGW's financial situation it may be unrealistic for the Company to

1 pay at the mid-point year after year through an incentive program that does not
2 require improvement in the financial, operational and service level of the
3 Company an incentive program that seems to be administered by the people that
4 benefit by it the most.

5
6 **BAD DEBT EXPENSE**

7 **Q. PLEASE SUMMARIZE THE OTS RECOMMENDATION FOR BAD DEBT**
8 **EXPENSE.**

9 A. The OTS recommendation is an uncollectible percentage of 4% based on the
10 Company's most recent collection rate experience of over 96%. PGW's collection
11 rate in Fiscal Year 2005 was 96.01% and in Fiscal Year 2006 the collection rate
12 was 96.57% (see PGW Statement No. 6, Exhibit RG-1). The two-year average
13 collection rate is 96.3%. When the write-off percentage of 4% is multiplied by the
14 OTS proposed gas revenues of \$974 million the result is an allowance of \$38.9
15 million ($\$974 \times 4\%$). The reduction to the Company's future test year claim is
16 \$20.1 million ($\$59 - \38.9).

17
18 **Q. DID THE COMPANY SUBMIT REBUTTAL TESTIMONY BASED ON**
19 **THE OTS RECOMMENDATION FOR BAD DEBT EXPENSE?**

20 A. Yes. Mr. Bogdonavage addressed this issue.

1 **Q. PLEASE SUMMARIZE THE COMPANY'S REBUTTAL TESTIMONY**
2 **CONCERNING BAD DEBT EXPENSE.**

3 A. The Company defends the method PGW used to calculate bad debt expense by
4 explaining that the method is not entirely based on funding a bad debt reserve
5 account. The Company points out the fact that OTS's recommendation was based
6 on different criteria in its last fully litigated rate case and that the recommendation
7 was accepted by the Commission. Finally, the Company proposes that OTS's
8 method of using the collection rate as an indicator of the factor used to calculate
9 future uncollectible accounts expense/bad debt expense is invalid because the
10 collections rate does not measure uncollectible accounts expense or write-offs and
11 that it assumes that improvements in the Company's collection rate will continue.

12
13 **Q. PLEASE ADDRESS MR. BOGDONAVAGE'S DEFENSE OF PGW'S**
14 **METHOD OF CALCULATING BAD DEBT EXPENSE.**

15 A. The Company's witness, Mr. Bogdonavage, explains that PGW's method for
16 calculating bad debt expense is "not entirely" a method which funds the reserve
17 for bad debt, as characterized by OTS. He proclaims that actual bad debt expense
18 includes the following: an estimate of the collectibility of year-end accounts
19 receivable, the reserve for the uncollectible accounts balance prior to a year end
20 adjustment, and the impact of accounts written off in the fiscal year. He continues

1 to say “moreover by determining the expense based upon the amount needed to
2 fund a reserve....PGW’s method again takes into account historic write off
3 experience.”

4
5 **Q. PLEASE SUMMARIZE THE WAY THE COMPANY’S CLAIM FOR**
6 **UNCOLLECTIBLE ACCOUNTS WAS DEVELOPED.**

7 A. The Company projected the ending accounts receivable balance by estimating that
8 a percentage of billed revenues (95%) will be collected and by estimating the
9 amounts that will be written-off (\$60.4 million) during the year. The Company
10 then takes the estimated ending accounts receivable balance multiplied by a
11 reserve factor (23.38%) to determine its claimed bad debt expense for the future
12 test year. Therefore, although the company takes into consideration an estimate of
13 collectibility and an estimate of net write-offs, the Company’s bad debt expense
14 claim is the amount the Company estimated for budget purposes that is needed to
15 adjust the bad debt reserve balance to the Company’s desired level.

16
17 **Q. PLEASE REITERATE WHY OTS OPPOSES THE COMPANY’S**
18 **METHOD?**

1 A. OTS opposes any company's use of a reserve appropriation for bad debt expense
2 because companies can set the amount of a reserve balance on various criteria
3 using estimates and reserve factors based on the company's and/or their auditor's
4 ideas of reasonableness. These estimates and factors can be speculative such as
5 the use of 95% collectibility estimate that PGW used in its calculation.

6

7 **Q. HOW DO UTILITIES GENERALLY RECOGNIZE UNCOLLECTIBLE**
8 **ACCOUNTS FOR RATEMAKING PURPOSES?**

9 A. Generally, for ratemaking purposes, utilities compute uncollectible accounts
10 expense on an annual prospective basis. While the uncollectible accounts expense
11 is a prospective claim, the proper calculation begins with an historic analysis of
12 actual net write-offs to gross revenues to develop an historic write-off ratio. Net
13 write-offs are gross write-offs less recoveries of amounts previously written off.
14 This ratio is then applied to projected revenues to determine the proper prospective
15 allowance.

16

17 **Q. DID OTS RECOMMEND THE USE OF THE NET WRITE-OFF RATIO IN**
18 **THE MOST RECENT LITIGATED PGW BASE RATE PROCEEDING?**

19 A. Yes.

20

21 **Q. DID THE COMMISSION ACCEPT OTS'S RECOMMENDATION IN**
22 **THAT CASE?**

1 A. Yes. In the Commission's Order at Docket No.R-00006042 the OTS
2 recommendation to use the five year net write-off ratio to calculate uncollectible
3 accounts expense was accepted.
4

5 **Q. PLEASE EXPLAIN WHY OTS DID NOT RECOMMEND THE USE OF**
6 **THE HISTORIC FIVE-YEAR NET WRITE-OFF RATIO?**

7 A. OTS did not recommend the use of the five year net write-off ratio because since
8 the case referred to above, filed in January of 2001, PGW has implemented
9 substantial improvements in its collection system that made the result of the five-
10 year net write-off ratio calculation an unrealistic expense for ratepayers to bear in
11 today's PGW environment. In fact, the net write-off ratio recommended by OTS
12 in 2001 was 7.616% versus the corresponding five-year net write-off ratio of
13 8.62% in 2007. OTS concluded that ratepayers should experience the benefits of
14 known and measurable improvements rather than a penalty because of the use of
15 an inappropriate indicator. PGW witness Craig White (PGW St.5R, p.18)
16 supports this decision as he addresses concerns of the Philadelphia School District,
17 the Housing Authority and the Archdiocese that PGW needs a rate increase
18 because of the "poor delinquent payments" of the residential customers and
19 PGW's "operational inefficiencies" in collecting those payments. Mr. White
20 answers "Absolutely not. The claims on this point....are both uninformed and
21 unfortunate in that they continue to perpetuate an unfounded myth. Since PGW

1 sought needed flexibility for its collections efforts, the Company's bad debt
2 expense has decreased while its collections have increased."

3
4 **Q. WHAT IMPROVEMENTS DID PGW IMPLEMENT?**

5 A. PGW implemented numerous organizational, process and system improvements
6 since the conclusion of PGW's base rate case at Docket No.R-00006042. The
7 principal components of PGW's collection improvement efforts, as detailed in
8 PGW's witness Gyory's testimony, PGW Statement No. 6, page 3, include: (1) the
9 full implementation of a Billing, Collections and Customer Service ("BCCS")
10 system; (2) improvements in its Customer service and Credit Collection Call
11 Centers; and , (3) implementation of the Collections Renewal Initiative ("CRI").
12 And In addition, the Company experienced the collection enhancements associated
13 with the enactment of Chapter 14. Improvements of this magnitude did produce
14 an increase in the collection rate of revenues and a corresponding decrease in the
15 uncollectible accounts expense will follow.

16
17 **Q. WHY DID OTS USE THE TWO YEAR COLLECTION RATE AS THE
18 BASIS FOR RECOMMENDING A 4% WRITE-OFF RATIO?**

19 A. The OTS recommendation to use the two year collection rate as the ratio which is
20 based on the premise that the most recent two-year history of collectibility of
21 revenues offers the best reflection of all of the improvements that PGW has
22 implemented to reduce uncollectible accounts expense. In fact, because of the

1 implementation of improvements the Company has shown a marked improvement
2 in its ability to collect revenues, as PGW witness Gyory testified in PGW
3 Statement No. 6, page 2, the twelve month collection rate improved from a rate of
4 91.24% in Fiscal 2004 to the 96.01% in Fiscal 2005 and 96.57% in Fiscal 2006.
5 Additionally, Mr. Gyory points out that this improvement occurred as PGW
6 experienced a 7% increase in billings due to the increase in wholesale gas costs.
7 Again, if the Company collects a higher percentage of revenues then they have a
8 lower percentage of revenues that are not collected and therefore a lower
9 maximum amount of uncollectible accounts expense. Some amount of the 4%
10 uncollected will be recovered through collections efforts.

11
12 **Q. MR. BOGDONAVAGE STATES THAT THE OTS RECOMMENDATION**
13 **ASSUMES THAT PGW WILL CONTINUE TO PERFORM AT THE 96**
14 **PERCENT COLLECTION RATE. DO YOU AGREE?**

15 A. Yes. OTS has no reason to assume that PGW will not continue the
16 implementation of Chapter 14, as well as the continued implementation of the
17 Company's Billing, Collections and Customer Service ("BCCS") system, the
18 improvements in its Customer service and Credit Collection Call Centers and the
19 implementation of the Collections Renewal Initiative ("CRI"). Therefore, I
20 believe the Company will have a collections rate at or above 96%. In addition,
21 added sales should not deter this achievement based on, PGW's witness Mr.
22 Gyory 's testimony as referenced above where he points out that the collections

1 improvement in 2006 occurred as PGW experienced a 7% increase in billings due
2 to the increase in wholesale gas costs.

3
4 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATION FOR BAD DEBT**
5 **EXPENSE.**

6 A. Again, I recommended a ratio of 4% using a two year collection rate as the ratio
7 which is based on the premise that the most recent two-year history of
8 collectibility of revenues offers the best reflection of all of the improvements that
9 PGW has implemented to reduce uncollectible accounts expense. Using a longer
10 history would negate the effect of the implementation of Chapter 14 and all of the
11 costly system improvements such as those made to the Billing, Collections and
12 Customer Service ("BCCS") system, the Customer Service and Credit Collection
13 Call Centers and the Collections Renewal Initiative ("CRI") that the Company has
14 made and began reaping the benefits of in the last two years.

15
16 **MARKETING – PROMOTION**

17 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATION FOR MARKETING**
18 **PROMOTION EXPENSE.**

19 A. I recommend that the Company claim be denied. Therefore, the Company's test
20 year expenses should be reduced by \$500,000. The basis for my recommendation
21 is that payments for incentives only increase the overall cost of service for all
22 utilities as each utility attempts to include these costs in rates. Additionally, the

1 Company lacks the proper Tariffs or prior Commission approval to institute such a
2 program. Finally, the ambiguity of a promotionally subsidized customer's ability
3 to negotiate dual fuel rates must be addressed.
4

5 **Q. DID THE COMPANY SUBMIT REBUTTAL TESTIMONY BASED ON**
6 **THE OTS RECOMMENDATION FOR MARKETING PROMOTION**
7 **EXPENSE?**

8 A. Yes. Mr. Bogdonavage addressed this issue.
9

10 **Q. DID YOU RECEIVE ADDITIONAL INFORMATION CONCERNING**
11 **THIS ISSUE?**

12 A. Yes. The Company outlined the Customer Incentive Program in the Company's
13 response to OTS-RE-99, which was due on March 19, 2007 and was not received
14 until April 4, 2007. This was two days before my direct testimony. Therefore
15 follow up interrogatories were sent out on April 6, 2007. The responses to these
16 interrogatories, OTS-RE-105, and OTS-RE-106 were received on May 7, 2007.
17

18 **Q. DID THE COMPANY PRESENT NEW INFORMATION IN THESE**
19 **INTERROGATORY RESPONSES?**

1 A. Yes. The Company stated in response to OTS-RE-105, Part E (see OTS Ex. No.
2 2-SR, Sch. 1, p. 2) that the projects for customer B and customer D would not take
3 place in the test year 2007. These two projects were expected to cost \$250,000
4 and \$225,000 respectively.

5
6 **Q. DOES THIS INFORMATION CHANGE YOUR RECOMMENDATION**
7 **FOR MARKETING PROMOTION EXPENSE?**

8 A. Yes. I recommend that the Company's claim be reduced by \$475,000 (\$250,000 +
9 \$225,000) based on the fact that these projects will not occur in the test year.
10 Therefore, the OTS recommends an allowance for marketing promotional expense
11 of \$25,000 (\$500,000 - \$475,000).

12
13 **LOBBYING EXPENSE-OUTSIDE SERVICES - DUES AND**
14 **SUBSCRIPTIONS**

15 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATION FOR LOBBYING**
16 **EXPENSE.**

17 A. My recommendation for lobbying expense is to reduce the Company's claim for
18 outside services by \$230,000 and reduce the Company's claim for dues and
19 subscriptions by \$15,200 as this expense is found in both of these accounts. This
20 recommendation is based on the premise that lobbying activities are not necessary
21 for the utility to provide safe and reliable service and lobbying activities are
22 considered below the line and should not be paid by ratepayers.

1 Q. DID THE COMPANY SUBMIT REBUTTAL TESTIMONY BASED ON
2 THE OTS RECOMMENDATION FOR LOBBYING EXPENSE?

3 A. Yes. Mr. Bogdonavage addressed this issue.
4

5 Q. PLEASE ADDRESS THE COMPANY'S REBUTTAL TESTIMONY
6 CONCERNING LOBBYING EXPENSE?

7 A. PGW witness Bogdonavage claims that he consulted with PGW's Vice President
8 of Regulatory Affairs and that he was allegedly informed that only 25% or
9 \$32,500 of the \$130,000 contract with an outside services firm for government
10 relations is related to lobbying activity. None of this information was included in
11 PGW's Direct testimony. OTS has not had the opportunity to examine this claim.
12 Mr. Bogdonavage concedes that 100% of the \$100,000 outside services contract
13 with WolfBlock government relations, LP is lobbying expense. He does not
14 specifically address the \$15,200 expense in dues and subscriptions; however he
15 does suggest that the PUC waive provisions of the Public Utility Code in light of
16 PGW's special circumstances.
17

18 Q. DISCUSS MR. BOGDONAVAGE'S RECOMMENDATION IN REGARDS
19 TO THE OUTSIDE SERVICES GOVERNMENT RELATIONS
20 CONSULTING CONTRACT WITH MARDI ENTERPRISES?

1 A. Although PGW has made an assessment that only 25% of the \$130,000 expense is
2 concerned with lobbying, the Company's description of the activities they
3 consider not related to lobbying is vague and undocumented. Therefore, I
4 continue to propose the rejection of the full amount.

5
6 **Q. REITERATE THE BASIS FOR YOUR RECOMMENDATION**
7 **CONCERNING LOBBYING EXPENSES?**

8 A. My recommendation is based on the premise that lobbying expenses are not
9 necessary for the utility to provide safe and reliable service and therefore should
10 not be paid by the ratepayers. These activities are considered below the line and
11 should not be paid by ratepayers.

12
13 **Q. PLEASE ADDRESS THE SUGGESTION OF MR. BOGDONAVAGE THAT**
14 **THE PUC WAIVE THE PROVISION OF THE PUBLIC UTILITY CODE**
15 **THAT EXCLUDES LOBBYING EXPENSES.**

16 A. To my knowledge PGW has not filed a formal Waiver Request with the PUC
17 regarding lobbying expenses. At this time, I would not support such a waiver as the
18 decision could result in PGW having an unfair advantage over other utilities in its
19 ability to influence governments and in addition, the precedent could result in
20 increased rates for affected customers due to excess expenses that are not
21 necessary for the utility to provide safe and reliable services.

1 **INJURIES AND DAMAGES**

2 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATION FOR INJURIES**
3 **AND DAMAGES EXPENSE.**

4 A. I recommended a reduction to the Company's test year claim for injuries and
5 damages of \$475,000. In addition, I recommend that the Company's test year
6 claim for special legal expenses be reduced by \$250,000 as these expenses are
7 expected for the class action case. The basis for this recommendation is that this
8 expense is an expected payment to settle a class action suit which is a one time,
9 non-recurring expense. Additionally, this expense is a projected liability if , and
10 when, the case settles and may be speculative as the Company expressed
11 uncertainty as to when the liability would occur if at all. A test year is based on
12 expenses that are recurring and known and measurable. Pending further
13 investigation of the incident, when these costs are known and measurable, OTS
14 may recommend that the costs be amortized.

15
16 **Q. DID THE COMPANY SUBMIT REBUTTAL TESTIMONY BASED ON**
17 **THE OTS RECOMMENDATION FOR INJURIES AND DAMAGES**
18 **EXPENSE?**

19 A. Yes. Mr. Bogdonavage addressed this issue.

20
21 **Q. PLEASE ADDRESS THE COMPANY'S REBUTTAL TESTIMONY**
22 **CONCERNING INJURIES AND DAMAGES EXPENSE.**

1 A. Mr. Bogdonavage disagrees with my conclusion that these expenses are non-
2 recurring and that large lawsuits of this nature normally happen to companies
3 periodically. He also provides an updated assessment that the Company “can
4 reasonably anticipate” for either a new settlement or a trial to be \$3,800,000 for
5 injuries, damages and legal fees.

6

7 **Q. DO YOU AGREE WITH MR. BOGDONAVAGE?**

8 A. I do not agree that PGW claims for this class action suit are recurring expenses.
9 The Company has not provided any proof that PGW has had reoccurring class
10 action suits and in fact PGW management have stated in an informal discovery
11 conference on March 21, 2007 that they have not had any other class action suits
12 and did not expect any in the future.

13

14 **Q. MR. BOGDONAVAGE PROVIDED AN UPDATE AMOUNT FOR THESE**
15 **EXPENSES. DOES THIS CHANGE YOUR RECOMMENDATION?**

16 A. No. The updated amount of \$3,800,000 is a projected liability if, and when, the
17 case settles or goes back to trial. However, this update supports the argument that
18 this claim is speculative. Therefore, I continue to recommend that these expenses
19 be denied and that pending further investigation of the incident and when these
20 expenses are known and measurable, OTS may recommend that the costs be
21 amortized.

1 **ADVERTISING**

2 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATION FOR**
3 **ADVERTISING EXPENSE.**

4 A. I recommended an allowance for advertising of \$1,217,000 which results in a
5 reduction of \$210,000 to the Company's claim. The reduction includes a
6 marketing expense of \$35,000 that relates to customer satisfaction, education and
7 promotion and a corporate communication expense of \$175,000 for PGW's
8 corporate awareness program (examples of both programs can be found in OTS
9 Ex. No. 2, Sch. 9 and 10). The recommendation was made because both programs
10 are used to promote the Company and include forms of image advertising. These
11 types of advertising are not necessary to provide safe and reliable utility service to
12 the customers and therefore should not be paid for by the ratepayers.

13
14 **Q. DID THE COMPANY SUBMIT REBUTTAL TESTIMONY BASED ON**
15 **THE OTS RECOMMENDATION FOR ADVERTISING EXPENSE?**

16 A. Yes. Mr. Bogdonavage addressed this issue.

17
18 **Q. PLEASE ADDRESS THE COMPANY'S REBUTTAL TESTIMONY**
19 **CONCERNING ADVERTISING EXPENSE?**

20 A. Mr. Bogdonavage testimony includes the rejection of both of my
21 recommendations concerning marketing advertising and concerning the corporate
22 awareness program.

1 Q. DISCUSS MR. BOGDONAVAGE'S TESTIMONY REGARDING THE
2 ADVERTISING EXPENSE FOR MARKETING.

3 A. Mr. Bogdonavage indicates that the \$35,000 marketing expense, which I
4 characterized as "relating to customer satisfaction, education and promotion"
5 because that is how the Company referred to it in PGW's response to OTS-RE-83
6 and OTS-RE-102, is just that "marketing-related" and should be allowed in rates.
7 He continues that the ads (an example of which is included in OTS Ex. No. 2, Sch.
8 9, p. 2) "are designed to promote the use of natural gas" and that this activity
9 benefits rate payers by increasing the base of customers over which fixed costs can
10 be recovered.

11
12 Q. DO YOU AGREE WITH THE COMPANY'S RECOMMENDATION?

13 A. No. I continue to recommend that the \$35,000 claim be rejected. My
14 recommendation is based on the premise that this expense is not necessary for the
15 Company to provide safe and reliable utility services and that expenses to promote
16 the use of one fuel over another encourages all utilities to do this and therefore
17 results in higher rates for all ratepayers. These expenses should be considered
18 below the line and not included in rates.

19
20 Q. DISCUSS MR. BOGDONAVAGE'S TESTIMONY REGARDING THE
21 ADVERTISING EXPENSE FOR THE CORPORATE AWARENESS
22 PROGRAM.

1 A. First, Mr. Bogdonavage claims that I incorrectly characterized this program as the
2 Corporate Awareness Program. Second, he denies that this program is image
3 related and that the program is PGW's "Awareness Program" which is exclusively
4 used to promote consumer awareness of action and activities they can take to
5 conserve energy. He provided examples of this advertising in JRB-15.

6
7 **Q. PLEASE RESPOND TO MR. BOGDONAVAGE'S COMMENTS.**

8 A. In fact, PGW characterized the program in response to OTS-RE-102, Part A (see
9 OTS Ex. No. 2, Sch. 10, p. 1) where the Company explained that the \$550,000
10 reduction "of advertising expenses related to the Corporate Communications
11 Department's corporate awareness advertising program". Secondly, the Company
12 was asked to supply copies of each type of advertising. The only ad that I received
13 which could have been related to this category was the ad I provided as OTS Ex.
14 No. 2, Sch. 9, p. 2.

15
16 **Q. DO YOU CONTINUE TO RECOMMEND THE REJECTION OF THIS**
17 **PART OF PGW'S CLAIM?**

18 A. No. Based on the examples that Mr. Bogdonavage has presented as JRB-15 in his
19 rebuttal testimony, I am revising my recommendation to an allowance for
20 advertising of \$1,392,000. This would result in a reduction of \$35,000 to the
21 Company's claim.

1 **REGULATORY FINES AND PENALTIES**

2 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATION FOR**
3 **REGULATORY FINES AND PENALTIES EXPENSE.**

4 A. I recommended that the Company's claim of \$50,000 be removed and that other
5 income be increased by \$50,000 to reflect the denial of this expense for
6 ratemaking purposes.

7
8 **Q. DID THE COMPANY SUBMIT REBUTTAL TESTIMONY BASED ON**
9 **THE OTS RECOMMENDATION FOR REGULATORY FINES AND**
10 **PENALTIES EXPENSE?**

11 A. Yes. Mr. Bogdonavage addressed this issue.

12
13 **Q. PLEASE ADDRESS THE COMPANY'S REBUTTAL TESTIMONY**
14 **CONCERNING REGULATORY FINES AND PENALTIES EXPENSE.**

15 A. Mr. Bogdonavage testified that the \$50,000 claim of PGW should be accepted. He
16 considers denying such expenditures as *pro forma* expenses as illogical and
17 nonproductive. He explains that civil fines and penalties assessed by regulatory
18 agencies are legitimate operating expenses for a municipal natural gas utility. He
19 continues explaining that when the PUC denies an expense that will nevertheless
20 be incurred, or is likely to be incurred, the effect is that an amount of income is
21 removed from the Company that would otherwise be used for capital expenditures,

1 to reduce the level of long term debt or to provide much needed cash flow.

2 Eventually, the Company will have to request a rate increase.

3

4 **Q. DO YOU AGREE WITH MR. BOGDONAVAGE'S RECOMMENDATION?**

5 A. Absolutely not! I continue to recommend that this expense be denied. I do not

6 think civil fines and penalties assessed by regulatory agencies are legitimate

7 operating expenses for any utility. Furthermore, I think it is illogical and

8 unproductive for any utility to conduct business in a way that such expenses will

9 nevertheless be incurred or are likely to be incurred.

10

11 **Q. DOES THE FACT THAT PGW IS A CASH FLOW COMPANY, CHANGE**
12 **YOUR RECOMMENDATION?**

13 A. No. I consider providing for the recovery of these expenses in rates the same as

14 allowing PGW management to violate regulatory statutes with the knowledge that

15 it won't impact their financial status. Again, my recommendation is based on the

16 premise that claims for expenses resulting from penalties or fines for violation of

17 regulatory statutes by any company or its officials should not be included in rates.

18 Only expenses that are reasonably and prudently incurred as well as expenses that

19 are necessary to the rendition of utility service should be included in rates.

20

21 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

22 A. Yes.

OTS Exhibit No. 2-SR
Witness: Janet M. Markovich

5-23-07
Phila
TC

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PHILADELPHIA GAS WORKS

Docket No. R-00061931

**DOCUMENT
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Exhibit to Accompany

the

Surrebuttal Testimony

of

Janet M. Markovich

Office of Trial Staff

Concerning:

Operation & Maintenance Expenses

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JUN 2 2 2007

**PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU**

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

Question OTS-RE-105: Reference the Company's response to OTS-RE-99 concerning the marketing promotion plan – Conversion Incentives.

- A. Explain why PGW considers these expenses a ratepayer responsibility?
- B. Explain in detail under what authority PGW includes capital expenditures for customers in rates?
- C. Demonstrate with detailed calculations that the projects listed provide a net benefit to rate payers.
- D. Has PGW included the increased MCF's sold as revenues in the test year or future forecasted years in JRB-1, page 1 or JRB-1, page 6? If so, provide the revenues for each fiscal year.
- E. Provide the start date for each of the projects listed.
- F. If the answer to Part D is no, provide the projected revenues by year.

Response Provided By: Joseph Smith
Vice President, Sales and Marketing Department

Response:

- A. Incentive programs serve both public and customer interests. Incentives are offered to customers who most likely will not convert from a different fuel source to natural gas due to the initial investment required for the conversion. In the long term, the ratepayers benefit from additional throughput on PGW's system. Additional throughput helps to ensure that PGW's facilities are more fully utilized and that operating costs are distributed among a greater number of ratepayers. Further, the new customer's facilities will be in service far beyond the discount period which means that ratepayers will reap the benefits far into the future.
- B. The proper consideration is whether inclusion in rates is just and reasonable. For the reasons stated in part A to this response, the costs related to the Customer Incentive Program are just and reasonable because it creates greater throughput which results in the reduction of base rates for already existing customers. Additionally, programs

like this are commonplace in Pennsylvania and other Pennsylvania utilities have similar programs.

- C. Customer C from PGW's response to OTS-RE-99 will be used as an example. This customer converted from a different energy source and is provided Interruptible Transportation service. The starting point is whether the capital costs to provide service exceed 5 years of margin (5 years in this case because it is a conversion). The margin in this case is \$49,000 annually, therefore, 5 years of margin is \$245,000. Capital costs to provide service are \$188,905. As a result, PGW will provide a CIP up to the difference between \$245,000 and \$188,905. The capital costs and the CIP are added in order to calculate the adjusted cost of \$233,905. The IRR (Internal Rate of Return) is calculated based on the adjusted cost (or PGW's investment) of \$233,905 and ten years of margin at \$49,000 annually. The IRR on this investment with a revenue stream of \$49,000 for ten years is 16% (PGW's internal rule of thumb is to approve CIP payments which have an IRR of 12% or greater). Ten years is used because that is the contract term. The volume that produces the margin in this calculation is also included in the contract as the take or pay volume. The simple payback of 4.8 years is $\$233,905 / \$49,000$.
- D. Revenues for commercial and industrial customers are forecasted on a per class basis and not forecasted on an individual basis. Nonetheless, when forecasting is performed on a per class basis, new customers are factored into the forecast.
- E. For customers A and C, the projects will take place in 2007. For customers B and D, the projects will not take place in 2007. Additionally, PGW is anticipating a FY 2008 spending level of \$750,000.
- F. Not applicable -- response to D is yes.

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PGW Hearing Exhibit 3

5-23-07
Phila
TC

JUN 22 2007

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Pennsylvania Public Utility Commission :

v. :

Docket No. R-00061931

Philadelphia Gas Works :

DOCUMENT
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STIPULATION

Philadelphia Gas Works ("PGW") and Office of Trial Staff ("OTS") stipulate as follows:

1. PGW agrees to conduct an independent evaluation of its Class 2 leak repair policies which evaluation shall include the costs and benefits of PGW's present policy as well as a projection of the cost and benefits of any modifications of that policy.
2. PGW agrees that the evaluation will occur in conjunction with its pending study regarding its cast iron main replacement program. The Class 2 leak repair evaluation report shall be completed within nine months of entry date of the Commission Order in this proceeding.
3. PGW agrees to file a report with OTS and the Gas Safety Division of the Commission's Bureau of Transportation and Safety within 60 days of completion of the Class 2 leak repair evaluation. The report will indicate the recommendations of the independent expert that PGW has accepted and those it has rejected, together with a full explanation of its position.
4. PGW agrees not to oppose any party's request to initiate an independent proceeding before the Commission seeking an order requiring PGW to implement any recommendation that it has rejected. The parties agree that the matter will first be assigned to the Office of Administrative Law Judge

("OALJ") Alternative Dispute Resolution ("ADR") process. If ADR fails to resolve the matter, the parties agree that it will be assigned to OALJ for the prompt scheduling of hearings.

AGREED TO BY:

Daniel Clearfield

Daniel Clearfield
For Philadelphia Gas Works

Date: 5/23/07

Allison Kaster

Allison Kaster
For Office of Trial Staff

Date: 5/23/07

PGW St. 3
5-23-07
Phila
TC

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

TESTIMONY OF

BARBARA BISGAIER

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

December 2006

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JUN 22 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

1 I. QUALIFICATIONS AND PURPOSE OF TESTIMONY

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

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

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

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

9 Q. SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS.

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

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

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

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

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

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

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

8
9 A. Public Financial Management, Inc. was engaged in 1992 by the City of
10 Philadelphia to serve as its Financial Advisor. That engagement included,
11 broadly, responsibility for the preparation of the Five-Year Financial Plans
12 mandated by the Pennsylvania Intergovernmental Cooperation Authority, general
13 financial planning for the City and traditional financial advisory work for the City
14 and its enterprises in connection with the issuance of long-term and short-term
15 debt. At the commencement of this engagement, the City's below-investment-
16 grade bond rating and general fiscal distress essentially barred it and its
17 enterprises from the public debt markets. In 1993, with the beginning of a return
18 to fiscal stability, the City began its return to the capital markets. I began serving
19 specifically as the Financial Advisor to PGW with the issuance of its 14th Series
20 Bonds. I have subsequently served as the Financial Advisor for each of PGW's
21 bond transactions. I have assisted PGW in the implementation of certain asset
22 management transactions, most notably the competitive acquisition of a Forward
23 Rate Agreement for its debt service reserve fund and the implementation and
24 subsequent unwind of a "knock-in" swap with Morgan Guaranty Trust Company.
25 I have also assisted PGW with the issuance of its commercial paper; that

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

27
28 A. Yes it does.

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

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Credit Profile
AFFIRMED

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

OUTLOOK: NEGATIVE

Rationale

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

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

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

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

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

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

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

Liquidity

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

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

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

Outlook

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

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

Business Description

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

Business Profile

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

Regulation

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

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

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

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

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

Markets

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

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

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

Operations

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

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

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

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

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

Competitiveness

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

Management

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

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

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

Financial Profile

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

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

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

Legal provisions/covenants

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

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

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

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

Philadelphia Gas Works Financial Statistics

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

(excluding comm. paper) (x)

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

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**STANDARD
& POOR'S****RATINGS DIRECT****RESEARCH****Summary: Philadelphia, Pennsylvania; Gas**

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Credit Profile

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

AFFIRMED

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

OUTLOOK:

NEGATIVE

Rationale

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

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

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

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

Outlook

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

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

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

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RESEARCH

Philadelphia; Gas

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Credit Profile

AFFIRMED

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

OUTLOOK: NEGATIVE

Rationale

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

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

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

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

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

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

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

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

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

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

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

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

Liquidity

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

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

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

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

Outlook

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

Debt Derivative Profile (DDP)

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

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

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

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

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PGW Sl. 3-R
5-23-07
Phila
TC

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

TESTIMONY OF

BARBARA BISGAIER

DOCUMENT
FOLDER

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

May 4, 2007

RECEIVED

JUN 22 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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

2 A. Barbara C. Bisgaier, Managing Director, Public Financial Management, Inc., 2 Logan
3 Square, Suite 1600, Philadelphia, Pennsylvania 19103-2770, (215) 567-6100. I am a
4 Financial Advisor to state and local governments and authorities. I submitted direct
5 testimony on behalf of PGW as PGW Statement No. 3.

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

7 A. I will provide a response from a financial and investor standpoint of the
8 recommendations and testimony of the Office of Trial Staff witness Plonski and OCA
9 witnesses Bleiweis and Lelash.

10 **Q. PLEASE PROVIDE AN OVERVIEW OF YOUR CONCLUSIONS REGARDING**
11 **THESE WITNESSES' TESTIMONY.**

12 A. Both the OTS and the OCA witnesses have testified that, in their opinion, the Company's
13 financial status is such that it has not justified any rate increase because the Company is
14 projecting that it will meet minimum coverage requirements in the test year and shows a
15 cash balance at year end. They also opine that PGW's over reliance on long term debt to
16 fund its capital needs is not an issue that can be addressed because it is outside the test
17 year or that it should be resolved by capital contributions from the City of Philadelphia.
18 They recommend a minimal increase – \$25 million – to permit PGW to payback a City-
19 provided \$45 million loan in FY 2008.

20 If adopted by the Commission, such conclusions will almost certainly have a serious
21 negative effect upon PGW's status with investment analysts, insurers and bankers and
22 jeopardize the progress the Company has made with these parties over the last several

1 years.¹ It is critical that the Commission recognize that the financial community that I
2 have described is sensitive to and understands the true vulnerability of PGW with regard
3 to liquidity and legitimately expects substantive rate relief to address their concerns
4 regarding the financial health of PGW. They understand that management has achieved
5 significant efficiencies and now must focus on achieving financial stability and
6 sustainability. There is a broad recognition, however, that there is not yet sufficient
7 flexibility to weather the next crisis without meaningful rate relief.

8 If the Company experiences a financial crisis -- which, unfortunately is made far more
9 likely by the recommendation for a \$25 million rate increase -- it will have a devastating
10 effect upon the Company's credit status and could well set the stage for PGW's bonds to
11 be downgraded to below investment grade.

12 **Q. HOW HAVE YOU STRUCTURED YOUR REBUTTAL TESTIMONY?**

13 A. My testimony is divided into two parts. The first part addresses the errors the parties
14 have made in analyzing (or failing to analyze) PGW's cash and liquidity needs. The
15 second part addresses the consequences to PGW if the Commission adopts the parties'
16 refusal to address PGW's unacceptably high debt-to-equity ratio.

17 **Q. HOW DO THESE ISSUES INTERRELATE?**

18 A. PGW will continue to face two very significant financial threats if the opposing parties'
19 position of granting only \$25 million in rate relief is accepted: a lack of basic cash
20 working capital with substantially reduced liquidity (i.e., cash plus short term borrowing

¹ Mr. Bogdonavage demonstrates how this effect has a detrimental impact on ratepayers and puts the Company at risk.

1 capability) and the necessity for complete reliance upon the issuance of debt to fund its
2 capital requirements, the potential loss of access to the long-term capital markets.

3 The only way to address both of these serious concerns is to increase PGW's rates
4 now to enable PGW to begin to produce internally generated funds in a timely manner. If
5 there is a sufficient rate increase, liquidity will improve to acceptable levels and PGW
6 will be able to break the cycle of exclusive reliance on debt for capital funding. The
7 positive by-product of that change will be that the percentage of debt in its capital
8 structure will also be reduced. Overall PGW's financial position will be far less risky,
9 the costs to customers will be reduced and PGW will be able to continue to take steps to
10 improve its service and reliability. While I discuss these two issues separately below
11 they are more properly viewed as two aspects of the same problem -- the lack of internal
12 generation for working capital and for financing capital projects.

13 Insufficient cash and liquidity -- the product of inadequate rate relief -- is a near-
14 term problem that will hit home as early as next year, the first year in which a rate
15 increase would become effective. The burden created by excessive debt in the capital
16 structure is more of a long term issue that will -- sooner or later -- drive the Company to
17 speculative capital sources with costly terms or, alternatively, deprive the Company of
18 market access altogether. After seven years of barely maintaining PGW through a
19 combination of bootstrapping efforts and a proven record of reform by management, the
20 issue remains the same: the internal generation of funds and cash reserve with which to
21 operate the Company.

22 **Q. PLEASE EXPLAIN THE POSITION OF THE OTS/OCA WITH RESPECT TO**
23 **PROVIDING PGW WITH AN ADEQUATE LEVEL OF CASH WORKING**
24 **CAPITAL AND LIQUIDITY?**

1 A. The recommendation for a \$25 million rate increase was deemed adequate by OTS/OCA
2 on the ground that for the test year, FY 2007, PGW is showing that it exceeds minimum
3 coverage levels and has approximately \$50 million of cash at the end of the period.
4 These parties have failed to recognize, however that 100% of PGW's projected "cash"
5 balance in the test year comes from utilization of its commercial paper program. That is,
6 it is completely borrowed. Similarly, Mr. Bogdonavage informs me that, with a \$25
7 million rate increase, at the end of FY 2008, the first full year in which rates set in this
8 case will be in effect, PGW is also projected to have \$50 million in cash at year end –
9 again, all of it from short term borrowing. The Company year end cash balance will
10 actually decline by a small amount (\$.1 million) than the prior year, indicating that, at the
11 rate increase level proposed by those parties compared to PGW, will have negative cash
12 from operations and no working capital allowance in its rates. In addition, \$114 million
13 of its commercial paper line will be outstanding, leaving the Company with only
14 \$36 million of additional short term borrowing capacity (\$150 million less \$114 million).
15 In total that equates to \$86.5 million of liquidity (i.e., cash and available short-term
16 borrowing), or just 36.5 days of cash/liquidity for operations – *all borrowed*.

17 **Q. PLEASE DISCUSS THE IMPORTANCE OF CASH TO PGW.**

18 A. Like any sustainable utility or business enterprise, PGW needs to generate sufficient cash
19 from operations to meet its obligations on a timely basis. Although PGW appears to have
20 been able to meet this basic standard in its presentation of the numbers, the fact of the
21 matter is that it has done so not by raising cash from operations, but rather by borrowing
22 both from its owner, the City of Philadelphia, and through the use of its tax-exempt
23 commercial paper program. Absent a substantial rate increase, PGW will end each of the
24 next five years in a negative cash position:

<u>Year</u>	<u>Year End Cash Balance</u>	<u>Year End Commercial Paper Outstanding</u>
2007	\$50,616,000	\$80,000,000
2008	\$50,327,000	\$145,000,000
2009	\$41,366,000	\$150,000,000
2010	\$21,624,000	\$150,000,000
2011	(\$17,053,000)	\$150,000,000
2012	(7,287,600)	\$150,000,000

For discussion purposes, consider what this means in 2008. In order to end the year with approximately \$50,000,000 of cash, PGW will have to have nearly all of its commercial paper (\$145,000,000) outstanding (which means that all the \$50 million is borrowed), and have, in effect, no additional liquidity with which to meet the basic demands of running the enterprise, let alone responding to price spikes in the natural gas market. This is the equivalent of using a home equity line of credit to pay for a family's normal budget expenses; leaving no flexibility to respond to unexpected expenses or increases in prices or – to further analogize to PGW – the effects of a devastating hurricane. With no rate increase, by 2011, with 100% of commercial paper outstanding, PGW will have defaulted on some payment obligation, since even short term borrowings to the greatest permitted amount will be inadequate to meet current needs. The commercial paper has been a permanent part of PGW's capital structure for nearly ten years and no longer serves its original purpose of smoothing annual cash flows to allow PGW to meet its operating requirements.

It is incomprehensible to me that it is simply assumed that an enterprise in such a cash constrained circumstance and with the challenges that face this enterprise will be able to meet its obligations to its customers and to its bondholders. There can be no

1 clearer signal to regulators and the financial community short of actual failure than the
2 near miss of January 2006 when PGW had cash on hand to cover approximately two days
3 of operating expenses. When PGW was faced with not paying its December 2005 gas
4 bill, a disaster was avoided only because the banks, at that critical moment, extended
5 more credit to the company (by increasing the commercial paper credit facility by \$50
6 million). It was pure good fortune and good fortune that is not likely to be replicated in
7 the future.

8 Unfortunately, the larger investment community understands all too well what
9 occurred then, while at the same time they fully appreciate the volatility of the gas
10 markets. I believe that failure to address the working capital problem now, will have a
11 very direct impact on PGW's ability to borrow at reasonable cost from conventional
12 market sources. There are clear indications in recent rating agency reports that the
13 recently experienced improvement needs to be sustained and that any failure to do so
14 would be perceived as a sign of increased risk, erosion of recent progress, and an event
15 that would impose consequences.²

16 With the limited rate relief proposed by OCA and OTS, PGW would be in
17 violation of the coverage requirement on its 1998 Ordinance Bonds by 2009 and would,
18 therefore, be in technical default.³ Unfortunately just as it reached a position of technical
19 default, by 2009, PGW would also be attempting to borrow on a long term basis for its
20 on-going capital program although the violation of the rate covenant in that same year

² Fitch Ratings, April 10, 2007 Credit Report.

³ Mr. Bogdonavage testifies that, even with a \$25 million rate increase, projected coverage levels would be so thin that the Company would have to file for another rate increase almost immediately in order to add sufficient income to ensure that it will meet its bond ordinance requirements.

1 would undoubtedly preclude PGW from entering the bond market. Not replenishing the
2 capital fund would, in turn, prevent PGW from continuing even the basic safety
3 improvements previously mandated by the PUC. By 2011, this technical default would
4 have become a payment default. (See Financial Projections; Base Rate Case Scenarios
5 attached to the rebuttal Testimony of Mr. Bogdonavage). My recommendation to
6 management is that if it were not to receive substantial rate relief, it will have no choice
7 but to file immediately to garner sufficient earnings in time to prevent its access to credit
8 access being compromised.

9 To address the issue of the debt to equity ratio, rate relief of only \$25 million
10 would obviously mean that there was no debt reduction and that debt to equity ratios
11 would remain in excess of 80%. Again, the goal is not to reduce this ratio for its own
12 sake, but rather that a reduction of the debt to equity ratio would mean that PGW was
13 able to continue to meet all of its obligations systemically without continuously relying
14 on borrowed cash (whether from the City or through the commercial paper program),
15 indicating greater financial health and reduced risk and vulnerability.

16 **Q. PLEASE COMMENT ON THE CHALLENGE OF OTS/OCA WITNESSES TO**
17 **YOUR RECOMMENDATION FOR A STANDARD FOR PGW'S LIQUIDITY**
18 **NEEDS.**

19 A. In my direct testimony I provided a standard rule of thumb for "free" cash for a municipal
20 utility whose rates are set using a cash flow methodology of at least 200 days of only
21 cash (not cash and short term debt at year end.) To meet this objective, utilities must be
22 producing cash and internal funding on a consistent basis (not paper funds from an
23 accounting convention – depreciation – that cannot be used by a cash flow utility to pay
24 operating expenses). PGW is doing none of these things; even counting its commercial
25 paper program, it has only a fraction of the liquidity that a company of this size and scope

1 should have. Further, given that it rarely has less than the full amount of its commercial
2 paper outstanding (i.e., borrowed), commercial paper no longer really represents a
3 measure of the Company's liquidity.

4 Mr. Plonski for OTS dismissed my testimony on this point presumably because it
5 was different from what he may be used to. The fact is that PGW is different from every
6 other major electric or gas utility regulated by the PUC. My testimony was not an
7 academic exercise, but was based on actual experience. My firm and I provide financial
8 advice and assistance to hundreds of municipal utilities and I am intimately familiar with
9 the financial and performance data that these municipal enterprises need to attain in order
10 to have access to the credit markets at reasonable terms. Having an adequate amount of
11 working capital on hand is crucial in order for such firms to be able to deal with short
12 term cash flow needs and emergencies. I note that Mr. Plonski provides no standard of
13 his own to guide this conversation.

14 Attached to this rebuttal testimony are analyses that show days of liquidity and
15 debt to equity ratios for several hundred municipal companies. (BB-3) Contrary to Mr.
16 Plonski's statement, several of those companies are municipal energy companies (or
17 combined energy and other utility types). The average days of liquidity for these
18 companies is 691. I have also attached a table showing days of cash (meaning cash
19 generated from operations, not borrowed) for several Pennsylvania natural gas
20 distribution utilities and the average debt-to-equity rates for AGA members generally.
21 (BB-5, 6) Again, their days of cash and percentage of debt in their capital structures
22 show the levels that would be considered typical for a company such as PGW if it were
23 privately owned. One essential point to understand is that the greater the potential

1 volatility of the Company's costs, the more days of cash required. A utility that sells
2 water from a local source such as a tap in a river to which it is solely entitled will not be
3 any where near as vulnerable to price volatility as a utility that must purchase a
4 commodity such as natural gas whose price is entirely influenced by international energy
5 trends and violent weather patterns. By any measure, PGW's present cash and liquidity
6 situation is seriously and dangerously deficient.

7 All of these data regarding comparable cash and liquidity standards show that, by
8 these reasonable measures, PGW's \$100 million request would only provide an important
9 first step on the path to remedy its problems. Even if the full increase were granted
10 (which I urge), PGW would produce only \$8.6 million of internally generated funds in
11 FY 2008 and no non-borrowed day of cash on hand until FY 2009.

12 **Q. WHAT ARE THE POTENTIAL CONSEQUENCES IF THE COMMISSION**
13 **DOES NOT SEE FIT TO CORRECT THIS PROBLEM?**

14 With only \$25 million of base rate relief, the rating agencies, bond analysts and insurers
15 have indicated to me that they will immediately re-evaluate PGW's credit. They are
16 waiting for this decision. It is my view that in analyzing the schedules that Mr.
17 Bogdonavage will provide to them showing the deterioration in performance indicators in
18 FY 2008 and 2009 those evaluations will be negative. I cannot be certain how negative
19 their immediate reaction will be; however, there is absolutely no doubt that as the impact
20 of that level of rate increase plays out, their reaction would be strong, clear and negative.
21 The only way that we might forestall what could be a serious downgrade would be to
22 indicate that PGW intends to file immediately for yet another round of rate relief. I
23 cannot be more explicit: the financial markets have been waiting for this rate decision,

1 trusting and expecting that management's efforts at turn-around and cash collection
2 would produce a positive response from PGW's regulator.

3 **Q. FOCUSING FOR A MOMENT ON THE PROBLEM OF EXCESSIVE DEBT IN**
4 **PGW'S CAPITAL STRUCTURE, HOW WILL THE PARTIES'**
5 **RECOMMENDATIONS AFFECT PGW'S DEBT-TO-EQUITY RATIO?**

6 A. As Mr. Bogdonavagc explains, a \$25 million rate increase will provide no improvement
7 and will actually result in an increase in the percentage of debt compared to total
8 capitalization during the next five years. PGW's debt percentage will tick down to 81%
9 in FY 2010 and then return to the 83% level by FY 2012. This is chiefly because, at \$25
10 million, PGW will not be able to avoid going to the bond market to borrow capital in
11 order to fund its construction budget. Ironically, PGW's debt to equity ratio would
12 improve if it is denied access to the bond market and is forced to begin the downward
13 spiral of disinvestment in its capital plant.

14 **Q. MR. PLONSKI CLAIMED THAT THE COMPANY HAD PROVIDED NO**
15 **EVIDENCE THAT IT NEEDED TO HAVE A 50/50 CAPITAL STRUCTURE.**
16 **CAN YOU COMMENT?**

17 A. First, Mr. Plonski misunderstood PGW's testimony on this point. PGW was requesting
18 additional rate relief in order to make progress in reducing its exclusive reliance on long
19 term debt to fund its capital construction. As I testified, a 50/50 capital structure would
20 be indicative of a reasonable balance between internally generated funding and long term
21 debt. In fact, even if PGW were to receive 100% of its request (\$100 million rate request
22 and retention of \$10 million per year in off-system sales/capacity release proceeds) it
23 would still achieve only a 54% debt percentage in FY 2012 (calculated assuming that
24 additional revenues did not begin to accrue until FY 2008 after a Commission final
25 decision). Moreover, it is my opinion that any knowledgeable analyst must conclude that

1 reducing the percentage of debt in PGW's capital structure is crucially necessary to avoid
2 a financial crisis. A high debt ratio indicates either that a capital program is excessive
3 and is driving up the debt level or that the construction program is properly sized, but that
4 non-debt funding is inadequate. For PGW it is the latter. PGW's only source of non-debt
5 funding is internal generation, but there is no internal generation. The debt percentage is
6 like a blood pressure or temperature reading in medicine. A dangerously high reading is
7 clearly a signal that a serious – and potentially life threatening – problem has developed
8 or is likely to develop in the future.

9 **Q. WHY IS A HIGH AMOUNT OF DEBT IN THE CAPITAL STRUCTURE SUCH A**
10 **SERIOUS POTENTIAL PROBLEM?**

11 A. The higher the level of debt in an operation the higher the level of risk of financial
12 failure. Specifically, in a circumstance such as the current cash flow and liquidity
13 shortage at PGW, the Company and the customers run the risk of not meeting the debt
14 service payment requirements, of compromising the ability to continue to access long
15 term debt markets and, then, of reducing needed investment that raises the likelihood of
16 major incidents. Moreover, this huge amount of debt creates enormous costs,
17 exacerbated by the multiplier effect of the bond covenant, that must be recovered in rates;
18 by contrast, a sufficient rate increase now would ameliorate this problem and result in
19 lower rates in the future. Ultimately, it isn't about money. It is about safe and reliable
20 service.

21 **Q. BOTH MR. LELASH AND MR. PLONSKI ALSO ASSERTED THAT PGW'S**
22 **RELIANCE ON DEBT IS A LONG TERM ISSUE AND NOT ONE THAT**
23 **AFFECTS THE TEST YEAR IN THIS CASE. CAN YOU COMMENT?**

24 A. I will respond from the perspective of a financial analyst; not one familiar with details of
25 the regulatory evaluation of base rates. The fact that in this immediate fiscal period

1 which ends in less than four months, PGW technically can make its debt service
2 payments but effectively will make the actual payments with borrowed funds is
3 unacceptable and essentially meaningless as a measure of PGW's financial health.
4 Rather, it is an indication of serious financial imbalance. Any analyst or evaluator of the
5 company will look appropriately at the effects of a change in rates on next year's
6 performance and the longer term prospects. For all of the reasons noted above, \$25
7 million is insufficient.

8 However, if one is constrained by practice to look at only this current fiscal
9 period, then you have to burden this year's financial results with the impact of the
10 additional debt service of the long term bonds that will be issued in the next few weeks.
11 This cost is a known amount. Mr. Bogdonavage presents such an analysis in an Exhibit
12 to his Rebuttal testimony. The results speak for themselves. The Company effectively
13 needs what it has requested to start to address its fundamentals now.

14 **Q. IS THE CITY IN A POSITION TO PROVIDE SUBSIDY TO PGW IN EXCESS**
15 **OF THE PLANNED GRANT BACK OF THE \$18 MILLION ANNUAL**
16 **PAYMENT IN 2007-2010?**

17 A. Ms. Wilkerson and Mr. Dubow are the experts on this issue and they have indicated in
18 their testimony that the answer is "No". Of relevance to the financial community is that
19 the need to rely on such subsidy indicates poor financial health. Even if it were possible
20 and even if it happened, receipt of large amounts of funds, on a continuing and annual
21 basis, would not eliminate the risks since the same financial analysts are quite aware of
22 the City's poor financial health and would question how long the infusion of funds to
23 PGW could continue.

24 **Q. ARE OTHER MUNICIPAL UTILITIES SUBSIDIZED BY GOVERNMENTAL**
25 **ENTITIES.**

1 A. Of course there are examples of taxpayer subsidies of municipal utility rates, but it is by
2 far the more usual and preferred practice for municipal utilities to be fully supported by
3 user rates and charges. This is considered a public policy matter of equity and fairness.
4 The City's own Water Department is, for example, supported entirely by customer rates
5 and charges. Further, it is also quite usual for municipal utilities to make variously
6 characterized payments to their sponsoring local government.

7 **Q. MR. LELASH, IN HIS DIRECT TESTIMONY, HAS SUGGESTED THAT PGW'S**
8 **ANNUAL PAYMENTS TO THE CITY OF PHILADELPHIA OF \$18 MILLION**
9 **PER YEAR IN THE 11-YEAR PERIOD FROM 1993-2003 IN THE**
10 **CUMULATIVE AMOUNT OF \$198 MILLION REPRESENTS THE**
11 **WITHDRAWAL OF CAPITAL FROM PGW, ABSENT WHICH PGW'S DEBT**
12 **RATIO WOULD BE LOWER. WHAT IS YOUR REACTION TO THIS**
13 **COMMENT?**

14 A. First, the financial community looks to the future ability of the Company to perform, not
15 that historical period. Second, while it is easy to make the suggestion that PGW's
16 retention of \$198 million would have materially improved its financial position, the
17 suggestion is uninformed because it totally ignores the realities of the relative financial
18 position of the City and PGW during this time period. For example, the City ended its
19 Fiscal Year 1993 with a fund balance of \$3.8 million (after the receipt of the \$18 million
20 PGW payment). It achieved this tiny fund balance only after the Pennsylvania
21 Intergovernmental Cooperation Authority, relying for security upon a newly-levied tax,
22 successfully financed the City's \$256 million cumulative deficit. The City had a below-
23 investment grade credit rating and no access to either the short or long term credit
24 markets. (In fact, in 1991, the City's inability to issue notes to meet its annual cash flow
25 requirements precipitated the final financial crisis that led to the formation of PICA).
26 PGW, on the other hand, was still in a financially sound position and was, indeed, able to
27 fund a portion of its capital requirements with internally generated funds. Given the

1 relative financial positions of PGW and the City in the early to mid 1990s, it would
 2 hardly have made sense for the City's taxpayers to have subsidized PGW's rate payers.
 3 Obviously that situation began to alter in the late 1990s as the City's finances grew
 4 stronger and PGW's (as a result of years without rate increases, unusually warm weather,
 5 management dysfunction and the flawed implementation of a billing and collection
 6 system) grew worse, reaching crisis proportions in 2001 and 2002. At that time, the City
 7 began to make a very substantial financial contribution to PGW.

8 **Q. WHAT LEVEL OF RATE INCREASE DO YOU BELIEVE IS NECESSARY TO**
 9 **PROVIDE MINIMALLY NECESSARY LEVELS OF CASH AND LIQUIDITY**
 10 **AND TO ADDRESS PGW'S DEBT BURDEN?**

11 A. Only with an \$80 million rate increase does PGW start to address its fundamental
 12 problems and reach a position in which its year end cash balance is actually in excess of
 13 its short-term borrowings. This data from Mr. Bogdonavage is instructive:

14	<u>Year</u>	<u>Year End Cash Balance</u>	<u>Year End Commercial</u>	<u>Non-borrowed Days</u>
15			<u>Paper Outstanding</u>	<u>of Cash on Hand⁴</u>
16	2008	\$50,266,000	\$83,000,000	-
17	2009	\$50,648,000	\$58,000,000	3
18	2010	\$50,838,000	\$54,000,000	5
19	2011	\$50,338,000	\$63,000,000	1
20	2012	\$49,723,,000	\$73,000,000	-

21
 22 In this scenario, PGW will have internally generated funds (approximately \$29.8
 23 million) and is able to pay down its debt (beyond normal amortizations) for the first time
 24 in 2009. It will also have a few days of non-borrowed cash on hand. In this scenario,
 25 PGW can be considered a fiscally sound enterprise as its fundamentals continue to

⁴ Non-Borrowed days of cash: funds placed into the Debt Reduction Fund plus cash minus short term borrowing compared to dollars per day of expenses.

1 improve over time. The debt to equity ratio of PGW (again, this is not a goal in itself, but
2 rather an indicator of financial sustainability) would have reached 62% by Fiscal Year
3 2012. In my opinion, this scenario -- a total \$80 million rate increase -- is the minimum
4 reasonable level of increase that the Commission should consider.

5 In summary, PGW is not now meeting the cost of its annual operations and debt
6 service from rates and, in fact, absent a substantial rate increase in the \$80 million range,
7 it will be forced to continue to rely on increasing levels of both long-term (bonds) and
8 short-term (commercial paper) debt to fund operations. With all of its commercial paper
9 outstanding and virtually no liquidity, any material emergency expenditure (such as the
10 gas price spike associated with disruptions to natural gas supplies) could well precipitate
11 the collapse of PGW.

12 The end of PGW's having to borrow its way from crisis to crisis is in sight. The
13 Company has made substantial progress which has been recognized by the financial
14 markets. Only a significant rate increase will permit it to achieve financial health and
15 avoid the inevitability of financial disaster.

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

17 A. Yes.

EXHIBIT BB-3

Government - Owned Utility Ratios

UtilityName	Days of Liquidity	LTD/(Total Equity + Total Liabilities)
Alameda County Water District	2,052	9.36%
Anchorage Water and Wastewater Utility	462	24.53%
Austin Water Utility	146	80.65%
Azusa Light & Water	1,221	35.07%
Birmingham Water Works Board	249	92.96%
Boston Water and Sewer Commission	325	37.34%
Bucks County Water and Sewer Authority	408	55.79%
Burbank Water and Power	820	20.32%
Burlington Public Works	386	51.00%
Cambridge Water Department	N/A	57.14%
Cedar Rapids Water Department	518	41.62%
Central Arkansas Water	1,526	8.23%
Central Lake Cty Joint Action Water Agency	249	0.00%
Central Texas WSC	2,744	66.95%
Charlotte-Mecklenburg Utilities	541	59.33%
Chester Water Authority	689	17.93%
chesterfield county department of utilities	3,300	4.00%
Cheyenne Board of Public Utilities	1,203	25.36%
Chicago Department of Water	583	50.97%
City Corporation	3,118	0.00%
City of Akron; Public Utilities Bureau	545	31.06%
City of Albuquerque Public Works Department	139	40.29%
City of Allentown	264	48.53%
City of Ames Water and Pollution Control	611	1.25%
City of Ann Arbor Water Utilities	504	39.47%
City of Arlington Water Utilities	1,155	18.51%
City of Arvada	6,980	17.30%
City of Asheville - Water Resources Dept.	626	43.27%
City of Bismarck	794	0.00%
City of Canton Water Department	15,026	29.25%
City of Casper Public Utilities	4,182	1.80%
City of Charlottesville	1,830	51.90%
City of Chesapeake Public Utilities	749	26.07%
City of Columbia Water Department	189	38.84%
City of Columbus, Division of Water		57.70%
City of Concord	819	0.00%
City of Corvallis	3,440	0.00%
City of Dayton, Department of Water	5,551	10.97%
City of Duluth	1,029	20.99%
City of Durham, Env. Res. Dept.	6,178	53.59%
City of Escondido	2,312	45.43%
City of Evanston	154	14.54%
City of Flagstaff	1,160	13.85%
City of Frederick	1,604	19.81%

EXHIBIT BB-3

Government - Owned Utility Ratios

City of Garland	911	18.18%
City of Grand Junction Water	1,854	0.00%
City of Grand Rapids Water System	732	41.72%
City of Great Falls Utilities	674	21.93%
City of Greensboro Water Resources Department	712	29.43%
City of Houston, Public Works and Engineering	158	79.00%
City of Idaho Falls	34,762	0.00%
City of Irving Water Utilities	853	28.16%
City of Kalamazoo Dept. of Public Utilities	985	19.10%
City of Kalispell	329	14.04%
City of Kansas City Missouri, Water Services Departm	794	25.59%
City of Lakeland, Department of Water Utilities	29	43.96%
City Of Laredo	196	5.91%
City of Lebanon Authority	648	36.83%
City of Longmont Water/Wastewater Utilities	1,270	0.00%
City of Manteca	1,173	2.66%
City Of Midwest City	424	0.00%
City of Milpitas	707	0.00%
City of Naperville	3,504	0.00%
City of Newark, OH Division of Water and Wastewat	100,075	53.32%
City of Oceanside	665	9.21%
City of Olympia	3,872	18.52%
City of Peoria	2,263	31.76%
City of Phoenix Water Services Department	722	40.59%
City of Port Huron	2,661	43.46%
City of Renton	0	18.45%
City of Richmond	459	50.00%
City of Rockford Water Division	358	21.36%
City of Rocky Mount	491	8.36%
City of Sacramento, Department of Utilities	1,874	40.06%
City of San Diego Water Department	9,496	25.98%
City of Santa Ana, Public Works Agency	909	22.01%
City of Santa Cruz Water Department	1,540	2.13%
City of Scottsdale Water Resources	1,258	5.06%
City of Sioux Falls	1,784	7.62%
City of Sugar Land	450	13.20%
City of Tallahassee, Water Utility	212	7.59%
City of Tempe - Water Utilities Department	1,871	23.27%
City of Twin Falls Water Department	1,206	36.34%
City of Tyler Water Utilities	3,400	31.38%
City of Waco Water Utilities	558	45.14%
City of Waterbury Bureau of Water	1,731	2.82%
City of Wilmington	1,654	60.33%
City of Winter Springs	2,209	61.95%
City Utilities of Springfield, MO	232	20.68%
City Water and Light	590	0.00%
Cleveland Division of Water	1,188	49.75%

EXHIBIT BB-3

Government - Owned Utility Ratios

College Station Utilities	829	37.36%
Columbus City Utilities	671	16.82%
Commissioners of Public Works, Charleston, S.C.	1,361	43.87%
Consolidated Waterworks District No. 1, Terrebonne	423	25.37%
Contra Costa Water District	890	42.81%
Council Bluffs Water Works	1,019	10.45%
County of Maui - Department of Water Supply	1,069	14.55%
Dallas Water Utilities	273	33.13%
Dare County Water Department	578	28.32%
Decatur Utilities	256	30.04%
Denton Municipal Utilities	642	60.61%
Denver Water	856	22.03%
Department of Water Supply	1,319	8.51%
Des Moines Water Works	203	14.72%
Desert Water Agency	2,407	0.00%
East Bay Municipal Utility District	918	54.06%
El Paso Water Utilities	0	0.00%
Elmira Water Board	199	44.39%
Erwin Utilities	1,252	23.27%
Eugene Water & Electric Board	1,187	47.59%
Evansville Water & Sewer Utility	617	16.55%
Fargo Water Treatment Plant	1,660	28.89%
Fort Worth Water Department	77	30.10%
Gainesville Regional Utilities	0	48.30%
Georgetown County Water & Sewer District	445	41.49%
Glendale Water and Power	356	0.00%
Grand Forks Water	1,445	20.54%
Grand Strand Water & Sewer Authority	1,025	41.75%
Greater Cincinnati Water Works	697	21.83%
Green Bay Water Utility	564	18.09%
Greenville Utilities Commission	1,711	34.30%
Greenville Water System	858	29.42%
Gwinnett County DPU	1,539	27.68%
Highline Water District	1,363	26.74%
Honolulu Board of Water Supply	890	10.55%
Huntsville Utilities	226	20.95%
Janesville Water Utility	1,118	18.61%
Jordan Valley Water Conservancy District	2,593	52.61%
Kansas City Board of Public Utilities	628	48.59%
Kennebec Water District	4,778	55.25%
Kenosha Water Utility	5,622	34.12%
Lafourche Parish Water District No. 1	2,050	36.97%
Lakehaven Utility District	2,374	17.22%
Lansing Board of Water & Light	835	26.42%
Leavenworth Water Department	1,487	0.00%
Lincoln Water System	420	18.96%
Long Beach Water Department	395	15.30%

EXHIBIT BB-3

Government - Owned Utility Ratios

Los Angeles Dept. of Water and Power	731	31.79%
Louisiana Water Company	750	36.01%
Louisville Water Company	207	19.11%
Lubeck Public Service District	10,386	39.05%
Macon Water Authority	1,028	29.93%
Madison County Water Department	12,607	100.00%
Manchester Water Department	8,299	7.96%
Manchester Water Works	384	14.46%
Martin County Utilities	266	32.04%
Massachusetts Water Resources Authority	275	40.51%
Medford Water Commission	649	0.00%
Mesa Consolidated Water District	978	24.30%
Metro Water Services	203	29.61%
Metropolitan Domestic Water Improvement District	1,349	75.65%
Metropolitan Utilities District of Omaha	447	0.14%
Miami Dade Water and Sewer Department	1,480	27.53%
Milwaukee Water Works	419	14.87%
Mobile Area Water and Sewer System	322	41.45%
Mohawk Valley Water Authority	598	92.61%
Mount Pleasant Waterworks	287	21.19%
Mountain Water Company	170	29.74%
Municipal Authority of Westmoreland County	195	56.65%
New York City Water Board	179	64.92%
New York Water Service Corporation	768	28.36%
North Wales Water Authority	246	2.91%
Northern Kentucky Water District	451	56.28%
Oak Creek Water and Sewer Utility	678	22.59%
Ocean City Md. Water Department	566	51.74%
Oklahoma City Water Utility	685	43.96%
Onondaga County Water Authority	1,390	7.36%
Orange County Utilities	2,538	5.27%
Orange Water and Sewer Authority	476	23.92%
Orlando Utilities Commission	192	59.96%
Owensboro Municipal Utilities	234	47.91%
Paducah Water Works	607	16.27%
Palm Beach County Water Utilities Department	1,674	17.08%
Portland Bureau of Water Works	613	32.37%
Portland Water District	465	17.34%
Providence Water	284	15.53%
Provo City Water Resources	1,051	8.10%
Public Works Commission	1,708	19.73%
River Falls Municipal Utility	204	5.28%
Riverside Public Utilities	883	28.26%
Rochester Public Utilities	630	0.00%
Saint Paul Regional Water Services	1,144	12.49%
Salem Public Works	1,108	49.88%
Salt Lake City Public Utilities	588	12.71%

EXHIBIT BB-3

Government - Owned Utility Ratios

San Antonio Water System	134	55.11%
San Bernardino Municipal Water Department	1,228	3.95%
San Francisco Public Utilities Commission	3,823	34.37%
Santa Clara Valley Water District	3,673	11.28%
Seattle Public Utilities	199	66.19%
Sheffield Utilities	1,703	14.65%
Snohomish County PUD #1	781	27.92%
South Bend Water Works	241	41.79%
South Burlington Water Department	13,446	12.25%
South Central Connecticut Regional Water Authority	260	63.73%
Southeast Morris County Municipal Utilities Authority	3,944	25.18%
Spartanburg Water System	439	56.18%
State college water authority	47	9.31%
Suffolk County Water Authority	854	45.73%
Sweetwater Authority	888	24.02%
Tacoma Public Utilities, Water Division	496	41.26%
The Metropolitan District	2,443	6.84%
Tohopekaliga Water Authority	696	18.18%
Town of Cary	1,924	24.76%
Town of Jupiter Utilities	1,856	27.16%
Truckee Meadows Water Authority	625	93.46%
Tualatin Valley Water District	2,155	9.52%
Tucson Water	292	35.31%
Tulsa Metropolitan Utility Authority	703	19.36%
United Water Delaware	164	0.00%
United Water Idaho	52	35.59%
United Water New Rochelle	545	0.00%
United Water New York	3,896	0.00%
Washington Aqueduct	15,530	22.17%
Washington Suburban Sanitary Commission	623	30.46%
Washoe County Department of Water Resources	2,195	16.32%
Water District No. 1, of Johnson County, KS (WaterO	1,078	19.12%
Waterloo Water Works	14,357	4.30%
Wichita Water & Sewer Utility	268	22.85%
Williamsport Municipal Water Authority	729	23.41%
AVERAGES	2,124	27.89%

EXHIBIT BB-4

GOVERNMENT-OWNED ENERGY UTILITY RATIOS

Utility Name	Days of Liquidity	LTD/(Total Equity + Total Liabilities)
Azusa Light & Water - CA	1,221	92.96%
City Water and Light - AZ	390	0.00%
Decatur Utilities - AL	256	30.04%
Denton Municipal Utilities - TX	642	60.60%
Erwin Utilities - TN	1,252	23.27%
Gainesville Regional Utilities - FL	0	48.30%
Lansing Board of Water & Light - MI	835	26.43%
Los Angeles Dept. of Water and Power - CA	731	31.79%
Owensboro Municipal Utilities - KY	234	47.91%
River Falls Municipal Utility - WI	204	5.28%
Riverside Public Utilities - CA	883	28.26%
Rochester Public Utilities - MN	630	0.00%
Sheffield Utilities - AL	<u>1,703</u>	<u>14.65%</u>
	AVERAGE	
	691	31.49%

EXHIBIT BB-5

Debt to Equity Ratios									
Pennsylvania Gas and Electric Utilities									
Source: PAPUC Annual Reports									
Year Ended December 31, 2005									
Gas	LTD	Equity	Total Cap	Debt to Equity	Electric	LTD	Equity	Total Cap	Debt to Equity
	000's omitted					000's omitted			
Columbia	185,215	239,728	424,943	43.59%	Duquesne	636,513	776,997	1,413,510	45.03%
Dominion Peoples	248,617	341,393	590,010	42.14%	First Energy (Penn Power)	200,201	311,037	511,238	39.16%
Equitable	766,434	1,065,790	1,832,224	41.83%	First Energy (Met Ed)	691,887	1,316,098	2,007,985	34.46%
NFG	218,310	574,317	792,627	27.54%					
PG Energy	-	272,878	272,878	0.00%					
PPL	60,000	174,667	234,667	25.57%	PPL	2,410,910	1,375,216	3,786,126	63.68%
PECO	4,341,785	1,705,268	6,047,053	71.80%	PECO	4,341,785	1,705,268	6,047,053	71.80%
UGI	237,000	290,888	527,888	44.90%	UGI	237,000	290,888	527,888	44.90%

EXHIBIT BB-6

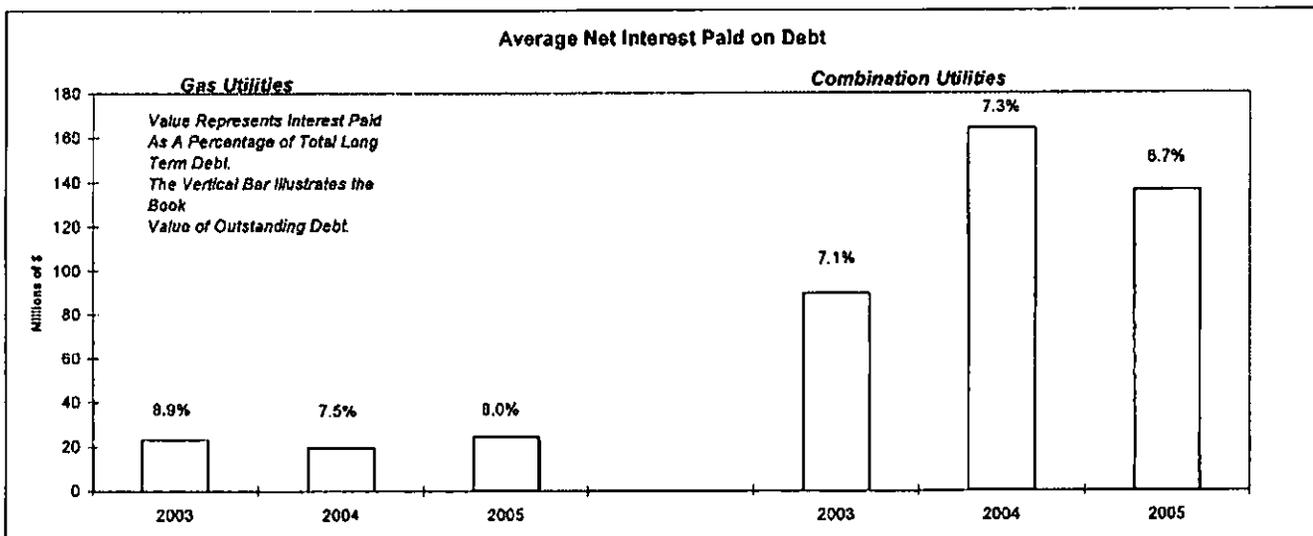
The total cost of capital for a utility reflects the cost of both debt and equity financing.⁷ Table 5 shows summary descriptors of capital costs for utilities by industry segment.

TABLE 5			
UTILITY DEBT AND DEBT COVERAGE			
AVERAGE VALUES			
	2003	2004	2005
Gas utilities			
Total LT Debt to Total Assets	22.1%	22.2%	22.5%
LT Debt to Total Capitalization	37.2%	37.0%	40.1%
EBITDA Interest Coverage	9.7x	8.6x	8.9x
Combination Utilities¹			
Total LT Debt to Total Assets	32.8%	33.1%	31.3%
LT Debt to Total Capitalization	51.1%	52.5%	52.6%
EBITDA Interest Coverage	5.6x	5.9x	5.8x

Source: AGA, USR.

¹ Figures represent combined gas and electric operations.

FIGURE 4



Note: Combination utility figures represent combined gas and electric operations.

Note again that the discussion of combination utility debt and capital structure cannot be limited to gas operations. Therefore, this portion of the analysis necessarily considers combined-commodity financial performance. The combination utilities feature a diversity of

⁷ For combination utilities, such measures necessarily reflect combined gas and electric financials. Some municipal utilities in this study have similar combined activity financing.

P&W
Bisgaier Rejoinder Exh. 5

5-23-07

Phila

TC

Docket # R-00061931

DOCUMENT FOLDER

Independent Consultant's Engineering Report

City of Philadelphia, Pennsylvania
Gas Works Revenue Bonds
Consisting of:

\$ 175,000,000¹

Gas Works Revenue Bonds
(1998 General Ordinance) Seventh Series

Philadelphia Gas Works
Philadelphia, Pennsylvania



BLACK & VEATCH
building a world of difference™

ENERGY WATER INFORMATION GOVERNMENT

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¹ Preliminary, subject to change.

Debt Service Requirements

Table 15 presents a summary of the existing and proposed long-term debt service requirements for the six-year projection period. The repayment of the City loan (\$45 million) is assumed to be made in two installments of \$2 million in 2007 and \$43 million in 2008. PGW's repayment of the City loan is subordinate to the debt service on any outstanding bonds issued under the General Bond Ordinances.

The proposed 2007 Bonds are assumed to be issued no earlier than March 2007. Debt service on this issue assumes a 30-year amortization schedule and a 6.5 percent interest rate. The 2007 Bonds are being issued to fund forecasted capital expenditures. No other future bond issues are projected for the forecast period.

Payments to City

In accordance with the Management Agreement and the Gas Choice Act, PGW makes an annual base payment of \$18 million to the City. The \$18 million payment for fiscal year 2004 was not paid and may be forgiven. In fiscal years 2005 and 2006, the \$18 million payment was made and was granted back. The City's current Five-Year Plan also provides for payment and grant back of the \$18 million for fiscal years 2007 and 2008.

Adequacy of Projected Revenues to Meet Projected Revenue Requirements Under Ordinance Requirements

Table 16 presents a pro forma statement developed from the revenue and expense projections for 2007 through 2012. This table in conjunction with Table 17, which presents a statement of cash flows, provides an indication of the adequacy of PGW's revenues and the financial feasibility of the currently proposed and future anticipated revenue bond sales.

The operating revenue projections presented earlier in Table 10, Line 41 are summarized in Lines 1 through 3 of Table 16. These projected revenues are based on PGW's currently effective rate schedules. Revenues from Other Sales, primarily unbilled gas adjustments, are shown on Lines 4, of Table 16. Since the Gas Choice Act mandates that the PUC approve and the PUC has acknowledged it has to approve PGW rates sufficient to meet PGW's bond covenants, as well as to provide PGW with needed liquidity, we reasonably assume the PUC will approve rate increases required to meet these requirements in a timely manner. Any combination of revenue enhancements, cost savings, and/or a permanent base rate increase in fiscal years 2007 through 2012 is included on Line 6 (Line 42 on Table 10) and represents, in our opinion, the minimum level of increase needed to:

- Cover the increase in non-gas operating expenses and interest expense since its 2002 rate case.
- Provide sufficient funds available for debt service to meet its rate covenant under the 1975 General Ordinance and the 1998 General Ordinance.
- Ensure, that in the long term, PGW has adequate liquidity when needed through internally generated funds without having to continually resort to borrowing funds externally for capital improvements.
- Repay the \$45 million loan to the City by 2008.
- Make the \$18 million annual payment to the City beginning in 2011.
- Repay short term commercial paper obligations.
- Provide additional earnings for further debt reduction.

Table 14
Historical and Projected Operation and Maintenance Expenses
(Thousands of Dollars)

Line No.	Description	Fiscal Year Ending August 31,												
		Historical					Projected							
		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	
Operating Expenses														
1	Natural Gas	266,350	431,320	303,806	427,433	450,868	509,701	625,076	630,836	658,487	623,363	562,396	558,243	550,889
2	Other Raw Materials	4	7	1	3	0	4	17	5	5	5	5	5	5
3	Subtotal Fuel	266,354	431,327	303,807	427,436	450,868	509,705	625,093	630,841	658,492	623,368	562,401	558,248	550,894
4	Gas Processing	14,033	13,400	13,912	16,952	17,384	15,584	15,234	15,715	17,245	17,458	17,670	17,935	18,270
5	Field Services	22,720	33,202	29,266	29,906	29,557	28,455	35,667	34,698	35,786	35,925	35,847	36,348	36,846
6	Distribution	14,246	14,837	13,791	16,804	15,778	15,115	15,179	16,536	16,837	17,152	17,477	17,832	18,217
7	Collection	12,609	11,473	7,805	8,504	10,730	10,971	9,952	7,944	7,771	7,872	7,974	8,101	8,230
8	Customer Services	10,759	14,228	13,130	13,704	13,514	12,512	11,053	14,125	14,168	14,398	14,657	14,863	15,152
9	Customer Accounting	3,669	1,717	6,232	6,976	7,496	7,695	7,337	7,625	7,690	7,787	7,825	7,922	8,019
10	Bad Debt Expense	54,642	67,633	51,548	85,000	71,000	70,424	40,132	59,492	58,847	56,072	52,353	48,378	46,599
11	Marketing & Point-of-Sale Expenses	3,041	3,486	2,815	2,832	2,677	2,592	2,467	2,992	3,088	3,031	3,085	3,140	3,132
12	Administrative & General	37,676	37,516	37,617	41,113	41,872	43,391	39,897	43,963	43,394	44,257	45,591	46,415	47,379
13	Health Insurance	24,241	27,404	29,194	30,259	32,863	33,571	35,076	37,784	41,944	45,904	49,654	53,719	58,126
14	Capitalized Fringe Benefits	(4,654)	(5,035)	(5,214)	(8,488)	(9,053)	(10,345)	(9,797)	(11,261)	(11,547)	(12,158)	(12,844)	(13,461)	(14,150)
15	Capitalized Admin. Charges	(4,858)	(7,224)	(6,440)	(5,694)	(6,193)	(6,706)	(6,779)	(7,950)	(7,258)	(7,529)	(7,379)	(7,220)	(7,008)
16	Regulatory Asset Amortization	1,984	(1,508)	2,836	3,750	3,750	0	0	0	0	0	0	0	0
17	Amortization of Restructuring Costs	965	965	0	0	1,097	1,087	1,087	0	0	0	0	0	0
18	Year 2000 & Deregulation Amortization	882	882	0	0	0	0	0	0	0	0	0	0	0
19	Pensions	1,096	2,301	8,496	13,013	14,973	14,702	17,563	15,075	14,611	14,265	13,911	13,571	13,235
20	Taxes	6,512	6,299	6,947	7,941	6,638	6,218	6,124	6,485	6,636	6,700	6,760	6,815	6,877
21	Environmental Expenses	0	0	79	241	334	0	0	0	0	383	507	639	753
22	Pro Forma Adjustments	0	0	0	0	0	0	0	217	603	250	250	0	0
23	Cost Savings/Productivity Improvements	0	0	0	0	0	0	0	(6,274)	0	0	0	0	0
24	Total Other Operating Expenses	199,563	221,576	212,017	262,818	254,317	248,263	220,222	237,166	249,815	251,767	253,338	254,997	259,645
25	Total Operating Expenses	465,917	652,903	515,824	690,254	705,185	757,968	845,315	868,007	908,307	875,135	815,739	813,245	810,539
26	Depreciation	32,614	32,559	32,654	33,712	35,607	39,547	37,955	38,213	39,565	40,825	42,091	43,531	43,515
27	Cost of Removal ^(a)	2,519	2,625	2,305	2,356	3,261	0	0	3,200	3,200	3,200	3,200	3,200	3,200
28	Less: Clearing Account Depreciation	(4,328)	(3,344)	(3,606)	(4,887)	(4,902)	(4,502)	(3,230)	(3,217)	(3,311)	(3,177)	(3,227)	(3,211)	(3,232)
29	Net Depreciation	30,805	31,840	31,353	31,181	33,966	35,045	34,725	38,196	39,454	40,848	42,064	43,520	43,483
30	Total Operating Expense & Dep'n.	496,722	684,743	547,177	721,435	739,151	793,013	880,040	906,203	947,761	915,983	857,803	856,765	854,022

(a) Cost of removal is included with Line 26 (Depreciation) in fiscal years 2005 and 2006

Table 15
Projected Long Term Debt Service Requirements
(Thousands of Dollars)

Description	Fiscal Year Ending August 31,					
	Projected					
	2007	2008	2009	2010	2011	2012
	\$	\$	\$	\$	\$	
Revenue Bonds under 1975 Ordinance						
Series 11C	0	0	0	0	11,017	14,005
Series 12A	0	0	0	0	0	0
Series 14	0	0	0	0	0	0
Series 15	777	777	777	777	777	777
Series 16	10,844	10,817	10,392	930	930	930
Series 17	19,552	18,012	16,466	14,934	13,121	11,560
Series 18	4,574	4,762	4,732	13,514	4,900	4,892
Total 1975 Ordinance Debt	35,748	34,368	32,368	30,155	30,745	32,164
Revenue Bonds under 1998 Ordinance						
<i>Senior Debt</i>						
First Series A	17,261	16,527	15,789	15,054	12,779	9,048
First Series B	0	0	0	0	0	0
Second Series	3,481	3,479	3,479	3,478	3,480	3,476
Third Series	1,866	3,318	3,314	3,314	3,314	3,316
Fourth Series	7,295	8,034	8,395	8,398	8,399	8,399
Fifth Series	6,000	6,000	6,000	8,418	8,416	8,418
A-2 Fifth Series Variable	1,050	1,050	1,050	1,050	1,050	1,050
Sixth Series	11,485	13,260	13,265	13,267	13,272	13,279
Seventh Series ^(a)	0	12,876	12,876	12,876	12,876	12,876
Senior Debt	48,438	64,544	64,168	65,856	63,587	59,862
<i>Subordinate Debt</i>						
First Series C	1,987	1,986	1,990	1,986	1,988	1,984
Total Subordinate Debt	1,987	1,986	1,990	1,986	1,988	1,984
Total 1998 Ordinance Debt	50,426	66,530	66,158	67,842	65,574	61,846
Capital Leases						
\$23M Capital Lease	0	0	0	0	0	0
Capital Leases	0	0	0	0	0	0
Total Long-Term Debt	86,174	100,898	98,526	97,997	96,319	94,010
City Loan ^(b)	2,000	43,000	0	0	0	0
Total Long Term Debt Service	88,174	143,898	98,526	97,997	96,319	94,010

(a) Projected debt service.

(b) Assumed debt service schedule.

Other operating revenues presented on Table 16, Line 8 include revenues from sales of energy-related appliance services and field collection charges. Projected Other Income for the System (Table 16, Line 28) includes interest earnings from the different reserve funds.

The projected operation and maintenance expenses shown on Table 16, Lines 10 through 26 are from Table 14. PGW's projected net operating income before interest is summarized on Line 29 of Table 16. Interest expense on existing bonds, proposed bonds, and capital leases is presented on Line 30. Other interest costs including loss from refunded debt and the allowance for funds used during construction ("AFUDC") are shown on Lines 32 and 33. PGW's projected net income is shown on Line 35 of the table and ranges from \$2.4 million to \$92.8 million.

On Table 17, Line 1 presents PGW's cash balance as of September 1 for each fiscal year. From this starting point, the net income line from Table 16 is combined with non-cash adjustments (such as depreciation and amortization) expensed on the Income Statement. External sources of funds are summarized on Lines 8 through 12 and include revenue bond proceeds, drawdowns on the capital improvement fund, capital lease proceeds, and the payment and grant back of the \$18 million for fiscal years 2007 and 2008. The total for all sources of funds is shown on Line 14 of Table 17.

Uses of funds are summarized on Lines 15 through 24 of Table 17. Lines 15 through 17 present the principal payments made on long-term debt, Line 18 shows additional debt reduction funding in the amount of \$100 million over the forecast period, CIP requirements are shown on Line 19, and payments to the City and short-term debt obligations are shown on Lines 20, 22, and 23. Changes in non-cash working capital items, including changes in accounts payable and accounts receivable, are shown in Line 24.

The net increase or decrease in available cash for each fiscal year is shown on Line 26 of Table 17. The ending cash balance for the year, which is the sum of Lines 1 and 26, is shown on Line 27. The ending cash balance for 2007 represents approximately 2 weeks of operations and maintenance expenses (excluding the cost of fuel) and the ending cash balances for fiscal years 2007 through 2012 represent approximately 2 to 8 weeks of operations and maintenance expense (excluding the cost of fuel). These projected year-end cash balances for fiscal years 2007 through 2012 should be sufficient for PGW to accommodate normal fluctuations in expenditures for utility operations.

A detailed calculation of debt service coverage requirements under the 1975 and 1998 General Ordinances is presented in Table 18. Debt service requirements do not include the letter of credit or remarketing fees for the 2007 Bonds. The results presented in the table indicate that provided the assumptions made herein are realized, PGW will meet the requirements of the 1975 and 1998 General Ordinances for all years in the projection period.

Sensitivity Analyses

The recent rate filing for \$100 million is necessary for PGW to:

- Cover the increase in non-gas operating expenses and interest expense since its 2002 rate case.
- Provide sufficient funds available for debt service to meet its rate covenant under the 1975 General Ordinance and the 1998 General Ordinance.
- Ensure, that in the long term, PGW has adequate liquidity when needed through internally generated funds without having to continually resort to borrowing funds externally for capital improvements.
- Repay the \$45 million loan to the City by 2008.

- Make the \$18 million annual payment to the City beginning in 2011.
- Repay short term commercial paper obligations.
- Provide additional earnings for further debt reduction.

If PGW does not receive the full rate increase requested, PGW will likely not be able to meet all of these stated goals.

By way of example, if PGW were to receive only a \$50 million annual increase in the rate filing, PGW would likely:

- Have less funds to reduce its long term debt.
- Rely less on internally generated funds.
- Possibly return to the debt markets as soon as late 2008 or 2009.
- Reduce capital spending.

If PGW were unable to meet the rate covenant required under the ordinance, PGW would then have to reduce expenditures, develop other sources of Project Revenues, and/or file for rate relief.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PGW St. 8

5/22/07

Phil wj/h

TESTIMONY OF

HOWARD S. GORMAN

DOCUMENT
FOLDER

ON BEHALF OF
PHILADELPHIA GAS WORKS

Docket No. R-00061931

December 2006

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SECRETARY'S BUREAU

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

3 A. My name is Howard Gorman. I am a Principal Consultant with Black & Veatch
4 Corporation ("Black & Veatch"). My business address is 898 Veterans Highway,
5 Hauppauge, NY 11788.

6 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
7 **PROFESSIONAL EXPERIENCE.**

8 A. My educational background and professional experience are outlined in my
9 curriculum vitae that is attached as Attachment A.

10 **Q. PLEASE BRIEFLY DESCRIBE THE SCOPE OF YOUR ENGAGEMENT**
11 **WITH PGW AND THE PURPOSE OF YOUR TESTIMONY.**

12 A. Black & Veatch has been retained by Philadelphia Gas Works ("PGW" or
13 "Company") to perform an unbundled, fully allocated class cost of service study
14 (generally, a "CCOSS" and the particular CCOSS that I address in this testimony,
15 the "PGW CCOSS"). One of the purposes of a CCOSS is to assign the total costs
16 and other elements of the revenue requirements of the Company to each Rate
17 Class. The costs assigned to each Rate Class can then be compared to the revenue
18 produced by the rates in the Company's current Gas Rate Tariff ("Tariff"), as well
19 as to the rates proposed by the Company in this proceeding.

20 I also present the results of a cost of service analysis of PGW's
21 Interruptible Transportation service, which is based on the PGW CCOSS. The
22 Company was directed to present such a cost study by the Commission in its
23 restructuring proceeding in Docket M-00021612.

1 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION**
2 **ON BEHALF OF PGW?**

3 A. Yes, I prepared and sponsored the PGW CCROSS in Docket R- 00006042 and
4 Docket R- 00017034 and prepared and sponsored testimony to support its
5 restructuring in Docket M-00021612.

6 **Q. WHAT WAS THE SOURCE OF THE INFORMATION THAT YOU USED**
7 **IN PERFORMING THIS ENGAGEMENT?**

8 A. All of the information about PGW's operations was provided by PGW, and I
9 relied on the genuineness and completeness of all information presented to me by
10 PGW. Costs and other data were provided by PGW for the Test Year (the Fiscal
11 Year ending August 31, 2007), including a limited number of pro forma
12 adjustments. These data included forecasted test year total system costs of
13 service, forecasted sales and transportation volumes, forecasted customer
14 information and forecasted revenues. In addition, other operating and plant
15 information was supplied by PGW for the purpose of cost classification and the
16 development of direct cost assignments and allocation factors that are required to
17 perform the cost allocation study. The budget was prepared by PGW on the
18 assumption of normal weather. The revenue requirements are set forth in the
19 testimony of Company witness Mr. Bogdonavage.

20 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

21 A. In Section 1, I provide background information and identify the exhibits that I am
22 sponsoring. In Section 2, I discuss the Class Cost of Service Study methodology.
23 In Section 3, I present the results of the CCOS and discuss the contents of the
24 exhibits. In section 4, I describe the computations that I performed based on the

1 Company's specifications for revenue allocation and proposed rates. In section 5,
2 I present the results of a cost of service analysis of PGW's Interruptible
3 Transportation service, which was prepared based on the results of the PGW
4 CCOSS.

5 **SECTION I – BACKGROUND INFORMATION**

6 **Q. PLEASE STATE PGW'S TARIFF REVENUE REQUIREMENT FOR THE**
7 **TEST YEAR.**

8 A. Based on the Test Year Budget, PGW's Tariff Revenue Requirement is \$1.144
9 billion. Please note that in this testimony, "sales" refers to volumes of natural gas
10 sold to customers and "revenues" refers to dollars received from customers on
11 account of sales, transport service or otherwise.

12 **Q. PLEASE EXPLAIN THE TERM "TARIFF REVENUE REQUIREMENT".**

13 A. As I use the term in my testimony, the "Tariff Revenue Requirement" is the
14 revenue that needs to be produced under PGW's Tariff in order to recover its total
15 cost of providing service, **before reduction for Customer Responsibility**
16 **Program ("CRP") Shortfall and for Senior Discounts.** Under the proposed
17 rates, PGW would not collect the full Tariff Revenue Requirement, because the
18 amounts collected would be reduced by the CRP Shortfall and by Senior
19 Discounts.

20 **Q. DID YOU COMPARE THE REVENUE UNDER THE CURRENT TARIFF**
21 **TO THE REVENUE UNDER THE TARIFF RATES THAT THE**
22 **COMPANY IS PROPOSING?**

23 A. Yes. Based on the costs and physical quantities in the Test Year Budget, PGW's
24 Test Year revenue under the current Tariff would be \$1.044 billion (Exhibit HSG-
25 1, line 10), excluding Other Operating Revenue and Non-operating Revenue and

1 before deducting CRP Shortfall and Senior Discounts. On a comparable basis
2 PGW's Test Year revenue under the Tariff rates proposed by the Company would
3 be \$1.144 billion (Exhibit HSG-6T, line 44 and Exhibit HSG-7, line 9).

4 **Q. PLEASE IDENTIFY THE EXHIBITS¹ THAT ARE INCLUDED WITH**
5 **YOUR TESTIMONY.**

6 A. The following exhibits are included with my testimony. They are discussed in
7 detail in Section 3 of my testimony.

8	Exhibit HSG-1	Summary of Results .
9	Exhibit HSG-1A	Revenue Requirement By Functional Classification
10	Exhibit HSG-1B	Total Class Allocation- Revenue Requirement By
11		Rate Class
12	Exhibit HSG-2	Functionalization
13	Exhibit HSG-3	Classifications
14	Exhibit HSG-4A through	
15	Exhibit HSG-4I	Class Allocations
16	Exhibit HSG-5A	Allocator Values – Functionalization
17	Exhibit HSG-5B	Allocator Values – Classification
18	Exhibit HSG-5C	Allocator Values – Class Allocation
19	Exhibit HSG-5D	Assignment or Allocator Used for Each Account
20	Exhibit HSG-6	Development of Allocator Values
21	Exhibit HSG-7	Company's Proposed Revenue Allocation and
22		Proposed Rates
23	Exhibit HSG-8	Interruptible Transportation Cost of Service
24		Analysis

25 **Q. PLEASE SUMMARIZE THE RESULTS OF YOUR WORK AS THEY**
26 **APPLY TO THE CHANGES TO THE TARIFF PROPOSED BY PGW IN**
27 **THIS FILING.**

28 A. I have reached the following results and conclusions based on my work:

- 29 1. Based on the costs and physical quantities in the Test Year Budget, the full
30 Tariff Revenue Requirement has been assigned among the Rate Classes on a
31 **cost causation** basis as shown on Exhibit HSG-1A, line 33.

¹ These exhibits are located in the Cost Service Study which is Volume III of this filing.

- 1 2. The **current** Tariff rates result in the Rate Class under and over-recoveries of
2 the Tariff Revenue Requirements, including the Rate increase requirement, as
3 shown in Exhibit HSG-1, line 25, and the return on rate base as shown on line
4 31.
- 5 3. The Company's **proposed** revenue allocation would result in the under and
6 over-recoveries of Tariff Revenue Requirements, including the Rate increase
7 requirement, as shown in Exhibit HSG-7, line 25.
- 8 4. The current (and proposed) monthly Customer Charges are significantly lower
9 than the customer related costs on a per customer-month basis in the Test Year
10 Budget, as shown on Exhibit HSG-1A, line 36.

11 **SECTION II – PGW CLASS COST OF SERVICE STUDY**

12 **Q. PLEASE BRIEFLY DESCRIBE THE PURPOSE IN PERFORMING A**
13 **CLASS COST OF SERVICE STUDY.**

14 A. An unbundled fully allocated CCOSS analyzes all the functional components of
15 the utility's total cost of service and assigns plant investments and operating
16 expenses, including gas supply costs, to determine the costs incurred by the utility
17 in providing products and services to each Rate Class. The CCOSS determines
18 the Revenue Requirement for each Rate Class. The Revenue Requirement for a
19 Rate Class is that portion of the total costs of service incurred by PGW, that can
20 be attributed to that Rate Class on a cost-causality basis. An important aspect of a
21 CCOSS is that all of the utility's costs of providing service must be analyzed and
22 allocated among the Rate Classes, so that the utility can establish rates that ensure,

1 subject to assumptions such as sales volumes and customer counts, that it recovers
2 all of its costs.

3 **Q. PLEASE EXPLAIN THE TERM “UNBUNDLED” WITH RESPECT TO**
4 **THE COSTS OF PROVIDING NATURAL GAS SERVICE.**

5 A. Unbundling is the separation of the utility’s cost of service into its various product
6 and service components. The PGW CCOSS follows the unbundling of PGW’s
7 rates pursuant to the Commission’s Order in Docket M-00021612. This is further
8 discussed in my discussion of the Functionalization step of the CCOSS.

9 **Q. PLEASE SUMMARIZE THE APPROACH THAT YOU FOLLOWED IN**
10 **PERFORMING THE PGW CCOSS.**

11 A. The most critical task in performing a CCOSS is establishing relationships
12 between customer requirements, load profiles and usage characteristics on the one
13 hand, and the costs incurred to serve those requirements on the other hand.

14 PGW designs its gas distribution system to meet three primary objectives:

- 15 1. To extend distribution services to all customers;
- 16 2. To meet the aggregate peak design day capacity requirements of all
17 customers entitled to receive service on the peak design day, and
- 18 3. To deliver volumes of natural gas to those customers either on a
19 sales or transportation service basis.

20 It is important that the allocation methods used within the CCOSS recognize these
21 *cost causative* characteristics of the company’s plant investments and operating
22 expenses. The CCOSS should objectively reflect cost causation factors
23 attributable to the utility's customers, their gas usage requirements, and system

1 operations, and to the extent possible, should not be influenced by desired end-
2 results, customer equity, or other rate design considerations.

3 The CCOSS was performed using the Rudden proprietary Gas Cost of Service
4 Model ("Model"), an EXCEL based spreadsheet computer model. The Model is a
5 tool that facilitates the allocation of common costs, speeds up computations and
6 eases documentation.

7 The study uses a basic three-step process of cost analysis: 1)
8 *functionalization* of rate base, purchased gas supply costs and expenses among the
9 following functions – supply, storage, transmission, distribution, onsite (including
10 metering and customer accounts) and Universal Service and Education Charge
11 ("USEC"); 2) *classification* of functionalized costs into demand, commodity and
12 customer cost categories; and 3) *class allocation* of functionalized, classified costs
13 among the Rate Classes. The Model provides functionalized and classified cost
14 information by service class, develops unbundled Tariff Revenue Requirements
15 by functional classification and in total for each Rate Class, and calculates unit
16 costs by function for demand, commodity and Rate Classifications.

17 **Q. WHY DID YOU USE BUDGETED DATA FOR THE TEST YEAR IN THE**
18 **PGW CCOSS?**

19 A. The purpose of using budgeted data is to avoid any effect of weather in the
20 CCOSS results and the ensuing rate design. The PGW budget assumes that
21 weather will be normal, and that weather related revenues and costs will be
22 consistent with average weather assumptions. If PGW were to base its cost of
23 service on actual historical data, the data would have to be normalized to remove

1 the effects of weather. It is more reliable to use budget data based on a weather-
2 normal year, than to normalize historical data.

3 **Q. ARE THERE NOTEWORTHY DIFFERENCES IN METHODOLOGY OR**
4 **APPROACH IN THE CURRENT CCOSS FROM THE PREVIOUS CCOSS**
5 **YOU PERFORMED FOR PGW?**

6 A. The methodology that I used is the same as that used in performing prior CCOSS
7 for PGW. In a few cases there were changes in the allocators selected for certain
8 accounts, with very small effect on the results of the CCOSS.

9 **Q. PLEASE DESCRIBE THE FUNCTIONALIZATION STEP OF A COSS.**

10 A. In the **functionalization** step, costs are separated by the utility's basic service
11 characteristics. The PGW CCOSS follows the functional unbundling of PGW's
12 Tariff pursuant to the Commission's Order in Docket M-00021612, as follows:

- 13 • *Supply* function includes the cost of purchased gas commodity adjusted for net
14 storage injections and withdrawals and net liquefied natural gas ("LNG")
15 liquefaction and vaporization.
- 16 • *Storage* function reflects costs incurred to ensure that firm customers' demand
17 can be met on the design day. It includes the costs of storage capacity, storage
18 demand, storage injections and withdrawals and annual demand charges.
19 These costs are included in the unbundled Load Balancing Charge.
- 20 • *Transmission* function includes pipeline demand charges.
- 21 • *Onsite* function includes the costs of operating activities starting at the meter
22 on the customer's premises and includes metering, billing and accounting and
23 certain customer assistance expenses.

- 1 • *USEC* function includes items collected through the USEC Charge, such as
2 CRP Shortfall, Senior Discounts, CAP portion of Uncollectible Accounts
3 Expense, and a portion of the costs of the Customer Assistance Program.
- 4 • *Distribution* function includes all other costs, including operating expenses the
5 amounts of Uncollectible Accounts Expense and Customer Assistance
6 Program not included elsewhere, and costs that are part of PGW's regulated
7 utility function.

8 The total of supply, storage and transmission functionalized costs applicable to
9 firm supply customers, excluding certain gas production costs, is recovered
10 through the Gas Cost Recovery charge.

11 **Q. PLEASE DESCRIBE THE CLASSIFICATION STEP OF A CCOSS.**

12 **A.** In the **classification** step, the previously functionalized costs are separated
13 according to the system design or operating characteristics that cause those costs
14 to be incurred. In this step, each cost is determined to be incurred to serve
15 **customers**, to supply the natural gas **commodity** or to meet various capacity
16 **demands** including coincident and non-coincident peaks.

17 **Customer** related costs are the costs incurred to attach a customer to the
18 distribution system, to meter gas usage and to maintain the customer's account.

19 Customer costs are a function of the number of customers served and continue to
20 be incurred whether or not the particular customer uses any gas. They include
21 capital costs associated with distribution mains, services and meters, and
22 operating costs such as customer service, field service, billing and accounting
23 expenses.

1 **Commodity** related costs are those costs that vary with the natural gas throughput
2 sold to, or transported for, customers. These costs include the cost of the
3 commodity, lost and unaccounted for gas, as well as related procurement and
4 supply management costs.

5 **Demand, or capacity**, related costs are associated with plant that is designed,
6 installed and operated to meet maximum hourly or daily gas flow requirements,
7 such as measuring and regulating equipment. Contracts for gas supply,
8 transportation (from supply source to City Gate) and storage are also demand
9 related, related to meeting design day demand and the demand throughout the
10 peak season. For PGW the peak season is December through February. Demand-
11 related costs associated with serving the *system design day* are allocated among
12 the Rate Classes based upon contribution to the *system design day* requirements.
13 Demand-related costs associated with managing supply throughout the *peak*
14 *season* are allocated among the Rate Classes based upon contribution to the *peak*
15 *season* requirements.

16 **Q. DO ALL EXPENSES FIT NEATLY INTO ONE OF THESE THREE**
17 **CLASSIFICATIONS?**

18 A. Most costs do fit neatly into one of the three classifications, but it may be
19 necessary to assign some costs among two classifications based upon special
20 external studies or based upon how related costs have been classified through the
21 use of internal classification allocation factors. For example, Account 376,
22 Mains, was classified as both customer and demand related due to their dual
23 function of connecting customers and meeting peak demand.

1 **Q. PLEASE DESCRIBE THE CLASS ALLOCATION STEP OF A CCOSS.**

2 A. In the **class allocation** step, the functionalized, classified costs are allocated
3 among the Rate Classes, based on causal relationships based on the utility's gas
4 system design and operations, its accounting records and its system and customer
5 load data (e.g., annual and peak period gas consumption levels). From the results
6 of those analyses, direct assignments of costs, as well as class allocators, are
7 chosen for each of the plant and expense elements.

8 **Q. PLEASE EXPLAIN THE TERM "DIRECT ASSIGNMENT."**

9 A. The term "direct assignment" means identifying plant investments or costs
10 incurred exclusively to serve a specific customer or group of customers. Direct
11 assignments best reflect the cost causation of serving individual customers or
12 groups of customers, and should be used whenever the data are available.

13 **Q. ARE A LARGE PORTION OF THE PLANT AND EXPENSES**
14 **TYPICALLY DIRECTLY ASSIGNED?**

15 A. No, it is not. The nature of utility operations is characterized by common or joint
16 use facilities. In addition, direct assignments require detailed information which
17 may be unavailable or may require a great deal of time to obtain and use.
18 Therefore, to the extent that a utility's plant and expense cannot be directly
19 assigned to customer groups, common allocation methods must be derived to
20 assign the remaining costs to the Rate Classes.

21 **Q. PLEASE EXPLAIN HOW ALLOCATORS ARE DERIVED.**

22 A. There are two types of allocation bases, or allocators, typically used in performing
23 a CCOSS and employed in the Model: external allocators and internal allocators.
24 *External allocators* are based on special studies derived from data in the utility's

1 accounting and other records. For example, gas sales, the volume of gas
2 consumed by each Rate Class, is an external allocator that is used to allocate some
3 of the gas commodity costs. Other examples of external allocators are number of
4 customers, estimated design day sales and historical bad debt experience. Exhibit
5 HSG - 2, Schedule 2 shows the main external allocators that were developed
6 based on data provided by PGW.

7 *Internal allocators* are based on some combination of external allocators,
8 previously directly assigned costs and other internal allocators. For example, the
9 allocators for property insurance costs are based on plant investment amounts
10 assigned to components of the rate base; it is necessary to compute the rate base
11 before property insurance costs can be assigned. Both external and internal
12 allocators are used in each of the functionalization, classification and class
13 allocation steps.

14 **Q. WHT ARE THE GUIDING PRINCIPLES IN PERFORMING A FULLY**
15 **ALLOCATED CCOSS?**

16 **A.** The essential element in performing a CCOSS is the selection of allocators based
17 on causal relationships between customer requirements, load profiles and usage
18 characteristics on the one hand, and the costs incurred by the Company in serving
19 those requirements on the other hand. The primary objectives in selecting
20 allocators are:

- 21 1. recognition of **cost causality** as opposed to **value of service**;
- 22 2. **stability** of results over time;
- 23 3. **logical consistency** and **completeness**; and

1 4. **ease of implementation.**

2 **Q. WHAT IS THE RATE BASE AND HOW DOES IT AFFECT THE PGW**
3 **CCOSS?**

4 A. The rate base is the cost, net of accumulated depreciation, of PGW's investment
5 in plant and other assets used to serve customers. In a typical investor-owned
6 utility, the size of the rate base is important because the utility is allowed to earn a
7 return on its investment in rate base. This is not the case for PGW, because
8 PGW's rates are designed to allow it to collect the dollar amount needed to meet
9 its financial requirements. Therefore, PGW's Tariff Revenue Requirement is not
10 directly affected by the size of the rate base. However the rate base is an
11 important allocator, because PGW, as most utilities, is asset or rate base intensive
12 and its assets drive a great many of PGW's costs. Therefore many costs are
13 functionalized, classified or allocated among Rate Classes in the same ratio as the
14 rate base or a portion of the rate base.

15 For example, interest expense on long-term debt is functionalized,
16 classified and allocated among Rate Classes using the rate base, because interest
17 expense is incurred to finance the purchase of the assets in the rate base.

18 **Q. WHAT ARE THE MAJOR COMPONENTS OF PGW'S RATE BASE?**

19 A. For purposes of discussing how I functionalized, classified and allocated the rate
20 base in the PGW CCOSS, I will refer to the following groupings of rate base
21 items. After presenting the list, I will describe how I treated each of these major
22 rate base categories:

- 23 • Production plant

- 1 • Storage plant
- 2 • Distribution plant
- 3 • General plant
- 4 • Depreciation reserve
- 5 • Other Rate Base items
- 6 • Working capital

7 **Q. WHAT IS THE TOTAL RATE BASE?**

8 A. The total rate base is \$1.409 billion, net of accumulated depreciation, as of the
9 end of the Test Year.

10 **Q. HOW DID YOU FUNCTIONALIZE, CLASSIFY AND ALLOCATE**
11 **AMONG RATE CLASSES EACH COMPONENT OF RATE BASE?**

12 A. The principal allocators for each component of the rate base are:

13 *Production plant* represents the investment in natural gas production assets which
14 are used to meet design day demand. These assets have been functionalized to
15 Supply, classified to demand, and allocated among Rate Classes based on design
16 day requirements.

17 *Storage plant* represents the investment in liquefied natural gas (“LNG”) facilities
18 which are used to meet design day demand, and to meet demand swings. These
19 assets have been functionalized to Storage, classified to demand, and allocated
20 among Rate Classes based on the design day requirements.

21 *Distribution plant* comprises:

- 22 • Mains- Mains have a dual purpose: (1) to attach a customer and enable
23 the customer to receive a minimal level of service, and (2) to provide

1 adequate capacity for the maximum demand level by the customer.
2 The first purpose is customer related and the second is demand related.
3 Ideally, to determine the customer component of the investment in
4 mains, we would perform a minimum system study or a zero-intercept
5 study. A zero-intercept study estimates the investment that would be
6 required, if instead of the existing mains, zero-diameter pipes were
7 installed. The estimated cost of the zero-diameter system is classified
8 as the customer component of mains, and the balance of the total
9 investment in mains is the demand component, because the costs
10 above the zero-diameter pipes are deemed to be incurred to serve
11 design day demands.

12 The data to do a zero-intercept study for PGW were not available.
13 However, Rudden's experience shows that the customer component of
14 mains typically ranges from approximately 25% to 50% of the total
15 investment based on zero-intercept studies. For PGW, an estimate of
16 25% was used to take into account the density of the PGW system, and
17 therefore, 25% of the investment in mains was classified as customer-
18 related and allocated among Rate Classes based on customer counts;
19 this number is at the bottom of the range cited.

20 The remaining 75% of the investment in mains was classified as
21 demand-related, and was allocated among Rate Classes based on the
22 design-day sendout subject to maximum distribution system
23 constraints but not to supply constraints.

- 1 • Services- Services connect individual customers to the system. These
2 assets have been functionalized to Distribution, classified as customer
3 related costs, and allocated among Rate Classes based on the estimated
4 total replacement cost for each Rate Class. Total replacement cost of
5 Services for a Rate Class was estimated by multiplying: X)
6 replacement cost of a service line with typical diameter for the Rate
7 Class, by Y) number of customers in the Rate Class.
- 8 • Meters and Meter installation- These assets have been functionalized
9 to the Onsite function, classified as customer related costs and
10 allocated among Rate Classes based on the estimated total replacement
11 cost for each Rate Class. Total replacement cost of Meters for a Rate
12 Class was estimated by multiplying X) replacement cost of a meter
13 with typical size for the Rate Class by Y) number of customers in the
14 Rate Class.
- 15 • Other Distribution plant- . These assets comprise a) House regulators
16 and House regulator installation, which have been re-functionalized to
17 the Onsite function, classified as customer-related and allocated among
18 the residential Rate Classes based on customer counts; b) Compressor
19 station equipment and Measuring and Regulator station equipment,
20 which was functionalized to Distribution, classified as demand-related
21 and allocated among the Rate Classes based on design day
22 requirements; and c) Land and land rights, Structures and
23 improvements and Other equipment, which were functionalized to

1 Distribution, classified as demand-related and allocated among Rate
2 Classes primarily using averages for Distribution plant.

3 General plant includes primarily Structures and improvements, Office furniture
4 and equipment, Transportation equipment, Communications equipment and tools.
5 These assets, which are used in performing more than one function or are used in
6 Administrative and general activities that support more than one function, were
7 functionalized, classified and allocated among Rate Classes primarily based on
8 direct labor content. Labor was used due to the nature of the assets and reflecting
9 common utility practice.

10 Depreciation reserve was provided by PGW detailed as to Production plant,
11 Storage plant, Distribution plant and Onsite plant, with Distribution detailed as to
12 Mains, Services and Meters. Each component of Depreciation reserve item has
13 been functionalized, classified and allocated among Rate Classes in the same ratio
14 as the related assets.

15 Other Rate Base Items is Construction Work in Process ("CWIP"). Each item in
16 CWIP was functionalized, classified and allocated among Rate Classes in the
17 same ratios as related in-service rate base assets.

18 Working capital represents PGW's need for cash to keep the business running
19 until revenues are collected to pay costs. Each item of working capital was
20 functionalized, classified and allocated among Rate Classes in the same ratio as
21 the activity which caused the item to be incurred.

1 **Q. WHAT ARE THE MAJOR CATEGORIES OF COSTS IN PGW'S COST**
2 **OF SERVICE?**

3 A. The major categories in PGW's cost of service are:

- 4 • Production costs
- 5 • Gas supply which includes gas commodity costs
- 6 • Storage costs
- 7 • Distribution costs
- 8 • Customer accounts, customer service and sales costs
- 9 • Administrative and general expenses
- 10 • Depreciation expense
- 11 • Tax expense; for PGW this is primarily payroll tax
- 12 • Interest and Surplus
- 13 • Rate increase requirement
- 14 • Other revenues and expenses

15 **Q. IN DETERMINING HOW YOU WOULD TREAT THESE EXPENSES IN**
16 **THE CCOSS, WAS THERE ANY OTHER IMPORTANT CATEGORY OF**
17 **COSTS THAT YOU CONSIDERED?**

18 A. Yes, Labor costs affect most of the cost categories because many costs are
19 assigned based on the direct labor content of other costs. For example, Account
20 870, Operations Supervision and Engineering, is allocated among Rate Classes
21 based on the direct labor content of distribution and onsite costs. To enable these
22 allocations to be performed, the direct labor content of each cost account was
23 obtained from PGW, and special allocators were developed so that costs could be
24 assigned based on only the direct labor content of accounts.

1 **Q. WHAT COSTS ARE INCLUDED IN PGW'S PRODUCTION COSTS?**

2 A. PGW's production costs include gas production costs and gas supply costs.

3 **Q. WHAT COSTS ARE INCLUDED IN PGW'S GAS PRODUCTION COSTS**
4 **AND HOW WERE THESE COSTS FUNCTIONALIZED, CLASSIFIED**
5 **AND ALLOCATED AMONG RATE CLASSES?**

6 A. PGW's gas production costs are the costs of operating the Passyunk and
7 Richmond plants which are used for propane gas and liquefied natural gas
8 ("LNG") to meet peak day requirements. Therefore these costs were
9 functionalized to Supply, classified as demand and allocated among Rate Classes
10 based on design day requirements.

11 **Q. WHAT COSTS ARE INCLUDED IN PGW'S GAS SUPPLY COSTS AND**
12 **HOW DID YOU FUNCTIONALIZE, CLASSIFY AND ALLOCATE**
13 **THESE COSTS AMONG RATE CLASSES?**

14 A. PGW's gas supply costs include commodity costs, producer demand charges,
15 storage costs, transportation contracts and LNG operating costs.

16 **Q. WHAT FACTORS DID YOU CONSIDER WHEN YOU**
17 **FUNCTIONALIZED, CLASSIFIED AND ALLOCATED THESE COSTS?**

18 A. PGW manages its storage and seasonal gas supplies throughout the year, and
19 especially the peak season, to ensure that sufficient commodity will be available
20 to meet demand from firm sales customers each day of the year including any
21 design day. This means, for example, that PGW may meet demand on a given day
22 from a combination of resources, rather than from current flowing gas supply
23 only, so as not to constrain future daily draws of current supply.

24 Therefore, in functionalizing, classifying and allocating among the Rate
25 Classes the gas costs, we considered that PGW purchases commodity throughout

1 the year, and maintains and manages a variety of resources, to meet design day
2 requirements and demand throughout the peak season.

3 **Q. HOW WERE THESE COSTS FUNCTIONALIZED, CLASSIFIED AND**
4 **ALLOCATED AMONG RATE CLASSES?**

5 A. Commodity costs include purchased gas costs and net injections / withdrawals
6 from storage and net liquefaction / vaporization of LNG, less a credit for gas used
7 by other utility operations. These costs were functionalized to supply and
8 classified to commodity. The portion of commodity costs due to firm sales were
9 allocated among the firm sales classes based on firm sales volumes, and the
10 portion due to non-firm sales were allocated among those classes based on non-
11 firm sales volumes.

12 Producer demand charges were functionalized to Supply (seasonal contracts) or
13 Storage (annual contracts), classified to demand and allocated among Rate Classes
14 based on design day requirements.

15 Storage costs, including demand, capacity and injection and withdrawal charges,
16 were functionalized to Storage and classified to demand.

17 For storage facilities used to meet peak season requirements, the storage demand
18 charges, which relate to maximum daily withdrawals, were allocated among Rate
19 Classes based on design day requirements; and capacity charges as well as
20 injection and withdrawal charges, which relate to the maximum volume stored,
21 were allocated among Rate Classes based on winter firm sales volumes.

22 For storage facilities used for year-round balancing, all charges were allocated
23 among Rate Classes based on annual throughput volumes.

1 Transportation contracts were functionalized to Transportation (pipeline
2 contracts) or Storage (storage transportation contracts), classified to demand and
3 allocated among Rate Classes based on design day requirements.

4 LNG operating expenses were functionalized to Storage, classified to demand and
5 allocated among Rate Classes based on design day requirements.

6 **Q. WHAT COSTS ARE INCLUDED IN PGW'S STORAGE COSTS AND**
7 **HOW DID WERE THESE COSTS FUNCTIONALIZED, CLASSIFIED**
8 **AND ALLOCATED AMONG RATE CLASSES?**

9 A. Storage costs are the costs of operating PGW's LNG facilities. PGW maintains
10 these facilities to meet peak demand, primarily on the design day. Therefore,
11 these costs were functionalized to Storage, classified as demand and allocated
12 among Rate Classes based on design day requirements.

13 **Q. WHAT COSTS ARE INCLUDED IN PGW'S DISTRIBUTION COSTS?**

14 A. Distribution costs are the costs of operating and maintaining PGW's City Gate
15 station, mains, services and meters, i.e., the gas delivery system. Some of these
16 costs are functionalized to distribution and some to onsite. All costs were
17 analyzed to determine whether they were incurred in order to manage gas supply,
18 maintain equipment or for supervision.

19 **Q. HOW WERE DISTRIBUTION COSTS FUNCTIONALIZED, CLASSIFIED**
20 **AND ALLOCATED AMONG RATE CLASSES?**

21 A. Costs relating to managing gas supply were functionalized to Distribution,
22 classified to demand and allocated among Rate Classes based on annual gas sales
23 volumes.

1 Costs related to the City Gate station and measuring and regulating equipment
2 were functionalized to Distribution, classified to demand and allocated among
3 Rate Classes based on design day requirements.

4 Costs of maintaining mains, services, meters and house regulators were
5 functionalized, classified and allocated among Rate Classes in proportion to
6 PGW's investments in the respective assets.

7 Costs of work performed on customer premises were functionalized to Onsite and
8 classified to customer. The portion of these costs related to PGW's parts and
9 labor plan were allocated to the residential classes, consistent with the allocation
10 of parts and labor plan revenue; and the remaining costs were allocated among
11 Rate Classes based on PGW's investment in meters.

12 Other distribution costs were functionalized between Distribution and Onsite in
13 proportion to the functionalization of distribution plant, and classified to
14 customer. The Distribution function portion was allocated among Rate Classes in
15 proportion to plant functionally classified as Distribution customer and the Onsite
16 function portion was allocated in proportion to plant functionally classified as
17 onsite customer.

18 Supervision costs were functionalized to Distribution and onsite in proportion to
19 the functionalization of Distribution plant and were classified and allocated
20 among Rate Classes in proportion to direct labor content of distribution function
21 expenses.

1 Q. **HOW WERE CUSTOMER ACCOUNTS COSTS FUNCTIONALIZED,**
2 **CLASSIFIED AND ALLOCATED AMONG RATE CLASSES?**

3 A. Customer accounts costs includes meter reading expenses, customer records and
4 collection expenses, related supervision, uncollectible accounts expense and
5 uncollectible accounts- CRP arrearages.

6 Meter reading expenses and related supervision were functionalized to Onsite,
7 classified to customer and allocated among Rate Classes based on investment in
8 meters and in number of meters. Exhibit HSG-6O shows how the METERREAD
9 allocator was developed.

10 Customer records and collection expenses and related supervision, which includes
11 telephone service, district offices, bill preparation, collection labor and support,
12 collection processing and other activities, were functionalized to Onsite, classified
13 to customer. For allocation among Rate Classes, the account was analyzed in
14 detail to identify different activities and each activity was allocated using an
15 appropriate basis. For example, telephone services and bill preparation were
16 allocated based on customer counts; collection efforts were allocated based on
17 accounts over 60 days past due. Exhibit HSG-6M shows how the Account903
18 allocator was developed. Exhibit HSG-6P shows how the Over60 allocator was
19 developed.

20 Uncollectible accounts expense, or bad debts expense, is presented net of
21 recoveries of amounts previously written off. This item was functionalized to
22 distribution and classified to customer, and allocated among Rate Classes based
23 on the average shares of total write-offs for the 10 months ended June 2006, fiscal

1 year 2001 and fiscal year 1998. The share of the write-off allocator for each Rate
2 Class is close to its share of account dollars over 60 days old, indicating the
3 allocator is not affected by PGW's judgment in writing off accounts. Exhibit
4 HSG-6Q shows how the Write-Offs was developed.

5 Uncollectible accounts- CRP arrearages were functionalized to USEC, classified
6 to customer and allocated among Rate Classes based on firm gas sales, consistent
7 with the recovery method for these costs under the USEC charge.

8 **Q. HOW WERE CUSTOMER SERVICE AND INFORMATION COSTS**
9 **FUNCTIONALIZED, CLASSIFIED AND ALLOCATED AMONG RATE**
10 **CLASSES?**

11 A. Customer service and information costs includes marketing costs, CAP program
12 costs, CRP shortfall and Senior discount.

13 Marketing costs were functionalized to Onsite classified to customer, then
14 analyzed to determine which customer types were addressed and allocated among
15 Rate Classes using the average number of customers for those classes. Exhibit
16 HSG-6N shows how the Account908 allocator was developed.

17 CAP program costs, CRP shortfall and Senior discount were functionalized to
18 USEC, classified to customer and allocated among Rate Classes based on firm gas
19 sales, consistent with the recovery method for these costs under the USEC charge.

20 **Q. HOW WERE ADMINISTRATIVE AND GENERAL EXPENSES**
21 **FUNCTIONALIZED, CLASSIFIED AND ALLOCATED AMONG RATE**
22 **CLASSES?**

23 A. Administrative and general expenses include administrative and general salaries,
24 office supplies and expenses, outside services, injuries and damages, employee
25 benefits, property insurance costs, regulatory commission expenses, miscellaneous

1 general expenses, maintenance of general plant and rents. These costs have been
2 reduced by offsets for capitalized labor costs and for gas used by the utility.

3 Administrative and general costs, except for items discussed immediately below,
4 are directly related to labor costs and therefore were functionalized, classified and
5 allocated among Rate Classes in the same ratios as direct labor content.

6 Property insurance costs were functionalized, classified and allocated among Rate
7 Classes in the same ratio as plant in service.

8 Regulatory commission expenses were functionalized to Distribution, classified to
9 customer and allocated among Rate Classes in the same ratios as the rate base.

10 Capitalized labor costs and Gas used by the utility were functionalized, classified
11 and allocated among Rate Classes in the same ratios as the costs which they are
12 reversing.

13 **Q. HOW WAS DEPRECIATION EXPENSE FUNCTIONALIZED,**
14 **CLASSIFIED AND ALLOCATED AMONG RATE CLASSES?**

15 A. Depreciation expense includes depreciation expense on plant in service and costs
16 of removal less capitalized depreciation expense.

17 A small amount of depreciation related to directly assigned mains costs
18 was functionalized to Distribution, classified to demand and directly assigned to
19 the appropriate Rate Class. The balance of depreciation expense was
20 functionalized, classified and allocated among Rate Classes in the same ratios as
21 plant in service.

1 **Q. HOW WAS TAX EXPENSE FUNCTIONALIZED, CLASSIFIED AND**
2 **ALLOCATED AMONG RATE CLASSES?**

3 A. Tax expense includes payroll tax expense and a credit for Capital and OAR taxes.
4 These items both relate to payroll costs, and were functionalized, classified and
5 allocated among Rate Classes based on direct labor content.

6 **Q. PLEASE DESCRIBE THE INTEREST AND SURPLUS REQUIREMENT**
7 **INCLUDED IN PGW's REVENUE REQUIREMENTS.**

8 A. Interest expense includes interest on long term debt, amortization of debt
9 discounts, premiums, and loss on reacquired debt, interest on tax-exempt
10 commercial paper and interest on customer deposits. It also include AFUDC
11 credit. The surplus is the Test Year budgeted surplus including pro forma
12 adjustments, as shown in Mr. Bogdonavage's testimony.

13 **Q. DO THESE REQUIREMENTS DIFFER FROM A TYPICAL INVESTOR-**
14 **OWNED UTILITY?**

15 A. Yes, they do. In a typical investor-owned utility, an important component of the
16 Revenue Requirement is the overall rate of return the utility is allowed to earn on
17 its investment in rate base. The return is usually stated as a percent return on the
18 rate base; the amount of the return is designed to allow the utility to pay interest
19 on debt capital and to provide a return on equity capital. However PGW includes
20 in its Tariff Revenue Requirements the dollar amount of its interest and surplus
21 requirements, rather than an amount based on returns to investors of debt and
22 equity capital stated in percentages. The rate increase requirement is also
23 different because, as stated by Mr. Bogdonavage, it is necessary as part of a plan
24 to rebuild PGW's capital and to improve its financial situation.

1 Q. ARE THERE OTHER SIGNIFICANT DIFFERENCES FROM A TYPICAL
2 INVESTOR-OWNED UTILITY?

3 A. Yes. A typical investor-owned utility will be subject to taxation including income
4 tax, gross receipts tax and other taxes. In order for the utility to recover the net
5 amount of cash it needs, any amounts that it collects must be adjusted to provide
6 for the payment of taxes.

7 PGW is not subject to an income tax or gross receipts tax and does not have to
8 take them into consideration when computing its Revenue Requirements.

9 Q. HOW WERE INTEREST EXPENSE AND AFUDC CREDIT
10 FUNCTIONALIZED, CLASSIFIED AND ALLOCATED AMONG RATE
11 CLASSES?

12 A. Interest expense was functionalized, classified and allocated among Rate Classes
13 in proportion to the rate base.

14 The Allowance for Funds Used During Construction Credit was functionalized
15 and classified in proportion to CWIP and allocated among Rate Classes in
16 proportion to the rate base.

17 Q. HOW WAS THE SURPLUS REQUIREMENT FUNCTIONALIZED,
18 CLASSIFIED AND ALLOCATED AMONG RATE CLASSES?

19
20 A. In a typical investor-owned utility, the return to equity holders is allocated among
21 Rate Classes in proportion to the rate base. PGW's surplus requirement serves a
22 similar function, and therefore the surplus requirement was functionalized to
23 Distribution, classified to customer and allocated among Rate Classes in
24 proportion to the rate base.

1 **Q. PLEASE DESCRIBE THE RATE INCREASE REQUIREMENT.**

2 A. As described in Mr. Bogdonavage's testimony, the rate increase requirement is
3 necessary as part of a plan to rebuild PGW's capital in order improve its
4 precarious financial situation and to finance a portion of its capital needs with
5 internally generated funds.

6 **Q. HOW WAS THE RATE INCREASE REQUIREMENT**
7 **FUNCTIONALIZED, CLASSIFIED AND ALLOCATED AMONG RATE**
8 **CLASSES?**

9 A. In choosing allocation factors, the objective is to allocate the amount among the
10 Rate Classes based on cost-causality, and developing appropriate allocation
11 factors. The rate increase requirement was functionalized to Distribution and
12 classified to customer. Because the major purpose of the rate increase is to
13 rebuild PGW's capital, and a substantial use of the funds generated will be to fund
14 capital expenditures and to reduce outstanding long term debt, the rate increase
15 was allocated among Rate Classes based on PGW's rate base.

16 **Q. MIGHT OTHER FACTORS BE CONSIDERED FOR ALLOCATING THE**
17 **RATE INCREASE REQUIREMENT AMONG THE RATE CLASSES?**

18 A. Yes, but after careful consideration, it was determined that allocation based on
19 PGW's rate base is the most appropriate factor. Other factors that we considered
20 would not have material impact on the allocation among the Rate Classes.

21 **Q. PLEASE DESCRIBE PGW'S NON-OPERATING REVENUES AND HOW**
22 **THEY ARE REFLECTED IN THE COMPUTATION OF THE REVENUE**
23 **REQUIREMENT.**

24 A. Non-operating revenues includes primarily interest and dividend income from
25 temporary cash investments, parts and labor plan revenue, bill paid turn-ons &
26 dig-ups revenue charged to customers, and miscellaneous other revenue. These

1 items are used to reduce the revenue requirement that would be collected under
2 the proposed new rates.

3 **Q. HOW WERE NON-OPERATING REVENUES FUNCTIONALIZED,**
4 **CLASSIFIED AND ALLOCATED AMONG RATE CLASSES?**

5 A. Interest and dividend income was functionalized, classified and allocated among
6 Rate Classes in proportion to the rate base, which is the same as interest expense.
7 Parts and labor plan revenue was functionalized to Onsite, classified to customer
8 and allocated among residential classes.

9 Bill paid turn-ons & dig-ups revenue was functionalized to Onsite, classified to
10 customer and allocated among Rate Classes based on average number of
11 customers.

12 Miscellaneous other non-operating income was functionalized, classified and
13 allocated among Rate Classes in proportion to the rate base.

14 **Q. HOW WERE PGW'S OPERATING REVENUES AT PRESENT RATES**
15 **COMPUTED AND ASSIGNED AMONG RATE CLASSES?**

16 A. For the following charges, revenues at present rates were computed by
17 multiplying present rates by forecast billing units, which were available by Rate
18 Class: Base Rate Revenue, GCR Revenue, Interruptible Gas Revenue, USEC
19 Revenue.

20 Finance charge revenue, determined from PGW's budget, was allocated among
21 the Rate Classes based on an analysis of over-60 day balances.

22 Miscellaneous service revenue, determined from PGW's budget, was allocated
23 among the Rate Classes in proportion to base rate revenue.

1 Transport Gas revenue, determined from PGW's budget, was directly assigned to
2 the GTS class.

3 Gas revenue adjustment, representing unbilled gas revenues, determined from
4 PGW's budget, was allocated among the Rate Classes in proportion to GCR
5 Revenue.

6 Revenue adjustment, representing reconciling amounts from the prior year,
7 determined from PGW's budget, were allocated among the Rate Classes as
8 follows: GCR reconciliation and Interruptible Revenue Credit reconciliation were
9 allocated in proportion to GCR Revenue; USEC reconciliation was allocated in
10 proportion to USEC Revenue; Restructuring & Consumer Education Charge
11 reconciliation was allocated in proportion to Base Rate revenue.

12 **Q. ARE THERE ANY OTHER COMPONENTS TO THE PGW COSS THAT**
13 **WARRANT DISCUSSION?**

14 **A.** No, the above testimony addresses all significant components of the PGW COSS.

15 **SECTION III – RESULTS OF THE PGW CCOSS**

16 **Q. PLEASE DESCRIBE THE INFORMATION ON EXHIBIT HSG-1**

17 **A.** Exhibit HSG-1 compares the revenue at current rates provided by each rate class
18 (line 12) to the revenue requirement allocated on a cost of service basis. The
19 revenue requirement includes operating expenses (line 18), interest and surplus
20 (line 21) and the rate increase requirement (line 24). The comparison of revenues
21 at present rates and the revenue requirement is shown on line 25. The amounts on
22 line 25 represent the increase or decrease needed for each Rate Class to provide
23 the \$100 million total rate increase requirement and for each Rate Class to pay its
24 full cost of service on a cost causation basis.

1 Line 22 shows the Rate Class cross-subsidies at present rates; that is,
2 before the rate increase requirement.

3 **Q. PLEASE DESCRIBE THE INFORMATION ON EXHIBIT HSG-1A and**
4 **EXHIBIT HSG-1B.**

5 A. Exhibit HSG-1A summarizes the results of the Class Allocations on Exhibits
6 HSG-4A through 4I by functional classification. Exhibit HSG-1B summarizes the
7 results of the Class Allocations on Exhibits HSG-4A through 4I by account detail.
8 Exhibit HSG-1B shows the allocation of each element of rate base (lines 9-92),
9 operating expenses (lines 93-194), depreciation expense (lines 195-200) and taxes
10 (lines 201-203) among the functions. Total operating expenses are on line 204.
11 The exhibit then shows operating revenues at present rates (lines 205-217), other
12 revenues (lines 218-228). Total revenue is on line 229 and income before interest
13 and surplus is on line 231. Interest and surplus requirements are on lines 232-236,
14 the rate increase requirement is on line 237, and the total is on line 238. A
15 comparison of revenue at current rates to the total revenue requirement on a cost
16 of service basis is on line 240. A negative number indicates that the Rate Class'
17 current revenue produces less than its full cost of service revenue requirement; a
18 positive number indicates that the Rate Class' current revenue produces more than
19 its full cost of service revenue requirement.

20 **Q. PLEASE DESCRIBE THE INFORMATION ON EXHIBIT HSG-2.**

21 A. Exhibit HSG-2 shows how each element of the revenue requirement has been
22 allocated among the functions: supply, storage, transmission, distribution, onsite
23 and USEC. The exhibit shows the allocator selected for each element, and the
24 result of the allocation. The line captions are the same as in Exhibit HSG-1B.

1 **Q. PLEASE DESCRIBE THE INFORMATION ON EXHIBIT HSG-3.**

2 A. Exhibit HSG-3 shows how each element of each functional revenue requirement
3 for the supply function (pages 1-6) and the distribution function (pages 7-12)
4 functions was classified as demand, commodity or customer. The exhibit shows
5 the allocator selected for each element, and the result of the allocation. The line
6 captions are the same as in Exhibit HSG-1B.

7 Items functionalized to Storage and Transmission are classified as 100% demand,
8 and items functionalized to Onsite and USEC are classified as 100% customer,
9 therefore these functions are not shown on the exhibit.

10 **Q. PLEASE DESCRIBE THE INFORMATION ON EXHIBITS HSG-4A**
11 **THROUGH HSG-4I.**

12 A. Exhibits HSG-4A through HSG-4I shows each element of each functionally
13 classified revenue requirement is allocated among the rate classes. The exhibit
14 shows the allocator selected for each element, and the result of the allocation. The
15 line captions are the same as in Exhibit HSG-1B.

16 **Q. PLEASE DESCRIBE THE INFORMATION ON EXHIBITS HSG-5A**
17 **THROUGH HSG-5D.**

18 A. Exhibit HSG-5A shows the assignment and allocator values for functional
19 assignment and allocation of the revenue requirement. Exhibit HSG-5B shows
20 the assignment and allocator values for classification of the functionalized
21 revenue requirement components. Exhibit HSG-5C shows the assignment and
22 allocator values for allocation of functionally classified components of the
23 revenue requirement among the Rate Classes. External allocators and internal
24 allocators are identified by "EXT" and "INT, respectively, next to their names on

1 Exhibits HSG-5A through 5C. External and internal allocators were discussed
2 above.

3 Exhibit HSG-5D shows the assignment or allocator used for each account, at each
4 step: functionalization; classification; and allocation among Rate Classes.

5 **Q. PLEASE EXPLAIN THE CUSTOMER RELATED COSTS IN THE PGW**
6 **COSS.**

7 A. As previously described, customer related costs are the costs incurred to attach a
8 customer to the distribution system, to meter gas usage and to maintain the
9 customer's account. The total of all customer costs for PGW is a function of the
10 number of customers served. Customer costs continue to be incurred whether or
11 not a particular customer uses any gas. They include capital costs associated with
12 distribution mains, services and meters, and operating costs such as customer
13 service and accounting expenses. Total customer costs by Rate Class for the Test
14 Year are shown on Exhibit HSG-1A, line 32, and on a unit basis, on Exhibit HSG-
15 1A, line 36. The unit is a customer-month; that is, these are the amounts PGW
16 should collect from each customer each month to recover fully its customer
17 related costs.

18 **Q. DID YOU COMPARE THE MONTHLY CUSTOMER CHARGES BEING**
19 **PROPOSED BY PGW TO THE CUSTOMER RELATED COSTS IN THE**
20 **PGW COSS?**

21 A. Yes. For every Rate Class, the monthly Customer Charges in the current Tariff
22 (which are the same as the proposed monthly Customer Charges) are lower than
23 the customer related costs on a per customer-month basis in the PGW COSS for
24 the Test Year.

- 1 Q. PLEASE DESCRIBE THE INFORMATION ON EXHIBIT HSG-6.
- 2 A. Exhibit HSG-6 presents the development of each of the main external allocators.
- 3 These are described below. Except where noted, all data relate to the Test Year.
- 4 Exhibit HSG-6A- All Gas Contracts And Costs. Lists and describes each gas
5 supply, transport and storage contracts, including relevant volumes and costs.
- 6 Exhibit HSG-6B- Allocation of Contract Demand Costs. Shows how the demand-
7 related volumes and costs in Exhibit HSG-6A are functionalized, classified and
8 allocated among the rate classes.
- 9 Exhibit HSG-6C- Design Day Sendout: Shows Design Day sendout for each of
10 the firm sales classes as provided by PGW's Gas Model.
- 11 Exhibit HSG-6D- PEAKDEMAND Allocator: Shows Design Day demand for
12 each rate class computed using Base and Thermal method; use to allocate demand
13 component of mains.
- 14 Exhibit HSG-6E- Gas Sales Allocator- Shows monthly billed sales volumes for
15 each rate class.
- 16 Exhibit HSG-6F Thruput Allocator- Shows monthly thrupt volumes for each
17 rate class; represents volumes on mains.
- 18 Exhibit HSG-6G GTS Allocator- Shows monthly sales volumes and revenues for
19 GTS rate class.
- 20 Exhibit HSG-6H Winter3 Allocator- Shows monthly billed sales volumes for
21 each firm sales rate class during the December-February.
- 22 Exhibit HSG-6I- GCR Allocator- Monthly billed sales volumes for each firm
23 sales rate class.
- 24 Exhibit HSG-6J- Cust Avg Allocator- Shows monthly number of customers for
25 each rate class.
- 26 Exhibit HSG-6K- Meter Invest Allocator- Computes investment in meters for
27 each rate class at current replacement cost for each meter type.
- 28 Exhibit HSG-6L Service Invest Allocator- Computes investment in services for
29 each rate class at current replacement cost for each service line.
- 30 Exhibit HSG-6M- Account903 Allocator- Allocates each activity in Customer
31 Records and Collection, Account 903, using an appropriate external allocator.
32 Rows 9-27 list each component activity, the activity cost in the Test Year budget,

1 and the allocator assigned to it. Rows 31-43 summarize the costs by allocator
2 (e.g., the costs for all activities to be allocated using Cust_Avg allocator are added
3 together) and show the amount allocated to each rate class. The allocator values
4 are on row 36 and row 43.

5 Exhibit HSG-6N- Account908 Allocator- Allocates each activity in Customer
6 Services and Informational Expenses, Account 908, using an appropriate external
7 allocator. Rows 9-14 list each component activity, the activity cost in the Test
8 Year budget, and the allocator assigned to it. Rows 18-28 summarize the costs by
9 allocator (e.g., the costs for all activities to be allocated using Cust_Avg allocator
10 are added together) and show the amount allocated to each rate class. The
11 allocator values are on row 22 and row 28.

12 Exhibit HSG-6O- METERREAD Allocator- Allocates each activity in Meter
13 Reading, Account 902, using an appropriate external allocator. Rows 9-12 list
14 each component activity, the activity cost in the Test Year budget, and the
15 allocator assigned to it. Rows 16-24 summarize the costs by allocator (e.g., the
16 costs for all activities to be allocated using Cust_Avg allocator are added together)
17 and show the amount allocated to each rate class. The allocator values are on row
18 19 and row 24.

19 Exhibit HSG-6P- Account Agings- Computes the allocator values for the
20 OVER60-D allocator. The columns 'Arrears 0-30', 'Arrears 31-60', 'Arrears 61-
21 90' and 'Arrears 91-Up' show the values in accounts receivable for each rate class
22 at June 30, 2006. The column 'Total Over 60' sums the dollars in the columns
23 'Arrears 61-90' and 'Arrears 91-Up', and the column '% Over60-D Total' shows
24 the percentage of the total for each rate class. The column '% Over60-D Prior
25 COS' shows the percentage of the total for each rate class from the 2002 base rate
26 case cost of service study. The column 'OVER60-D Allocator' takes the average
27 of the percentage in the columns '% Over60-D Total' and '% Over60-D Prior
28 COS'; these are the allocator values.

29 Exhibit HSG-6Q- Write-Offs- Computes the allocator values for the WRITE-
30 OFF allocator. The actual write-off amounts for each rate class are presented for
31 fiscal years 2006 (10 months t June 2006), 2001 and 1998. The percentage of the
32 total represented by each rate class is computed for each of these periods. The
33 column 'WRITE_OFF Allocator' takes the average of the percentages; these are
34 the allocator values.

35 Exhibit HSG-6R- GTS-DIR-MAINS, GTS-DIR-EXP, GTS-DIR-ACCDEP-
36 Develops direct assignment values for mains based on the mains constructed for
37 specific customers. The information and methodology are consistent with that
38 used in PGW's 2002 base rate case.

39 Exhibit HSG-6S- Test Year Tariff Revenue at Current Rates- Proof of revenue at
40 current rates.

1 Exhibit HSG-6T- Test Year Tariff Revenue at Proposed Rates- Proof of revenue
2 at proposed rates.

3 **SECTION IV – COMPANY’S PROPOSED REVENUE ALLOCATION**

4 **Q. WHAT IS THE TOPIC OF THIS SECTION 4 OF YOUR TESTIMONY?**

5 A. In this section I describe the computations that I performed based on the
6 Company’s specifications for revenue allocation and proposed rates. The
7 purpose of these computations was to allocate the Company’s Tariff Revenue
8 Requirement among the Rate Classes, and to compute the Company’s proposed
9 distribution charge rates that would produce the indicated revenue.

10 **Q. PLEASE DESCRIBE THE COMPANY’S APPROACH TO REVENUE**
11 **ALLOCATION.**

12 A. The Company used a two-step approach to revenue allocation. First, a Tentative
13 Revenue Allocation was performed by allocating the Tariff Revenue Requirement
14 among the Rate Classes based on the Company’s specifications for rates of return
15 and other parameters. Then, the Rate Class Tentative Revenue Allocations were
16 used to develop the Company’s proposed distribution charge rates, based on the
17 approach that each pair of Heating and Non-heating classes would continue to
18 have the same rates as each other.

19 **Q. HOW DID YOU COMPUTE RATE OF RETURN?**

20 A. For PGW, rate of return was computed as Income before Interest and Surplus
21 divided Rate Base. Under the proposed Tariff Revenue Requirement, the Rate
22 Increase requirement is included in Income before Interest and Surplus.

1 Q. WHAT WAS THE COMPANY'S APPROACH TO THE TENTATIVE
2 REVENUE ALLOCATION OF THE TARIFF REVENUE REQUIREMENT
3 AMONG THE RATE CLASSES?

4 A. The Company specified the following rules for allocating the Tariff Revenue
5 Requirement among the Rate Classes:

- 6 1. No changes to GTS / IT Rate Class because these customers' rates are
7 set by contract.
- 8 2. Interruptible sales Rate Classes customer charges were increased by
9 the system average increase distribution revenue increase (distribution
10 revenue includes delivery charge revenue plus customer charge
11 revenue). This worked out to a 23% increase in Customer charges for
12 Interruptible sales Rate Classes. No other changes were made to
13 Interruptible sales Rate Classes because the margins are credited to the
14 GCR.
- 15 3. Residential Heating distribution revenue would be set so that its
16 relative rate of return moved 20% closer to the system average. That
17 is, under present rates, the Residential Heating rate of return is 4.56%,
18 or 21.4% less than the system average rate of return of 5.79%. The
19 Company proposed to move the Residential Heating class to 10.69%,
20 or 17.1% less than the system average rate of return of 12.89%. The
21 proposed 17.1% difference is one-fifth less than the existing difference
22 of 21.4%.
- 23 4. For all other firm sales Rate Classes distribution revenue would be set
24 so that while they made the same progress (as each other) toward the

1 system average rate of return while achieving the total Tariff Revenue
2 Requirement, provided that a) each such Rate Class had at least 5%
3 rate of return; b) no such Rate Class had a rate of return more than
4 200% of the system average.

5 The results of these computations are presented on Exhibit HSG-7A.

6 **Q. WHAT WAS THE COMPANY'S APPROACH TO USING THE**
7 **TENTATIVE REVENUE ALLOCATION TO DEVELOP PROPOSED**
8 **NEW TARIFF RATES?**

9 A. The Company specified for developing proposed rates for firm sales classes:

- 10 1. No changes to Customer charges.
- 11 2. Delivery charges are the same for each of the following sets of Rate
12 Classes:
 - 13 a. Residential Heat, Residential Non-Heat and Philadelphia
14 Housing Authority General Service
 - 15 b. Commercial Heat and Commercial Non-Heat
 - 16 c. Industrial Heat and Industrial Non-Heat
 - 17 d. Municipal Heat and Municipal Non-Heat

18 The results of these computations are presented on Exhibit HSG-7B. The
19 proposed rates used to prepare the proof of revenue at Company's proposed rates,
20 Exhibit HSG-6T.

21 **Q. WHAT WAS THE EFFECT OF MAINTAINING EQUAL DELIVERY**
22 **CHARGES FOR THESE SETS OF RATE CLASSES?**

23 A. By maintaining the same delivery charge rates (as each other) for these sets of
24 Rate Classes, the results of the actual proposed rates differ from some of the
25 tentative revenue allocation criteria specified by the Company. For example, the

1 Company's tentative revenue allocation criteria specified 20% progress toward
2 unity for the Residential Heating Rate Class, and the actual proposed rates would
3 result in 32% progress. Also, the Company's tentative revenue allocation criteria
4 specified that no Rate Class would have a return greater than 200% of the system
5 average, and the actual proposed rates would result in the Commercial Heating
6 Rate Class have a return equal to 210% of the system average, and other Rate
7 Classes would have larger returns. The results are shown on Exhibit HSG-7C.

8 **Q. PLEASE DESCRIBE THE INFORMATION ON EXHIBIT HSG-7C.**

9 A. Exhibit HSG-7C show the results of the Company's proposed rates.

10 Lines 18 and 19 show return on rate base at the Company's proposed rates and at
11 the present rates. Lines 21 and 22 shows relative rates of return, comparing each
12 class to the system average. Line 23 shows the progress toward full cost of
13 service (unity) by each Rate Class.

14 Line 25 and 26 show the subsidies at the Company's proposed rates and at the
15 present rates.

16 Lines 28, 29 and 30 show the revenue increase that the Company is proposing for
17 each Rate Class as percentages of full tariff revenue, non-gas revenue and
18 distribution revenue, (delivery charge revenue plus customer charge revenue).

19 **SECTION V – INTERRUPTIBLE TRANSPORTATION COST OF SERVICE**
20 **ANALYSIS**

21 **Q. PLEASE DESCRIBE THE PURPOSE OF EXHIBIT HSG-8.**

22 A. The Company was directed to present such a cost study by the Commission In its
23 restructuring proceeding in Docket M-00021612, the Company was directed to
24 prepare a cost study of its Interruptible Transportation ("IT") service. Exhibit

1 HSG-8 is prepared in compliance with this directive, and shows the cost of service
2 for IT service.

3 **Q. HOW WAS THIS COST OF SERVICE ANALYSIS PREPARED?**

4 A. In the PGW COSSS, IT service is included with General Transportation Service
5 ("GTS") in the Rate Class identified as GTS / IT.. For this cost of service
6 analysis, it was necessary to separate IT from GTS. It was further determined to
7 separate IT into subclasses based primarily on customer volumes.

8 Both GTS and IT are interruptible transportation service, and both require each
9 customer to enter into a contract with minimum take provisions. Thus the nature
10 of service provide by PGW to all GTS / IT customers is the same.

11 The IT cost of service analysis allocates the total GTS / IT revenue requirement,
12 \$5.8 million, and the \$13.8 million GTS / IT rate base, among the following
13 subclasses:

- 14 • GTS
- 15 • IT-3
- 16 • IT -5, IT-6 and IT-8
- 17 • All other IT

18 Each major component of the revenue requirement, and each major element of the
19 rate base, was allocated based on an external allocators such as Direct assignment;
20 Meter counts, Thruput, or an internal allocator such as Rate Base or Operating
21 Expenses. Exhibit HSG-8 identifies each component of the revenue requirement
22 and rate base, and the allocation basis for each (lines 19-42).

1 The total revenue requirement allocated to each subclass is on line 42, and the
2 unitized results are on line 14.

3 This analysis employs the same methodology as used in the PGW CCOSS, and
4 the results are substantially the same as if each subclass had been included as a
5 separate class in the PGW CCOSS.

6 **Q. DOES THIS CONCLUDE YOUR TESTIMONY TODAY?**

 A. Yes.

ATTACHMENT A

1 **HOWARD S. GORMAN**

2 **Principal Consultant**

3 **Black & Veatch Corporation**

4 Mr. Gorman has more than 15 years of experience in the energy industry, and more than 25 years
5 of professional experience in accounting, finance and rate and regulatory matters. Mr. Gorman
6 specializes in the development of revenue requirements, accounting systems, fully allocated and
7 unbundling cost of service studies, rate design, financial modeling, forecasting and analysis, and
8 competitive practices. He is a chief developer of Rudden's proprietary Electric and Gas Cost of
9 Service Models.

10 Mr. Gorman has testified on matters pertaining to revenue requirements, cost of service, cost
11 allocations and related matters. He has testified before the New Jersey Board of Public Utilities,
12 the New York State Public Service Commission, the Ontario Energy Board, the Pennsylvania
13 Public Utility Commission and the Philadelphia Gas Commission.

14 Mr. Gorman assisted Philadelphia Gas Works in its base rate cases in 2001 and 2002, and in its
15 Restructuring filing. In these filings, Mr. Gorman prepared fully allocated / unbundled cost of
16 service studies, submitted pre-filed testimony, rebuttal testimony and oral testimony to the, and
17 assisted in preparing legal briefs and case management.

18 Mr. Gorman's other rate and regulatory clients have included Baltimore Gas & Electric, Freeport
19 Electric, Hydro One Networks, KeySpan Energy, Midwest Energy, Niagara Mohawk Power
20 Company, Village of Rockville Centre, as well as American Transmission Company, Midwest
21 Independent System Operator, New York Independent System Operator and PJM
22 Interconnection, LLC.

23 **PROFESSIONAL EMPLOYMENT**

24	1997 - Present	Black & Veatch Corporation (originally joined R.J. Rudden Associates)
25		Principal Consultant
26	1995 - 1997	Independent Consultant
27	1987 - 1995	Trigen Energy Corporation
28		1987-1993 Corporate Controller; Trigen was formed in 1987
29		1993-1995 Treasurer; Trigen had IPO with NYSE listing in 1994
30	1982 - 1987	Coleco Industries, Inc.
31		Director, Treasury
32	1976 - 1979	Touche Ross & Co.
33		Staff Accountant

34 **EDUCATION**

35 New York University, B.S., Accounting, 1976
36 Harvard Business School, MBA, 1981

37

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

REBUTTAL TESTIMONY OF

DOCUMENT
FOLDER

HOWARD S. GORMAN

ON BEHALF OF
PHILADELPHIA GAS WORKS

Docket No. R-00061931

May 4, 2007

RECEIVED

JUN 22 2007

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

1 Q. PLEASE STATE YOUR NAME.

2 A. My name is Howard Gorman.

3 Q. HAVE YOU PREVIOUSLY TESTIFIED IN THIS PROCEEDING?

4 A. Yes, I provided direct testimony on behalf of Philadelphia Gas Works ("PGW" or
5 "Company"). The purpose of my direct testimony was to describe the fully
6 allocated class cost of service study that I performed for PGW (the "CCOSS"), as
7 well as the results of a cost of service analysis of PGW's Interruptible
8 Transportation service which PGW was directed to present in its restructuring
9 proceeding in Docket M-00021612.

10 Q. HAVE YOU MODIFIED YOUR DIRECT TESTIMONY IN ANY WAY?

11 A. Yes, I provided a revised CCOSS to correct two errors. All references in my
12 rebuttal testimony are to the revised CCOSS, and all exhibits in the revised
13 CCOSS are labeled 'REVISED (Mar 30)'.

14 Q. PLEASE STATE THE PURPOSE OF YOUR REBUTTAL TESTIMONY.

15 A. My rebuttal testimony will respond to the direct testimony of the following
16 witnesses in the following areas:

- 17 • Pennsylvania Office of Consumer Advocate ("OSBA") Witness
18 Knecht claims the CCOSS "contains a number of biases that generally
19 result in the over-allocation of costs to commercial customers."
20 However, he has "accepted PGW's base rates CCOSS methodology
21 for the purpose of revenue allocation in this proceeding" (OSBA St. 1,
22 p. 2).

- 1 • Pennsylvania Office of Consumer Advocate (“OCA”) Witness
2 Galligan proposes an alternative method to classify distribution mains.
3 However, he endorses the Company’s proposed residential rate
4 increase and rate design.
- 5 • Office of Trial Staff (“OTS”) Witness Kubas disagrees with the way I
6 classify and allocate the cost of distribution mains and the cost of
7 Industrial Measuring and Regulating Station Equipment (account 385).
- 8 • School District Of Philadelphia (“Schools”), Archdiocese of
9 Philadelphia (“Archdiocese”) and Philadelphia Housing Authority
10 (“PHA”) Witness Mondre claims that Schools, Archdiocese and PHA
11 should be exempt from the proposed rate increase because they should
12 not have to pay for “residential customers’ poor delinquent payments”
13 (Schools- Mondre, p. 9, line 2), which she believes is the cause of the
14 proposed rate increase.
- 15 • Schools Witness Mondre also claims that Schools should be treated as
16 a “single customer unit” because Schools “maintains one central point
17 for billing and account administration”. (Schools- Mondre, p. 12, line
18 19.)

19 **OSBA WITNESS KNECHT**

20 **Q. WHAT COMMENTS DID MR. KNECHT MAKE REGARDING THE**
21 **CCOSS?**

22 **A.** Though Mr. Knecht has “accepted PGW’s base rates CCOSS methodology for the
23 purpose of revenue allocation in this proceeding,” he indicates:

- 1 • He would like to see a separate CCOSS for GCR-related costs, and a
2 separate CCOSS for non-GCR costs.
- 3 • He believes there are biases which generally result in the over-
4 allocation of costs to commercial customers and recommends the
5 Company address these in its next base rate filing.
- 6 • He believes that system average rates of return is not a useful
7 measurement in evaluating revenue allocation, and he proposes an
8 alternative revenue allocation.

9 **Q. DOES MR. KNECHT PROPOSE ANY ADJUSTMENTS TO YOUR**
10 **CCOSS?**

11 A. No, he accepts the results of the CCOSS as the starting point for revenue
12 allocation (i.e., the allocation of the proposed revenue increase or decrease).

13 **Q. TURNING TO MR. KNECHT'S COMMENTS, DO YOU AGREE THAT**
14 **SEPARATE CCOSS' SHOULD BE PREPARED FOR GCR-RELATED**
15 **COSTS AND NON-GCR COSTS?**

16 A. While this would be an interesting exercise, the results as they impact the base
17 rates that are the subject of this proceeding would be small. We know this by
18 comparing the Non-Gas Full Tariff Revenue Requirement for the Revised (Mar
19 30) CCOSS (bundled) and the Revised (Mar 30) No GCR CCOSS (unbundled).¹
20 For example, for Residential Heating, the Non-Gas Full Tariff Revenue
21 Requirement for the Revised (Mar 30) CCOSS (bundled) is \$397.3 million, while

¹ The Non-Gas Full Tariff Revenue Requirement equals Total Operating Expenses (line 18) plus Interest and Surplus (line 21) plus Rate Increase Requirement (line 24) minus Gas Tariff Revenue (line 8) and minus Other Revenue/Adjustments (line 11).

1 for the Revised (Mar 30) No GCR CCOSS (unbundled) it is \$399.0 million, a
2 difference of approximately 0.43%.

3 **Q. WHAT DOES MR. KNECHT'S RECOMMEND WITH REGARD TO GCR**
4 **RATE DESIGN?**

5 A. Mr. Knecht observes that while he would change the allocation basis of some of
6 the GCR costs, this base rates proceeding is not the appropriate forum for
7 changing GCR rate design. Mr. Knecht also observes, "the current volumetric
8 method used by PGW for recovering GCR costs is consistent with most of the
9 purchased gas cost rate methods used at other Pennsylvania NGDCs" (OCA St. 1,
10 p. 10, line 1) and he recommends that no changes be made in this proceeding to
11 PGW's GCR mechanism.

12 **Q. DO YOU CONCUR WITH MR. KNECHT THAT THE CCOSS**
13 **CONTAINS BIASES THAT RESULT IN OVER-ALLOCATION OF**
14 **COSTS TO COMMERCIAL CUSTOMERS?**

15 A. No, I do not. However because Mr. Knecht recommends accepting the results of
16 the CCOSS, I will not refute Mr. Knecht's assertions. I reserve the right to do so
17 should any of them become an issue in this proceeding.

18 **Q. WHAT CONCERNS DOES MR. KNECHT EXPRESS ABOUT THE**
19 **COMPANY'S PROPOSED REVENUE ALLOCATION?**

20 A. Mr. Knecht believes that the relative rate of return measure is not a useful measure
21 of progress towards unity,² because it "can imply that progress is being made
22 toward cost-based rates, when common sense (and all other metrics) says
23 otherwise." (OSBA St. 1, p. 19, line 17).

² Unity means that a class' rate of return is equal to the system average rate of return.

1 The metrics to which Mr. Knecht compares the relative rate of return are the
2 Revenue-Cost Ratio and the absolute level of subsidies paid or received (Table
3 IÉc-3 following OSBA St. 1, p. 18, following line 14).

4 **Q. PLEASE DESCRIBE THE RELATIVE RATE OF RETURN MEASURE**
5 **AND WHY IT IS IMPORTANT.**

6 A. The relative rate of return is computed for each rate class by dividing the rate of
7 return for that rate class by the system average rate of return. If a rate class'
8 relative rate of return is 100%, then it is paying its fully allocated share of the
9 utility's revenue requirements. If a rate class' relative rate of return is less than
10 100%, then it is paying less than its share, and if a rate class' relative rate of return
11 is more than 100%, then it is paying more than its fully allocated share. One of
12 the goals of revenue allocation is usually to move each rate class closer to 100%
13 relative rate of return.

14 **Q. DO THE COMPANY'S PROPOSED RATES MOVE EACH CLASS'**
15 **RELATIVE RATE OF RETURN CLOSER TO UNITY?**

16 A. Yes, under the Company's proposed rates all rate classes would move closer to
17 unity. These results can be seen on Exhibit HSG 7C Revised (Mar 30), lines 21-
18 23. For example, Residential Heating moves 32% closer to unity, Commercial
19 Heating moves 17% closer to unity and Industrial Heating moves 33% closer to
20 unity. Progress for each Non-Heating class is greater than for the respective
21 Heating class.

1 OCA WITNESS GALLIGAN

2 **Q. PLEASE SUMMARIZE MR. GALLIGAN'S COMMENTS REGARDING**
3 **THE CCOSS.**

4 A. Mr. Galligan believes that there is no customer-related component of distribution
5 mains. As a result, he claims that I misallocate "distribution mains plant
6 investment and related costs" (OCA St. 3, p. 3, line 15).

7 I classify 25% of distribution mains investment as customer-related, based on an
8 estimated zero-intercept analysis, and 75% as demand-related with allocation
9 based on peak demands. Mr. Galligan recommends that distribution mains be
10 classified 80% as commodity-related and allocated based on average demand
11 (commodity), and 20% as demand-related and allocated using peak demand.

12 Mr. Galligan prepares an alternative cost of service study. Based on the results of
13 his alternative method, he endorses the Company's proposed residential rate
14 increase and rate design. He does not comment on the effect on other classes

15 **Q. WHAT REASONS DOES MR. GALLIGAN OFFER REGARDING WHY**
16 **HE BELIEVES THERE IS NO CUSTOMER COMPONENT OF**
17 **DISTRIBUTION MAINS.**

18 A. Mr. Galligan offers the following claims:

- 19 • The different results shown for customer related costs between
20 the zero-intercept and minimum system studies provided in
21 response to OSBA-II-20 raise "significant concerns with the
22 validity of these customer cost determinations." (OCA St. 3, p.
23 8, line 19.)

- 1 • He states, “Mains are not sized for the number of customers served
2 from them, but for the loads placed upon them.” (OCA St. 3, p. 9, line
3 10).
- 4 • He claims that Professor Bonbright, in Principles of Public Utility
5 Rates, “clearly agrees that distribution costs, except for those costs that
6 can be definitely earmarked to benefit specific customers, are not
7 properly classified as customer costs.” (OCA St. 3, p. 10, line 38).
- 8 • He concludes that because “It would be economically irrational to
9 extend natural gas delivery service to a customer who would use no
10 gas.” (OCA St. 3, p. 11, line 18), therefore, “it is its gas usage
11 requirements, both annual and peak demands, which are the cause of
12 PGW’s distribution mains costs,” (OCA St. 3, p. 11, line 24).

13 **Q. PLEASE RESTATE THE FIRST REASON PROVIDED BY MR.**
14 **GALLIGAN AS TO WHY THERE SHOULD BE NO CUSTOMER**
15 **COMPONENT OF DISTRIBUTION MAINS.**

16 **A.** Mr. Galligan states,

17 “After simply assuming a PGW customer cost component
18 of mains at 25 percent of all the mains costs that PGW has
19 incurred since its inception, Mr. Gorman, as indicated
20 above, later determined that customer costs of mains is 21.2
21 percent when estimated on a zero-intercept basis, or 46.7
22 percent when estimated on a minimum system basis. Both
23 the zero-intercept and minimum system methods attempt to
24 measure the same thing – the customer component of

1 distribution mains. That customer costs could differ by so
2 much, \$138.4 million, depending upon how they are
3 determined by Mr. Gorman, raises significant concerns with
4 the validity of these customer cost determinations.” (OCA
5 St. 3, p. 8, line 19).

6 **Q. DID YOU “SIMPLY ASSUME” WHAT IS THE CUSTOMER**
7 **COMPONENT OF PGW’S DISTRIBUTION MAINS?**

8 A. No, of course not. I provided an estimate based on my experience and that of
9 some of my colleagues at Black & Veatch. This estimate turned out to be very
10 close to a subsequent analysis that was prepared based on additional information.
11 My estimate was a customer component of 25% and a zero-intercept study
12 prepared using the additional data to indicate a customer component of 21.2%.

13 **Q. WHY IS THIS NUMBER SO DIFFERENT FROM THE MINIMUM**
14 **SYSTEM ESTIMATE IF, AS MR. GALLIGAN STATES, THEY**
15 **“ATTEMPT TO MEASURE THE SAME THING”?**

16 A. The zero-intercept study and the minimum system study do not attempt to
17 measure the same thing. A minimum system study will always indicate a higher
18 number than a zero-intercept study, because the minimum system has some load
19 carrying capacity while the zero-intercept system has none. That the minimum
20 system has a load carrying capacity is well-known. This fact does not diminish
21 the reasonableness of the method or its result, it merely means that a minimum
22 system result requires an adjustment in order eliminate this load carrying capacity
23 in order for the result to be comparable to the zero intercept result and to
24 estimating the customer component. The zero-intercept method, which I used,
25 requires no such adjustment.

1 Q. IS MR. GALLIGAN CORRECT IN ASSERTING THAT “MAINS ARE
2 NOT SIZED FOR THE NUMBER OF CUSTOMERS SERVED FROM
3 THEM, BUT FOR THE LOADS PLACED UPON THEM.” (OCA ST. 3, P.
4 9, LINE 10)?

5 A. No, he is not correct. Mr. Gilligan would have the Commission ignore the
6 relationship between the number of customers served and the capital cost of
7 distribution mains. The cost of a distribution main is a function of both its length
8 and diameter. Clearly, the more customers there are on the system, the more
9 length of distribution mains are required, and the higher the cost.

10 Q. DOES THE EXAMPLE PROVIDED BY MR. GALLIGAN SUPPORT HIS
11 CONCEPT THAT “MAINS ARE NOT SIZED FOR THE NUMBER OF
12 CUSTOMERS SERVED FROM THEM”?

13 A. No it does not. Mr. Galligan compares two blocks, one with 10 residential
14 customers each with 1 mcf peak load, and one with a single commercial customer
15 with 10 mcf peak load. (OCA St. 3, p. 9, line 12). Mr. Galligan contends that the
16 cost of the distribution main that serves each block is the same, and therefore it is
17 illogical that each residential customer should have the same customer cost
18 assigned to it as the commercial customer.

19 The assumption that all 10 residential customers are on the same block is what
20 drives the apparent paradox. The capital costs of distribution mains are affected
21 by the location of the customers; if the residential customers were on 10 different
22 blocks then the paradox disappears. As an estimate of this distance / location-
23 related cost causation factor, customer count is used as a proxy, based on the
24 hypothesis that longer distribution mains are generally required to interconnect 10
25 residential customers with 1 mcf peak load than one commercial customer with 10
26 mcf peak load. That is, distribution mains costs exhibit economies of scale with

1 respect to the size of the customer, and large customers typically cost less to serve
2 per unit of demand than smaller customers.

3 **Q. PLEASE RESTATE THE THIRD REASON PROVIDED BY MR.**
4 **GALLIGAN AS TO WHY THERE SHOULD BE NO CUSTOMER**
5 **COMPONENT OF DISTRIBUTION MAINS.**

6 A. Mr. Galligan claims that Professor Bonbright, in Principles of Public Utility
7 Rates, “clearly agrees that distribution costs, except for those costs that can be
8 definitely earmarked to benefit specific customers, are not properly classified as
9 customer costs.” (OCA St. 3, p. 10, line 38). To support this, he recites the
10 following passage from Principles of Public Utility Rates:

11 “...because of the cost analyst’s frequent practice of including, not just
12 those costs that can be definitely earmarked as incurred for the benefit
13 of specific customers but also a substantial fraction of the annual
14 maintenance and capital costs of the secondary (low voltage)
15 distribution system – a fraction equal to the estimated annual costs of a
16 hypothetical system of minimum capacity. This minimum capacity is
17 sometimes determined by the smallest sizes of conductors deemed
18 adequate to maintain voltage and to keep from falling of their own
19 weight. In any case, the annual costs of this phantom, minimum-sized
20 distribution system are treated as customer costs and are deducted from
21 the annual costs of the existing system, only the balance being
22 included among those demand-related costs to be mentioned in the
23 following section. Their inclusion among the customer costs is
24 defended on the ground that, since they vary directly with the area of
25 the distribution system (or else with the lengths of the distribution
26 lines, depending on the type of distribution system), they therefore vary
27 indirectly with the number of customers.

28
29 What this last-named cost imputation overlooks, of course, is the very
30 weak correlation between the area (or the mileage) of a distribution
31 system and the number of customers served by this system. For it
32 makes no allowance for the density factor (customers per linear mile or
33 per square mile). Indeed, if the Company’s entire service area stays
34 fixed, an increase in number of customers does not necessarily betoken
35 any increase whatever in the costs of a minimum-sized distribution
36 system.

1 While, for the reason just suggested, the inclusion of the costs of a
2 minimum-sized distribution system among the customer related costs
3 seems to me clearly indefensible, its exclusion from the demand-
4 related costs stands on much firmer ground.”

5 **Q. IF PROFESSOR BONBRIGHT DOES NOT SUPPORT INCLUSION OF**
6 **THE ZERO-INTERCEPT COMPONENT OF DISTRIBUTION MAINS IN**
7 **CUSTOMER COSTS, DOES HE SUPPORT THEIR INCLUSION IN**
8 **COMMODITY-RELATED COSTS OR DEMAND-RELATED COSTS?**

9 A. No, Professor Bonbright does not support any allocation method for the zero-
10 intercept component:

11 “But if the hypothetical cost of a minimum-sized distribution system is
12 properly excluded from the demand-related costs for the reasons just
13 given, while it is also denied a place among the customer costs for the
14 reason previously stated, to which function does it belong? The only
15 defensible answer, in our opinion, is that it belongs to none of them.
16 Instead, it should be recognized as a strictly unallocable cost.”

17 (Principles of Public Utility Rates, “Fully Distributed Costs chapter,
18 *Customer Costs* section).

19 **Q. DOES PROFESSOR BONBRIGHT SEE ANY CIRCUMSTANCES IN**
20 **WHICH THERE IS AN ACCEPTABLE CLASSIFICATION**
21 **METHODOLOGY OF THE ZERO-INTERCEPT COMPONENT OF**
22 **DISTRIBUTION MAINS?**

23 A. Yes, Professor Bonbright believes classifying the zero intercept component of
24 distribution mains as customer-related can be theoretically justified, and that the
25 problem is due to practical issues:

26 “What this last-named cost imputation³ overlooks, of course, is the very weak
27 correlation between the area (or the mileage) of a distribution system and the number
28 of customers served by this system.”

29
30 And further,

31 “Allocation, in whole or in part, would be at least theoretically
32 possible if a customer-density parameter were added to the three
33 traditional cost components. But if this factor were embodied, not

³ That is, classification of the zero-intercept component as customer-related.

1 only in cost analysis but in the resulting rate differentials, rates would
2 not be uniform throughout a given community and hence would violate
3 a generally accepted tradition.”

4 Therefore, although there may be subsequent issues with rate design, Professor
5 Bonbright believes classifying the zero intercept component of distribution mains
6 as customer-related can be theoretically justified.

7 **Q. WHAT DO OTHER RECOGNIZED AUTHORITIES SAY ABOUT THE**
8 **TREATMENT OF THE ZERO-INTERCEPT COMPONENT**
9 **DISTRIBUTION MAINS?**

10 A. The American Gas Association (“AGA”) Gas Right Fundamentals supports the
11 inclusion of the zero-intercept component of distribution mains in customer costs:

12 “The customer component of distribution costs reflects the theoretical
13 distribution system that would be needed to serve customers at
14 nominal or minimal load conditions”. (Gas Right Fundamentals, 1987
15 Edition, p. 136).

16 **Q. PLEASE RESTATE THE FOURTH AND FINAL REASON PROVIDED**
17 **BY MR. GALLIGAN AS TO WHY THERE SHOULD BE NO CUSTOMER**
18 **COMPONENT OF DISTRIBUTION MAINS.**

19 A. Mr. Galligan concludes that because “It would be economically irrational to
20 extend natural gas delivery service to a customer who would use no gas.” (OCA
21 St. 3, p. 11, line 18) Therefore, “it is its gas usage requirements, both annual and
22 peak demands, which are the cause of PGW’s distribution mains costs” (OCA St.
23 3, p. 11, line 24).

24 What is apparently being said is that if the utility were to construct a zero-
25 intercept system, it would have no load carrying capacity, and therefore the utility
26 would have no revenue, so it would never build such a system; that is, the utility
27 would only a build a system if it knew that its customers would use it.

1 Q. DOES THIS SUPPORT THE NOTION THAT THERE IS NO CUSTOMER
2 COMPONENT OF DISTRIBUTION MAINS?

3 A. No, it does not. The fact that the utility would not recover the costs of the
4 distribution system without having adequate throughput is a function of *rate*
5 *design* not cost causation. If the utility's rates included a customer charge to
6 reflect the customer component, and a demand charge to reflect the peak demand,
7 the utility's revenue and economic viability would not be dependent on
8 throughput. Further, the fact that utility's revenue might vary because peak
9 demands and number of customers might vary is also irrelevant. These are
10 business risks for which the utility is compensated in its rate of return, and not a
11 consideration in cost allocation.

12 Q. PLEASE SUMMARIZE THE DISCUSSION REGARDING THE
13 CUSTOMER COMPONENT OF DISTRIBUTION MAINS.

14 A. The capital costs for distribution mains are a function of length and diameter, as
15 well as the location of the customers. The more customers there are on the
16 system, the more length of distribution mains are required, and the higher the cost.
17 In allocating the cost of the zero-intercept component, the use of customer counts
18 is a proxy for distance and density.
19 The fact that a zero-intercept system is hypothetical has no impact on the analysis,
20 and the fact that the utility needs revenue from throughput to recover the capital
21 costs of distribution mains is a function of rate design not causation. In fact, in
22 some cases revenue is increasingly less related to throughput due to trends such as
23 revenue decoupling.

1 Professor Bonbright believes that classification of the zero-intercept component of
2 distribution mains is an intractable issue, and he rejects both customer and
3 demand classification. However, he allows that classifying the zero intercept
4 component as customer-related can be theoretically justified, and that the problem
5 is due to practical issues.

6 Finally, the AGA Gas Right Fundamentals manual endorses classifying the zero
7 intercept component of distribution mains as customer-related.

8 **Q. PLEASE REVIEW MR. GALLIGAN'S COMMENTS REGARDING THE**
9 **CLASSIFICATION AND ALLOCATION OF DISTRIBUTION MAINS.**

10 A. The Company's CCOSS classifies 25% of distribution mains as customer-related,
11 based on a zero-intercept study, and 75% as demand-related with allocation based
12 on peak demands. Mr. Galligan recommends that distribution mains be classified
13 80% as commodity-related and allocated based on average demand (commodity),
14 and 20% as demand-related and allocated using peak demand.

15 **Q. PLEASE REVIEW THE CLASSIFICATION AND ALLOCATION OF**
16 **DISTRIBUTION MAINS AS REFLECTED IN THE COMPANY'S CCOSS**
17 **AND AS RECOMMENDED BY MR. GALLIGAN.**

18 A. The Company's CCOSS classifies 25% of distribution mains as customer-related,
19 based on a zero-intercept study, and 75% as demand-related with allocation based
20 on peak demands. Mr. Galligan recommends that distribution mains be classified
21 80% as commodity-related and allocated based on average demand (commodity),
22 and 20% as demand-related and allocated using peak demand.

1 Q. WHAT REASONS DOES MR. GALLIGAN OFFER AS TO WHY HE
2 BELIEVES THAT DISTRIBUTION MAINS SHOULD BE CLASSIFIED
3 AS BOTH COMMODITY-RELATED AND DEMAND-RELATED?

4 A. Mr. Galligan states, "Because distribution mains exist and are related to both
5 annual demands and peak demands, both annual and peak demands must be
6 recognized in the allocation of distribution mains costs, if the allocation is to be in
7 accord with the principle of cost-causality." (OCA St. 3, p. 13, line 19). He also
8 states, "PGW's system was built and costs were incurred to deliver gas both at the
9 time of peak system demand and generally throughout the year." (OCA St. 3, p.
10 14, line 10).

11 Q. WHAT REASONS DOES MR. GALLIGAN OFFER AS TO WHY HE
12 BELIEVES THAT DISTRIBUTION MAINS SHOULD BE CLASSIFIED
13 AS BOTH COMMODITY-RELATED AND DEMAND-RELATED?

14 A. Mr. Galligan offers the following reasons:

- 15 • "Because distribution mains exist and are related to both annual
16 demands and peak demands, both annual and peak demands must be
17 recognized in the allocation of distribution mains costs, if the
18 allocation is to be in accord with the principle of cost-causality." (OCA
19 St. 3, p. 13, line 19), and "PGW's system was built and costs were
20 incurred to deliver gas both at the time of peak system demand and
21 generally throughout the year." (OCA St. 3, p. 14, line 10).
- 22 • "Rational investment decision analysis requires the consideration of
23 annual volumes delivered across a natural gas distribution company's
24 system. A gas distribution system would not exist if all demand related
25 costs were the responsibility of peak demands. A viable gas market is

1 dependent upon the ability to amortize delivery costs over a sufficient
2 volume of service so as to result in a unit cost that can be recovered
3 from the price at which gas can be sold and still compete with other
4 energy sources.” (OCA St. 3, p. 15, line 6).

5 **Q. PLEASE DISCUSS THE FIRST REASON MR. GALLIGAN OFFERS AS**
6 **TO WHY DISTRIBUTION MAINS SHOULD BE CLASSIFIED AS BOTH**
7 **COMMODITY-RELATED AND DEMAND-RELATED.**

8 A. Mr. Galligan believes that distribution mains should be classified as both
9 commodity-related and demand-related because they exist and are used to meet
10 both annual and peak demands. However, the costs of the mains are *causally*
11 *related only* to peak demands, and *not* to annual demands. The parameters needed
12 to design distribution mains length and diameter, as well as the location of the
13 customers. Annual usage is not a consideration in the design of distribution
14 mains.

15 That the costs of the mains are causally related *only* to peak demands, and not to
16 annual demands is illustrated by the example was provided by Mr. Galligan. For
17 the block with 10 residential customers, “The main running down the street would
18 have to be capable of delivering 10 Mcf at peak.” (OCA St. 3, p. 9, line 13). For
19 the block with a single commercial customer with 10 mcf peak load.” The main
20 for that one customer has to be sized to deliver 10 Mcf when the plastics factory
21 demand peaks.” (OCA St. 3, p. 9, line 15). In Mr. Galligan’s own example, there
22 is no mention of the annual demands of the customers, only of the numbers of
23 customers and their peak demands.

1 This demonstrates that the costs of the mains are causally related *only* to peak
2 demands, and not to annual demands, and there is no justification for allocating
3 any portion of distribution mains based on annual demand.

4 **Q. PLEASE DISCUSS THE SECOND REASON MR. GALLIGAN OFFERS**
5 **AS TO WHY DISTRIBUTION MAINS SHOULD BE CLASSIFIED AS**
6 **BOTH COMMODITY-RELATED AND DEMAND-RELATED.**

7 A. Mr. Galligan believes that because utilities design rates are based on volumes of
8 gas delivered, the costs incurred are related to volumes of gas delivered as well.

9 This is not so. The fact that the utility would not recover the costs of the
10 distribution system without having adequate throughput is a function of *rate*
11 *design* not cost causation. If the utility's rates included a customer charge to
12 reflect the customer component, and a demand charge to reflect the peak demand,
13 the utility's revenue and economic viability would not be dependent on
14 throughput.

15 **Q. PLEASE SUMMARIZE THE DISCUSSION REGARDING THE**
16 **CLASSIFICATION AND ALLOCATION OF DISTRIBUTION MAINS.**

17 A. Mr. Galligan believes that distribution mains should be classified as both
18 commodity-related and demand-related because they exist and are used to meet
19 both annual and peak demands, and because the related costs are collected based
20 on annual volumes of throughput. Neither of these reasons indicate that the cost
21 of distribution mains is causally related to annual demands.

22 The parameters needed to design distribution mains length and diameter, as well
23 as the location of the customers. Annual usage is not a consideration in the design
24 of distribution mains, and therefore no portion of the cost of distribution mains
25 should be classified based on annual demand.

1 OTS WITNESS KUBAS

2 Q. PLEASE SUMMARIZE MR. KUBAS' COMMENTS REGARDING THE
3 CCOSS.

4 A. Mr. Kubas disagrees with the CCOSS on the following issues:

- 5 • Mr. Kubas believes that there is no customer component of distribution
6 mains.
- 7 • Mr. Kubas believes that distribution mains should be allocated using
8 the Average and Excess Demand method that is discussed in the
9 AGA's Gas Rate Fundamentals.
- 10 • Mr. Kubas believes that Account 385, Industrial Measuring and
11 Regulating Equipment, should be allocated only to large industrial
12 customers.

13 Q. WHY DOES MR. KUBAS BELIEVE THAT THERE IS NO CUSTOMER
14 COMPONENT OF DISTRIBUTION MAINS?

15 A. Mr. Kubas provides the following reasons:

- 16 • "Mains were built to deliver gas, and the cost of mains can not be
17 assigned to one specific customer". (OTS St. 3, p. 12, line 17).
- 18 • Mr. Kubas cites the Commission's 1994 Decision and Order in Docket
19 R-00932670, that direct customer costs include "the depreciation;
20 return and income taxes associated with meter and services
21 investment; the O&M costs for meters and services; and the expenses
22 associated with meter reading and billing." Mr. Kubas concludes that
23 there is no customer component of distribution mains because there is
24 no mention of them in the cited section. (OTS St. 3, p. 12, line 9).

1 Q. PLEASE DISCUSS THE FIRST REASON OFFERED BY MR. KUBAS AS
2 TO WHY HE BELIEVES THAT THERE IS NO CUSTOMER
3 COMPONENT OF DISTRIBUTION MAINS.

4 A. Mr. Kubas states, "Mains were built to deliver gas, and the cost of mains can not
5 be assigned to one specific customer" (OTS St. 3, p. 12, line 17). This is the same
6 as the claim made by Mr. Galligan, "Because distribution mains exist and are
7 related to both annual demands and peak demands, both annual and peak demands
8 must be recognized in the allocation of distribution mains costs, if the allocation is
9 to be in accord with the principle of cost-causality." (OCA St. 3, p. 13, line 19).

10 Q. DO YOU AGREE WITH THIS REASON?

11 A. No, I do not. It is the cost relationship that determines how distribution mains
12 should be allocated. As I stated above when discussing Mr. Galligan's testimony,
13 the costs of the distribution mains are *causally related only* to peak demands, and
14 *not* to annual demands (i.e., total gas deliveries). The parameters needed to design
15 distribution mains length and diameter, as well as the location of the customers.
16 Annual usage is not a consideration in the design of distribution mains.

17 Q. PLEASE DISCUSS THE SECOND REASON OFFERED BY MR. KUBAS
18 AS TO WHY HE BELIEVES THAT THERE IS NO CUSTOMER
19 COMPONENT OF DISTRIBUTION MAINS.

20 A. The Commission's 1994 Decision and Order in Docket R-00932670 that is cited
21 by Mr. Kubas is a discussion of the *customer charge* that can be included in rates,
22 and not of the *customer component* of costs; it is a discussion of rate design not
23 cost allocation. The Decision and Order does not discuss cost allocation at all,
24 and should not be used for guidance in cost allocation.

1 Q. **WHY DOES MR. KUBAS BELIEVE THAT DISTRIBUTION MAINS**
2 **SHOULD BE ALLOCATED USING THE AVERAGE AND EXCESS**
3 **DEMAND METHOD DESCRIBED IN GAS RATE FUNDAMENTALS?**

4 A. Mr. Kubas states, "The A&E method is one of the methods accepted by the
5 Commission and described in the Gas Rate Fundamentals guidebook as a
6 reasonable method for allocating the cost of distribution mains among the various
7 classes that share the use of distribution mains. The A&E method reflects the fact
8 that mains are built to deliver volumes during both peak and average times.
9 Therefore, an equal amount of weight should be given to both events." (OTS St. 3,
10 p. 13, line 19.)

11 Q. **DO YOU SUPPORT THIS APPROACH?**

12 A. No, I do not. The A&E method as described in the Gas Rate Fundamentals
13 guidebook does not use a 50/50 weighting, but weights the Average Demand
14 equal to the system load factor (i.e., the ratio of average demand to peak demand)
15 and the Excess Demand at 1 minus the system load factor. If the A&E approach
16 is applied as specified in the Gas Rate Fundamentals guidebook, it produces a
17 result that is equal to the Peak demand method used in the Company's CCOSS⁴.
18 There is no support provided for the 50/50 weighting.

19 Q. **PLEASE DISCUSS MR. KUBAS' COMMENTS REGARDING ACCOUNT**
20 **385 INDUSTRIAL MEASURING AND REGULATING EQUIPMENT.**

21 A. Mr. Kubas is correct, this item was inadvertently allocated among all customer
22 classes and should be allocated only to classes with large industrial customers.
23

⁴ The Gas Rate Fundamentals guidebook uses class non-coincident peaks. For PGW, these are the same as contribution to system peak with very minor differences.

1 SCHOOLS, ARCHDIOCESE AND PHA WITNESS MONDRE

2 Q. PLEASE SUMMARIZE MS. MONDRE'S COMMENTS REGARDING
3 THE CCOSS AS IT PERTAINS TO SCHOOLS, ARCHDIOCESE AND
4 PHA.

5 A. Ms. Mondre claims that Schools, Archdiocese and PHA should be exempt from
6 the proposed rate increase because they should not have to pay for "residential
7 customers' poor delinquent payments" (Schools- Mondre, p. 9, line 2), which she
8 believes is the cause of the proposed rate increase. Specifically:

- 9 • The proposed rate increase should not be applied to Schools, which is
10 in the MS class and not Residential, because "PGW intends to apply
11 funds from the MS rate class to pay for residential deficits, which acts
12 to penalize the School District for PGW's operational inefficiencies
13 and its residential customers' poor delinquent payments." (Schools-
14 Mondre, p. 9, line 2).
- 15 • The Archdiocese should not have to pay any rate increase for its
16 Residential accounts because "The Archdiocese's Residential accounts
17 represent a miniscule portion of PGW's overall GS-R customer base.
18 Its payment history is sound, therefore it has not contributed to PGW's
19 well-known difficulties in collection from Residential customers."
20 (Archdiocese- Mondre, p. 8, line 20.)
- 21 • "Since PHA's payments to PGW more than cover its operating costs, it
22 should not be asked to subsidize less responsible customers." (PHA-
23 Mondre, p. 11.)

1 Q. IS MS. MONDRE CORRECT IN CLAIMING THAT THE PROPOSED
2 RATE INCREASE SHOULD NOT BE APPLIED TO SCHOOLS,
3 ARCHDIOCESE AND PHA BECAUSE IT IS DUE TO “RESIDENTIAL
4 CUSTOMERS’ POOR DELINQUENT PAYMENTS” AND BECAUSE
5 SCHOOLS, ARCHDIOCESE AND PHA PAY THEIR BILLS ON TIME?

6 A. No, this is not correct. If by “residential customers’ poor delinquent payments” is
7 meant Uncollectible Accounts’ Expense (account 904) and the related collection
8 efforts, Customer Records & Collection Expense (account 903), then it is not true
9 that other classes are being asked to pay for these costs. I allocated both of these
10 accounts in the CCOSS based on PGW’s experienced write-offs and collection
11 efforts; the amounts allocated to each rate class are based on its class historical
12 experience only.

13 In addition, unfortunately, even if a customer has a good payment record, that
14 customer must be considered as part of its class. It is not possible to consider the
15 payment history and the usage characteristics of each customer in allocating costs
16 or designing rates.

17 Finally, with regard to Schools, Exhibit HSG 1 Revised (Mar 30), line 25, shows
18 that MS class, to which Schools belongs, requires an increase of \$712K to meet
19 its fully allocated cost of service at system average rate of return. This increase is
20 indicated regardless of the results of the residential class’ required increase.

21 Q. PLEASE SUMMARIZE MS. MONDRE’S COMMENTS REGARDING
22 BILLING FOR SCHOOLS.

23 A. Ms. Mondre states that Schools should be treated as a “single customer unit’ as a
24 single premises with one delivery and metering point for purposes of assessing
25 meter charges” because Schools “maintains one central point for billing and
26 account administration”. (Schools- Mondre, p. 12, line 17.)

1 Q. **BASED ON THE NUMBER OF SCHOOLS' DELIVERY AND METERING**
2 **POINTS, WOULD YOU EXPECT THAT SCHOOLS BE TREATED AS A**
3 **"SINGLE CUSTOMER UNIT"?**

4 A. No. Schools has multiple delivery and metering points. The savings due to the
5 fact that Schools "maintains one central point for billing and account
6 administration" are only a small portion of the total cost which includes services,
7 meters, billing (a separate bill is computed for each account even if all of the bills
8 are sent to the same place) and other items.

9 Q. **DOES THIS CONCLUDE YOUR TESTIMONY TODAY?**

10 A. Yes it does.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY
COMMISSION

EXHIBITS TO DIRECT TESTIMONY OF
HOWARD S. GORMAN

CLASS COST OF SERVICE STUDY
FUTURE TEST YEAR ENDED AUGUST 31, 2007

REVISED (MAR 30)

DOCKET NO. R-00061931

CLASS COST OF SERVICE STUDY
FUTURE TEST YEAR ENDED AUGUST 31, 2007

REVISED (MAR 30)

The following changes were made to the Cost of Service Study as originally filed:

1. PeakDemand allocator was corrected to include all GTS / IT Transport volumes (Exhibit HSG-6D, row 27). The GTS / IT volumes on that schedule now agree to the daily average GTS / IT volumes on Exhibit HSG-6G.
2. The split of IT groups shown on Exhibit HSG-8 was updated to reflect the data contained in the response to OTS-RS 33. This change affected only Exhibit HSG-8.

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Exhibit HSG-1

Summary of Results

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

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

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

	Total	NGV	BPS	BPS	BPS	LBS	LBS	LBS	LBS	LBX	Co-Gen	GTS/IT
		Direct	Small	Large	A/C	Small	Large	Large	Δ Large	Δ L	InDirect	Trans only
		RC-10	RC-11	RC-12	RC-13	RC-14	InDirect	Direct	Direct	InDirect	RC-19	RC-20
7 Revenues at Current Rates												
8 Gas Full Tariff Revenue	609,786	4	2,549	26,172	1,108	6,029	4,076	218	24	587	162	0
9 Non-Gas Full Tariff Revenue	434,342	1	47	146	3	22	13	2	6	12	10	7,256
10 Full tariff gas revenue at current rates	1,044,127	5	2,597	26,317	1,111	6,051	4,089	220	30	599	172	7,256
11 Other revenue / Adjustments	31,585	0	62	145	6	31	21	6	0	4	1	130
12 Net revenues	1,075,712	5	2,659	26,462	1,117	6,082	4,110	226	30	602	173	7,386
14 Operating Expenses												
15 Supply, Storage and Transmission	651,439	4	1,963	23,250	1,314	6,362	4,516	247	27	652	191	1,471
16 Other Operating expenses	234,080	1	192	1,021	37	186	122	9	10	27	9	2,379
17 Universal Service and Energy Conservation	108,546	1	0	0	0	0	0	0	0	0	0	0
18 Total Operating Expenses	994,066	5	2,155	24,271	1,351	6,548	4,638	256	37	679	200	3,850
19												
20 Income before Interest and Surplus	81,646	(0)	504	2,191	(234)	(466)	(528)	(30)	(7)	(76)	(27)	3,537
21 Interest and Surplus	81,646	0	128	1,183	49	255	173	8	4	29	8	1,030
Current Revenue OVER (UNDER) Total												
22 Requirements- Before Rate Increase Requirement	(0)	(0)	376	1,008	(282)	(721)	(701)	(37)	(11)	(105)	(35)	2,507
23												
24 Rate Increase Requirement	100,000	0	157	1,449	60	312	212	9	4	36	10	1,261
Current Revenue OVER (UNDER) Total												
25 Requirements-Including Rate Increase Requirement	(100,000)	(1)	219	(441)	(342)	(1,033)	(913)	(47)	(15)	(141)	(45)	1,246
26 AS ORIGINALLY FILED	(100,000)	(1)	216	(467)	(342)	(1,037)	(916)	(47)	(15)	(142)	(46)	2,070
Increase (Decrease) in Tariff Rates for Full												
27 Cost of Service with Rate Increase Requirement	9.6%	14.9%	(8.4%)	1.7%	30.7%	17.1%	22.3%	21.2%	50.1%	23.6%	26.4%	(17.2%)
28												
29 Rate Base	1,409,193	6	2,212	20,423	839	4,394	2,985	133	61	504	144	17,769
30												
31 Return on Rate Base at Present Rates (Before All Interest and Surplus)	5.8%	(0.1%)	22.8%	10.7%	(27.8%)	(10.6%)	(17.7%)	(22.2%)	(11.6%)	(15.1%)	(18.7%)	19.9%
32												
(0.0000) 0.0000 2.360.7039 ##### ##### 4,657.2227 3,158.1213 ##### 6.5273 ##### ##### #####												

Exhibit HSG-1A

Revenue Requirement By Functional Classification

Exhibit HSG-1B

Total Class Allocation- Revenue Requirement By Rate Class

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

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			TOTAL Class Allocation						
Account Description	Account Code	Total Allocated Dollars	Municipal Heat RC-8	ousing Aut: GS RC-9	NGV Direct RC-10	BPS Small RC-11	BPS Large RC-12	BPS A/C RC-13	
I. GAS PLANT IN SERVICE									
A. INTANGIBLE PLANT	301-303	0	0	0	0	0	0	0	
B. PRODUCTION PLANT									
Land and Land Rights	304	1,453	33	24	0	0	0	0	
Structures and Improvements	305	17,346	396	282	0	0	0	0	
Boiler Equipment	306	2,497	57	41	0	0	0	0	
Other Power Equipment	307	229	5	4	0	0	0	0	
L.P.G. Equipment	311	5,081	116	83	0	0	0	0	
Purification Equipment	317	(37)	(1)	(1)	0	0	0	0	
Resid. Refine Equipment	318	8	0	0	0	0	0	0	
Gas Mixing Equipment	319	157	4	3	0	0	0	0	
Subtotal - Plant Accounts 305-338	305-338	25,281	578	411	0	0	0	0	
Other Equipment	320	20,102	459	326	0	0	0	0	
SNG Plant	320	0	0	0	0	0	0	0	
Subtotal - PRODUCTION PLANT	304-338	46,836	1,070	761	0	0	0	0	
C. STORAGE PLANT (Mostly LNG Plant)									
Structures and Improvements	361	7,396	169	120	0	0	0	0	
Gas Holders	362	33,679	770	547	0	0	0	0	
Purification Equipment	363	201	5	3	0	0	0	0	
Liquification Equipment	364	29,564	676	480	0	0	0	0	
Vaporizing Equipment	365	12,152	278	197	0	0	0	0	
Compressor Equipment	366	14,279	326	232	0	0	0	0	
Measuring and Regulating Equipment	367	12,077	276	196	0	0	0	0	
Other Equipment	368	17,531	401	285	0	0	0	0	
Subtotal - Plant Accounts 361-368	361-368	126,879	2,900	2,061	0	0	0	0	
Subtotal - STORAGE PLANT	360-368	126,879	2,900	2,061	0	0	0	0	
D. TRANSMISSION PLANT									
	370-373	0	0	0	0	0	0	0	

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

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Account Description	Account Code	Total Allocated Dollars	TOTAL Class Allocation				TOTAL Class Alloc			
			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	
E. DISTRIBUTION PLANT										
Land and Land Rights	374	101	2	68	1	14	0	1	0	
Structures and Improvements	375	2,533	44	1,709	37	347	10	31	10	
Mains	376	540,564	21,136	390,040	7,514	61,532	1,677	5,181	1,732	
Mains- Direct Assignment	376Direct	7,574	0	0	0	0	0	0	0	
Compressor Station Equipment	377	1,180	23	885	19	180	5	16	5	
Meas. & Reg. Stat. Equip. - General	378	16,545	322	12,419	268	2,520	72	225	74	
Services	380	491,117	49,028	396,508	8,042	27,886	647	1,543	481	
Meters	381	78,972	6,575	53,178	3,645	12,638	248	591	218	
Meters Install.	382	99,534	8,287	67,024	4,594	15,929	312	745	275	
House Regulators	383	3,927	432	3,494	0	0	0	0	0	
House Regulator Install.	384	4,895	539	4,355	0	0	0	0	0	
Subtotal - Plant Accounts 383-384	383-384	8,821	971	7,849	0	0	0	0	0	
Indust. Meas. & Reg. Station Equipment	385	1,663	32	1,248	27	253	7	23	7	
Other Equipment	387	<u>4,452</u>	<u>78</u>	<u>3,004</u>	<u>65</u>	<u>610</u>	<u>17</u>	<u>54</u>	<u>18</u>	
Subtotal - DISTRIBUTION PLANT	374-387	1,253,057	86,499	933,932	24,212	121,908	2,996	8,411	2,820	
F. GENERAL PLANT										
Land and Land Rights	389	3,713	275	2,816	88	384	9	24	8	
Structures and Improvements	390	65,834	4,880	49,936	1,564	6,812	164	432	137	
Office Furniture and Equipment	391	80,912	5,998	61,374	1,922	8,372	202	531	168	
Transportation Equipment	392	27,083	2,008	20,543	643	2,802	68	178	56	
Stores Equipment	393	707	52	537	17	73	2	5	1	
Tools, Shop and Garage Equipment	394	8,816	654	6,687	209	912	22	58	18	
Power Operated Equipment	396	400	30	304	10	41	1	3	1	
Communication Equipment	397	19,503	1,446	14,794	463	2,018	49	128	41	
Miscellaneous Equipment	398	7,662	568	5,812	182	793	19	50	16	
Subtotal - GENERAL PLANT	389-399	214,631	15,911	162,802	5,100	22,208	536	1,409	447	
TOTAL UTILITY PLANT										
		1,641,403	105,790	1,227,121	32,128	170,569	4,288	12,180	4,039	
II. DEPRECIATION RESERVE										
Production Plant	108.2	32,971	641	24,747	535	5,021	144	448	147	
Local Storage Plant	108.3	79,233	1,542	59,471	1,285	12,066	345	1,076	352	
Mains	109	188,353	7,365	135,905	2,618	21,440	584	1,805	604	
Mains- Direct Assignment	08.52Direc	4,713	0	0	0	0	0	0	0	
Services	109	198,089	19,775	159,929	3,244	11,248	261	623	194	
Meters	109	53,485	4,453	36,015	2,468	8,559	168	400	148	
Distr Other	109	15,664	274	10,570	228	2,144	61	191	63	
General Plant	109	<u>94,257</u>	<u>6,987</u>	<u>71,496</u>	<u>2,240</u>	<u>9,753</u>	<u>235</u>	<u>619</u>	<u>196</u>	
TOTAL - DEPRECIATION RESERVE	108	666,765	41,038	498,133	12,617	70,231	1,798	5,162	1,702	

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

		TOTAL Class Allocation							
		Total	Municipal	ousing Autl	NGV	BPS	BPS	BPS	
Account	Account	Allocated	Heat	GS	Direct	Small	Large	A/C	
Description	Code	Dollars	RC-8	RC-9	RC-10	RC-11	RC-12	RC-13	
E. DISTRIBUTION PLANT									
41 Land and Land Rights	374	101	2	1	0	0	3	0	
42 Structures and Improvements	375	2,533	52	37	0	6	70	2	
43 Mains	376	540,564	8,592	6,939	0	1,138	12,054	371	
44 Mains- Direct Assignment	376Direct	7,574	0	0	0	0	0	0	
45 Compressor Station Equipment	377	1,180	27	19	0	0	0	0	
46 Meas. & Reg. Stat. Equip. - General	378	16,545	378	269	0	0	0	0	
47 Services	380	491,117	1,418	3,308	3	287	825	41	
48 Meters	381	78,972	543	444	1	73	145	7	
49 Meters Install.	382	99,534	685	559	1	92	183	9	
50 House Regulators	383	3,927	0	0	0	1	0	0	
51 House Regulator Install.	384	4,895	0	0	0	1	0	0	
52 Subtotal - Plant Accounts 383-384	383-384	8,821	0	0	0	2	0	0	
53 Indust. Meas. & Reg. Station Equipment	385	1,663	38	27	0	0	0	0	
54 Other Equipment	387	4,452	91	65	0	11	124	4	
55 Subtotal - DISTRIBUTION PLANT	374-387	1,253,057	11,827	11,669	5	1,612	13,404	434	
F. GENERAL PLANT									
58 Land and Land Rights	389	3,713	28	37	0	3	13	0	
59 Structures and Improvements	390	65,834	503	660	0	55	224	8	
60 Office Furniture and Equipment	391	80,912	618	811	0	67	275	10	
61 Transportation Equipment	392	27,083	207	271	0	23	92	3	
62 Stores Equipment	393	707	5	7	0	1	2	0	
63 Tools, Shop and Garage Equipment	394	8,816	67	88	0	7	30	1	
64 Power Operated Equipment	396	400	3	4	0	0	1	0	
65 Communication Equipment	397	19,503	149	195	0	16	66	2	
66 Miscellaneous Equipment	398	7,662	59	77	0	6	26	1	
67 Subtotal - GENERAL PLANT	389-399	214,631	1,640	2,151	1	178	729	27	
69 TOTAL UTILITY PLANT		1,641,403	17,437	16,641	6	1,790	14,134	461	
II. DEPRECIATION RESERVE									
72 Production Plant	108.2	32,971	754	535	0	0	0	0	
73 Local Storage Plant	108.3	79,233	1,811	1,287	0	0	0	0	
74 Mains	109	188,353	2,994	2,418	0	397	4,200	129	
75 Mains- Direct Assignment	08.52Direct	4,713	0	0	0	0	0	0	
76 Services	109	198,089	572	1,334	1	116	333	16	
77 Meters	109	53,485	368	300	1	50	98	5	
78 Distr Other	109	15,664	322	229	0	40	435	13	
79 General Plant	109	94,257	720	945	0	78	320	12	
80 TOTAL - DEPRECIATION RESERVE	108	666,765	7,540	7,048	2	681	5,387	176	

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

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			TOTAL Class Allocation							
Account	Account	Total	LBS	LBS	LBS	LBS	LBX	Co-Gen	GTS / IT	
Description	Code	Allocated	Small	arge-InDire	Large-Direc	Large-Direc	XL-Indirect	InDirect	Trans only	
		Dollars	RC-14	RC-15	RC-16	RC-17	RC-18	RC-19	RC-20	
E. DISTRIBUTION PLANT										
41 Land and Land Rights	374	101	1	0	0	0	0	0	6	
42 Structures and Improvements	375	2,533	13	9	0	0	1	0	154	
43 Mains	376	540,564	2,190	1,484	29	4	246	25	18,678	
44 Mains- Direct Assignment	376Direct	7,574	0	0	0	0	0	0	7,574	
45 Compressor Station Equipment	377	1,180	0	0	0	0	0	0	0	
46 Meas. & Reg. Stat. Equip. - General	378	16,545	0	0	0	0	0	0	0	
47 Services	380	491,117	93	32	5	31	61	51	825	
48 Meters	381	78,972	16	7	1	12	7	6	617	
49 Meters Install.	382	99,534	21	9	1	15	8	7	778	
50 House Regulators	383	3,927	0	0	0	0	0	0	0	
51 House Regulator Install.	384	4,895	0	0	0	0	0	0	0	
52 Subtotal - Plant Accounts 383-384	383-384	8,821	0	0	0	0	0	0	0	
53 Indust. Meas. & Reg. Station Equipment	385	1,663	0	0	0	0	0	0	0	
54 Other Equipment	387	4,452	23	15	0	0	3	0	270	
55 Subtotal - DISTRIBUTION PLANT	374-387	1,253,057	2,357	1,556	37	61	326	89	28,901	
F. GENERAL PLANT										
58 Land and Land Rights	389	3,713	2	1	0	0	0	0	21	
59 Structures and Improvements	390	65,834	40	26	3	3	6	2	378	
60 Office Furniture and Equipment	391	80,912	49	31	3	4	7	3	464	
61 Transportation Equipment	392	27,083	16	11	1	1	2	1	155	
62 Stores Equipment	393	707	0	0	0	0	0	0	4	
63 Tools, Shop and Garage Equipment	394	8,816	5	3	0	0	1	0	51	
64 Power Operated Equipment	396	400	0	0	0	0	0	0	2	
65 Communication Equipment	397	19,503	12	8	1	1	2	1	112	
66 Miscellaneous Equipment	398	7,662	5	3	0	0	1	0	44	
67 Subtotal - GENERAL PLANT	389-399	214,631	130	84	9	10	20	8	1,232	
69 TOTAL UTILITY PLANT		1,641,403	2,486	1,640	46	71	346	97	30,133	
II. DEPRECIATION RESERVE										
72 Production Plant	108.2	32,971	0	0	0	0	0	0	0	
73 Local Storage Plant	108.3	79,233	0	0	0	0	0	0	0	
74 Mains	109	188,353	763	517	10	1	86	9	6,508	
75 Mains- Direct Assignment	08.52Direc	4,713	0	0	0	0	0	0	4,713	
76 Services	109	198,089	38	13	2	12	25	21	333	
77 Meters	109	53,485	11	5	1	8	4	4	418	
78 Distr Other	109	15,664	79	54	1	0	9	1	949	
79 General Plant	109	94,257	57	37	4	5	9	3	541	
80 TOTAL - DEPRECIATION RESERVE	108	666,765	948	625	18	26	132	37	13,462	

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	Account Description	Account Code	Total Allocated Dollars	TOTAL Class Allocation				TOTAL Class Alloc		
				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
119	B. NATURAL GAS STORAGE, TERMINAL									
120	LNG Operating Exp Admin	840	728	14	546	12	111	3	10	3
121	Training	841	2,874	56	2,157	47	438	13	39	13
122	Subtotal - O&M Accounts 840-841	840-841	3,602	70	2,704	58	549	16	49	16
123	Fuel- LNG Power	842	1,204	23	904	20	183	5	16	5
124	Maintenance Exp- Admin	843	6,324	123	4,747	103	963	28	86	28
125	Oper Exp Admin	850	662	13	497	11	101	3	9	3
126	Subtotal - Maint. Accounts 843.1-850	843.1-850	6,986	136	5,243	113	1,064	30	95	31
127	Subtotal - NATURAL GAS STORAGE	840-850	11,791	229	8,850	191	1,796	51	160	52
128										
129	C. TRANSMISSION EXPENSES	856-863	0	0	0	0	0	0	0	0
130										
131	D. DISTRIBUTION EXPENSES									
132	Operation Supv & Engineering	870	603	38	456	10	59	2	4	1
133	Gas Control	871	1,114	30	749	35	172	7	15	5
134	Mains and Services Expenses	874	2,950	185	2,217	46	277	7	22	7
135	Natural Gas Oper Exp	875	1,099	21	825	18	167	5	15	5
136	Meas & Reg Exp- City Gate Stations	877	266	5	200	4	41	1	4	1
137	Meter & House Regulator Expenses	878	18,007	1,522	12,309	792	2,746	54	128	47
138	Customer Install- Gas Business Costs	879	3,716	309	2,502	172	595	12	28	10
139	PLP Costs	879PLP	3,511	384	3,102	0	0	0	0	0
140	Other expenses	880	8,671	851	6,884	170	588	12	29	10
141	Distribution Rents	881	9	1	7	0	1	0	0	0
142	Maint. Supervision & Engineering	885	717	45	542	12	71	2	5	2
143	Maint. of Mains	887	6,287	246	4,536	87	716	20	60	20
144	Maint. of Meas. & Reg. Station Expenses-C	889	1,343	26	1,008	22	205	6	18	6
145	Natural Gas Equipment	891	452	12	304	14	70	3	6	2
146	Maint. of Services	892	1,430	143	1,154	23	81	2	4	1
147	Maint. of Meters & House Regulators	893	2,639	223	1,804	116	402	8	19	7
148	Subtotal - DISTRIBUTION EXPENSES	870-893	52,816	4,041	38,600	1,522	6,191	140	358	126
149	Total - OPERATION & MAINTENANCE EX		697,356	20,430	472,839	20,146	104,399	3,992	8,882	3,143
150										
151	II. CUSTOMER ACCOUNTS EXPENSES									
152	Customer Service - Administrative	901	930	83	761	15	54	1	2	1
153	Meter Reading - Administrative	901	124	8	94	3	12	0	1	0
154	Collection - Administrative	901	170	15	139	3	10	0	0	0
155	Meter Reading Expenses	902	1,742	115	1,324	37	170	6	13	5
156	Customer Records & Collection Expense	903	26,956	2,418	22,056	436	1,558	24	56	17
157	Uncollectible Accounts	904	40,808	3,265	34,523	490	1,755	82	286	0
158	Uncollectible Accounts in CRP	904CRP	11,450	323	8,172	377	1,877	76	162	58
159	Total - CUSTOMER ACCOUNTS EXPENS		82,180	6,227	67,069	1,360	5,435	189	520	81

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		TOTAL Class Allocation							
Account Description	Account Code	Total Allocated Dollars	Municipal	ousing Aut	NGV	BPS	BPS	BPS	
			Heat RC-8	GS RC-9	Direct RC-10	Small RC-11	Large RC-12	A/C RC-13	
119	B. NATURAL GAS STORAGE, TERMINAL								
120	LNG Operating Exp Admin	840	728	17	12	0	0	0	
121	Training	841	2,874	66	47	0	0	0	
122	Subtotal - O&M Accounts 840-841	840-841	3,602	82	58	0	0	0	
123	Fuel- LNG Power	842	1,204	28	20	0	0	0	
124	Maintenance Exp- Admin	843	6,324	145	103	0	0	0	
125	Oper Exp Admin	850	662	15	11	0	0	0	
126	Subtotal - Maint. Accounts 843.1-850	843.1-850	6,986	160	113	0	0	0	
127	Subtotal - NATURAL GAS STORAGE	840-850	11,791	269	191	0	0	0	
128									
129	C. TRANSMISSION EXPENSES	856-863	0	0	0	0	0	0	
130									
131	D. DISTRIBUTION EXPENSES								
132	Operation Supv & Engineering	870	603	7	6	0	1	6	
133	Gas Control	871	1,114	20	17	0	3	39	
134	Mains and Services Expenses	874	2,950	32	31	0	5	42	
135	Natural Gas Oper Exp	875	1,099	25	18	0	0	0	
136	Meas & Reg Exp- City Gate Stations	877	266	6	4	0	0	0	
137	Meter & House Regulator Expenses	878	18,007	118	96	0	16	32	
138	Customer Install- Gas Business Costs	879	3,716	26	21	0	3	7	
139	PLP Costs	879PLP	3,511	0	26	0	0	0	
140	Other expenses	880	8,671	27	57	0	5	13	
141	Distribution Rents	881	9	0	0	0	0	0	
142	Maint. Supervision & Engineering	885	717	8	8	0	1	8	
143	Maint. of Mains	887	6,287	100	81	0	13	140	
144	Maint. of Meas. & Reg. Station Expenses-C	889	1,343	31	22	0	0	0	
145	Natural Gas Equipment	891	452	8	7	0	1	16	
146	Maint. of Services	892	1,430	4	10	0	1	2	
147	Maint. of Meters & House Regulators	893	2,639	17	14	0	2	5	
148	Subtotal - DISTRIBUTION EXPENSES	870-893	52,816	429	417	0	52	309	
149	Total - OPERATION & MAINTENANCE EX		697,356	12,425	10,109	4	2,015	23,560	
150									
151	II. CUSTOMER ACCOUNTS EXPENSES								
152	Customer Service - Administrative	901	930	1	11	0	1	0	
153	Meter Reading - Administrative	901	124	1	1	0	0	2	
154	Collection - Administrative	901	170	0	2	0	0	0	
155	Meter Reading Expenses	902	1,742	16	19	0	2	24	
156	Customer Records & Collection Expense	903	26,956	36	318	0	23	5	
157	Uncollectible Accounts	904	40,808	0	408	0	0	0	
158	Uncollectible Accounts in CRP	904CRP	11,450	222	183	0	0	0	
159	Total - CUSTOMER ACCOUNTS EXPENS		82,180	277	943	0	26	30	

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			TOTAL Class Allocation							
Account Description	Account Code	Total Allocated Dollars	LBS	LBS	LBS	LBS	LBX	Co-Gen	GTS / IT	
			Small RC-14	arge-InDirec RC-15	Large-Direc RC-16	Large-Direc RC-17	XL-Indirect RC-18	InDirect RC-19	Trans only RC-20	
119 B. NATURAL GAS STORAGE, TERMINAL										
120 LNG Operating Exp Admin	840	728	0	0	0	0	0	0	0	
121 Training	841	2,874	0	0	0	0	0	0	0	
122 Subtotal - O&M Accounts 840-841	840-841	3,602	0	0	0	0	0	0	0	
123 Fuel- LNG Power	842	1,204	0	0	0	0	0	0	0	
124 Maintenance Exp- Admin	843	6,324	0	0	0	0	0	0	0	
125 Oper Exp Admin	850	662	0	0	0	0	0	0	0	
126 Subtotal - Maint. Accounts 843.1-850	843.1-850	6,986	0	0	0	0	0	0	0	
127 Subtotal - NATURAL GAS STORAGE	840-850	11,791	0	0	0	0	0	0	0	
128										
129 C. TRANSMISSION EXPENSES	856-863	0	0	0	0	0	0	0	0	
130										
131 D. DISTRIBUTION EXPENSES										
132 Operation Supv & Engineering	870	603	1	1	0	0	0	0	9	
133 Gas Control	871	1,114	11	8	0	0	1	0	0	
134 Mains and Services Expenses	874	2,950	7	5	0	0	1	0	64	
135 Natural Gas Oper Exp	875	1,099	0	0	0	0	0	0	0	
136 Meas & Reg Exp- City Gate Stations	877	266	0	0	0	0	0	0	0	
137 Meter & House Regulator Expenses	878	18,007	4	2	0	3	1	1	134	
138 Customer Install- Gas Business Costs	879	3,716	1	0	0	1	0	0	29	
139 PLP Costs	879PLP	3,511	0	0	0	0	0	0	0	
140 Other expenses	880	8,671	1	1	0	1	1	1	20	
141 Distribution Rents	881	9	0	0	0	0	0	0	0	
142 Maint. Supervision & Engineering	885	717	1	1	0	0	0	0	11	
143 Maint. of Mains	887	6,287	25	17	0	0	3	0	217	
144 Maint. of Meas. & Reg. Station Expenses-C	889	1,343	0	0	0	0	0	0	0	
145 Natural Gas Equipment	891	452	4	3	0	0	0	0	0	
146 Maint. of Services	892	1,430	0	0	0	0	0	0	2	
147 Maint. of Meters & House Regulators	893	2,639	1	0	0	0	0	0	20	
148 Subtotal - DISTRIBUTION EXPENSES	870-893	52,816	57	37	2	4	9	4	506	
149 Total - OPERATION & MAINTENANCE EX		697,356	6,420	4,554	249	32	661	194	1,977	
150										
151 II. CUSTOMER ACCOUNTS EXPENSES										
152 Customer Service - Administrative	901	930	0	0	0	0	0	0	0	
153 Meter Reading - Administrative	901	124	0	0	0	0	0	0	0	
154 Collection - Administrative	901	170	0	0	0	0	0	0	0	
155 Meter Reading Expenses	902	1,742	5	4	0	0	1	0	0	
156 Customer Records & Collection Expense	903	26,956	1	0	2	0	0	0	6	
157 Uncollectible Accounts	904	40,808	0	0	0	0	0	0	0	
158 Uncollectible Accounts in CRP	904CRP	11,450	0	0	0	0	0	0	0	
159 Total - CUSTOMER ACCOUNTS EXPENS		82,180	6	4	3	0	1	0	7	

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		TOTAL Class Allocation								
Account Description	Account Code	Total Allocated Dollars	LBS	LBS	LBS	LBS	LBX	Co-Gen	GTS / IT	
			Small RC-14	arge-InDire RC-15	arge-Direc RC-16	Large-Dire RC-17	XL-Indirect RC-18	InDirect RC-19	Trans only RC-20	
160										
161 III. CUSTOMER SERVICE & INFORMATI										
162 Customer Assistance- Marketing	908	4,055	0	0	0	0	0	0	0	
163 CAP Costs	908CAP	2,000	0	0	0	0	0	0	0	
164 CRP Shortfall	480CRP	78,655	0	0	0	0	0	0	0	
165 Senior Discounts	480Sen	16,441	0	0	0	0	0	0	0	
166 Total - CUSTOMER SERVICE & INFORM/		101,151	0	0	0	0	0	0	0	
167										
168 Total - CUSTOMER ACCOUNTS, SERVIC		183,331	6	4	3	0	1	0	7	
169										
170 IV. ADMINISTRATIVE & GENERAL EXPEI										
171										
172 A. Labor-Related:										
173 Administrative & General Salaries	920	12,257	7	5	1	1	1	0	70	
174 Office Supplies & Expenses	921	10,596	6	4	0	1	1	0	61	
175 Administrative Expenses Transferred	922	(19,211)	(12)	(7)	(1)	(1)	(2)	(1)	(110)	
176 Outside Services Employed	923	2,251	1	1	0	0	0	0	13	
177 Injuries & Damages	925	6,424	4	3	0	0	1	0	37	
178 Employee Pensions and Benefits	926	55,953	34	22	2	3	5	2	321	
179 Subtotal - O&M Accounts 920-923, 926		68,270	41	27	3	3	6	3	392	
180										
181 B. Plant-Related:										
182 Risk Management - Corporate Insurance P	924	1,341	2	1	0	0	0	0	27	
183 Subtotal - O&M Accounts 924-925, 935		1,341	2	1	0	0	0	0	27	
184										
185 C. Other-Related:										
186 Regulatory Commission Expenses	928	3,763	12	8	0	0	1	0	47	
187 Duplicate Charges- Gas Used by Util	929	(6,486)	0	0	0	0	0	0	0	
188 Misc. Gen'l Expenses	930	1,567	1	1	0	0	0	0	9	
189 Subtotal - Duplicate Charges	929	(4,919)	1	1	0	0	0	0	9	
190 Rents	931	243	0	0	0	0	0	0	1	
191										
192 Total - ADMINISTRATIVE & GENERAL EX		68,698	56	37	3	4	8	3	477	
193										
194 TOTAL - OPERATING EXPENSES (Excl C		323,122	120	78	7	8	18	7	991	
195										
196 VI. DEPRECIATION EXPENSE										
197 Original Cost Depreciation expense	403	37,607	62	41	1	2	9	2	762	
198 Depreciation expense- Direct Assignment	403Direct	589	0	0	0	0	0	0	589	
199 Total - DEPRECIATION EXPENSE	403	38,196	62	41	1	2	9	2	1,351	
200										