# BEFORE THE HOUSE JUDICIARY COMMITTEE

# TESTIMONY OF

# CRAIG WHITE

# ON BEHALF OF PHILADELPHIA GAS WORKS

## Regarding H.R. 100

## November 27, 2001

Mr. Chairman, members of the Committee, on behalf of Philadelphia Gas Works, thank you for this opportunity to appear before you today. I am Craig White, Acting Chief Operating Officer of PGW. One of my responsibilities, as COO and, formerly, as Senior VP of Marketing, is to oversee and plan PGW's gas supply operations. In that capacity, I will attempt to address the concerns expressed in H.R. 100 about the fluctuations in energy prices that consumers have seen in the last 12-18 months. Specifically, I will discuss the gas price increases of last winter, PGW's response to them, and where we stand as we head into this coming winter. As a preview, I will tell you that as we look forward, PGW customers will see significantly lower bills this winter as compared to last year. This is not only a result of lower wholesale gas prices, but also PGW's gas procurement efforts and a commitment to provide our customers with natural gas at the lowest possible cost while ensuring safety and reliability. First, some background on PGW itself.

PGW is a 165 year old gas distribution company and the nation's largest municipally owned natural gas distribution company. PGW serves over 520,000 residential, commercial and industrial customers. From a total revenue standpoint, it's the largest natural gas distribution company in Pennsylvania. The Company has over 3,000 miles of distribution mains and 3,000 miles of distribution services in its service territory, the City of Philadelphia. Of our over 480,000 residential customers, some 420,000 heat their homes with natural gas. Approximately 150,000 of these residential customers are at or below 150 percent of the Federal poverty level. This represents 15% of the total number of low income gas customers statewide.

Since the area served by PGW is not a gas-producing area, PGW and its natural gas customers are dependent upon the interstate natural gas pipeline system to deliver the natural gas that they need. The Company purchases gas from producers in the Southwest United States and then contracts with interstate pipelines to deliver the gas to our distribution system. Significantly, PGW has available only two interstate pipelines from which it can receive gas. The Company also contracts for the use of eleven different gas storage facilities and has its own on-system LNG facilities.

During Fiscal Year 2000, PGW delivered approximately 64.2 billion cubic feet ('Bcf") to its residential, commercial and industrial customers, and transported 14 Bcf of gas for end-users who buy gas independently and have PGW deliver it to their facilities.

Like most companies, PGW manages its gas supply through a mix of flowing gas supplies, and off-system, underground storage. In addition, PGW's unique LNG facilities are used as part of its supply mix. PGW utilizes this mix to satisfy its obligation to meet customers' demand on the coldest day (peak day) as well as to meet customers' annual requirements. All of these strategies are dedicated to keeping gas prices to consumers as low as possible, consistent with our safety and reliability obligations. Certain of its gas supply contracts use pre-established rates, but others set the purchase price on the basis of widely used, established market indicia. The Company also makes forward purchases during off peak months, when gas prices are lower, and stores or displaces the gas using one of its eleven storage fields or its LNG facilities. In this way, last year, the Company was able to lock in lower prices for about 40% of its gas purchases and has continued this practice in anticipation of this coming winter. The Office of Consumer Advocate has testified that our lock-in efforts have saved consumers tens of millions of dollars in avoided natural gas costs.

As you also may be aware, as a result of the passage of the Natural Gas Choice and Competition Act, and starting in July 2000, overall regulatory responsibility for PGW was transferred from the Philadelphia Gas Commission to the Pennsylvania

Public Utility Commission (the Gas Commission continues to approve our annual operating and capital improvement budgets). While full regulatory responsibility does not attach until PGW undergoes restructuring next year, PGW's rates and service are now subject to PUC review and approval. As part of that process, the PUC recently ruled on PGW's $65 million base rate increase request – authorizing us to increase our rates by a total of $33.6 million (although PGW has asked the PUC to reconsider that decision). Additionally, the PUC has approved a settlement of our second annual Gas Cost Rate filing, pursuant to which PGW reduced its GCR by over $2.00/Mcf on September 1, 2001 — representing a $135 million savings to PGW ratepayers — and will further reduce its GCR rate in a few days.

***Last Winter's Gas Price Hikes***

As previously stated, PGW will have a substantially lower GCR this year than last. The recent decrease in PGW's GCR came after a winter in which PGW was forced to increase its rates significantly because of the dramatic rise in the price of natural gas, the impacts of which were experienced nationwide. In the fall of 2000, the country saw gas prices jump by 100% to 200%. In December and January, the average price actually reached $10.00/Dth, compared to a price of $2.50-$3.00/Dth the prior year. I have attached a chart prepared by the Department of Energy which dramatically depicts these unprecedented price spikes (Attachment 1).

What caused these astounding price hikes? The consensus is that it was a combination of factors, including: 1) very low wellhead gas prices prior to last year as compared to prices in the general economy; 2) a corresponding reduction in gas well drilling; 3) increased demand spurred by the robust economy and greater use of natural gas by electric power plants; 4) less than full storage capacity throughout the country; and 5) a colder than normal fall and winter, at least in the initial months. The result was gas prices that were higher than anything we have experienced in the last twenty years.

How did PGW respond? As indicated above, PGW's gas supply relies on a mix of advanced purchases, which among other things, it stores or otherwise has available by the use of its LNG facilities, and purchases where the price is based upon current market prices. Even though PGW's storage facilities were filled to capacity last winter at prices significantly below the market price, and even though PGW was able to lock-in the price for a portion of its flowing supply at prices below the market, the company still had to purchase a portion of its gas at market prices in order to meet customer demand. As such, last winter's price spikes had an immediate and significant effect upon PGW's gas costs. Since PGW is not an investor owned utility, there are no equity investors to infuse the company with funds. To meet our customer's demand, it was essential for us to pass those cost increases on in our version of a Purchased Gas

Clause (PGC), our Gas Cost Rate (GCR), so that we would have the cash to continue to pay the gas bills that we were receiving.

As you may know, PGW's rate can be separated into two components: a base rate charge (consisting of a customer charge and a "per Mcf charge") and a Gas Cost Rate. Since the GCR collects most of PGW's gas costs (as well as the costs of certain low income and most of the cost of its senior citizen assistance program), it is set at a projected level once a year and then updated quarterly to adjust for actual experience. Significantly, and as a general rule, PGW's GCR charges customers for gas costs on a dollar-for-dollar basis; that is, if PGW overestimates the cost of gas and overrecovers monies, PGW refunds the difference. Of course, the reverse is also true; any unforeseen increases in gas costs are also passed on to the customer. Importantly, the gas cost portion of PGW's GCR recovers only gas costs — no profit or return — and 100% of any savings that PGW might realize, from gas sales to other utilities for example, is flowed back to firm customers.

While these historically high gas prices imposed additional costs on all Pennsylvania companies, the burden was especially acute for PGW. Last winter's gas cost increases impacted PGW's already difficult financial situation by further increasing the level of uncollectible accounts and diminishing cash working capital. Accordingly, it was imperative that, at the very least, PGW's Gas Cost Rate tracked the increase in gas prices as closely as possible. To insure this occurred, the Company submitted requests to adjust the GCR with the PUC last fall and winter.

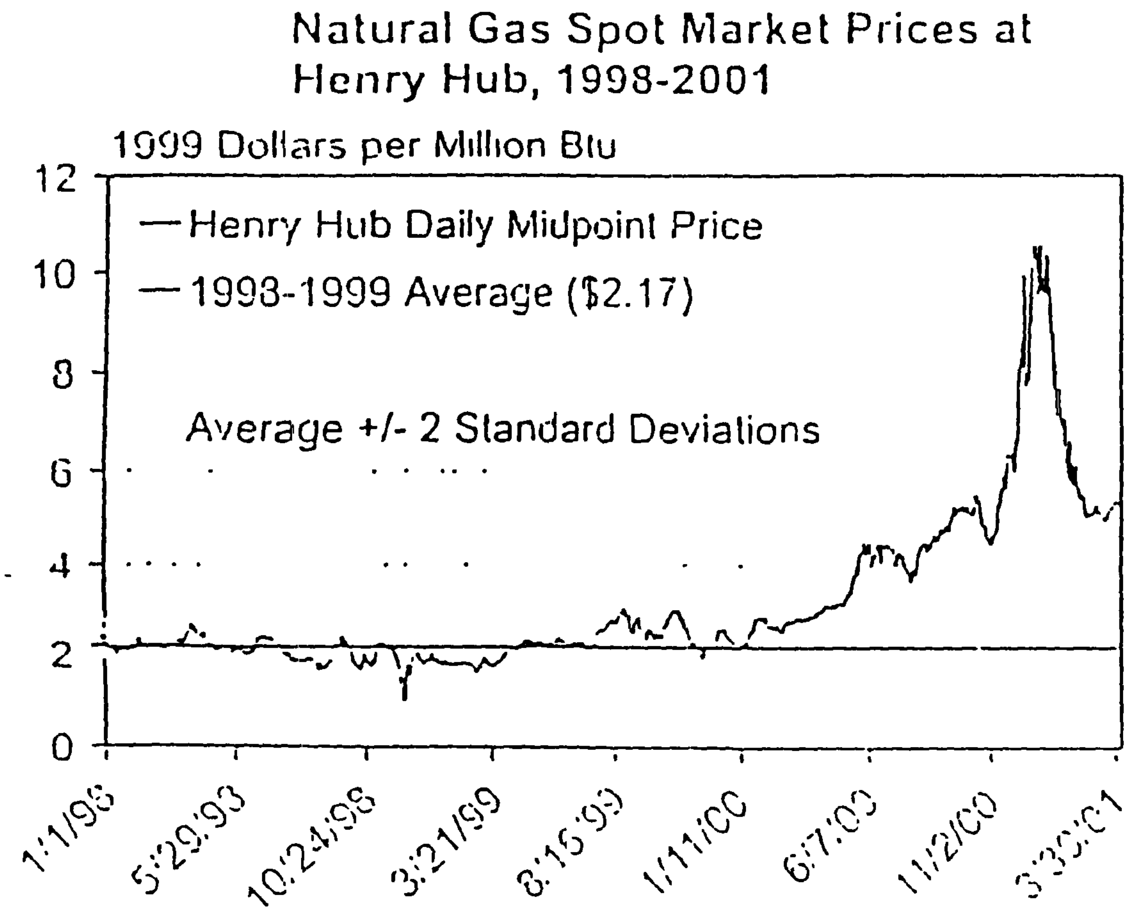
The PUC reviewed those requests and found them reasonable. By March 2001, PGW's GCR rate stood at $6.70/Mcf. On an annual basis, that represented an increase of roughly $3.70/Mcf. I would emphasize that 100% of these increases were in response to the national gas price spike with which every company and every natural gas customer in the Nation has had to deal.

Thankfully, there has been a steady and significant drop in wellhead prices since March 2001. This drop is so significant that PGW has been able to reduce its Gas Cost Recovery rate from $6.70 to $4.37 per Mcf effective September 1. This rate change will result in an approximate $232 annual reduction in the typical residential heating customer's bill. Further, PGW anticipates an additional gas cost rate reduction effective December 1 of this year — which will reduce our GCR rate still further, to no more than $3.60/Mcf. All of these future decreases will be passed on to our customers.

What can consumers expect for the rest of the winter? All indications are that the slowing economy will keep gas costs at moderate levels compared to last winter. Supply continues to be adequate if not greater than last winter. But, that doesn't mean we are entirely out of the woods. Cold weather or other unexpected events could drive gas costs back up. At present, however, so long as wholesale gas costs continue to stay low, we are hopeful that we will not be seeing the kinds of levels that burdened customers nationwide last winter.

In conclusion, Mr. Chairman, I sincerely hope that my remarks assist in your Committee's review of energy price fluctuations in the Commonwealth. I would be delighted to respond to any questions that you might have.

**ATTACHMENT 1**




3rd Quarter 2000 - 4.47

4th Quarter 2000 - 6.41

1st Quarter 2001 - 6.44

Source U S Natural Gas Markets Recent Trends and Prospects for the Future May 2001, Energy Information Administration, U S Department of Energy