

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

REBUTTAL TESTIMONY OF

HAROLD WALKER, III

ON BEHALF OF
PHILADELPHIA GAS WORKS

DOCKET NO. R-2020-3017206

Philadelphia Gas Works

General Rate Increase Request

Topic:
Benchmarking

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VALUATION AND RATE CONSULTANTS, LLC



Valley Forge, Pennsylvania

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

A. My name is Harold Walker, III. I am employed by Gannett Fleming Valuation and Rate Consultants, LLC as Manager, Financial Studies. My business mailing address is 1010 Adams Avenue, Audubon, Pennsylvania 19403.

Q. ARE YOU THE SAME HAROLD WALKER WHO PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

A. Yes.

SCOPE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The Philadelphia Gas Works (“PGW” or “Company”) asked me to respond to and comment on the direct testimony submitted by Bureau of Investigation and Enforcement (“I&E”) witness Anthony Spadaccio and the direct testimony submitted by Office of Consumer Advocate (“OCA”) witness David S. Habr.

SUMMARY

Q. PLEASE SUMMARIZE YOUR COMMENTS ON I&E’S AND OCA’S TESTIMONIES.

A. I respectfully disagree with I&E’s proposed 2.13-times debt service coverage, 68 days cash, and 77% debt ratio for PGW. I also disagree with OCA’s proposed 1.88-times debt service coverage, 73 days cash, 78.33% debt ratio, and \$30 million annual reduction in construction expenditures for PGW.

1 Specifically, the Pennsylvania Public Utility Commission (“Commission”) should not
2 accept I&E’s and OCA’s proposals because:

- 3 • OCA’s recommended reduction in capital expenditures is not based on an
4 engineering review and does not ensure that PGW will be able to continue to
5 provide safe reliable service if a reduction in capital expenditures were mandated;
- 6 • OCA’s recommended debt service coverage, days cash, and debt ratio metrics are
7 based on reducing PGW’s credit rating which would harm PGW’s ability to issue
8 bonds and increase costs to ratepayers; and
- 9 • I&E’s and OCA’s proposals place PGW’s credit rating in jeopardy especially in
10 light of the fact that PGW’s financial attributes, or financial ratios and metrics
11 must be even higher than otherwise to counterbalance the negative demographic
12 statistics that are documented by OCA.

13 Based upon the results of my entire benchmark study contained in my direct and
14 rebuttal testimonies, my recommendation is that PGW be afforded a timely rate increase
15 to cover its costs and at least maintain its financial stability. The benchmark study shows
16 that PGW’s financial performance generally improved each year since 2014 based on both
17 average performance, over the 2014 to 2018 time period, and the trend from 2014 through
18 2018. I note however that the benchmarking study also shows that PGW lags its peers on
19 some key benchmark, or metrics, such as days of cash on hand to cover operating expenses
20 (“days cash”) and debt to total capitalization (“debt ratio”).

21 The benchmark study also reviews forecasted benchmarking metrics of PGW’s
22 financial performance that were estimated reflecting the proposed \$70 million rate
23 increase. The forecasted benchmark analysis shows that there is a continuing need to
24 support PGW’s financial stability with a timely rate increase in this amount to enable PGW

1 to further strengthen its credit profile and to lessen the gap between itself and its peers.
2 The recommendations of the other Parties obviously will not achieve this.

3 **PEER GROUPS**

4 **Q. ON PAGES 8 THROUGH 11 OF PGW ST. NO. 4, YOU DISCUSS THE**
5 **SELECTION OF THE PEER GROUPS USED IN YOUR BENCHMARK STUDY.**
6 **DID OCA COMMENT ON YOUR PEER GROUPS?**

7 A. No.

8 **Q. WHAT PEER GROUPS WERE USED IN YOUR BENCHMARK STUDY AND**
9 **HOW WERE THEY SELECTED?**

10 A. As stated in PGW St. No. 4, I considered the financial and operating statistics of PGW
11 when I selected the companies used for comparison purposes. This process resulted in the
12 selection of 23 “peer” utilities companies which operate in the same basic industry as PGW.
13 The 23 “peer” utilities companies were separated into three peer groups including:
14 municipally owned utilities; Pennsylvania investor-owned utilities; and investor-owned
15 utilities that operate outside of Pennsylvania. It should be noted that the three peer groups
16 are collectively referred to as the “Peer Groups”.

17 I selected a group of municipally owned utilities (“MUNI Group”) since PGW is a
18 municipal utility. The composition of the MUNI Group includes mainly local distributing
19 companies (“LDCs”) from across the country. Since PGW’s service is price regulated by
20 the Commission, a group comprised of investor-owned gas utilities operating in
21 Pennsylvania (“IOUPA Group”) was also selected. In forming a third peer group I
22 selected investor-owned LDCs that operate outside of Pennsylvania (“IOU Group”). In
23 selecting the companies for the IOU Group, I considered all IOU natural gas distribution

1 companies that operate in the North Atlantic region from Maryland to Massachusetts,
2 excluding Pennsylvania, after considering PGW's other characteristics.

3 **Q. DID I&E COMMENT ON YOUR PEER GROUPS?**

4 A. Yes. On pages 11 to 12, Mr. Spadaccio states that he agrees with my selection of the
5 MUNI Group. On page 10 Mr. Spadaccio states that he disagrees with my selection of the
6 IOUPA Group and the IOU Group because he believes they are not similar to PGW and
7 states, "the differences are most clearly demonstrated in the capital structures of Mr.
8 Walker's IOUPA and IOU Groups and PGW."

9 I agree with Mr. Spadaccio that the capital structures ratios of the IOUPA and IOU
10 Groups are different than PGW. However, besides the capital structures ratios, I also
11 presented 21 other benchmark ratios for all three Peer Groups and some of those
12 benchmark ratios show the similarity of PGW to the IOUPA and IOU Groups. As Mr.
13 Spadaccio acknowledges, "PGW's position as both the largest municipally-owned gas
14 distribution utility in the nation and a municipally-owned utility that has its rates regulated
15 by the Commission are factors that combined, make it difficult to find a group of similar
16 utilities."

17 **Q. DID I&E PROVIDE OR RECOMMEND ALTERNATIVE PEER GROUPS TO**
18 **REPLACE THE IOUPA AND IOU GROUPS?**

19 A. No.

20 **CONSTRUCTION EXPENDITURES**

21 **Q. DOES I&E RECOMMEND THAT PGW SHOULD REDUCE THEIR CAPITAL**
22 **EXPENDITURES?**

23 A. No.

1 **Q. DOES OCA RECOMMEND THAT PGW SHOULD REDUCE THEIR CAPITAL**
2 **EXPENDITURES?**

3 A. Yes. On page 3, Mr. Habr recommends PGW reduce its Fully Projected Future Test Year
4 construction expenditure by \$30 million.

5 **Q. DOES MR. HABR HAVE ANY ENGINEERING TRAINING?**

6 A. No, Mr. Habr's training or education is in economics.

7 **Q. DOES MR. HABR HAVE ANY UTILITY MANAGEMENT EXPERIENCE?**

8 A. No.

9 **Q. DOES MR. HABR LIST ANY SPECIFIC CONSTRUCTION PROJECTS THAT**
10 **SHOULD BE ELIMINATED?**

11 A. No.

12 **Q. DO YOU AGREE WITH OCA THAT PGW SHOULD REDUCE THEIR ANNUAL**
13 **CAPITAL EXPENDITURES BY \$30 MILLION?**

14 A. No, not unless OCA can ensure that PGW can continue to provide safe reliable service
15 after reducing their annual capital expenditures by \$30 million. I note that an annual
16 reduction of \$30 million capital expenditures represents a 20% reduction of projected
17 capital expenditures which is a substantial decrease.

18 **BENCHMARK METRICS**

19 **Q. WHAT ASPECTS OF PGW'S SERVICE AREA MAY CAUSE CONCERN TO THE**
20 **MAJOR CREDIT RATING AGENCIES AND HAVE NEGATIVE CREDIT**

1 **TRAITS REGARDLESS OF THE BENCHMARK METRIC ACHIEVED OR**
 2 **PROJECTED?**

3 A. As explained in my direct testimony (PGW St. No. 4), the major credit rating agencies
 4 evaluate the economy of the area served as part of their credit assessment. In particular,
 5 the major credit rating agencies look at median household income (“MHI”) and poverty
 6 rates of the service area as compared to the nation as a whole. The MHI of PGW’s service
 7 area is about 74% (2018) of the national average and the poverty rate is about 208% (2018)
 8 of the national average according to the American Community Survey (ACS), the Census
 9 Bureau. Neither of these demographic statistics is supportive of credit quality and
 10 suggests PGW’s financial attributes, or financial ratios and metrics must be higher than
 11 otherwise to counterbalance the negative demographic statistics.

12 According to OCA’s testimonies¹, these already negative demographic statistics
 13 are likely to worsen as a result of COVID-19 and if they do, it will put additional pressure
 14 on PGW’s credit rating. Consequently, PGW’s financial attributes, or financial ratios and
 15 metrics must be even higher than otherwise to counterbalance the negative demographic
 16 statistics that are documented by OCA.

17 **Q. HOW DO OCA’S AND I&E’S RECOMMENDED DEBT SERVICE COVERAGE**
 18 **FOR PGW COMPARE TO THE MUNI GROUP’S DEBT SERVICE COVERAGE?**

19 A. Mr. Habr recommends (page 6) a debt service coverage of 1.88-times and Mr. Spadaccio
 20 recommends (page 21) a debt service coverage of 2.13-times. As stated in PGW St. No.
 21 4, a higher debt service coverage is less risky and from 2014 to 2018, the MUNI Group’s
 22 debt service coverage averaged 2.53-times. Therefore, the MUNI Group’s debt service

1 See: OCA Statement 1 at pages 10, 11, 13, 14, 15, 16, and 18; OCA Statement No. 3 at page 3; and OCA Statement 5 at pages 6, 7 and 8.

1 coverage was 35% higher than Mr. Habr's recommended debt service coverage and 19%
2 higher than Mr. Spadaccio's recommended debt service coverage.

3 **Q. HOW DO OCA'S AND I&E'S RECOMMENDED DAYS CASH FOR PGW**
4 **COMPARE TO THE MUNI GROUP'S DAYS CASH?**

5 A. Mr. Habr recommends (Exhibit DSH-3) days cash of 73-days and Mr. Spadaccio
6 recommends (page 17) days cash of 68-days. As stated in my direct testimony, higher
7 days cash is less risky and from 2014 to 2018, the MUNI Group's days cash averaged 197-
8 days. Therefore, the MUNI Group's days cash was 168% higher than Mr. Habr's
9 recommended days cash and 190% higher than Mr. Spadaccio's recommended days cash.

10 **Q. HOW DO OCA'S AND I&E'S RECOMMENDED DEBT RATIO FOR PGW**
11 **COMPARE TO THE MUNI GROUP'S DEBT RATIO?**

12 A. Mr. Habr recommends (Exhibit DSH-4) a debt ratio of 78.33% and Mr. Spadaccio
13 recommends (page 7) a debt ratio of 77%. As I explained in my direct testimony, a higher
14 debt ratio is riskier and from 2014 to 2018, the MUNI Group's debt ratio averaged 63%.
15 Therefore, Mr. Habr's recommended debt ratio for PGW is 25% higher than the MUNI
16 Group's debt ratio and Mr. Spadaccio's recommended debt ratio for PGW is 23% higher
17 than the MUNI Group's debt ratio.

18 **Q. BESIDES DEBT SERVICE COVERAGE, DAYS CASH AND DEBT RATIO, DO**
19 **OCA AND I&E RECOMMEND OR CALCULATE ANY OTHER CREDIT**
20 **METRICS FOR PGW?**

21 A. No.

1 **Q. WHY ARE THE DEBT SERVICE COVERAGE, DAYS CASH AND DEBT RATIO**
 2 **IMPORTANT FOR PGW?**

3 A. The major credit rating agencies review several metrics as part of their credit assessment.
 4 However, there are three key metrics which the major credit rating agencies give strong
 5 consideration to: debt ratio; days cash; and debt service coverage. Each metric measures
 6 a unique type of risk: Leverage & Risk (debt ratio); Liquidity (days cash); and Solvency
 7 (debt service coverage).

8 When viewing the three key metrics it is important to understand the metrics are
 9 not isolated metrics, rather they work in tandem with one another so that the sum of their
 10 implications (risk) must offset one another if investment risk is to remain unchanged. For
 11 example, if the risk of Leverage (debt ratio) is high, then the risk measured for Liquidity
 12 and Solvency (days cash and debt service coverage) must offset Leverage’s higher risk in
 13 order for the total risk (investment risk) to remain unchanged. It is also important to recall
 14 PGW’s financial attributes, or financial ratios and metrics must be even higher than
 15 otherwise to counterbalance the negative demographic statistics that are documented by
 16 OCA.

17 I believe regulatory support has played a key role in PGW being able to present a
 18 better credit profile resulting in improved bond ratings and ultimately lowering cost to

	Peer Group	FPPTY Aug-31-2021		
	MUNI Group Average Metric	PGW Request	OCA Recommendation	I&E Recommendation
Rate Increase Recommended		\$70 MM	-\$3 MM	\$47 MM
Debt Service Coverage	2.53	2.27	1.88	2.13
Days Cash	197	87	73	68

Table 1

1 customers as a result of having the ability to finance at lower interest rates than otherwise
2 would have been the case.² Table 1 shows a comparison between the MUNI Group's
3 metrics and the three key metrics for PGW based on their rate increase request and the rate
4 increase (decrease) recommended by OCA and I&E. Table 1 demonstrates the need for
5 continued regulatory support for PGW to improve, or at least maintain, their credit profile
6 and to lessen the gap between PGW and the MUNI Group.

7 I believe adopting either the recommended positions of OCA or I&E will place
8 PGW's current bond rating in jeopardy and would not suggest regulatory support that has
9 been cited as one of the reasons for PGW's current bond rating. As Mr. Spadaccio stated
10 at page 8, "[a] higher bond rating is typically synonymous with lower borrowing costs,
11 which would ultimately benefit ratepayers."

12 **Q. IS THERE EVIDENCE THAT OCA IS DESIROUS OF LOWERING PGW'S BOND**
13 **RATING?**

14 A. Yes. On page 6 Mr. Habr states, "[m]y proposed debt service coverage ratio, 1.88, is the
15 average ratio for the period 2010 through 2016" and on page 8 Mr. Habr states, "[m]y 1.88
16 debt service coverage ratio combined with the \$30 million reduction in net construction
17 expenditures yields End-of-Year days of cash (73.50 days)." According to the
18 information shown on table 1 on page 7 of Mr. Habr's testimony, PGW's current bond
19 rating from Moody's is A3 while PGW's bond rating from Moody's averaged Baa2 from
20 2010 through 2016. Similarly, PGW's current bond rating from S&P is A while PGW's
21 bond rating from S&P averaged BBB+ from 2010 through 2016 and PGW's current bond

2 See pages 20-21 of PGW St. No. 4 for cited examples from the major credit rating agencies of the importance of regulatory support.

1 rating from Fitch is BBB+ while PGW's bond rating from Fitch averaged BBB from 2010
2 through 2016.³

3 Therefore, each of the three major credit rating agencies evaluated PGW as being
4 a higher credit risk and assigned a lower bond rating during the period 2010 through 2016
5 than they currently do. If the Commission were to adopt OCA's recommended financial
6 metrics which are based on the average metrics from 2010 through 2016 it will likely result
7 in PGW's bond rating being lowered. Both Mr. Spadaccio and I agree that a higher bond
8 rating lowers borrowing costs and ultimately benefits ratepayers. A lower bond rating
9 could result in PGW's access to the municipal bond market becoming more difficult; it will
10 certainly result in higher borrowing costs, which will have to be paid by ratepayers for
11 many years. Accordingly, OCA's recommendations should not be accepted.

12 **Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?**

13 A. Yes, it does. However, I reserve the right to supplement my testimony as additional issues
14 arise during this proceeding.

3 The major credit rating services such as S&P Global Ratings ("S&P"), Moody's Investors Service ("Moody's"), and Fitch Ratings Inc. ("Fitch") assess a bond issuer's financial strength using letter grades. These credit rating agencies append modifiers, such as + or - for S&P and Fitch and 1, 2, and 3 for Moody's to each generic rating classification. For example, an "A" credit profile is comprised of three subsets such as A+, A, A- for S&P and Fitch or A1, A2 or A3 for Moody's. The modifier of either "+" or "1" indicates that the obligation ranks in the higher end of its generic rating category; the modifier "2" indicates a mid-range ranking; and the modifier of "-" or "3" indicates a ranking in the lower end of that generic rating category.

VERIFICATION

I, Harold Walker, III, hereby state that: (1) I am employed by Gannett Fleming Valuation and Rate Consultants, LLC as Manager, Financial Studies; (2) I have been retained by Philadelphia Gas Works ("PGW") for purposes of this proceeding; (3) the facts set forth in my testimony are true and correct to the best of my knowledge, information and belief; and (4) I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

July 13, 2020

Dated



Harold Walker, III, Manager, Financial Studies
Gannett Fleming Valuation and Rate Consultants, LLC