Proposed Sale of Philadelphia Gas Works to UIL Holdings Corporation

Financial Advisor Assessment

Prepared for

Philadelphia City Council

October 2014

DISCLAIMER

The analyses contained herein were prepared by Concentric Energy Advisors, Inc. ("Concentric") as part of the process of determining an independent valuation of Philadelphia Gas Works ("PGW") as of August 31, 2014 and evaluating the bids received by the City of Philadelphia (the "City") for the purchase of PGW. The analyses contained herein shall not be deemed to be a complete review of all aspects of PGW or any contemplated transaction involving PGW. In addition, the analyses and opinions included herein shall not be construed as either legal or accounting opinions related to the proposed transaction.

The analyses contained herein are based upon general financial, market and other conditions and circumstances as they existed and could be evaluated, and the information made available to Concentric as of the date of the analyses. Concentric relied, without independent verification, on the accuracy and completeness of all financial and other information publicly available or otherwise furnished or made available to it by the City and PGW. With respect to the financial projections and other data relating to PGW, Concentric assumed that such data and projections have been reasonably prepared and, to the extent applicable, in accordance with accepted utility practice and reflect the best currently available estimates. Concentric expresses no opinion as to such data, projections and other information, or the assumptions upon which they were based. Concentric did not undertake a physical inspection of PGW, its facilities or its assets.

Concentric's analyses involve various determinations as to the most appropriate and relevant methods of analysis, including financial analysis, and the application of those methods to the particular circumstances. Therefore, our analyses are not readily susceptible to summary description. Furthermore, in arriving at an independent valuation, assessing the terms of the proposed transaction, and in performing our assessment of the bids received for the purchase of PGW, Concentric did not attribute any particular weight to any analysis or factor considered by it; rather, Concentric made its determination as to the value of PGW and the bids received to purchase PGW and performed its assessment of the terms of the proposed transaction on the basis of qualitative judgments of the significance and relevance of each of the financial and comparative analyses and other factors. Accordingly, Concentric believes that its assessment must be considered as a whole and that considering any portion of the analyses or of the factors Concentric considered without considering all analyses and factors could create a misleading or incomplete view of the process underlying our assessment.

The summary set forth below does not purport to be a complete description of the analyses or factors considered by Concentric. Concentric's opinion is based on its consideration of the collective results of all such analyses and factors.

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GLOSSARY

A&G	Administrative and general
APA	Asset Purchase Agreement
ATWACC	After-tax weighted average cost of capital
Bcf	Billion cubic feet
BIRT	Business Income & Receipts Tax
Brokers	J.P. Morgan Securities LLC and Loop Capital Markets LLC
CAGR	Compound annual growth rate
CAP	Customer Assistance Programs
CARES	Customer Assistance and Referral Evaluation Services
CBA	Collective bargaining agreement
CFO	Chief Financial Officer
City	City of Philadelphia
City Administration	The Mayor's Office of the City of Philadelphia
City Council	Philadelphia City Council
Concentric	Concentric Energy Advisors, Inc.
COO	Chief Operating Officer
CRP	Customer Responsibility Program
CWP	Conservation Works Program
DCF	Discounted cash flow
DSIC	Distribution System Improvement Charge
DSM	Demand side management
EBITDA	Earnings before interest, taxes, depreciation and amortization
ECR	Efficiency Cost Recovery mechanism
ELIRP	Enhanced Low Income Retrofit Program
EOP	Economic Opportunity Plan
GCR	Gas Cost Rate
IPO	Initial public offering
J.P. Morgan	J.P. Morgan Securities LLC
Joint Application	Application filed by the City and UIL with the Pennsylvania Public Utility Commission for any required approvals
Lazard	Lazard Frères & Co. LLC
LDC	Local distribution company
LNG	Liquefied natural gas
Loop Capital Markets	Loop Capital Markets LLC
MACRS	Modified Accelerated Cost Recovery System
MMcf/day	Million cubic feet per day
MMO	Minimum municipal obligation
Moody's	Moody's Investors Service
O&M	Operations and maintenance
OPEB	Other postemployment benefits
PAPUC	Pennsylvania Public Utility Commission
PFMC	Philadelphia Facilities Management Corporation
PGC	Philadelphia Gas Commission
PGW	Philadelphia Gas Works
PP&E	Property, plant and equipment

GLOSSARY

PTWACC	Pre-tax weighted average cost of capital
PPP	Public-private partnership
PURTA	Public utility realty tax
RFQ	Request for qualifications
ROE	Return on equity
S&P	Standard & Poor's
SEC	Securities and Exchange Commission
Tort Claims Act	Political Subdivision Tort Claims Act of Pennsylvania
UESF	Utility Emergency Services Fund
UIL	UIL Holdings Corporation
USEC	Universal Service and Energy Conservation
UWUA Local 686	Utility Workers Union of America Local 686
WACC	Weighted average cost of capital
WNA	Weather Normalization Adjustment

I. EXECUTIVE SUMMARY

The fundamental decision before the Philadelphia City Council ("City Council") is whether the proposed sale of Philadelphia Gas Works ("PGW") to UIL Holdings Corporation ("UIL") is better for the citizens of Philadelphia than continued ownership by the City of Philadelphia (the "City") now and for the future. In reaching its decision, City Council should consider the myriad of financial, employment, rate, public policy, economic development, and social considerations, as well as the programs and functions that PGW provides as a City-owned utility. City Council retained Concentric Energy Advisors, Inc. ("Concentric") to provide it with information to inform its decision. Concentric was not retained to render its opinion on whether the proposed sale of PGW to UIL is better for the citizens of Philadelphia than continued City ownership or whether City Council should approve the proposed transaction. In addition, the analyses and opinions included herein do not constitute either legal or accounting opinions, nor do they constitute a fairness opinion of the proposed transaction.

This Financial Advisor Assessment responds to specific questions addressing the Sale Process, a Comparison of Final Bids, Concentric's Independent Valuation of PGW, Potential Rate Impacts, the Commercial Terms of the Proposed Transaction, and Other Considerations. These questions and Concentric's responses are highlighted below and discussed in more detail throughout the remainder of this report.

A. Sale Process Overview and the City Administration's Objectives

Question 1: What management and ownership alternatives did the Mayor's Office of the City of Philadelphia (the "City Administration") consider for PGW?[1]

Concentric's Response: The City Administration's February 2012 Strategic Assessment identified five alternatives: (1) enhanced status quo, (2) strategic sale, (3) public-private partnership ("PPP") in the form of a long-term lease; (4) initial public offering ("IPO"); and (5) management services

[1] The City Administration and the City Council are two separate bodies within City government, each with different roles in the potential sale of PGW. The City Administration is acting on behalf of the City as the seller in the proposed sale of PGW to UIL. The City Council is the 17 member governmental body that must enact an ordinance that authorizes the sale of PGW to UIL.

agreement. The City Administration's RFP solicited proposals for the sale of PGW only. Specific proposals for any other alternatives were not sought by the City Administration.

Question 2: What were the objectives and conditions placed by the City Administration on a sale of PGW? Did these objectives and conditions reflect the objectives of City Council?

Concentric's Response: The City Administration articulated certain overarching objectives for a sale of PGW:

- The City desires to sell substantially all of PGW if, and only if, the best terms obtainable from a responsible bidder are beneficial in the long term to the City; and
- The City expects that any ultimate purchaser of PGW will have the financial capacity and operational experience necessary to finance, acquire, operate, and maintain PGW as a natural gas distribution company under the Natural Gas Choice and Competition Act, 66 Pa. C.S. Sections 2201 et seq., including operating the system in a prudent, safe, efficient, and responsible manner that serves the City and PGW's customers at a reasonable cost.

In addition, the City articulated five specific objectives and conditions:

1. Maintain the Senior Citizen Discount program in its current form and all Pennsylvania Public Utility Commission ("PAPUC")-mandated discount programs;
2. Implement a base rate freeze for a mutually agreed-upon period of time;
3. Honor the collective bargaining agreement ("CBA") in place at the time of sale closing;
4. Maintain PGW headquarters in Philadelphia and a specified minimum number of employees in Philadelphia for at least three years; and
5. Satisfy liabilities for PGW-related pensions and for other post-employment benefits (management and funding), as applicable, including maintaining dedicated trust funds for any PAPUC-granted rate recovery of employee benefits.

It is Concentric's understanding that some City Council members were briefed during the development and management of the City Administration's solicitation process. It is unclear if all of City Council's objectives and conditions were considered. As noted in Figure 6, City Council members raised a number of other considerations during Concentric's review, not all of which were addressed in the City Administration's RFP or by the terms of its proposed sale of PGW to UIL.

Question 3: Was the City's solicitation process competitive and was its management consistent with industry standards?

Concentric's Response: The City Administration's solicitation process and its management of that process as summarized below were consistent with industry standards and provided for a competitive auction. The process was reasonable and meets Concentric's expectation for an appropriate approach to market and sell a regulated local distribution company ("LDC") (see Section VI).

B. *Comparison of Final Bids*

Question 4: Was UIL's final bid the best proposal received through the solicitation process based on price and a high level review of the transaction terms?

Concentric's Response: Based on Concentric's review of the PGW transaction materials and the transaction terms analysis developed by the City Administration, Concentric concludes that UIL's final proposal was the best bid received (see Section VII).

C. Independent Valuation

Question 5: Does the proposed purchase price of $1.86 billion reasonably reflect PGW's value?

Concentric's Response: Yes. Concentric concludes that the proposed purchase price of $1.86 billion reasonably reflects PGW's value (see Section VIII).

D. Potential Rate Impacts

Question 6: How might rates be impacted by a sale of PGW to UIL? How might accelerating the cast iron main replacement program impact the Distribution System Improvement Charge ("DSIC") and costs to ratepayers?

Concentric's Response: Base rates will remain the same after a sale of PGW to UIL through at least December 31, 2017, although UIL could file for rate relief during the base rate freeze period under certain circumstances, as discussed in Section IX. The impact on rates from the sale of PGW to UIL beyond the base rate freeze period depends on many factors, some that are more within the control of UIL than others. Concentric's analysis indicates that an initial rate increase under UIL ownership could be reduced or deferred (or both) relative to PGW's $50 million forecasted rate increase in 2018.[2]

If the transaction is approved, the way rates are established will change after the rate freeze expires. PGW's rates are presently determined on a cash flow basis, and are designed to provide PGW with sufficient cash flow to meet its operating and debt service needs. Rates under UIL ownership would be set on a cost-of-service basis that is designed to provide the utility owner with the opportunity to earn a fair return to shareholders. The DSIC recovery mechanism will also change from a "pay-as-you-go" basis, in which costs are recovered in the year of expenditure, to a cost-of-service basis, in which investments are recovered over time together with the associated cost of borrowing. This will result in lower annual DSIC-related rates associated with individual DSIC investments in the early years of the investment, so the infrastructure replacement program can be accelerated without having an initial negative impact on ratepayers. DSIC-related charges under the cost-of-service approach, however, will eventually surpass those charges that would be recorded on a "pay-as-you-go" approach. In addition, under the cost-of-service approach, the lifecycle cost (in nominal dollars) of DSIC investments will be greater than the lifecycle cost that would be incurred under the "pay-as-you-go" approach because as a privately-held entity, PGW would be reimbursed for the carrying cost of its capital investment (see Section IX).

2 On August 19, 2014, PGW released its five-year forecast for fiscal years 2016 through 2020, in which its 2018 forecasted rate increase was reduced to $40 million based on updated assumptions including additional margin on LNG sales, reduction in personnel in 2018 resulting from the Business Transformation-Building Consolidation initiative, and other updated assumptions from the prior five-year forecast. While Concentric reviewed the August 19, 2014 five-year forecast to understand the nature of any changes between the current and prior forecasts, we did not update assumptions in our financial valuation to reflect the updated forecast. The reason is primarily that the updated forecast was not available to bidders during the PGW sales process, and thus the prior forecast is more reflective of the PGW management assumptions available to bidders at the time they were preparing their bids. In addition, there is no reason to assume that the updated assumptions regarding increased LNG sales and personnel reductions, as well as other updated assumptions, could not also be achieved by a privately-held PGW, and thus would also reduce the privately-held PGW's need for rate relief.

E. Commercial Terms of the Proposed Transaction

Question 7: What are UIL's contractual commitments within the Asset Purchase Agreement ("APA") with respect to the following, when do these commitments expire, and what happens when they do?

i. Employment levels, wages and benefits
ii. Liability-related commitments
iii. Rate-related transaction terms
iv. Economic Opportunity Plan ("EOP")
v. Philadelphia presence (*e.g.*, headquarters)
vi. Indemnification
vii. Required approvals and other governmental filings
viii. "No shop" provision
ix. Termination dates

Concentric's Response: Concentric reviewed the APA and related documents as incorporated by reference to determine the commercial nature of the proposed transaction and UIL's contractual commitments as they pertain to certain key terms identified in the question above. The APA is a complex contract; Section X contains a more detailed summary of the identified terms and of the APA itself.

i. Employment levels, wages and benefits. UIL's employment levels, wages and benefits commitments are described in Section X.A of this report. These terms include:

- Offers of employment – APA Section 6.10 – all existing employees must be offered employment (a) at a level of base pay at least equal to such employee's base pay in effect immediately prior to the closing, (b) with benefits that, together with wages, are in the aggregate substantially comparable to the benefits and wages in effect for the employee immediately prior to the closing until May 15, 2015, and (c) with a primary work location within the City of Philadelphia;
- Employment commitment – APA Section 7.1(e) – the APA provides for a three-year employment commitment of no less than 1,350 employees. PGW currently

employs approximately 1,600 employees of whom approximately 413 are or will be retirement eligible as of December 31, 2014. Actual employment levels may fall to as low as 1,350 if the reduction in headcount is due to voluntary separation by employees, including retirement;

- Assumption of CBA – APA Section 2.2(a)(i) – UIL will assume PGW's CBA with the Utility Workers Union of America Local 686 ("UWUA Local 686"), which expires on May 15, 2015;
- Transferred employee benefits – APA Section 7.2(a) – Transferred employees shall be covered by UIL-sponsored benefit plans. UIL shall determine the form and terms of any particular benefit plan. All accrued but unused sick leave and vacation balances shall be transferred with the employees and paid subject to the then in effect CBA and policies, and service and seniority shall be recognized for eligibility, vesting, accrual and determination of benefit levels;
- Pension and defined contribution plans – APA Section 7.2(b) – As of the closing date, the City shall (1) cause eligibility and benefit accruals under PGW's pension plan to cease, and (2) terminate PGW's defined contribution plan. UIL shall adopt a "mirror" pension plan for transferred employees and shall allow for benefit accruals under the mirror pension plan at least through May 15, 2015; and
- Other postemployment benefits ("OPEB") – APA Section 7.2(c) – UIL shall assume and maintain PGW's OPEB plan and trust to provide post-employment benefits to existing participants in PGW's pension plan and employees who become "Eligible Retirees". An "Eligible Retiree" (1) at the time of his or her retirement, is or was eligible for benefits under PGW's pension plan or UIL's mirror pension plan, and (2) upon retirement elected to receive an immediate pension benefit. The OPEB plan and post-employment benefits shall be maintained by UIL and provided to: 1) all Eligible Retirees as of Closing; 2) all employees who are or become Eligible Retirees under the terms of the OPEB plan on or before the Closing; and 3) all transferred employees who are or become eligible to receive post-retirement benefits under the terms of the OPEB plan on or before the last day of the Continuation Period as a result of service with PGW or combined service with PGW and UIL. Under Section 7.2(a)(iii) of

the APA, "Continuation Period" is defined as the period of time "as of the Closing Date and for at least until May 15, 2015." UIL cannot terminate any post-employment benefit earned by OPEB participants or in which they are vested; nor can it reduce the level of post-employment benefits provided under the OPEB plan in effect immediately before Closing or change the terms under which an employee or transferred employee becomes eligible for such post-employment benefits.

ii. Liability-related commitments. Sections 2.2 and 2.3 of the APA establish the respective responsibilities of UIL and the City for liabilities associated with PGW. These terms are described in Section X.B. The City will retain certain defined liabilities (*e.g.*, bonds and indebtedness, PGW's pension plan and defined contribution plan). UIL will be responsible for all other liabilities, including all environmental liabilities at any location, including formerly owned manufactured gas plant properties. The City will also retain liabilities for proceedings that are due to pre-closing events and that fall within the scope of the Political Subdivision Tort Claims Act of Pennsylvania ("Tort Claims Act"). Under Section 11.2 of the APA, however, UIL will indemnify the City for such costs. Concentric understands that the intent of this provision is, to the extent possible, to extend the protections of the Tort Claims Act to UIL.

iii. Rate-related transaction terms. UIL has committed to certain rate-related provisions that are found in Section 7.1 of the APA. These terms are discussed in Section X.C and include a base rate freeze through December 31, 2017, and inclusion of the PGW Senior Citizen Discount program and all current PAPUC-mandated discount programs for PGW customers in UIL's proposed initial tariff filing with the PAPUC. The rate freeze applies to base rates, but not automatic rate adjustment riders, charges and surcharges, or special or negotiated contract rates (see Appendix II for a complete list). The APA does not preclude UIL from filing for additional automatic rate adjustment riders, charges or surcharges. Also, the APA specifically provides that, during the base rate freeze period, UIL may file to recover additional costs resulting from new taxes, governmental charges or PAPUC-mandated discount programs, or seek extraordinary rate relief as allowed under the Public Utility Code. With regard to the PAPUC-mandated discount programs, it is important to note that UIL's commitment is to file them with the PAPUC for the PAPUC's approval, and to make "commercially reasonable efforts" (as defined in the APA) to have these or similar programs included in its initial rates. This commitment is limited to the initial proposed tariff filing for the PAPUC-mandated discount programs, but UIL will continue to propose the Senior Citizen Discount program in all base rate filings until there are no eligible participants.

iv. Economic Opportunity Plan. In Section 6.2 (c) of the APA, UIL committed to submit an EOP to the City "promptly following Closing." Closing will occur after approval of City Council, the Mayor, and the PAPUC and after all closing conditions have been satisfied.

v. Philadelphia presence (*e.g.*, headquarters). UIL's commitments pertaining to maintaining a presence in Philadelphia include:

- Establishing its headquarters for PGW within the City for at least three years, as set forth in Section 7.1 (d) of the APA. New Haven and Philadelphia will be the dual headquarters locations of UIL (with no time commitment specified);
- Establishing an advisory board for the PGW operations for at least three years as stated in the APA in Section 6.2 (d). A substantial majority of board members shall be residents of the City; and
- Increasing the size of UIL's board of directors by one, and, after consultation with the City, appointing to the board a person who resides in the City as discussed in Section 6.2 (e) of the APA.

UIL has also publicly stated that it will maintain PGW customer service centers and its call center in Philadelphia; however UIL is not contractually committed to these actions through the APA.

vi. Indemnification. Mutual indemnification provisions were agreed to by UIL and the City in Section 11 of the APA.

vii. Required approvals and other governmental filings. The transaction requires that PGW and UIL obtain certain standard approvals in order to close. As a first step, City Council and the Mayor must approve an ordinance that authorizes and facilitates the transaction. The form of ordinance sought is set forth in the Seller Disclosure Letter. The City may amend, revise or add to the ordinance so long as the amendments do not adversely affect UIL, and the City Administration shall consult UIL regarding any amendments and provide a copy of the ordinance to UIL before submitting it to City Council. In addition, no later than 60 days following the introduction of the ordinance in City Council, UIL and the City Administration shall file a Joint Application to the PAPUC for any required approvals by the PAPUC.

viii. "No shop" provision. Section 6.1 (h), of the APA includes a "no shop" provision in which the City has agreed not to enter into any arrangements or agreements, relating to a sale, merger or otherwise, of all or any material portion of PGW until closing. In addition, under the "no shop" provision, the City cannot knowingly disclose confidential information concerning PGW except as necessary to conduct PGW's business. Both parties agree that there may be no adequate remedy at law for a breach of the agreement and that money damages may not be appropriate and, therefore, UIL has the right to injunctive relief.

ix. Termination dates. There are a number of milestones established in Section 10 of the APA that allow UIL to terminate the APA or provide that it will terminate automatically. The first termination trigger date passed when an ordinance approving the sale was not enacted by July 15, 2014. UIL now has the right to terminate the APA at any time without penalty. To date, UIL has not terminated the contract under this provision. The APA will terminate without any action by either UIL or the City if an ordinance approving the sale has not been enacted by December 31, 2014. UIL may also terminate the contract at any time after the ordinance is enacted, if the ordinance ceases to be in full force and effect. Finally, the APA automatically terminates if closing has not occurred by March 31, 2015, although this date can be extended by up to a total of three months.

Question 8: Are the commercial terms in the APA reflective of market norms for similar transactions?

Concentric's Response: From a commercial perspective, the terms committed to by UIL in the APA are generally customary for utility merger and acquisition transactions. It is worth highlighting that:

- Most of UIL's employment-related conditions are linked to the expiration date of the current CBA, May 15, 2015. While it is customary for certain commitments to expire on a date-certain, sometimes linked to a CBA, the relatively short remaining term of the CBA means that all but the three-year employment commitment expire on May 15, 2015, rendering these commitments limited;
- The explicit assumption by UIL of all environmental liabilities is a benefit for the City. Further, that the City will retain responsibility only for those liabilities specifically identified as "Retained Liabilities" and that UIL will assume all liabilities not retained by the City could also be a benefit to the City; and
- Base rate freezes and other rate-related commitments are common in utility merger and acquisition transactions. UIL's rate-related commitments, particularly with respect to discount programs, are dependent on PAPUC approval and, with regard to programs other than the Senior Citizen Discount program, there are no contractual requirements beyond the initial tariff filing.

Question 9: Does the transaction as agreed to between the City and UIL satisfy the specific objectives and conditions placed by the City Administration on a sale of PGW? Does the transaction satisfy City Council's objectives?

Concentric's Response: Based on our review and analysis of the transaction terms, Concentric concludes that the announced transaction meets the City Administration's stated objectives to the extent such objectives can be met through a legally-binding sales agreement. Our conclusion regarding this question is qualified in that (a) the transaction has not yet closed and any conditions placed on it prior to the close, either by City Council or the PAPUC, may affect those transaction terms that are intended to meet the City's stated objectives, (b) UIL's ability to "maintain" the Senior

Citizen Discount is subject to PAPUC approval in the Joint Application and any subsequent tariff-related regulatory proceedings; and (c) UIL's commitment to the Customer Responsibility Program ("CRP") could be satisfied by commercially reasonable efforts to have some other version of this program similar in purpose approved.

It is Concentric's understanding that City Council did not have the opportunity to fully participate throughout the entire sale process. As noted in the response to Question 2, in Concentric's meetings with City Council members, a number of other considerations related to a possible sale of PGW that were not explicitly addressed in the APA were raised. Additionally, City Council's expressed interest in other management and operations alternatives for PGW was not considered.

F. Other Considerations

Question 10: What financial impact do the elimination of the franchise fee and the imposition of property and income taxes have on the City?

Concentric's Response: After a sale of PGW, the City will no longer receive the annual $18 million franchise fee. On a present value basis, Concentric has valued the foregone franchise fee at between $171 million and $200 million. The City will, however, gain new sources of revenue from a privately-held PGW, including property taxes, the Business Use and Occupancy tax, and the BIRT. The new sources of revenue from property and income taxes are forecast to be considerably less than the franchise fee.

Question 11: What other objectives, conditions and/or considerations could be examined by City Council? Are there specific commitments City Council members have sought that are not definitive or are not addressed in the APA?

Concentric's Response:

There are other public policy issues that were raised by City Council members that City Council could evaluate in its decision-making process. Those issues include, but are not necessarily limited to: 1) the continuation of PGW's customer support programs; 2) the continuation of programs not mentioned in the APA; 3) the disposition of PGW's liens on customers' properties; 4) safety considerations; 5) risks related to the liabilities retained by the City after the close of the transaction; 6) economic development and job creation; and 7) the lack of limitations on UIL's ability to sell some or all of PGW's assets in the future. As discussed in Section XI, UIL's commitments for certain of those issues after the closing of the transaction are not definitive or are not addressed in the APA. For example:

- PGW has a significant number of customers that are at or below 150 percent of the Federal poverty level and PGW employs certain programs and business practices to help those customers (*e.g.*, PGW's hardship fund). The APA does not include any provisions or state how UIL will conduct these programs and procedures in the future;
- PGW currently has approximately 89,000 liens on properties within the City for unpaid gas bills, totaling approximately $125 million. It is Concentric's understanding that PGW has a policy to defer collecting on the liens until the property is sold by its owner. These liens will be transferred to UIL at closing. UIL has stated publicly that it will not foreclose on any owner-occupied residential properties on which it has an inherited PGW lien. However, there are no such lien-related commitments in the APA[3], and the APA does not preclude UIL from selling liens to a third party for collection;
- The APA does not include commitments regarding economic development (*e.g.*, attracting and retaining new businesses) and job creation; and
- The APA does not prohibit UIL from selling any portion or all of PGW assets at any time after closing.

<u>Question 12</u>: What role will City Council have regarding the oversight and/or regulation of PGW if the sale is approved? What is the governance and regulatory structure under which a UIL-owned PGW would operate?

<u>Concentric's Response</u>: City Council's role with regard to the oversight and/or regulation of PGW will be greatly diminished or eliminated if the sale is approved. The overall governance and regulatory structure of PGW will be significantly simplified, with fewer entities having direct

[3] In a meeting with Concentric on July 31, 2014, UIL stated that it will not foreclose on any owner-occupied residential properties on which it has inherited liens from PGW.

oversight of the utility. The PAPUC will be the primary regulatory authority overseeing PGW, and will continue to have ultimate rate setting authority for PGW (see Section XI).[4]

II. Background

On March 2, 2014, UIL and the City entered into an APA pursuant to which UIL will acquire assets, including the natural gas supply, distribution, liquefaction and vaporization business and operations, including natural gas line and equipment repair and maintenance, as well as certain liabilities of PGW.

For the proposed sale to be consummated, it must be approved by City Council and the PAPUC. City Council must enact an authorizing ordinance including approval of the sale of the purchased assets by majority vote. The ordinance will become law if signed by the Mayor of Philadelphia.

Concentric was retained by City Council for two separate but related engagements: (1) to act as City Council's financial advisor for its evaluation of the proposed sale of PGW to UIL and (2) to prepare a highest and best use study of PGW.[5]

As the financial advisor to City Council, Concentric assessed: (1) whether UIL's proposed purchase price of $1.86 billion reasonably reflects PGW's value; (2) whether UIL's bid to purchase PGW, inclusive of its proposed terms, was the best bid available to the City at the time of the competitive solicitation;[6] and (3) how the proposed sale of PGW to UIL compares to continued ownership by the City with respect to finances, employment, rates, public policy, economic development, and social considerations. This report provides a summary of Concentric's assessment, as well as Concentric's responses to key questions posed by City Council.

III. Description of the Financial Advisor Assignment

The fundamental decision before City Council is whether the proposed sale of PGW to UIL is better for the citizens of Philadelphia than continued ownership by the City now and for the future.

4 The City can apply for intervener status in PGW related matters before the PAPUC.
5 Concentric's highest and best use study of PGW is contained in a separate report.
6 City Council, through Concentric, also retained Foley & Lardner LLP to review the proposed terms of the PGW/UIL transaction.

In reaching its decision, City Council should consider the myriad of financial, employment, rate, public policy, economic development, and social considerations, as well as the programs and functions that PGW currently provides as a City-owned utility.

Concentric was not retained to render its opinion on whether the proposed sale of PGW to UIL is better for the citizens of Philadelphia than continued City ownership or whether City Council should approve the proposed transaction. Rather, Concentric was retained to provide City Council with information to inform those decisions.

Our assessment specifically responds to the following questions that will be addressed in the following sections of this report:

Sale Process Overview and the City Administration's Objectives

1. What management and ownership alternatives did the City Administration consider for PGW?
2. What were the objectives and conditions placed by the City Administration on a sale of PGW? Did these objectives and conditions reflect the objectives of City Council?
3. Was the City Administration's solicitation process competitive and was its management consistent with industry standards?

Comparison of Final Bids

4. Was UIL's final bid the best proposal received through the solicitation process based on price and a high level review of the transaction terms?

Independent Valuation

5. Does the proposed purchase price of $1.86 billion reasonably reflect PGW's value?

Potential Rate Impacts

6. How might rates be impacted by a sale of PGW to UIL? How might accelerating the cast iron main replacement program impact the DSIC and costs to ratepayers?

Commercial Terms of the Proposed Transaction

7. What are UIL's contractual commitments within the APA with respect to the following, when do these commitments expire, and what happens when they do?

   i. Employment levels, wages and benefits
   ii. Liability-related commitments
   iii. Rate-related transaction terms
   iv. Economic Opportunity Plan
   v. Philadelphia presence (*e.g.*, headquarters)
   vi. Indemnification
   vii. Required approvals and other governmental filings
   viii. "No shop" provision
   ix. Termination dates

8. Are the commercial terms in the APA reflective of market norms for similar transactions?

9. Does the transaction as agreed to between the City Administration and UIL satisfy the specific objectives and conditions placed by the City Administration on a sale of PGW? Does the transaction satisfy the City Council objectives?

Other Considerations

10. What financial impact do the elimination of the franchise fee and the imposition of property and income taxes have on the City?

11. What other considerations should be examined by City Council? Are there specific commitments City Council members have sought that are not definitive or are not addressed in the APA?

12. What role will City Council have with regard to the oversight and/or regulation of PGW if the sale is approved? What is the governance and regulatory structure under which a UIL-owned PGW would operate?

Concentric's assessment will not and cannot respond to the following questions:

1. Were the objectives and conditions placed by the City Administration on a sale of PGW the appropriate objectives and conditions?
2. What are the net proceeds to the City from the proposed transaction?
3. What property or other taxes will or should be imposed on a privately-held PGW?
4. Other than the commitments contained in the APA, how will UIL perform with respect to the following:

    i. Achievement of cost savings
    ii. Acceleration of main replacement
    iii. Quality of service
    iv. Number of employees after May 15, 2015
    v. Employee benefits after May 15, 2015
    vi. Rate programs (*e.g.*, Customer Responsibility Program and the Senior Citizen Discount)
    vii. Automatic rate adjustment riders, charges and surcharges

5. Should City Council approve the proposed sale of PGW to UIL?

IV. CONCENTRIC'S DUE DILIGENCE

As part of Concentric's assessment of the transaction, we reviewed a significant amount of materials, held meetings and interviews with various stakeholders, and performed independent analyses, as described throughout this report. Figure 1, below, contains a chronological list of meetings, conference calls and activities conducted by Concentric as part of its due diligence process.

Figure 1: Concentric's Due Diligence

Date	Description
April 3, 2014	Kick-off meeting with City Council Internal Working Group and City Council
April 10, 2014 to June 30, 2014	Access to 6,000+ documents in PGW bidder virtual data room
Various	Submitted five rounds of information requests to the City Administration
April 10, 2014 to *Ongoing*	Weekly conference calls with City Council Internal Working Group
May 8, 2014	Meeting with PGW management and members of the City Administration
May 8, 2014	Meeting with Community Legal Services of Philadelphia
May 8, 2014	Meeting with City Council Internal Working Group
May 9, 2014	Meeting with UWUA Local 686
May 19, 2014	Conference call with J.P. Morgan Securities LLC ("J.P. Morgan"), Lazard Frères & Co. LLC ("Lazard"), Loop Capital Markets LLC ("Loop Capital Markets"), and members of the City Administration
May 19, 2014	Conference call with Ballard Spahr LLP, Eckert Seamans Cherin & Mellott, LLC, City Solicitor, and members of the City Administration
May 29, 2014	Follow-up conference call with Lazard and members of the City Administration
June 11, 2014	Conference call with PGW's Chief Financial Officer ("CFO") and Chief Operating Officer ("COO") and members of the City's Administration
June 16, 2014	Meeting with City Council Internal Working Group
June 16, 2014	Meeting with City Council President and Councilwoman Tasco
June 17, 2014	Meetings with City Council members and staff
July 31, 2014	Meeting with UIL and members of the City Administration
July 31 and August 1, 2014	Meetings with City Council Internal Working Group
July 31 and August 1, 2014	Meetings with City Council members and staff

V. OVERVIEW OF PGW

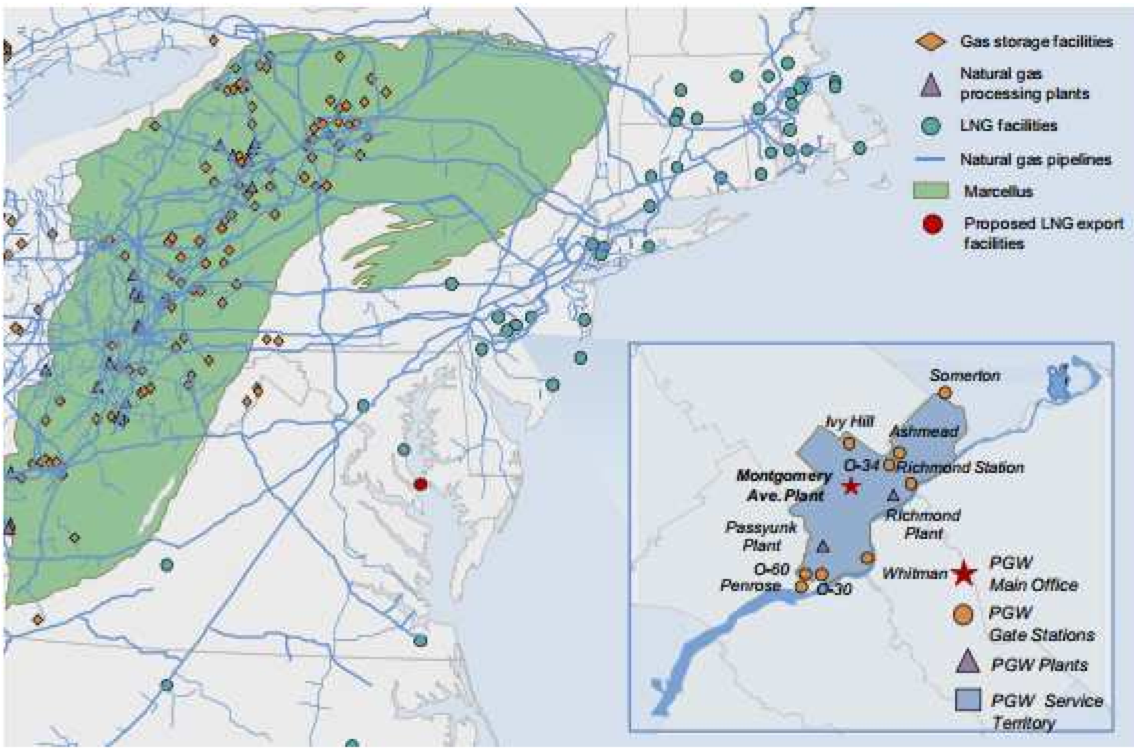
A. Summary Description

PGW is the largest municipally-owned natural gas LDC in the United States, serving the City of Philadelphia, which has over 1.5 million residents. PGW currently owns, operates and maintains a distribution system of approximately 3,030 miles of natural gas mains, 465,966 service lines and 207 regulator stations. PGW operates two facilities for the liquefaction, storage, and vaporization of natural gas. These facilities have a combined storage capacity of approximately 4.3 billion cubic feet ("Bcf") of liquefied natural gas ("LNG"), the ability to liquefy up to 16 million cubic feet per day

("MMcf/day") of natural gas and eight vaporizers with over 550 MMcf/day of LNG vaporization capacity. PGW's natural gas supply is taken directly from two interstate natural gas pipelines (*i.e.*, Texas Eastern Transmission LP and Transcontinental Gas Pipe Line Company, LLC) and storage. PGW does not have any natural gas production facilities and has approximately one mile of transmission lines.

Figure 2 provides an overview of PGW's service area and key infrastructure.

Figure 2: Service Area and Key Infrastructure[7]



PGW serves over 512,000 customers, most of which are residential customers that make up approximately 95 percent of all PGW customers by number of accounts and contribute approximately 74 percent of total operating revenue.[8] A combination of commercial, industrial, municipal and housing authority customers make up the remaining five percent of accounts and 26 percent of revenue. For reference, the most recent three years of PGW's historical income statements and balance sheets can be found in Appendix I.

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7 Philadelphia Gas Works Teaser, August 2013, at 3.
8 As of December 31, 2012. Philadelphia Gas Works Teaser, August 2013, at 3.

PGW employs approximately 1,600 people. Since 1983, PGW employees are required to be Philadelphia residents. Approximately 70 percent of those employees are members of UWUA Local 686 while the remaining 30 percent are non-union. 413 employees will be eligible for retirement by December 2014.[9] The current CBA with union workers expires on May 15, 2015.

If the proposed transaction is approved by City Council and closes, it will have the effect of considerably increasing the size of UIL's operations. Figure 3 shows that with the addition of PGW, UIL's revenues and natural gas sales will double and its number of customers will almost double.

Figure 3: Stand Alone PGW vs. UIL Merged Utility

	PGW Stand Alone FY 2013 Annual Report	Merged UIL[10] (gas LDCs only)
Revenues ($000)	688,000	1,556,000
Customers	506,467	899,062
Sales (Mcf)	73,340,091	147,554,248
Employees	1,633	2,395
Miles of Pipe	3,024	8,071

B. Oversight

PGW is managed by the Philadelphia Facilities Management Corporation ("PFMC"), a not-for-profit corporation, pursuant to an agreement between the City and PFMC. Various aspects of oversight of PGW are performed by the Philadelphia Gas Commission ("PGC"), which consists of the City Controller, two members appointed by City Council and two members appointed by the Mayor. In addition, certain activities and transactions require authorization of City Council. Since 2000, rate setting authority for PGW resides with the PAPUC.

9 Gas Commission Hearing Transcript, July 23, 2014, at 218.

10 Revenues, customers, volumes, and employees from documents filed with the Massachusetts Department of Public Utilities and the Connecticut Public Utilities Regulatory Authority. Miles of pipe from UIL's Form 10-K for the fiscal year ended December 31, 2013.

C. Rates

PGW's rates are made up of a base component (*i.e.*, base rates) as well as a number of rate adjustment riders, charges and surcharges. In accordance with City ordinances and state law, PGW follows a "cash flow" methodology of developing rates that is intended to provide adequate revenues to cover PGW's operating expenses and debt service obligations, as well as to meet certain bond covenants, including debt coverage requirements. In setting rates, the PAPUC also considers other factors, including PGW's ability to fund its construction programs, the amount of debt PGW has as a ratio of its total sources of funds, PGW's access to capital and its ability to maintain its bond ratings and service quality. Lastly, PGW's rates are also set to allow for recovery of the $18 million annual base payment (also referred to as the "franchise fee") paid to the City.

PGW's tariff contains the various mechanisms through which PGW recovers its costs (discussed below). The base rates contained in PGW's tariff are fixed until such time as the PAPUC approves a change in base rates. There are several rate classifications that apply to different types of customers, including: 1) residential; 2) senior citizens; 3) municipal; 4) Philadelphia Housing Authority; 5) commercial; and 6) industrial. The last base rate change was approved by the PAPUC in 2010. Other mechanisms in PGW's tariff allow for more regular adjustments to portions of PGW's rates and charges to reflect changes in underlying costs. The most significant of those mechanisms from a cost perspective is the Gas Cost Rate ("GCR"), since natural gas is PGW's largest expense (*i.e.*, $255.5 million of $532.9 million in total operating expenses in 2013).[11] PGW recovers its natural gas costs on a dollar-for-dollar basis through quarterly adjustments (either increases or decreases) to the GCR. Other riders, adjustment mechanisms, and surcharges included in PGW's tariff include:

- An Efficiency Cost Recovery Mechanism ("ECR") that recovers approved energy efficiency program costs;
- A Universal Service and Energy Conservation ("USEC" or "USS") Surcharge that recovers: (1) discounts provided to customers pursuant to the CRP; (2) discounts provided to customers pursuant to the Senior Citizen Discount; (3) the costs of the Conservation Works Program ("CWP") and the Enhanced Low Income Retrofit Program ("ELIRP"); and (4)

[11] PGW 2013 Comprehensive Annual Report, at 68.

past due arrearages forgiven pursuant to the CRP/Customer Assistance Programs ("CAP") Program Design Stipulation for customers entering the CRP on or after September 1, 2003;

- An OPEB Surcharge that recovers the amounts necessary to fund PGW's OPEB obligations;
- A Weather Normalization Adjustment ("WNA") Clause that results in a positive or negative adjustment to rates depending on whether the heating season was colder or warmer than the normal heating season defined in the last base rate proceeding; and[12]
- A DSIC that recovers the reasonable and prudent costs incurred to repair, improve, or replace eligible property that is completed and placed in service and recorded between rate cases and to provide PGW with the resources to accelerate the replacement of aging infrastructure.

Appendix II contains a complete list of PGW's automatic rate adjustment riders, charges and surcharges, and, for reference, Appendix III provides PGW's base rate classes, as contained in PGW's tariff.

D. Customer Support Programs

PGW has programs in place that are primarily designed to respond to the needs of its low-income and senior citizen customers. As noted above, subsidies provided to low-income and other customers are recovered by PGW from other customers through the USEC and ECR mechanism as well as through base rates. Descriptions of PGW's main customer programs are provided in the figure below:

12 PGW is one of only two LDCs in Pennsylvania that have a PAPUC-approved WNA in effect. See Philadelphia Gas Works Teaser, August 2013, at 4.

Figure 4: PGW's Customer Programs (FY 2014 Projections)[13]

Program	Description	Cost of program	# of Customers	Rider/ Surcharge/ Adj. Mechanism
Customer Responsibility Program	CAP under which customers with household income at or below 150% of the Federal poverty level who meet other qualifications receive a discounted monthly bill based on 8%, 9%, or 10% of income.	$67.0 million	76,042	USEC
Senior Citizen Discount	A 20% reduction in monthly charges for gas service for senior citizens who satisfy certain conditions. This program was closed to new entrants in 2003, but participants at that time were "grandfathered" into the program.	$6.2 million	23,000	USEC
Customer Assistance and Referral Evaluation Services Program ("CARES")	PGW's CARES program is designed to assist customers experiencing temporary hardships affecting their ability to pay their gas bill.	$827,000	3,000	Base rates
Demand Side Management ("DSM") Portfolio (Energy Sense)[14]	Includes six programs that include rebates, retrofits, and financial incentives for PGW's residential, commercial and industrial customers (DSM program includes ELIRP, but ELIRP is recovered through a different surcharge)	$3.0 million	5,879	ECR
Enhanced Low Income Retrofit Program (formerly CWP)	Energy usage reduction and weatherization program for CRP customers. Participation is mandatory.	$7.5 million[15]	2,185[16]	USEC
Utility Emergency Services Fund ("UESF", or the "Hardship Fund")	PGW provides hardship funds by matching grants paid by UESF on behalf of low-income customers whose service is terminated or threatened to be terminated.	$1.2 million	2,000	Base rates

13 This figure uses fiscal year 2014 projections contained in PGW's June 1, 2013 Universal Service and Energy Conservation Plan 2014-2016, unless otherwise noted.

14 Demand Side Management Program, Annual Report, FY 2013 Results, PGW, January 2, 2014, at 2 (excludes "Portfolio-wide Administrative Costs" and "Participant Costs").

15 Response to Public Advocate's data request PA-OB-65 regarding the Fiscal Year 2015 Operating Budget proceeding.

16 *Ibid.*

The degree to which these programs are addressed in the APA is discussed further in Section X.C. and XI of this report.

VI. SALE PROCESS OVERVIEW AND CITY ADMINISTRATION'S OBJECTIVES

This section answers the following questions:

Question #1: What management and ownership alternatives did the City Administration consider for PGW?

Question #2: What were the objectives and conditions placed by the City Administration on a sale of PGW? Did these objectives and conditions reflect the objectives of City Council?

Question #3: Was the City Administration's solicitation process competitive and was its management consistent with industry standards?

A. Strategic Assessment Phase

Leading up to the RFP process that resulted in the proposed sale of its PGW assets to UIL, the City Administration sought to consider management and ownership alternatives for PGW. In 2010, the City Administration hired Lazard to help evaluate the City's strategic options for PGW. Lazard was asked to provide valuation, financial, analytical and technical services for the independent assessment of the feasibility and consequences of transferring ownership and/or operation of PGW to a private entity through a sale or long-term lease and to consider certain financial, social, and public policy criteria when conducting the assessment.

Lazard reviewed the following potential management and ownership alternatives for PGW:[17]

- "Enhanced" status quo (*i.e.*, continued City ownership of PGW with enhancements to its operation);

17 Lazard's Strategic Assessment (February 2012), at 17.

- Strategic sale to a private operator/consortium;
- PPP in the form of a long-term lease to a private operator/consortium, with the City maintaining ownership;
- IPO in which PGW's shares are listed on a public stock exchange; and
- Management services agreement, under which the City maintains ownership and enters into a contract with a third party contractor.

In its February 2012 Strategic Assessment, Lazard recommended that the City pursue a strategic sale of PGW:

> … Lazard believes that a privatization via strategic sale would likely meet or exceed the City's estimate of its PGW-related Liabilities, while also meeting the City's stated policy criteria (i.e., preserve current social programs). Based on feedback from the Market Sounding process and general observations of the broader current M&A environment in the Power & Utilities sector, a strategic sale appears to be both feasible and likely to result in a higher value to the City relative to other privatization structures, such as a PPP or IPO. In Lazard's estimation, the benefits of a privatization transaction would also likely exceed the present value of the $18 million annual payment currently forecasted to be made from PGW to the City. These benefits include potential excess transaction proceeds received by the City, a portion of future tax payments collected by the City from a privatized PGW, reduced ongoing financial and operating risk, and qualitative benefits related to reallocating administrative resources toward other City operating priorities.[18]

In making this recommendation, Lazard further stated:

> A successful privatization of PGW would require that the City develop a plan to build broad support from the City Council, City Administration, Commonwealth Offices, the PA PUC and PGW Management. Such support is critical to convincing potential acquirers that a sale process would be a worthwhile allocation of time and resources. A privatization process should also incorporate a comprehensive strategy addressing the concerns/positions of each PGW stakeholder (e.g., ratepayers, City taxpayers, unions, PA PUC, Buyer, etc.).[19]

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18 *Ibid.*, at 4. In that report, Lazard provided a valuation range for PGW of $1.15 billion to $1.85 billion, dependent on the terms of the transaction and post-merger cost savings. PGW-related liabilities were estimated at between $1.0 billion and over $1.4 billion.

19 *Ibid.*, at 7.

B. *Lazard's Cost/Benefit Analysis – October 2013*

As a follow-up to the February 2012 Strategic Assessment, the City Administration and PGW retained Lazard again in September 2012 to provide an independent Cost/Benefit Analysis of the financial costs and benefits of proceeding with a sale. Lazard's Cost/Benefit Analysis was released in October 2013. The report included a financial analysis of the potential impact of a sale on various future annual taxes that would be collected by the City from a private entity relative to the $18 million annual franchise fee that the City currently receives. Lazard's Cost/Benefit Analysis concluded that:

- PGW's enterprise value was between $1.45 billion and $1.90 billion;
- Additional benefits to the City of a sale of PGW included between $11 million and $17 million of total expected future tax receipts (on a present value basis);
- The present value of the foregone franchise fee resulting from the sale of PGW to a privately-held entity was between $124 million and $155 million;[20]
- Estimated costs to the City of a sale of PGW, including the unrealized net present value of the annual franchise fee, were approximately $1.20 billion; and
- The projected net sale proceeds were thus estimated to be between $422 million and $872 million.[21]

C. *PGW Sale Process*

In late 2012, the City Administration announced its intention to initiate a competitive solicitation process pursuant to which it would seek proposals for the sale of PGW. Subsequently, the City Administration issued an RFP seeking advisors for the competitive solicitation. J.P. Morgan and Loop Capital Markets (together, referred to herein as the "Brokers") were hired by the City in the spring of 2013 to act as the City's brokers with respect to the sale of PGW.

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20 Lazard valued the franchise fee as a perpetual dividend to the City, and thus calculated a range of present values for the future stream of franchise fee payments using a range of costs of equity. For further analysis regarding the value of the franchise fee to the City, see Section XI of this report.

21 Philadelphia Gas Works Cost/Benefit Analysis, October, 2013, at 4.

In August 2013, the Brokers launched the sale process with a "teaser letter" and a Request for Qualifications ("RFQ") sent to approximately 153 parties. At that time, members of the City Administration and the Brokers met with some City Council members to describe the process. 33 parties submitted qualifications and 32 parties were qualified in the sale process.

The sale process was structured as a two-stage auction with bidders submitting their indicative bids in round one and, for those who were qualified by the Brokers to enter the second stage, a final bid for the purchase of PGW following detailed due diligence. In late September 2013, the indicative bid stage was launched and the Brokers provided qualified bidders with a Confidential Information Memorandum, a "broker model" (*i.e.*, a Microsoft Excel-based spreadsheet to assist bidders with assessing PGW's financial results under private ownership), and a process letter. On November 1, 2013, 11 indicative bids were received and nine other parties indicated that they would be interested in partnering with a participant in the second stage of the process where detailed due diligence could be undertaken by bidders. Seven parties were "short listed" and invited to participate in the second stage of the sale process in which bidders visited PGW and met with PGW's management. Bidders also had access to a virtual data room containing over 6,000 documents with key materials related to the financials and operations of PGW. Five bidders were active participants in the second stage of the sale process while two of the original "short listed" parties withdrew from the process. Final bids were received from the five active bidders on January 31, 2014 and ranged from approximately $1.4 billion to almost $1.9 billion.

The City and its Brokers used the enterprise value range provided by Lazard in its October 2013 Cost/Benefit Analysis to evaluate the final bids. The Brokers also compared bids to one another, seeking the highest price and the best terms for the City. Based on that comparison, the lowest of the five bidders was excluded from further participation in the process. Bid negotiations with the remaining four bidders took place in February 2014. On February 24, 2014, the City selected UIL as the winning bidder and on March 3, 2014 the City announced that it had signed an agreement to sell the PGW assets to UIL.

UIL's winning bid included a gross purchase price of $1.86 billion for the assets of PGW, which will be adjusted based on the balance of net current assets at closing.[22] Concentric understands that the net proceeds derived from the proposed sale of PGW (*i.e.*, the proceeds to the City after PGW's debt is defeased, PGW's unfunded pension liability is funded, and other costs of the transaction to the City are accounted for) are an important consideration in an overall assessment of the transaction. The City has provided an estimate of the net proceeds available to be deposited into the City's pension fund.[23] For informational purposes, Figure 5 provides a list of expenses per the City Administration's analysis that are expected to be deducted from the gross purchase price of $1.86 billion to arrive at the net proceeds. Concentric has not evaluated or independently verified the data provided in Figure 5.[24]

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22 In general, net current asset balances (*i.e.*, "working capital," which is current assets less current liabilities) can be expected to change between the signing of a transaction and its closing. That is because the seller must continue to operate its business prior to closing, and items such as cash, accounts receivable, and accounts payable vary from month to month. Working capital adjustments are typical terms in corporate transactions, and are intended to reimburse the seller for the final amount of working capital it has on its books at the time of closing. Such adjustments are also intended to be "value neutral," in that if the seller builds up working capital between the signing and closing of a transaction, it will be reimbursed for such a buildup on a dollar for dollar basis, whereas, if the seller depletes working capital between the signing and closing of a transaction, it will receive less in purchase price on a dollar for dollar basis. UIL's final bid assumes a cash balance of $0 and a working capital balance of $175 million at closing. To the extent the final working capital amount at closing differs from $175 million, the City will receive either more (if working capital exceeds $175 million) or less (if working capital is less than $175 million) in cash. For reference points, the average monthly working capital balance was $168.2 million and $170.5 million in fiscal years 2013 and 2012, respectively.

23 Presentation to PICA on the sale of PGW to UIL Holdings, Inc. (*sic*), May 20, 2014.

24 Concentric did, however, request the City Administration's assumptions that are reflected in the high and low end working capital adjustment figures. In response, the City Administration provided its most recent PGW net current asset value calculation, which assumed a March 2015 closing. The City Administration explained that PGW has a cyclical business that results in greater net current assets in December through March compared to other months in the fiscal year. That increase during those months is driven by customer accounts receivable and materials and supplies, including PGW's gas inventory, offset by accounts payable. The City Administration further explained that it used March 2013 as the starting point for its analysis of the likely range of working capital adjustments. The City Administration used March 2013 to reflect normal weather and collection patterns, and it also assumed that the delayed payments resulting from the cold 2013/2014 heating season would be "caught up" by March 2015 (*i.e.*, the assumed closing date). The City provided data that showed that PGW's net current assets were $211.832 million in March 2013 (*i.e.*, $36.8 million higher than the $175 million assumed in the transaction with UIL). However, net current assets were only $185.016 million in March 2014. Per the City Administration, the "upside" of $25 million was thus conservative when compared to March 2013 actual net current assets. The downside adjustment of -$10 million was based on the City Administration's assumption of $20 million below the March 2014 net current asset figure of approximately $185 million. Finally, the City Administration noted that if the transaction closes beyond March 2015, net current assets will likely be below $175 million based on historical results, but this would only be the case until the customary cyclical point where net current assets typically increase again.

Figure 5: Use of Proceeds ($ millions)

	Low	High
Purchase Price	$1,860	$1,860
Working Capital Adjustment	($10)	$25
Net Purchase Price	$1,850	$1,885
Less Debt Defeasance[25]	($930.82)	($888.22)
Less Closing Costs	($16.19)	($14.14)
Less Unfunded PGW Pension Liability	($271.99)	($224.24)
Less FY 2015 and FY 2016 Franchise Fee	($36.0)	($27.0)
Less Reserves	($175.0)	($100.0)
Net Proceeds Available for City Pension Fund Deposit	**$420.0**	**$631.4**

While the City Administration estimates that between $420.0 million and $631.4 million will be available for deposit into the City's pension fund, the final amount of any deposit will not be known until the proposed sale of PGW to UIL closes and the various adjustments and costs have been ascertained.

D. City Administration's Sale Objectives

In the RFQ provided to bidders in August 2013, the City Administration articulated certain overarching objectives for a sale of PGW.[26] These included:

- The City desires to sell substantially all of PGW if, and only if, the best terms obtainable from a responsible bidder are beneficial in the long term to the City; and

25 Debt defeasance costs are net of PGW's cash balance as of the closing date. The "low" and "high" amounts apparently indicate that cash balances will likely be lower or higher (thereby leaving a greater or lesser amount of debt to be defeased using sale proceeds), depending upon the exact date of closing. PGW's historical financial statements indicate that cash balances are often higher in the same months of the year in which working capital amounts are at their lowest.

26 The City Administration's objectives were also included as assumptions in both Lazard's Strategic Assessment (February 2012) and Cost/Benefit Analysis (October 2013).

- The City expects that any ultimate purchaser of PGW will have the financial capacity and operational experience necessary to finance, acquire, operate, and maintain PGW as a natural gas distribution company under the Natural Gas Choice and Competition Act, 66 Pa. C.S. Sections 2201 et seq, including operating the system in a prudent, safe, efficient, and responsible manner that serves the City and PGW's customers at a reasonable cost.[27]

In addition, five specific objectives and conditions were articulated in the RFQ:

1. Maintain the Senior Citizen Discount program in its current form and all PAPUC-mandated discount programs;
2. Implement a base rate freeze for a mutually agreed-upon period of time;
3. Honor the CBA in place at the time of sale closing;
4. Maintain PGW headquarters in Philadelphia and a specified minimum number of employees in Philadelphia for at least three years; and
5. Satisfy liabilities for PGW-related pensions and for OPEB (management and funding), as applicable, including maintaining dedicated trust funds for any PAPUC-granted rate recovery of employee benefits.[28]

It is Concentric's understanding that various City Council members, and other stakeholders, were briefed during the City Administration's sale process, but did not have the opportunity to fully participate throughout the entire process. As noted in the response to Question 2, in Concentric's meetings with City Council members and their staff, a number of other considerations or objectives for a possible sale of PGW and other considerations that were not explicitly addressed in the APA were raised. (See Figure 6, below, for a summary of the considerations raised in these meetings). Additionally, City Council's interest in other management and operations alternatives for PGW was not considered in the City Administration's sales process. Where an (*) is noted, this indicates that this objective was either considered in the Lazard strategic assessment or addressed in the APA, but does not purport to assess or opine on whether all of City Council's interests were fulfilled or not.

27 Request for Qualifications, August 2013, at 1.
28 *Ibid.*

Figure 6: Summary of City Council's Considerations

Economic and Financial Objectives	Workforce and Employment Objectives
Economic and Financial Objectives 1. Maximize proceeds (*) 2. Minimize costs and customer rates (*) 3. Annual revenues to City (franchise fees, taxes) (*) 4. "Upside potential" to City (including margin enhancement) 5. Funding PGW pension and OPEB obligations (*)	***Workforce and Employment Objectives*** 1. Job preservation (*) 2. Continuity of benefits/wages (*) 3. Retention of workforce (*) 4. Job creation 5. Training and development of sustainable workforce (*e.g.*, high school and vocational school partnerships) 6. Preservation of current CBA (*)
Social and Public Policy Objectives 1. Continuation of existing discount programs (*) 2. Continuation of existing hardship fund and energy efficiency programs 3. Offering additional programs (*e.g.*, targeting economic development) 4. Collections and shut off policies 5. EOP (*) 6. City's economic development (*e.g.*, supporting Philadelphia becoming an "energy hub")	***Risk-Related Objectives*** 1. Transfer operating risks (*) 2. Retention of institutional knowledge (impact of possible mass retirement) 3. Manage liability exposure (*e.g.*, pensions and OPEBs, environmental) (*)
Safety and Operational Objectives 1. Preserve safety standards 2. Cast iron main replacement management (*e.g.*, rate of replacement versus costs to replace, disruption, safety) 3. Gas supply and other pipeline infrastructure improvements (as means of reducing costs, attracting business to Philadelphia, creating jobs)	***Governance/Oversight and Other Objectives*** 1. Maintaining breadth of governance/oversight, including City Council involvement 2. Maintaining presence in Philadelphia (*e.g.*, headquarters) (*) (customer service / call centers and employee residency were not addressed in APA) 3. If sale, Philadelphia representation in acquirer's business (*e.g.*, Board) (*) 4. Comparative benefits of alternative ownership structures other than a sale (*)

The specific terms of the APA pertinent to these objectives are described in more detail in Sections X and XI of this report.

Question #1: What management and ownership alternatives did the City Administration consider for PGW?

Response to Question #1: The City Administration's February 2012 Strategic Assessment identified five alternatives: (1) enhanced status quo, (2) strategic sale, (3) PPP in the form of a long-term lease; (4) IPO; and (5) managed services agreement. The City Administration's RFP solicited proposals for the sale of PGW only. Specific proposals for any other alternatives were not sought by the City Administration.

Question #2: What were the objectives and conditions placed by the City Administration on a sale of PGW? Did these objectives and conditions reflect the objectives of City Council?

Response to Question #2: As noted in Section VI.D, above, the City Administration stated that it (1) desired to sell PGW only if the best transaction terms obtainable from a responsible bidder are beneficial to the City in the long-term, and (2) the purchaser of PGW has the experience necessary to, among other things, operate PGW in a prudent, safe, efficient, and responsible manner that serves the City and PGW's customers at a reasonable cost. The City Administration also sought to maintain in its current form the Senior Citizen Discount program and all PAPUC-mandated discount programs and implement a base rate freeze for a to-be-agreed-upon period of time. The City Administration required that a purchaser honor the CBA in place at the time of closing and maintain PGW's headquarters and a specified minimum number of employees in Philadelphia for at least three years. Finally, the City Administration required that a transaction satisfy liabilities associated with PGW's pension and OPEB liabilities, including maintaining dedicated trust funds for any PAPUC-granted rate recovery of employee benefits.

It is Concentric's understanding that some City Council members were briefed during the development and management of the City Administration's solicitation process. It is unclear if all of City Council's objectives and conditions were considered. As noted in Figure 6, above, during Concentric's review, City Council members have raised a number of other considerations, not all of which were addressed in the City Administration's RFP or by the terms of its proposed sale of PGW to UIL.

Question #3: Was the City Administration's solicitation process competitive and was its management consistent with industry standards?

Response to Question #3: The City Administration's solicitation process and its management of that process as summarized above were consistent with industry standards and provided for a competitive auction. In Concentric's opinion, the sale process was reasonable and meets our expectation for an appropriate approach to market and sell a regulated LDC.

VII. HIGH-LEVEL COMPARISON OF FINAL BIDS

This section answers the following question:

Question #4: Was UIL's final bid the best proposal received through the solicitation process based on price and a high level review of the transaction terms?

On March 11, 2014, the City Administration provided City Council with a high-level comparison of the four final bids that were received for the purchase of PGW. This document is reproduced in Appendix IV. Figure 7 shows the final purchase prices submitted by each of the four bidders.

Figure 7: Final Purchase Price Comparisons ($ billions) [29]

	Bidder 1 (UIL)	Bidder 2	Bidder 3	Bidder 4
Purchase Price[30]	$1.860	$1.836	$1.720	$1.700

Note: The identities of Bidders 2, 3, and 4 are confidential.

Concentric has confirmed that by the end of the negotiation process, UIL offered the highest purchase price for PGW. Additional considerations include UIL's minimum employment commitment of 1,350 employees for three years, as described further below, which was the highest workforce level proposed by any of the final bidders. Concentric also reviewed the comparison matrix of bidders' proposed modifications to the APA that was initially prepared by the City Administration. Concentric has confirmed that UIL's proposal compared favorably with the proposals of the other final bidders in terms of the nature and amount of proposed changes to the City's APA. Also, as discussed in more detail in Section X.J, the Mayor has stated that the proposed transaction meets the City's specific objectives for a sale of PGW.

29 Letter from the Mayor's Office to City Council President Clarke, March 11, 2014, at 6.
30 All bids assumed a net current asset balance of $175 million at closing except for Bidder 4 who did not explicitly define its net current asset assumption.

Question #4: Was UIL's final bid the best proposal received through the solicitation process based on price and a high level review of the transaction terms?

Response to Question #4: Based on Concentric's review of the transaction materials and the transaction terms analysis developed by the City Administration, Concentric concludes that UIL's final proposal was the best bid received.

VIII. INDEPENDENT VALUATION

This section answers the following question:

Question #5: Does the proposed purchase price of $1.86 billion reasonably reflect PGW's value?

To assist City Council in its review of the proposed sale, Concentric performed a valuation analysis of PGW. The purpose of this analysis is to establish an independent valuation of PGW in order to assess the bids received and whether they were reasonably indicative of PGW's value. In developing our overall opinion of value, Concentric considered the results of three valuation methodologies: (1) a discounted cash flow ("DCF") analysis; (2) a comparable transactions analysis; and (3) a comparable trading multiples analysis.

The underlying theory supporting the DCF analysis is that the value of an asset today is equal to the sum of all future cash flows generated by the asset, discounted to a present value at the investor's cost of capital. Therefore, the DCF analysis performed by Concentric evaluated forecasted revenues, costs, and cash flows for PGW using assumptions applicable to a privately-held natural gas utility and based on data that was approximately contemporaneous with the sales process period. In performing the DCF analysis, Concentric evaluated multiple scenarios and considered different levels of cost savings that may be achievable after the potential sale to a privately-held utility. Those scenarios included the "Moderate Synergies Case" and "Industry Benchmark Synergies Case" used by Lazard in its Cost/Benefit Analysis. In those two cases, cost savings were forecasted based on levels of achievable savings announced in other utility mergers (note, potential cost savings under UIL ownership are further discussed in Section IX, as well as in Appendix V).

The comparable transactions and comparable trading multiples analyses are examples of relative valuation methods by which the value of an asset today is established by reference to the value of other, comparable assets. Details of Concentric's valuation approaches are described in more detail in Appendix V.

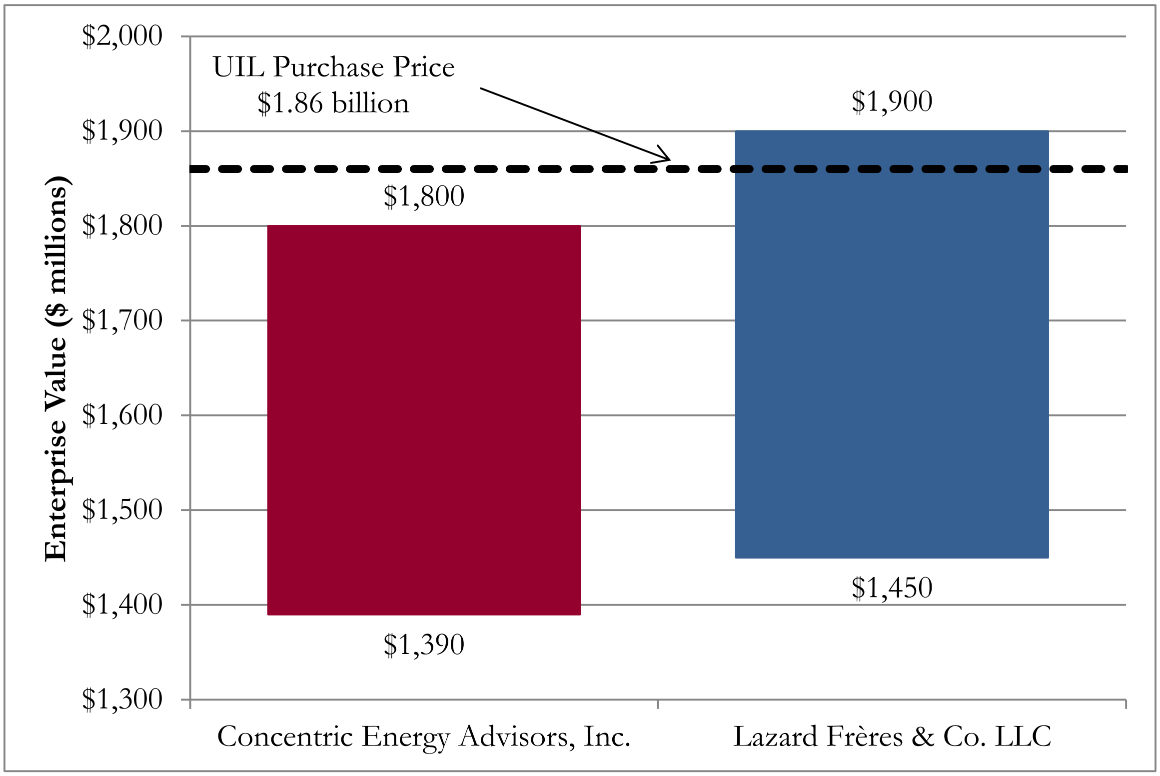
To establish a range of values for PGW, Concentric considered the results of all three approaches outlined above, but gave greater weight to the DCF results because that model most directly accounts for the specific forecasted performance of the asset being valued. Concentric further placed greater emphasis on the "Moderate Synergies Case" for the reasons discussed in Section IX. Based on our overall analysis, Concentric concluded that the value of PGW as of August 31, 2014 is between \$1.39 billion and \$1.80 billion. That range is moderately to slightly below the proposed purchase price of \$1.86 billion, and it generally overlaps with the valuation range provided by Lazard. Figure 8 presents a graphical comparison of Concentric's valuation range to Lazard's valuation range as of October 2013 and UIL's proposed purchase price of \$1.86 billion. Based on its independent valuation, Concentric concludes that UIL's purchase price of \$1.86 billion for PGW is reasonably reflective of PGW's value. While Concentric did not review UIL's specific valuation assumptions,[31] we identified the following factors that likely contributed to the purchase price offered by UIL being at the higher end of the range of analytical results:

- The sale process was highly competitive leading bidders to price their proposals more aggressively than under a low competition scenario;
- UIL may anticipate cost savings toward or above the upper range of those announced in other utility mergers (*i.e.*, 28.0 percent) based on the specific circumstances of both UIL and PGW;
- UIL may have identified additional value that it expects will be achievable from expansion opportunities such as off-system LNG sales;[32] and
- Other merger benefits, such as geographical and regulatory diversity, also likely represent sources of value for UIL that it priced into its purchase offer.

31 In competitive auctions, bidders do not typically disclose the specific financial modeling assumptions supporting their bids, as such disclosures would reduce competitive positioning.

32 Please see Concentric's highest and best use study for an analysis of PGW's LNG facilities and associated expansion opportunities.

Figure 8: Valuation Comparison



<u>Question #5</u>: Does the proposed purchase price of $1.86 billion reasonably reflect PGW's value?

<u>Response to Question #5</u>: Yes. Concentric concludes that the proposed purchase price of $1.86 billion reasonably reflects PGW's value.

IX. POTENTIAL RATE IMPACTS

This section answers the following question:

<u>Question #6</u>: How might rates be impacted by a sale of PGW to UIL? How might accelerating the cast iron main replacement program impact the DSIC and costs to ratepayers?

A. Rate Setting Differences Between Municipal and Private Ownership

The approach to developing rates for a privatized PGW will change from that of a municipally-owned PGW. As described above, PGW currently follows a cash flow methodology of developing rates. Under a privately-held utility model, however, rates are typically set to allow the utility an opportunity to earn its authorized return on equity ("ROE"). Specifically, rates for a privately-held utility are designed to reflect the underlying costs of providing utility service, including its cost of capital (*i.e.*, its ROE and cost of debt) to fund its operations. This is referred to as the "cost-of-service" basis of ratemaking. The costs to be recovered by a regulated, privately-held utility typically include operations and maintenance ("O&M") expenses, administrative and general ("A&G") expenses, depreciation expense on capital investment, non-income taxes (*e.g.*, property taxes), Federal, state, and local income taxes, and the cost of capital (*i.e.*, the cost of equity and the cost of debt, each weighted by their proportional share of the utility's total capital structure). In addition, there are certain costs that a privately-held PGW will no longer bear, either because of its status as a non-City-owned utility (*e.g.*, the franchise fee, which is discussed in more detail below, is not applicable to UIL) or due to the commitments made in the APA (*e.g.*, the City's retention of the PGW pre-close pension liabilities means UIL will longer bear costs related to that obligation).

The following figure summarizes the ratemaking methodologies for rates charged by PGW under municipal ownership and the rates typically charged by a privately-held LDC.

Figure 9: Ratemaking Methodologies: Municipal versus Private Ownership

	Municipal	Investor Owned Utility
Primary Basis for Rates	• Cash flow based • Rates set to provide adequate cash flow to meet debt service coverage requirements • Rates also set to cover O&M and depreciation expenses, as well as the costs of capital improvements, retirement of debt and working capital requirements	• Cost of service based • Rates set to provide the utility with the opportunity to earn its authorized ROE • Specifically, rates set to provide adequate revenues to provide utilities the opportunity to recover their costs of providing regulated service, including the cost of capital to fund investments and operations
Other Considerations for PGW	The PAPUC also considers the following in setting PGW's rates under City ownership • PGW's non-borrowed cash balances • Short term borrowing capacity and internal generation of funds to fund construction • Bond ratings, and comparable debt to equity ratios and financial performance • Comparable levels of expenses • PGW's management quality, efficiency and effectiveness • Service quality and reliability • Effect on universal service[33]	Many of the considerations the PAPUC has for a City-owned PGW will remain the same for a privately-held PGW • The PAPUC may consider the items listed under Municipal Other Considerations either implicitly or explicitly, when authorizing rates for PGW • Certain PGW costs will no longer be incurred by a private buyer: o Franchise fee o Pre-closing pension expense

Currently, PGW funds its capital investment program and operations through a combination of debt and internally-generated funds. A privately-held PGW will also rely on those sources of funds, but also will access capital from the equity markets. The figure below provides a further description of the cost of external capital for investor-owned utilities.

33 September 14, 2011 PGW bond prospectus, at 44.

Figure 10: Investor-Owned Utility Sources of Capital

Debt	Equity
• The cost of debt represents interest payments to creditors, and is typically reflected in rates at the utility's embedded cost of debt. • Debt is typically provided at a lower cost than equity, but a utility cannot fund its entire operations and capital improvement programs solely with debt. Such a financing structure would place a greater cash burden on the utility, harm its credit metrics, and lower its credit ratings (all else being equal). • Payments to debt holders are tax deductible by the utility, creating a lower effective cost to the utility.	• The cost of equity represents the return required by equity shareholders in order to provide their capital to the utility. • Equity shareholders' claims on the company are subordinate to those of debt providers, and equity participants hold residual risk in the company. The cost of equity is therefore typically greater than the cost of debt. • Payments to equity holders are not tax deductible by the utility, creating a greater effective cost to the utility.

B. Potential Rate Impacts of the Proposed Transaction

Likely rate impacts of the proposed transaction fall into three categories: (1) base rate impacts; (2) additional costs resulting from new taxes, governmental charges, or PAPUC-mandated service programs; and (3) rider and adjustment mechanism rate impacts.

i. Base Rate Impacts

The exact timing, size, and construct of any base rate filing made by a privatized PGW after the three-year base rate freeze cannot be known at this time. It can be expected, however, that at such time as a privatized PGW is no longer able to earn its required ROE (or is unable to earn within a range of its required ROE that is acceptable to a privatized PGW), the company will file for rate relief. Major drivers that will affect the size and timing of any base rates filing made by UIL include: (1) its ability to achieve cost savings in excess of costs to achieve those savings (*i.e.*, net synergies); (2) changes in UIL's external costs to fund investments and continued operations (*i.e.*, the cost of equity and the cost of debt); (3) increases in capital spending for investments that are not reflected in base rates or recovered through the DSIC, especially when natural gas demand does not increase at a commensurate rate; (4) unexpected changes in UIL's costs to provide service or the emergence of new costs; and (5) changes in revenues from changes in demand for sales and transportation services. The discussion below focuses on synergy savings (item (1) above) and the cost of equity (part of item (2) above), as those are new cost drivers as compared to a municipally owned PGW.

In general, the other items listed above equally impact PGW under both ownership scenarios, and thus they are omitted from further discussion.

- Synergies are a concept that was discussed in the Lazard reports and which Concentric has also reflected in our valuation of PGW. Synergies represent savings achieved by merging operations of two companies such that the cost to operate the combined operations is less than it would be to operate each company on a standalone basis. Synergies are most often achieved in utility mergers through headcount reductions, integration of back-office infrastructure such as information systems, elimination of duplicative corporate functions, increased purchasing power, and the sharing of best practices. If UIL can achieve synergy savings, then its need for a rate increase would be reduced or deferred as compared to a scenario in which no savings are achieved, all else being equal.

  In its Strategic Assessment and subsequent Cost/Benefit Analysis, Lazard estimated the value of PGW under two difference synergies scenarios: (1) a "Moderate Synergies Case," and (2) an "Industry Benchmark Synergies Case," in which the post-transaction PGW would be able to achieve cost savings in specified O&M expense accounts.[34] Lazard's synergy savings percentages were based on savings amounts that had been forecasted to be achieved in the announcements of other utility mergers. The "Moderate Synergies Case" included 14.0 percent (or approximately $30 million per year) in cost savings, and the "Industry Benchmark Synergies Case" included 28.0 percent (or approximately $60 million per year) in cost savings.[35]

  In Concentric's opinion, the range of 0.0 percent to 28.0 percent synergies is a reasonable range for the cost savings that may be achievable after the transaction is closed, and is generally consistent with the announced synergy savings amounts in other utility mergers. Concentric has placed more weight in our evaluation on the midpoint rather than on the high and low end of that range, because (a) some amount of savings is likely to be achieved

34 Philadelphia Gas Works Cost/Benefit Analysis, October, 2013, at 20.

35 Concentric's analysis resulted in a similar level of O&M savings based on the "Moderate Synergies Case" and the "Industry Benchmark Synergies Case." Specifically, Concentric's analysis found total annual savings of between approximately $30 million and $65 million in the "Moderate Synergies Case" and "Industry Benchmark Synergies Case", respectively.

by UIL indicating that 0.0 percent synergies is too low, and (b) the high end of the range has a lower likelihood of being achieved because UIL would likely have to first incur incremental costs in order to eventually achieve that level of savings. Those costs are referred to in mergers as "costs to achieve," and would reduce the net amount of any savings. Furthermore, UIL has stated that it believes the "Moderate Synergies Case" is achievable.[36]

- Changes in the cost of equity occur for numerous reasons, including changes in general economic conditions, increased or decreased riskiness of the utility, and changes in equity returns available at other, comparable companies. Equally important to a utility's required ROE is its ability to earn that ROE. To the extent that UIL determines it cannot, based on current rates, earn an ROE that allows it to attract sufficient equity capital at a reasonable cost to fund its operations, it will most likely file for rate relief.

PGW has previously forecasted that it will require an approximately $50 million increase in revenues, an equivalent expense reduction, or some combination thereof in 2018 in order to satisfy its cash flow requirements.[37] In addition, while provided as a hypothetical example only, UIL has indicated that a rate increase after a sale of PGW could be 20 percent less than $50 million (*i.e.*, a $40 million increase).[38]

As part of Concentric's independent valuation of a privately-held PGW, Concentric forecasted the future revenues and costs of PGW based on our analysis of past trends of these revenues and costs and our expectations regarding future performance. Concentric's analysis of the forecasted cash flows of a privatized PGW includes assumptions regarding the size and timing of future rate increases. Specifically, following the three-year base rate freeze, Concentric assumed that a

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36 UIL Holdings Corporation Conference Call to Announce Acquisition of Philadelphia Gas Works Operations, March 3, 2014. On that conference call, UIL stated, "We haven't put specific numbers out, but I think if you look at the Lazard moderate case, that is a reasonable assumption for what might be achievable."

37 As noted previously, PGW recently released its five-year forecast for fiscal years 2016 through 2020, in which its 2018 forecasted rate increase was reduced to $40 million based on updated assumptions. Concentric did not update assumptions in our financial valuation to reflect the updated forecast because the updated forecast was not available to bidders during the PGW sales process, and thus the prior forecast is more reflective of the PGW management assumptions available to bidders at the time they were preparing their bids. In addition, there is no reason to assume that the updated assumptions regarding increased LNG sales and personnel reductions, as well as other updated assumptions, could not also be achieved by a privately-held PGW, and thus would also reduce the privately-held PGW's need for rate relief.

38 Hypothetical Example of Customer Bill Impacts – Sale vs. no Sale ($ in millions), UIL Holdings, April 9, 2014.

privatized PGW will file for rate relief if it earns less than its required ROE. For this analysis, Concentric assumed that after filing for rate relief, PGW would receive a rate increase that would provide it with sufficient revenue to cover its costs and provide a 9.75 percent return to equity shareholders, which is approximately the current average authorized ROE for gas LDCs in the U.S.[39] Concentric notes that the actual size of any rate increase as well as the authorized rate of return would be subject to the PAPUC's ratemaking process and approval.

Based on our analysis, Concentric concluded that it is reasonable to assume that UIL will file for a rate increase in the 2018 to 2020 time frame.[40] Concentric's analysis indicates that if UIL files a rate case for increased revenues in 2018, the size of the requested rate increase would likely be less than the $50 million increase forecasted by PGW. Specifically, even if the company achieves $0 net synergies (*i.e.*, cost savings in excess of any incremental costs incurred to achieve synergies) through 2018, Concentric's analysis indicates that UIL's requested rate increase would be approximately $35 to $40 million in order for it to earn an assumed authorized ROE (*i.e.*, 9.75 percent) in 2018. UIL's ability to achieve net synergies, either at the "moderate" level included in Lazard's analysis of 14.0 percent or the "industry benchmark" level included in Lazard's analysis of 28.0 percent, would either decrease the required rate increase or postpone the need for a rate case beyond 2018 (or both).

ii. New Taxes, Governmental Charges, or PAPUC-Mandated Service Programs

As discussed further in Section X, the APA contains terms under which a private PGW can file with the PAPUC during the base rate freeze period (*i.e.*, the period between the close of the proposed transaction and December 31, 2017) to recover from ratepayers costs resulting from new taxes or governmental charges or PAPUC-mandated service programs, and/or seek extraordinary rate relief in accordance with the Public Utility Code. UIL also has the ability under Section 6.3 of the APA to seek future rate recovery of pension and OPEB obligations, "costs of conversion to an investor-owned utility," and meter relocation costs by requesting of the PAPUC the ability to establish regulatory assets. A regulatory asset is an accounting concept that allows a utility to defer the

39 According to Regulatory Research Associates, a division of SNL Financial LC, recent rate cases in Pennsylvania involving natural gas LDCs were decided via negotiated settlements. These settlements specified the overall dollar amount of the rate increases but did not specify the individual rate case components (*e.g.*, ROE and capital structure). Therefore, Concentric considered the national average for authorized ROEs for natural gas LDCs.

40 In addition, UIL has stated that, "We do need to implement some higher rates at some point, and that would be in the *2018 timeframe*." Emphasis added. UIL Holdings Corporation Conference Call to Announce Acquisition of Philadelphia Gas Works Operations, March 3, 2014.

recognition of expenses if future recovery of those expenses (through an increase in rates) is probable.[41]

"New taxes or governmental charges" is not a defined term in the APA, and thus could be interpreted as either taxes or governmental charges that did not exist for any taxable entity prior to the sale of PGW, or taxes or governmental charges that are new for PGW. The distinction is that there are certain taxes, such as income taxes and property taxes that PGW currently does not pay as a municipal entity, but that a privately-owned PGW would pay. Technically, those types of taxes could be defined as "new" for PGW. However, the City stated in a data response to Concentric that:

> UIL does not intend to seek recovery of property taxes prior to the next base rate case (which would not be filed earlier than 2017 for new rates to be effective January 1, 2018), provided that the property tax rates and terms of application to non-governmental entities remain unchanged from those currently applicable to non-governmental entities.

Extraordinary rate relief is a concept contained within the Public Utility Code. Specifically, under Title 66 of Pennsylvania's Consolidated Statutes, §1308(e), any utility can petition the PAPUC at the time of a rate request filing, or during the pendency of such a filing, for extraordinary rate relief for the portion of the total rate relief requested that can be demonstrated to be required by the utility immediately in order to maintain its:

> [F]inancial stability in order to enable the utility to continue providing normal services to its customers, avoid reductions in its normal maintenance programs, avoid substantially reducing its employment, and which will provide no more than the rate of return on the utility's common equity established by the commission in consideration of the utility's preceding rate filing.

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41 Specifically, a regulatory asset is established pursuant to Generally Accepted Accounting Principles when certain items that would normally be reflected in a company's income statement are capitalized on the company's balance sheet and amortized to the income statement as the associated costs are recovered from ratepayers. In general, in order for regulatory assets to be established, the following criteria must be met:

1. The company's rates are set by a third-party, independent regulator (or its own governing board, if so allowed by law);
2. The rates are designed to recover the cost of service; and
3. It is reasonable to assume that the rates can be charged to and collected from customers.

Furthermore, in order for costs to be capitalized and not expensed in the current period, it must be probable that future revenue in an amount at least equal to the capitalized costs will result from the costs' inclusion in rates, and the future revenue has to be provided to allow recovery of the previously incurred costs, as opposed to a future costs that are similar in nature.

The PAPUC is required to approve (in whole or in part) or deny such requests within 30 days of filing.

iii. Rider and Adjustment Mechanism Rate Impacts

Under the APA, UIL's initial proposed tariff will reflect PGW's current separate automatic rate adjustment riders, charges, and surcharges (see Appendix II). Those automatic rate adjustment riders, charges, and surcharges are exempt from the base rate freeze, and thus will presumably continue to be regularly updated in accordance with the tariff to reflect changes in underlying costs and weather conditions. Under the APA, UIL is also not prohibited from filing for changes in any automatic rate adjustment riders, charges or surcharges authorized by the PAPUC; nor is it prohibited from requesting approval of new automatic rate adjustment riders, charges or surcharges.

In addition to changes in the way that base rates are structured, the DSIC is also likely to change under private ownership. Currently, PGW recovers DSIC costs on a "pay-as-you-go" basis, in which the DSIC-related capital expenditures, up to a maximum of five percent of distribution revenue, are recovered from ratepayers in the year in which they are incurred. Privately-held utilities in Pennsylvania have DSICs that are structured to recover costs on a cost-of-service basis, in which DSIC-related capital expenditures, together with the cost of capital to fund those expenditures, are recovered over the useful life of the distribution investments.

Because the investments are recovered over time (as opposed to all in one year) under the cost-of-service ratemaking methodology, the annual charges attributable to any one investment will be lower than under the "pay-as-you-go" ratemaking methodology. The cost-of-service basis also provides for greater inter-generational equity than the "pay-as-you-go" basis, as customers who come onto or off of the system during the period of cost recovery will only pay for that portion of the investment that benefits them.

However, since a private utility is permitted to recover its cost of capital associated with an investment, the overall cost recovered by a private utility will be higher, on an undiscounted basis, over the life of the investment than under the "pay-as-you-go" basis of recovery.[42] The following figure demonstrates this for a hypothetical $100 investment that is recovered over 10 years.[43]

Figure 11: Total DSIC Cost Recovery Example

	Year 1	2	3	4	5	6	7	8	9	10	Total
Municipal Ownership ("Pay-As-You-Go")	$100										$100
Private Utility Ownership (Cost-of-Service)	$13	$15	$15	$14	$13	$13	$12	$12	$11	$10	$128

PGW currently seeks to recover about $22 million per year through the DSIC, which is close to the statutory maximum. UIL has stated that it will have the opportunity to accelerate infrastructure investments,[44] in part reflecting the way in which the cost-of-service recovery method initially lowers the annual amount to be recovered for each year's investments.[45] UIL has also provided the chart below illustrating the projected annual DSIC recovery amounts under different main replacement acceleration scenarios. UIL's analysis shows that the rate to customers for the DSIC will start lower under the cost-of-service ratemaking methodology compared to the "pay-as-you-go" ratemaking methodology, but will eventually cross-over and become higher.[46] UIL's analysis also shows that as more miles of main are replaced per year, the sooner the cross-over will occur.

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42 The present value of the two schedules of cost recovery amounts would be equal, however, assuming the same discount rate is applied to both recovery schedules.

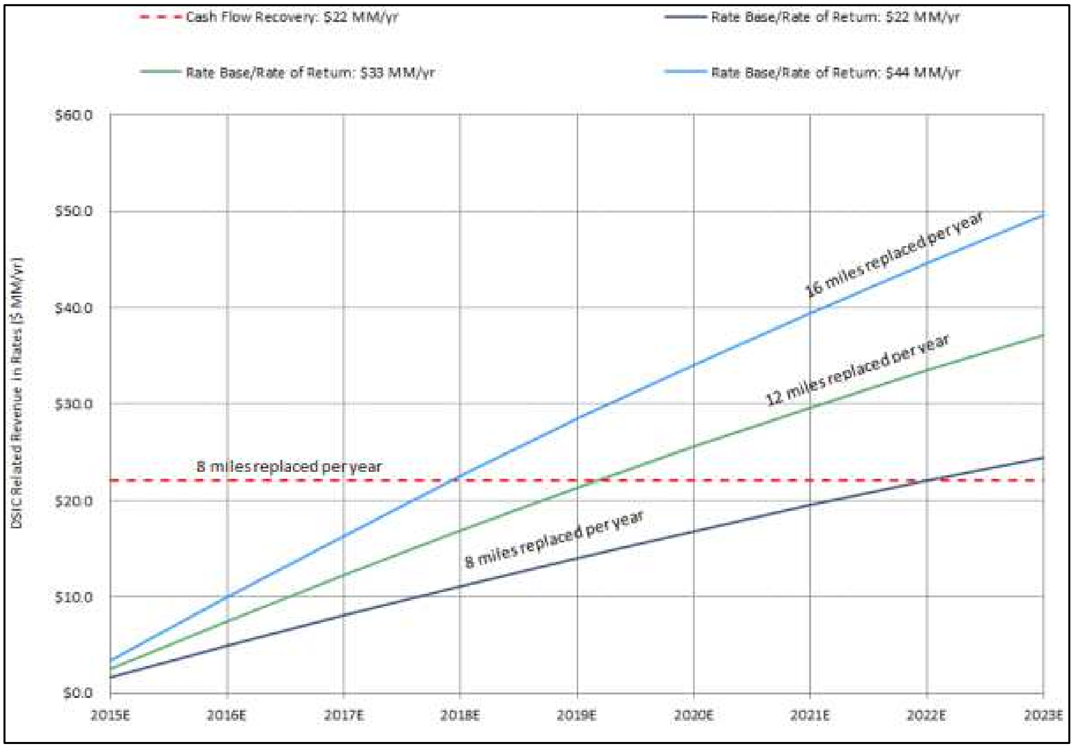
43 This simplified analysis assumes a 9.75 percent return on equity, a 4.40 percent cost of debt, and a 50.0 percent equity percentage.

44 See, *e.g.*, UIL Holdings Corporation, "Acquisition of Philadelphia Gas Works Operations" Investor Presentation, March 3, 2014, at 4.

45 UIL has not made any contractual commitments in the APA to accelerate its infrastructure investments in DSIC or otherwise.

46 On a cumulative basis, the "cross-over" point would be further out in the future than what is depicted in this figure. For instance, under the "8 miles replaced per year" scenario, customers will have paid $176 million by 2022 under the "pay-as-you-go" method (*i.e.*, eight years multiplied by $22 million), whereas they will only have paid approximately $100 million by 2022 under the cost-of-service method (using UIL's assumptions). This suggests that the cross-over point on a cumulative spend basis would be sometime in the 2030s.

Figure 12: UIL's Analysis of Rate Impacts of DSIC Investment Acceleration



Concentric has not independently verified the underlying assumptions of this figure, nor are we providing an opinion as to its accuracy in reflecting DSIC charges under the "pay-as-you-go" versus the cost-of-service methodology.[47] However, Concentric believes it is instructive for City Council in that it provides UIL's analysis of the level of DSIC-related revenues based on its internal assumptions. Furthermore, assuming the linear relationship between miles replaced and spend levels that is depicted in the figure above (i.e., increasing the miles replaced by 50 percent increases the DSIC charges by 50 percent), any additional acceleration in the pipeline replacement program beyond the 16 miles replaced per year, shown in the figure as the top-left most line, would shift that line further up and to the left. Therefore, while we have not ascertained the exact rate impact of any acceleration in the pipeline replacement program, any further acceleration beyond the levels depicted in the figure above would decrease the cost advantage of the cost-of-service method (at an accelerated replacement level) relative to the "pay-as-you-go" method (at eight miles replaced per

[47] The ultimate effect on PGW's rates of any acceleration by UIL of infrastructure replacement will depend on a number of factors, including: (1) the number of miles replaced per year, (2) the incremental cost per mile of accelerating the replacement program, (3) the rate parameters (namely the depreciation rate, ROE, cost of debt, and capital structure) applied in the DSIC formula, and (4) the breakdown between those investments that are recovered through the DSIC versus those sought for recovery under base rates.

year). Although PGW customers would gain the benefit of having more of its cast iron pipes replaced in a shorter period of time, they would also incur the cost of additional construction-related disruptions. It is beyond the scope of this report to assess whether such levels of acceleration are operationally feasible, or the impact they might have on a privately-owned PGW or the City.

Question #6: How might rates be impacted by a sale of PGW to UIL? How might accelerating the cast iron main replacement program impact the DSIC and costs to ratepayers?

Response to Question #6: Base rates will remain the same after a sale of PGW to UIL through at least December 31, 2017, although UIL can file for rate relief during the base rate freeze period if there is an imposition of new taxes, governmental charges, or PAPUC-mandated service programs or to seek extraordinary rate relief. UIL can also request for the establishment of regulatory assets to recover certain costs or seek to implement additional riders.

The impact on base rates of a sale of PGW to UIL beyond the base rate freeze period depends on many factors, some that are more within the control of UIL than others. Concentric has analyzed the potential for and timing of potential base rate case activity on the part of UIL, and our analysis indicates that an initial rate increase under UIL ownership could be reduced or deferred (or both) relative to PGW's $50 million forecasted rate increase in 2018.

Under a cost-of-service-based DSIC used by investor-owned utilities, ratepayers will pay for DSIC-related investments over the expected life of those investments, as opposed to incurring those costs all in the year of expenditure, as is done under the PGW "pay-as-you-go" approach. This will result in lower annual DSIC-related charges in the early years of the investment, and the infrastructure replacement program could therefore be accelerated initially without negatively impacting (and perhaps even lowering costs to) ratepayers. However, under the cost-of-service approach, the lifecycle cost (in nominal dollars) of DSIC investments will surpass the lifecycle cost that would be incurred under the "pay-as-you-go" approach at some point, since a privately-held PGW would also be reimbursed for the carrying cost of its capital investment. How quickly this would occur depends on the amount by which replacement is accelerated, as well as the specific ratemaking parameters (*e.g.*, ROE, depreciation rate) that UIL is authorized to use in the DSIC cost recovery formula.

X. Commercial Terms of the Proposed Transaction

This section answers the following questions:

Question #7: What are UIL's contractual commitments within the APA with respect to the following, when do these commitments expire, and what happens when they do?

a. Employment levels, wages and benefits
b. Liability-related commitments
c. Rate-related transaction terms
d. Economic Opportunity Plan
e. Philadelphia presence (*e.g.*, headquarters)
f. Indemnification
g. Required approvals and other governmental filings
h. "No shop" provision
i. Termination dates

Question #8: Are the commercial terms in the APA reflective of market norms for similar transactions?

Question #9: Does the transaction as agreed to between the City and UIL satisfy the specific objectives and conditions placed by the City Administration on a sale of PGW? Does the transaction satisfy City Council's objectives?

Concentric reviewed the APA to determine the commercial nature of the proposed transaction and UIL's contractual commitments. This section contains an overview of transaction terms in certain key areas, including those raised by City Council members to-date, as well as Concentric's business-level general assessment of these terms and their consistency with market norms for utility transactions. This section also considers whether the proposed transaction satisfied the objectives and conditions placed by the City Administration on a sale of PGW that were identified in Section VI. In this section, Concentric may at times refer to certain representations made by UIL and the City Administration that are outside of the APA in order to provide greater context for City Council, but not all such commitments are addressed.

The APA is a complex contract with many detailed provisions. This section does not purport to include all of the terms committed to by the parties, rather it highlights certain key terms, such as those pertaining to employment, rates, and liabilities, which establish the overall commercial nature of the transaction. This section also does not purport to distinguish between investor and municipally-owned utilities for purposes of considering how the proposed transaction terms compare to industry norms. Nor does this section consider whether transaction terms for a municipally-owned utility should differ from those for an investor-owned utility. Such considerations are identified in Section XI. Finally, Concentric's assessment is business-level in nature and should in no way be considered a legal opinion or analysis.

A. Employment-Related Transaction Terms

The APA contains a number of employment-related terms that are summarized below:

i. Offers of employment – APA Section 6.10

ii. Employment commitment – APA Section 7.1(e)

iii. Assumption of CBA – APA Section 2.2(a)(i)

iv. Transferred employee benefits – APA Section 7.2(a)

v. Pension and defined contribution plans – APA Section 7.2(b)

vi. OPEB – APA Section 7.2(c)

A discussion of each is followed by Concentric's assessment.

i. Offers of Employment – APA Section 6.10

Each individual who is an employee of PGW, PFMC, or the PGC[48] will be offered employment by UIL. Offers of employment must be (a) at a level of base pay at least equal to such employee's base pay in effect immediately prior to the closing and with benefits that, together with wages, are in the aggregate substantially comparable to the benefits and wages in effect for the employee immediately prior to the closing, and (b) with a primary work location within the City of Philadelphia. Taken together, this is a "Qualifying Offer."[49] As described below, UIL's wage and benefit commitment is linked to the expiration date of the current CBA, May 15, 2015.

[48] An "Employee" must be employed before the Closing Date. See APA Section 1.1.
[49] See Section 6.10(b) of the APA.

The City shall assist UIL in encouraging employees to accept Qualifying Offers from UIL. Employees who accept Qualifying Offers of employment shall become "Transferred Employees."[50] The "Workforce Amount" is the number of Transferred Employees at Closing.[51]

ii. Employment Commitment - APA Section 7.1(e)

UIL commits to maintain the Workforce Amount within the City of Philadelphia for three years. However, the APA allows actual employment levels to fall to 1,350 if the reduction in employment under the Workforce Amount is due to employees' voluntary separations, including retirements. As noted in Section V, PGW currently employs approximately 1,600 employees, of whom approximately 413 are now or will be retirement eligible as of December 31, 2014.[52] For a period of three years, UIL is required to replace departing employees only if the total number of employees falls below 1,350. After the three-year commitment, UIL may employ any number of employees that it believes is necessary and appropriate to manage PGW. In its March 2, 2014 Securities and Exchange Commission ("SEC") Form 8-K filing, UIL stated that: *"For three years following the Closing, Buyer will not institute layoffs and will employ at least 1,350 employees in the City of Philadelphia."*

iii. Assumption of CBA – APA Section 2.2(a)(i)

UIL will assume PGW's CBA, which expires on May 15, 2015.[53] Under the terms of the APA, the City is precluded from entering into a new or renewing or extending the current CBA, except if closing has not occurred by May 1, 2015, in which case the City is permitted to renew or extend the existing CBA so long as the terms and conditions do not adversely impact UIL and UIL is present at all negotiations.[54] It is Concentric's understanding that as of August 31, 2014, no formal negotiations have begun between the City Administration and/or UIL and UWUA Local 686. It is also Concentric's understanding that there have been preliminary exchanges of positions with respect to a successor CBA.

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50 See Section 6.10(b) of the APA.
51 See Section 1.1 of the APA.
52 Gas Commission Hearing Transcript, July 23, 2014, at 218.
53 See Section 2.2 (a)(i) of the APA.
54 See Section 6.1(a)(viii) of the APA.

iv. Transferred Employee Benefits – APA Section 7.2(a)

UIL is responsible for the following Transferred Employee benefits:

- Transferred Employees shall be covered by UIL-sponsored benefit plans.[55] As noted above, benefits, together with wages, must be in the aggregate substantially comparable to the benefits and wages in effect for such employees immediately prior to the closing date, through May 15, 2015. UIL shall determine the form and terms of any particular benefit plan;
- All sick leave and vacation balances accrued but unused as of closing shall be transferred with Transferred Employees to UIL and paid at separation from employment with UIL in accordance with the then-applicable CBA or leave policy;
- UIL shall recognize service and seniority of Transferred Employees for eligibility, vesting, accrual and determination of benefit levels;
- If UIL terminates a Transferred Employee before May 15, 2015, UIL will provide that employee with severance benefits that are at least as generous as the severance benefits that would have been provided by the City; and
- UIL shall take steps to insure that there is no interruption of health or medical insurance benefits of any Transferred Employee.

v. Pension and Defined Contribution Plans – APA Section 7.2(b)

As of the closing date, the City shall (1) cause eligibility and benefit accruals under PGW's pension plan to cease, and (2) terminate PGW's defined contribution plan. In their place, UIL shall adopt a "mirror" pension plan for Transferred Employees and shall allow for benefit accruals under the mirror pension plan at least through May 15, 2015. Concentric understands that the terms and conditions of the mirror pension plan are intended to be the same as PGW's current pension plan, but due largely to the fact that UIL is a private-sector company and PGW is a municipal entity, there

55 To the extent not otherwise provided for in the CBA or any other applicable agreement for Transferred Employees. See Section 7.2(a)(iii) of the APA.

are some differences between the current PGW pension plan and the mirror pension plan.[56] Concentric has not assessed the nature or magnitude of these differences.

vi. OPEB – APA Section 7.2(c)

UIL shall assume and maintain PGW's OPEB plan and associated OPEB trust to provide post-employment benefits to existing participants in PGW's pension plan[57] and employees who become "Eligible Retirees." An "Eligible Retiree" is an individual who (1) at the time of his or her retirement, is or was eligible for benefits under PGW's pension plan or UIL's mirror pension plan, and (2) upon retirement elected to receive an immediate pension benefit. UIL shall also assume the City's existing obligations and liabilities for benefits under PGW's OPEB plan.

The OPEB plan and post-employment benefits shall be maintained by UIL and provided to: 1) all Eligible Retirees as of Closing; 2) all employees who are or become Eligible Retirees under the terms of the OPEB plan on or before the Closing; and 3) all transferred employees who are or become eligible to receive post-retirement benefits under the terms of the OPEB plan on or before the last day of the Continuation Period as a result of service with PGW or combined service with PGW and UIL. Under Section 7.2(a)(iii) of the APA, "Continuation Period" is defined as the period of time "as of the Closing Date and for at least until May 15, 2015." UIL cannot terminate any post-employment benefit earned by OPEB participants or in which they are vested; nor can it reduce the level of post-employment benefits provided under the OPEB plan in effect immediately before the Closing Date or change the terms under which an employee or transferred employee becomes eligible for such post-employment benefits.

vii. Concentric's Assessment

Employment, wage and benefit commitments like those contained in the APA are customary in utility merger and acquisition transactions. It is also customary for certain commitments to expire on a date-certain, sometimes linked to a CBA. It is worth highlighting, however, that given the relatively short remaining term of PGW's existing CBA, all but the three-year employment level commitment will expire on May 15, 2015.

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56 The WGP Acquisition LLC Defined Benefit Pension Plan (the "Mirror Plan") Summary, Exploring the Sale website. The full Mirror Pension Plan can also be found at the Exploring the Sale website.

57 See Section 2.2(b) of the APA.

B. Liability-Related Transaction Terms

Sections 2.2 and 2.3 of the APA establish the responsibility of UIL and the City for liabilities associated with PGW.

i. Liabilities Retained by the City

Section 2.3 of the APA identifies the liabilities associated with PGW that the City will retain and be responsible for ("Retained Liabilities"). These are liabilities and obligations associated with: 1) bonds; 2) taxes (other than transaction taxes) for periods on or prior to the closing date of the transaction; 3) PGW's pension plan and defined contribution plan; 4) any indebtedness or guarantees of indebtedness; 5) interest rate or other swaps, hedging agreements or derivative transactions; and 6) assets retained by the City.[58]

As noted in Section VI, the City will use a portion of the proceeds from the transaction to defease all outstanding bonds of the City that are payable from the revenues of the PGW operations; PGW's net debt defeasance costs are estimated to be in the range of $888 million to $931 million. The City will also use a portion of the sale proceeds from the transaction to pay-off PGW's unfunded pension liabilities.

The City will also retain liabilities for proceedings that are due to pre-closing events and that fall within the scope of the Torts Claim Act. Under Section 11.2 of the APA, however, UIL will indemnify the City for such costs. Concentric understands that the intent of this provision is to extend, to the extent possible, the protections of the Torts Claim Act to UIL. As noted above, Concentric is not rendering a legal opinion on this or any other provision of the APA.

ii. Liabilities Transferred to/Assumed by UIL

Section 2.2 of the APA identifies the liabilities associated with PGW that the City will transfer to UIL and that UIL will assume and be responsible for. UIL will be responsible for all liabilities other than the liabilities specifically retained by the City (the Retained Liabilities described above). These

58 The assets that the City will retain ("Excluded Assets") are identified in Section 1.1 of the APA and include, but are not limited to, cash, cash equivalents, personal property, rights to refunds of taxes for periods on or before the closing date of the transaction, assets related to PGW's pension plan and defined contribution plan, and certain documentation.

"Assumed Liabilities" include the employment-related liabilities noted in Subsection A, above (*i.e.*, the CBA, the OPEB plan, the OPEB trust, and the City's OPEB liabilities for PGW). UIL's Assumed Liabilities also explicitly include all environmental liabilities arising from or relating to the business or purchased assets for the period before, on or after closing. This includes liabilities at any location, including those now or formerly owned, leased, licensed, operated or managed by PGW (including its predecessors and other "business operators") and liabilities from formerly owned manufactured gas plant properties.[59]

Other Assumed Liabilities include:

- Transaction taxes payable to the City up to $1.5 million and all transaction taxes payable to the Commonwealth of Pennsylvania;[60]
- Regulatory liabilities to refund or credit customers in future periods that result from ratemaking action by the PAPUC;[61] and
- Trade accounts payable and other accrued and unpaid current expenses for goods and services incurred by or for the business for the period prior to closing.[62]

iii. Concentric's Assessment

The definition and treatment of Assumed Liabilities, in particular the explicit assumption by UIL of all environmental liabilities, is a benefit for the City. Additional benefits to the City are that (1) the City will retain responsibility only for those liabilities specifically identified as Retained Liabilities, and (2) UIL will assume all liabilities not retained by the City.

C. Rate-Related Transaction Terms

UIL has committed to certain rate-related provisions that are found in Section 7.1 of the APA. These commitments include a base rate freeze through December 31, 2017,[63] and inclusion of the

59 See Section 2.2 (a)(iii) of the APA.
60 See Section 2.2 (a)(iv) of the APA.
61 See Section 1.1 Definition "Regulatory Liabilities".
62 See Section 2.2 (c) of the APA.
63 See Section 7.1 (a) of the APA.

Senior Citizen Discount, and the PAPUC-mandated discount programs in UIL's initial proposed tariff.[64]

i. Base Rate Freeze

PGW's base rates include a customer charge and a demand charge that its various customer classes (*e.g.*, residential, commercial) pay for service. Base rates exclude natural gas commodity costs and other costs recovered through separate riders, charges and surcharges. UIL is committed to (1) filing an initial tariff with the PAPUC as part of its filing for approval of the transaction (the Joint Application to be filed jointly with the City to the PAPUC) pursuant to which UIL would offer tariffed services at the same base rates charged by PGW immediately prior to the closing date, and (2) not filing a subsequent request that would result in an increase in base rates effective for service rendered prior to January 1, 2018. Appendix III contains PGW's base rate classes, per the PGW Gas Service Tariff No. 2.

As noted above, base rates specifically exclude automatic rate adjustment riders, charges and surcharges, as well as special or negotiated contract rates. Appendix II contains a complete list of PGW's automatic rate adjustment riders, charges and surcharges and a summary of some key rate mechanisms is provided in Section V. Figure 13 presents the breakdown of base rates versus automatic rate adjustment riders, charges and surcharges for an average residential heating customer in 2013.[65] The chart demonstrates that approximately 50.0 percent of a residential heating customer's bill is subject to change during the base rate freeze period, a significant portion of which is accounted for by the GCR. This change will not necessarily result in an increase in billings as some of the automatic rate adjustment riders, charges and surcharges described in Appendix II can either decrease or increase when adjusted quarterly or annually.

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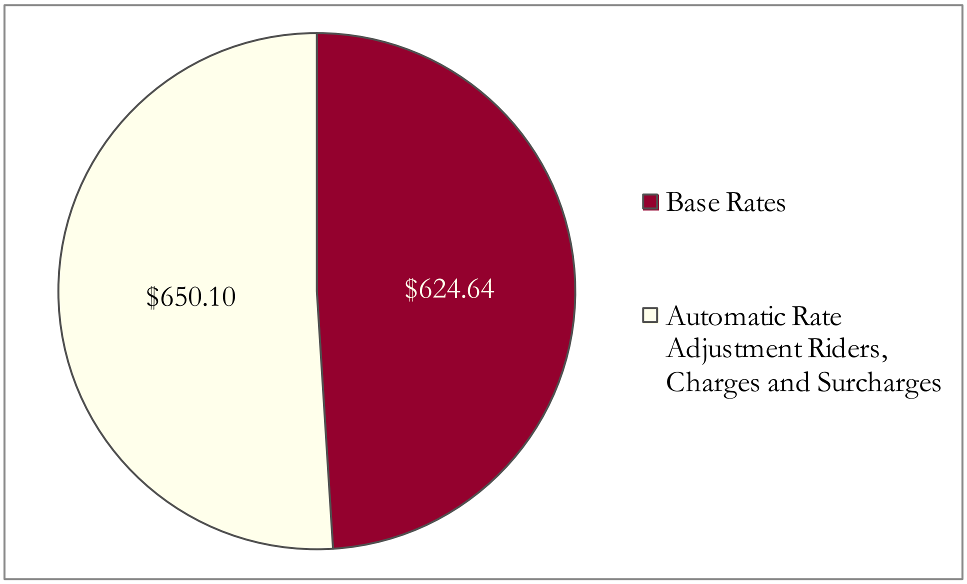
64 See Section 7.1 (c) of the APA.

65 Concentric's analysis is based on PGW's estimate of average annual consumption for a residential heating customer in fiscal year 2014 assuming normal weather and therefore does not incorporate the WNA, but includes all other surcharges and riders. Concentric estimated monthly usage based on PGW's Gas Sendout Allocator included in the Class Cost of Service Study filed in Docket No. R-2009-2139884.

Figure 13: Base Rates vs. Automatic Rate Adjustment Riders, Charges and Surcharges as Components of Customers' Annual Bills



The APA specifically provides that UIL may file to recover additional costs resulting from new taxes, governmental charges or PAPUC-mandated service programs, or seek extraordinary rate relief as allowed under the Public Utility Code.[66] The APA also does not preclude UIL from filing for additional automatic rate adjustment riders, charges and surcharges after the close of the transaction.

ii. Senior Citizen Discount Program

UIL shall include the PGW Senior Citizen Discount program (1) in its initial tariff filing with the PAPUC, and (2) in all of its subsequent base rate filings until there are no eligible participants in the program.[67]

iii. PAPUC-Mandated Discount Programs

UIL shall include in its proposed initial tariff all current PAPUC-mandated discount programs for PGW customers. Such programs are identified in Section 7.1(c) of the redacted Seller Disclosure Letter as 1) the PGW Senior Citizen Discount; and 2) the CRP.[68] UIL shall use commercially reasonable efforts to have such PAPUC-mandated discount programs or other support programs

66 See Section 7.1(a)(i) of the APA.
67 See Section 7.1(b) of the APA.
68 See Section 7.1(c) of the APA.

similar in purpose included in its initial PAPUC-approved rates. The redacted Seller Disclosure Letter does not identify any other PGW customer programs except for the two noted above, as part of the PAPUC-mandated discount programs.

iv. Other Rate-Related Terms

The APA also provides for the following other rate-related terms:

- A request in the Joint Application to (a) establish regulatory assets[69] in respect of the pension and OPEB obligations of PGW, and (b) transfer any existing regulatory assets and liabilities to UIL;[70]
- UIL may include in the Joint Application a request to establish regulatory assets in respect of the costs of conversion of PGW to an investor-owned utility;[71] and
- If the PAPUC issues an order prior to the approval of the Joint Application requiring PGW to relocate meters, a request to establish regulatory assets in respect of the associated costs may be filed.[72]

v. Concentric's Assessment

Base rate freezes and other rate-related commitments are common in utility merger and acquisition transactions. It is also common for such commitments to be both time certain and subject to certain exceptions. Further, it is typical that any commitments related to regulated rate-related filings are subject to the approval of the state PUC. If the transaction is consummated, PAPUC approval would be required for any regulated services or rates offered by UIL. Accordingly, the PAPUC would have the authority to approve, reject or modify the proposed initial tariff, including

69 As discussed above, a regulatory asset is an accounting concept that allows a utility to defer the recognition of expenses if future recovery of those expenses through an increase in rates is probable.

70 See Section 6.3(b)(C) and 6.3(b)(F) of the APA.

71 *Ibid.*

72 See Section 6.3 (b)(F) of the APA. PGW responded to a data request from Concentric regarding the Leak Detection PILOT program that was referred to in Section 6.3 of the APA. PGW stated that: "The PAPUC issued an order on this matter on May 23, 2014. PGW does not expect a material financial impact because the shut off valve installations can be achieved through normal maintenance and capital measures during the 20 year compliance period. The cost estimate to implement this Final Rulemaking Order is $20 million to $25 million over a 20-year period to PGW. Based on PGW's analysis of the impact of the PAPUC Order, UIL does not intend to request a regulatory asset for meter relocation costs as part of the Joint Application."

the Senior Citizen Discount program[73] and the CRP. With regard to the Senior Citizen Discount program, UIL's contractual commitment is met by proposing the program to the PAPUC. If the PAPUC does not approve the tariff as filed, UIL would have no contractual obligation to continue the program. With regard to the other discount programs, UIL's contractual commitment is met by including them in its initial tariff submission and using commercially reasonable efforts to have such programs, or other programs similar in purpose, included in its initial rates. UIL has no contractual commitment thereafter. It should be noted that City Council could seek to intervene in PAPUC proceedings regarding PGW's rates to present its view, on behalf of its constituents, of PGW's rates and programs. Also, the PAPUC has approved the current form of these programs in past filings.

D. Economic Opportunity Plan

In Section 6.2 (c), UIL committed to submit an EOP to the City "promptly following Closing".[74] Closing will occur after approval of City Council, the Mayor, and the PAPUC and after all closing conditions have been satisfied.

E. Philadelphia Presence

UIL committed to a number of terms pertaining to maintaining a presence in Philadelphia. These commitments include:

- Establishing its headquarters for PGW within the City for at least three years after the closing date;[75]
- Establishing an advisory board for PGW operations, consisting of a substantial majority of members who shall be resident in the City, for at least three years after the closing date;[76]
- Increasing the size of UIL's board of directors by one and appointing to the board a person resident in the City after consultation with the City;[77]

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73 Concentric understands that it is unclear if the PAPUC will have statutory authority to continue the Senior Citizen program for a private PGW.

74 See Section 6.2 (c) of the APA. Concentric understands that the Philadelphia Code, Sections 17-1601-(d) and 17-1601(2) requires that certain large contracts, projects and real estate transactions must include an EOP as a condition of receiving City Council's approval. To date, UIL has not provided an EOP to City Council.

75 See Section 7.1(d)(i) of the APA.

76 See Section 6.2 (d) of the APA.

77 See Section 6.2 (e) of the APA.

- Effective upon closing, New Haven and Philadelphia will be the dual headquarters locations of UIL[78] (no time commitment specified); and
- Additionally, UIL has publicly stated that it will maintain PGW customer service centers and its customer call center in Philadelphia.[79] However, UIL is not contractually committed to these actions through the APA.

F. Indemnification

Mutual indemnification provisions were agreed to by the parties in Section 11 of the APA. Except arising out of fraud, criminal misrepresentation or willful misconduct, neither UIL nor the City shall be liable for any exemplary, punitive, special, remote or speculative damages including lost profits.[80] The City is also not liable for indirect or consequential damages.[81] The following indemnification for breaches of general representations and warranties will survive for 12 months after the closing date:[82]

- $100,000 in aggregate after which UIL and the City are liable for all losses incurred by UIL and the City indemnities;
- $50,000 for any individual loss; and
- Losses that in the aggregate exceed $20 million, but not exceeding $100 million.

Concentric concludes that the indemnification provisions provided in the APA are commercially reasonable.

G. Required Approvals and Other Governmental Filings

The transaction requires that the City and UIL obtain certain standard approvals in order to close as noted in Sections 6.3 and 8.1 of the APA. As a first step, City Council and the Mayor must approve an ordinance that authorizes and facilitates the transaction. The APA states that City Council will

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78 See Section 7.1 (d) (ii) of the APA.
79 Letter from Mayor Michael Nutter to City Council President Darrell Clarke on March 11, 2014, "Summary of Proposed Sale of PGW to UIL Holdings".
80 See Section 11.3(a) and 11.4(a) of the APA.
81 See Section 11.3(a) of the APA.
82 See Section 11.5 (a) of the APA. That Section also notes that "Seller Fundamental Representations" and "Buyer Fundamental Representations" will survive the closing for purposes of Section 11.1(a) and 11.2(a) indefinitely.

have enacted and the Mayor will have approved an ordinance in the form set forth in the Seller Disclosure Letter to authorize and facilitate the transaction; City Council may amend, revise or add to the ordinance so long as the amendments do not adversely affect UIL; and the City shall consult UIL regarding any amendments.[83]

In addition, the APA provides that no later than 60 days following the introduction of the ordinance in City Council, UIL and the City shall file a Joint Application to the PAPUC for any required approvals by the PAPUC accompanied by any required direct testimony in support of the Joint Application.[84]

H. "No Shop" Provision

In Section 6.1 (h), of the APA includes a "no shop" provision in which the City has agreed not to enter into any arrangements or agreements, relating to the direct or indirect disposition, whether by sale, merger or otherwise, of all or any material portion of PGW until the termination of the APA or closing, whichever comes first. In addition, under the "no shop" provision, the City cannot knowingly disclose, directly or indirectly, to any person any confidential information concerning PGW except as necessary to conduct PGW's business. Both parties agree that there may be no adequate remedy at law for a breach of the agreement and that money damages may not be appropriate and, therefore, UIL has the right to injunctive relief.[85]

I. Termination Dates

Article 10 in the APA contains several contract termination dates. UIL may terminate the contract if an ordinance approving the sale has not been enacted by July 15, 2014. To date, UIL has not exercised its rights under this provision. UIL can also terminate the contract if at any time after the ordinance becomes enacted it ceases to be in full force and effect.[86] In addition, the APA will terminate without any action by either UIL or the City if an ordinance approving the sale has not

83 See Section 8.1(b) of the APA.
84 See Section 6.3(b)(i) of the APA.
85 See Section 6.1(h) of the APA.
86 See Section 10(e) of the APA.

been enacted by December 31, 2014.[87] Finally, the APA automatically terminates if closing has not occurred by March 31, 2015, although this date can be extended by up to a total of three months.[88]

J. City Administration's Sale Objectives

As noted in Section VI, above, the City Administration articulated five specific objectives or conditions for a sale of PGW:

1. Maintain the Senior Citizen Discount program in its current form and all PAPUC-mandated discount programs;
2. Implement a base rate freeze for a mutually agreed-upon period of time;
3. Honor the collective bargaining agreement in place at the time of sale closing;
4. Maintain PGW headquarters in Philadelphia and a specified minimum number of employees in Philadelphia for at least three years; and
5. Satisfy liabilities for PGW-related pensions and for other post-employment benefits (management and funding), as applicable, including maintaining dedicated trust funds for any PAPUC-granted rate recovery of employee benefits.[89]

In announcing the transaction, the Mayor stated that the proposed transaction meets the City's objectives:

> UIL submitted the highest bid for PGW and agreed to contract terms that were important to the City. Our agreement keeps rates frozen for three years, maintains PGW's discount programs for low-income families and seniors, safeguards PGW employee and retiree pensions and positions PGW to take full advantage of the abundant supply of natural gas in Pennsylvania to make our city and region a prime energy hub.[90]

Concentric's general assessment is that the proposed transaction meets the letter of the City Administration's objectives and conditions.

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87 See Section 6.1(h) of the APA.
88 See Section 10(f) of the APA.
89 Request for Qualifications, August 2013, at 1.
90 "City of Philadelphia Reaches Agreement to Sell PGW to UIL for $1.86 Billion," posted to exploringthesale.com on March 3, 2014.

K. Responses to Specific Questions

<u>Question #7</u>: What are UIL's contractual commitments within the APA with respect to the following, when do these commitments expire, and what happens when they do?

a. Employment levels, wages and benefits
b. Liability-related commitments
c. Rate-related transaction terms
d. Economic Opportunity Plan
e. Philadelphia presence (*e.g.*, headquarters)
f. Indemnification
g. Required approvals and other governmental filings
h. "No shop" provision
i. Termination dates

<u>Question #8</u>: Are the commercial terms in the APA reflective of market norms for similar transactions?

<u>Response to Questions #7 and #8</u>:

As summarized above, Concentric believes that from a commercial perspective, the terms committed to by UIL in the APA are generally customary for utility merger and acquisition transactions. It is worth highlighting that:

- Most of UIL's employment-related conditions are linked to the expiration date of the current CBA, May 15, 2015. While it is customary for certain commitments to expire on a date-certain, sometimes linked to a CBA, the relatively short remaining term of the CBA means that all but the three-year employment commitment expire on May 15, 2015, rendering these commitments limited;
- The explicit assumption by UIL of all environmental liabilities is a benefit for the City. Further, that the City will retain responsibility only for those liabilities specifically identified as "Retained Liabilities" and that UIL will assume all liabilities not retained by the City could also be a benefit to the City; and
- Base rate freezes and other rate-related commitments are common in utility merger and acquisition transactions. UIL's rate-related commitments, particularly with respect to discount programs, are dependent on PAPUC approval and, with regard to programs other than the Senior Citizen Discount program, there are no contractual requirements beyond the initial tariff filing.

Question #9: Does the transaction as agreed to between the City and UIL satisfy the specific objectives and conditions placed by the City Administration on a sale of PGW?

Response #9: Based on our review and analysis of the transaction terms, Concentric concludes that the announced transaction meets the City Administration's stated objectives to the extent such objectives can be met through a legally-binding sale agreement. Our conclusion regarding this question is qualified in that (a) the transaction has not yet closed and any conditions placed on it prior to the close, either by City Council or the PAPUC, may affect those transaction terms that are intended to meet the City's stated objectives; (b) UIL's ability to "maintain" the Senior Citizen Discount is subject to PAPUC approval in the Joint Application and any subsequent tariff-related regulatory proceedings; and (c) UIL's commitment to the CRP could be satisfied by commercially reasonable efforts to have some other version of this program similar in purpose approved.

It is Concentric's understanding that City Council did not have the opportunity to fully participate throughout the entire sale process. As noted in the response to Question 2, a number of other objectives for a possible sale of PGW and other considerations that were not explicitly addressed in the APA were raised in Concentric's meetings with City Council members. Additionally, City Council's interests related to other management and operations alternatives for PGW were not considered.

XI. OTHER CONSIDERATIONS

This section answers the following questions:

Question #10: What financial impact do the elimination of the franchise fee and the imposition of property and income taxes have on the City?

Question #11: What other objectives, conditions and/or considerations could be examined by City Council? Are there specific commitments City Council members have questioned that are not definitive or are not addressed in the APA?

Question #12: What role will City Council have with regard to the oversight and/or regulation of PGW if the sale is approved? What is the governance and regulatory structure under which a UIL-owned PGW would operate?

City Council's decision whether to approve the sale of PGW will require it to weigh other considerations that were not included as part of the APA, but are impacted by the transaction. This section reviews some of those considerations, including the loss of the franchise fee and gain of new sources of revenue to the City such as property taxes; commitments that are not absolute or are unstated in the APA; and City Council's role in post-sale oversight of PGW.

A. Loss of the Franchise Fee

Per the Management Agreement between the City and PFMC, PGW currently pays an annual franchise fee of $18 million to the City. It is Concentric's understanding that the franchise fee will no longer be required to be paid by PGW to the City if the proposed transaction closes. That is a cost to the City associated with the transaction.

The present value of the future stream of franchise fee payments that will be foregone by the City if the transaction is approved can be estimated by valuing the franchise fee payment as a perpetuity. This approach divides the annual franchise fee payment of $18.0 million by a discount rate that reflects the risk profile of the payments, including consideration of the historical variability in the payments, the financial conditions that caused the City to grant back the franchise fee from 2004 to 2010, and the risk that those conditions could reoccur. The risk profile of the franchise fee payment is similar to a dividend to the City, given the recent history of the City granting the $18 million back to PGW from 2004 to 2010. The implied yield of the franchise fee payment (*i.e.*, approximately 5.00 percent of PGW's 2013 total net position), is also similar to the dividend yield on the book value of publicly-traded U.S. natural gas LDCs. Additionally, the characterization of the franchise fee as a "dividend payment" has been employed by Standard & Poor's ("S&P").[91] However, since the franchise fee is mandated by the City's Management Agreement with PFMC,[92] and the City has not granted back the franchise fee since 2010, the franchise fee also has certain risk characteristics similar to an operating expense for PGW. That view is shared by Moody's Investor Service ("Moody's"), which treats the franchise fee as an "operating expense,"[93] in its analysis of PGW and by Fitch Ratings, which refers to the $18 million annual payment as "required."[94]

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91 S&P ratings report, "Philadelphia Gas Works," August 22, 2011.

92 As amended through Bill No. 100006, signed into law March 17, 2010. The payment is further required by PGW's 1975 and 1998 bond ordinances. See the General Gas Works Revenue Bond Ordinance of 1975 (Bill No. 1871) and the General Gas Works Revenue Bond Ordinance of 1998 (Bill No. 980232).

93 Moody's Investor Service New Issue Report, August 23, 2011.

94 Fitch Ratings, "Fitch Affirms Philadelphia, PA's Gas Works 1975 Rev Bonds & 1998 Ordinance Bonds; Outlook Stable," August 8, 2014.

Given these considerations, Concentric has calculated the present value of the franchise fee using a discount rate of 9.00 percent to 10.50 percent, which is the observed required return on equity (or discount rate) for a proxy group of eight U.S. natural gas companies. While that range reflects equity discount rates, since those natural gas LDCs have less financial risk than PGW as measured by the debt component of their capital structures (*i.e.*, the average debt percentage for that group of utilities is approximately 55.00 percent, whereas PGW's debt percentage as of fiscal year-end 2013 was approximately 75.00 percent), the range of discount rates is lower than would be used for a utility with PGW's relatively high debt percentage. Thus, in Concentric's opinion, the range of discount rates from 9.00 percent to 10.50 percent reflects the historical risk profile of the franchise fee payments, while also giving consideration to the more recent and short-term forecasted lower variability in the payment. Using that range of discount rates provides a present value of the stream of future franchise fee payments of $171 million to $200 million.

B. Property and Income Taxes

There will be new sources of revenue to the City once PGW is no longer under municipal ownership. The City and the School District of Philadelphia impose the following taxes that Concentric understands will be payable by a privately-held PGW:

- Real estate taxes are levied on all real property in Philadelphia. For 2014, the combined tax rate for the City and the School District of Philadelphia is 1.34 percent;[95]
- The Business Use and Occupancy tax is a tax imposed at a rate of 1.13 percent on the commercial or industrial use or occupancy of real estate within Philadelphia, with an

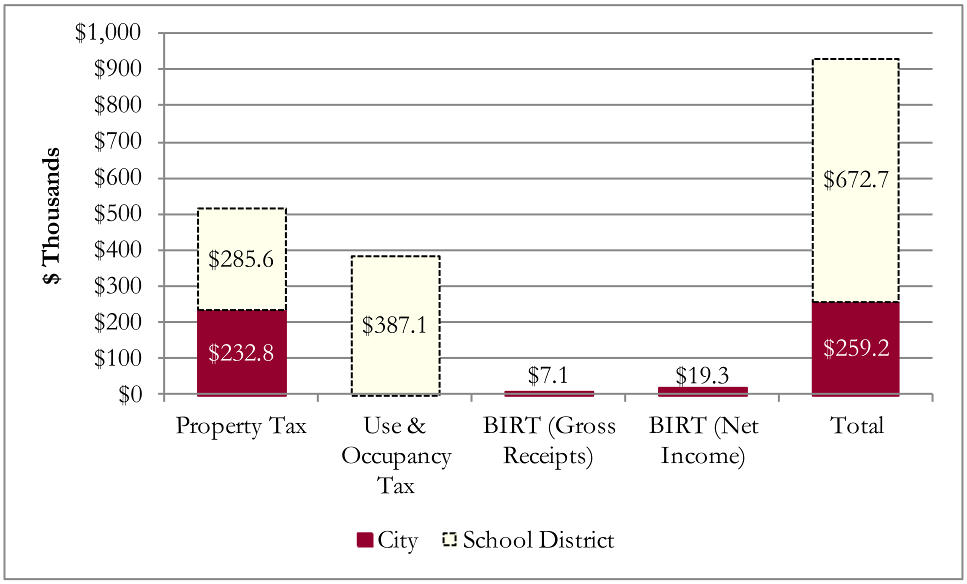
95 According to the Pennsylvania Department of Revenue, the Public Utility Realty Tax ("PURTA") is levied against certain entities furnishing utility services regulated by the PAPUC or a similar regulatory body. The Commonwealth of Pennsylvania imposes this tax on public utility realty in lieu of local real estate taxes and distributes the local realty tax equivalent to local taxing authorities. The PURTA tax base is the fair market value of utility realty, which is defined as the assessed value of the realty as adjusted by the common level ratio of the county in which the realty is located. Public utilities furnishing sewage services and municipal authorities furnishing public utility service are exempt from PURTA. Also exempt are easements, rights-of-way, pipelines, railroad beds, tracks or other lines, and machinery and equipment not affixed to the land. Land and improvements indispensable to the generation of electricity are excluded from the PURTA tax base and the realty tax equivalent, as are certain other property subject to local taxation. The Pennsylvania Department of Revenue annually calculates a variable tax rate in order to raise an amount of revenue equal to the distribution of the realty tax equivalent to the local taxing authorities. An additional tax rate of 7.6 mills (*i.e.*, 0.76 percent) is applied to the tax base and remains in Pennsylvania's General Fund (Pennsylvania Department of Revenue, The Tax Compendium, October 2012). Concentric included this additional tax rate in its calculation of property taxes, but, since the revenue from the additional tax rate does not go directly to the City, Concentric excluded it from the analysis provided in Figures 14 and 15.

exempted amount per property and with all revenues going to the School District of Philadelphia; and

- The Business Income & Receipts Tax ("BIRT") is a City-imposed tax of 1.415 mills on all gross receipts and 6.43 percent on all net income that are not PAPUC or Interstate Commerce Commission regulated. There are also credits and exemptions that reduce the amount of BIRT owed to the City, including the Keystone Opportunity Zone, Community Development Credit, Jobs Creation Tax Credit, Philadelphia Re-Entry Employment Program, Sustainable Business Tax Credit, Green Roof Tax Credit, Veterans Tax Credit, and Internship Tax Credit.

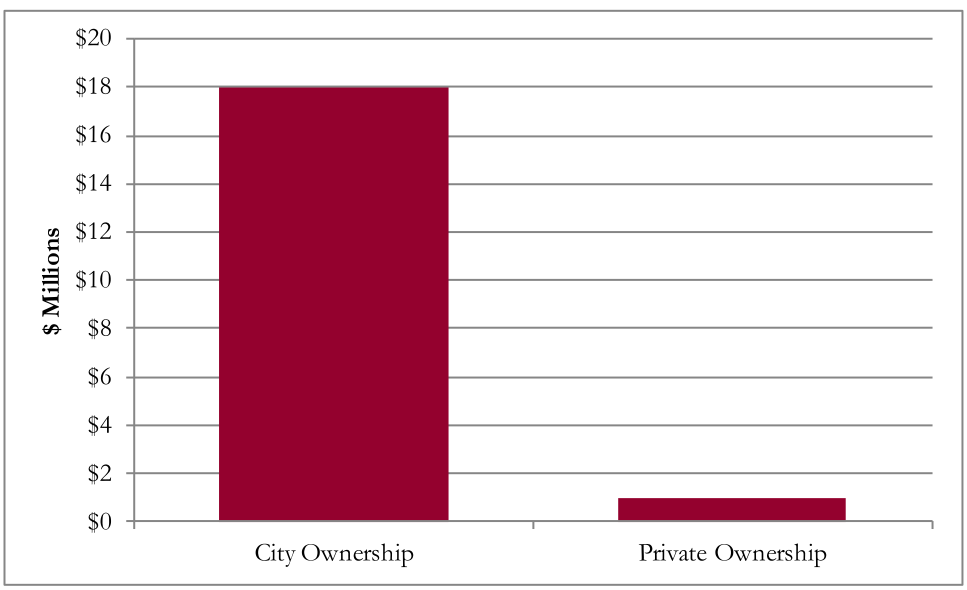
The quantification of the annual total amount of property and income taxes requires assumptions regarding: (1) forecasted annual taxable bases (*i.e.*, which PGW properties are taxable, the valuation of taxable properties, and the forecasted level of taxable gross receipts and net income); and (2) the current and forecasted tax rates. Figure 14, below, provides the forecasted annual property and income taxes from the sources listed above, and Concentric's assumptions regarding those items are contained in Appendix V.

Figure 14: Breakdown of FY 2015 Estimated City and School District Revenue from PGW under Private Ownership



As can be seen in the figure below, the forecasted annual amount of new sources of revenue to the City is considerably less than the $18 million franchise fee.

Figure 15: FY 2015 Estimated Ongoing Annual City Revenue from PGW



It is important to note that this is an analysis of two isolated components of the transaction that excludes consideration of other sources of costs (e.g., funding of unfunded pension liabilities, transaction costs, etc.) and benefits (e.g., purchase price, transfer of certain liabilities, etc.) to the City. Any evaluation of the total impact on the City from a cost and benefit perspective should be considered in the broader context of the total transaction, but such an evaluation is beyond the scope of this report.[96]

C. Other Objectives, Conditions and/or Considerations

As discussed in Sections VI and X, above, the City Administration established certain overarching as well as five specific objectives and conditions for a sale of PGW. In Concentric's meetings with City Council members, a number of other considerations were raised that were highlighted in Figure 6, also above. Some of these considerations are discussed in more detail below. This is not to suggest that these are the only considerations that City Council may wish to have addressed.

i. PGW Customer Programs

PGW maintains a variety of customer assistance programs including those described in Section V.[97] The APA states that the proposed initial tariff will reflect base rates and separate automatic rate adjustment riders, charges and surcharges in effect as of the day of the submission of the Joint Application filed with the PAPUC by the City and UIL. The APA does not state how UIL will manage or operate the underlying customer programs that are paid through the riders, charges and surcharges and in some cases base rates.[98]

With regard to the Senior Citizen Discount program, UIL's contractual commitment is met by proposing the program to the PAPUC. While UIL has indicated that its intention is to continue these programs, if the PAPUC does not approve the tariff as filed, UIL would have no contractual

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96 It is further important to note that the future elimination of costs or emergence of new costs to a privately-held PGW would have been reflected in UIL's and the other bidders' proposed purchase prices for PGW. For example, in a hypothetical example in which a privately-held PGW did not have to pay property taxes, it is reasonable to assume that bids to purchase PGW would have increased to reflect the overall lower costs of operating PGW. Likewise, in a hypothetical example in which a privately-held PGW was required to continue paying the $18 million franchise fee, it is reasonable to assume bids would have decreased to reflect these higher anticipated costs.

97 Those programs include: CRP, CARES, the Senior Citizens Discount, ELIRP and the Hardship Fund.

98 For example, PGW's Universal Services Plan for 2014-2016 is now pending before the PAPUC for approval. The APA does not state whether UIL will be bound by this plan. Similarly, PGW's DSM program will expire in August 2015, unless renewed by the PAPUC. While the ECR rider referenced in the APA provides the mechanism through which DSM (EnergySense) program costs are recovered from customers, without a DSM, there would be no costs to charge through this mechanism. Similarly, changes to the size and/or scope of the DSM program could result in changes to the costs charged through this mechanism.

obligation to continue the program. With regard to the other PAPUC-mandated discount programs, UIL's contractual commitment is met by including those programs in its initial tariff submission and using commercially reasonable efforts to have such programs, or other programs similar in purpose, included in its initial rates and has no commitment thereafter. If the PAPUC does not approve the tariff as filed, UIL would have no contractual obligation to continue the programs unchanged.[99]

ii. Other Customer Programs Not Mentioned in the APA

PGW has programs and business practices in addition to the CRP and the Senior Citizen Discount program to help the significant number of its customers that are at or below 150 percent of the Federal poverty level. As highlighted in Section V.D, those programs include the Hardship Fund, CARES and DSM (including ELIRP). Although there is reference to the USEC surcharge and ECR mechanism continuing, none of these programs are addressed in the APA.

iii. PGW Lien Policy

PGW has a significant number of liens on properties within its service territory for unpaid gas bills. Currently, PGW has approximately 89,000 liens on properties within the City totaling approximately \$125 million.[100] Upon the sale of liened property, the lien obligation is paid by a seller through the sale proceeds. It is Concentric's understanding that PGW currently has a policy of not collecting on the liens until the property is sold. It is unknown how in the future UIL will treat property liens the City will transfer to UIL at closing.[101] UIL has stated publicly that it will not foreclose on any owner-occupied residential properties on which it has a transferred PGW lien, but UIL has not made this commitment in the APA. Nor does the APA preclude UIL from transferring the liens to a third party for collection.

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99 The PAPUC approved the current tariff provisions in past rate cases.

100 PGC records.

101 In the APA, municipal liens are included as a "Purchased Asset," as that term is defined in the agreement, as part of "accounts receivable arising out of or related to the Business." Concentric understands that if UIL closes the transaction and receives the liens as part of the purchased assets, it will have the same rights, privileges and remedies as were held by the transferring municipality to enforce and collect the transferred lien of the municipal claim. 53 P.S. § 7147.

iv. Employment and Operational Considerations

As noted previously, UIL commits in the APA to employ at least 1,350 employees for at least three years. There are currently approximately 1,600 employees at PGW, of which approximately 400 will be eligible to retire by December 31, 2014. If approximately 250 of these employees retire before the transaction closing, and thus the Workforce Amount at closing would be 1,350, the APA does not address what would happen to the operational performance, customer satisfaction or safety of the PGW system or how it would manage without those employees.

v. Liabilities

As noted in Section X, the City has retained certain liabilities in the APA, including the following retained liability stated in Section 2.3(f):

> [A]ny proceedings based on conduct, operation, actions, inaction, facts, circumstances, conditions or otherwise related to the Business, including proceedings arising from or related to any other Assumed Liability, but solely to the extent any such Proceeding (i) arises out of events occurring before the Closing Date and (ii) falls within the scope of the Political Subdivision Tort Claims Act of Pennsylvania as of the date hereof.

However, Section 11.2(e) of the APA provides that UIL is required to indemnify and hold the City harmless for any liabilities arising out of Section 2.3(f). The APA does not provide an exception for events that are aggravated or contributed to by UIL's subsequent actions.

vi. Subsequent Sale of PGW Assets

The APA does not prohibit UIL from selling any portion or all of PGW assets at any time after the sale is closed.

D. City Council's Role in Post-Sale Oversight of PGW

If PGW is sold to UIL, City Council, the City Controller, and the Mayor will lose the level of oversight those offices currently hold. Direct external governance of PGW will be limited to the PAPUC. The City, through its various offices, would have to apply for intervener status in PGW related matters before the PAPUC. Intervening in PGW rate cases before the PAPUC will require certain costs including hiring outside consultants and possibly regulatory counsel. The direct oversight structure of PGW as a municipally-owned and as an investor-owned utility is provided in Figure 16 and Figure 17.

Figure 16: Current Regulatory Oversight

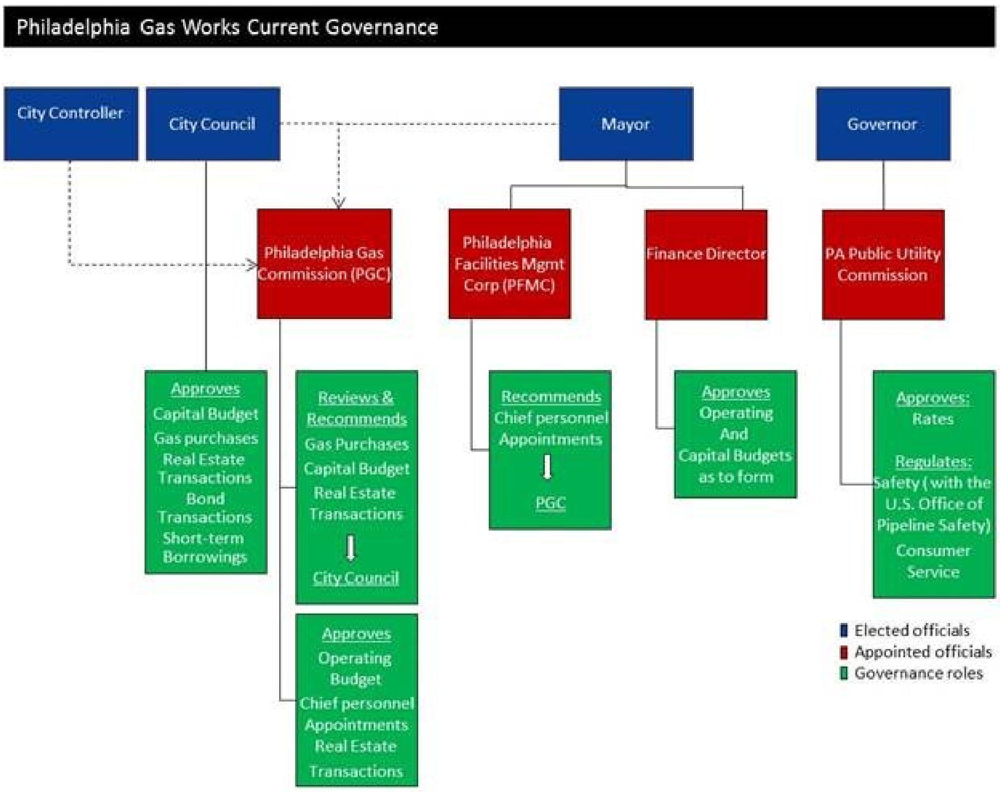
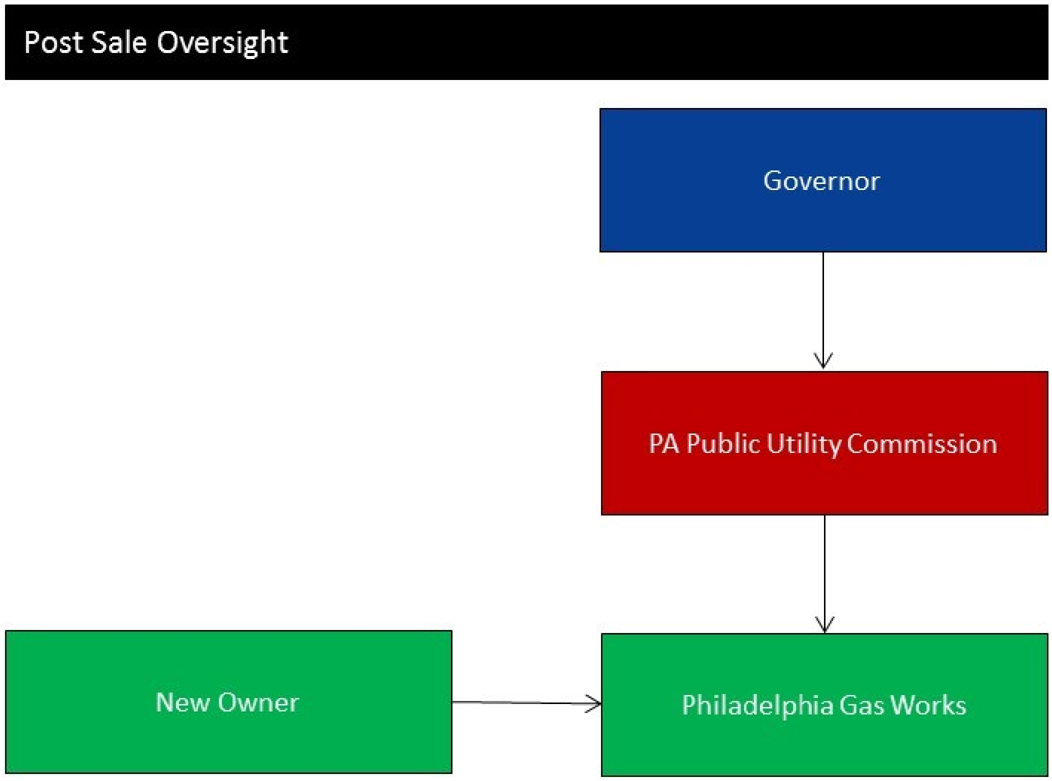


Figure 17: Under UIL Ownership



<u>Question #10:</u> What financial impact do the elimination of the franchise fee and the imposition of property and income taxes have on the City?

<u>Response to Question #10</u>: After a sale of PGW, the City will no longer receive the annual $18 million franchise fee. On a present value basis, Concentric has valued the foregone franchise fee at between $171 million and $200 million. The City will, however, gain new sources of revenue from a privately-held PGW, including property taxes, the Business Use and Occupancy tax, and the BIRT. The forecasted new sources of revenue from property and income taxes are considerably less than the franchise.

<u>Question #11</u>: What other objectives, conditions and/or considerations could be examined by City Council? Are there specific commitments City Council members have sought or inquired about that are not definitive or are not addressed in the APA?

<u>Response to Question #11</u>: There are other public policy issues that were raised by City Council members that City Council could evaluate in its decision-making process. Those issues include, but are not necessarily limited to: 1) the continuation of PGW's customer support programs; 2) the continuation of programs not mentioned in the APA; 3) the disposition of PGW's liens on customers' properties; 4) safety considerations; 5) risks related to the liabilities retained by the City after the close of the transaction; 6) economic development and job creation; and 7) the lack of limitations on UIL's ability to sell some or all of PGW's assets in the future. UIL's commitments for certain of those issues after the closing of the transaction are not definitive or are not addressed in the APA.

<u>Question #12</u>: What role will City Council have with regard to the oversight and/or regulation of PGW if the sale is approved? What is the governance and regulatory structure under which a UIL-owned PGW would operate?

<u>Response to Question #12</u>: City Council's role with regard to the oversight and/or regulation of PGW if the sale is approved will be greatly diminished if the sale is approved. The overall governance and regulatory structure of PGW will be significantly simplified, with fewer entities having direct oversight of the utility. The PAPUC will be the primary regulatory authority over PGW, and will continue to have ultimate rate setting authority for PGW.

XII. CONCLUSION

Concentric greatly appreciates the opportunity to present our analysis and findings related to the proposed sale of PGW to UIL. Concentric recognizes that this is a complex matter to evaluate, and we are hopeful that the information contained herein will inform City Council as to the key commercial, financial and economic aspects of the proposed APA. Concentric further recognizes that the aspects of the proposed transaction that are reviewed in this report do not represent the totality of all issues to be considered by City Council as it evaluates the proposed transaction. Finally, we recognize that in reaching its decision, City Council will necessarily weigh the myriad of financial, employment, rate, public policy, economic development, and social considerations, as well as the programs and functions that PGW provides as a City-owned utility. As such, while this report responds to specific questions regarding the PGW sales process and results, the decision whether to approve of the sale will necessarily depend on City Council's conclusions regarding the ability of a privately-held PGW to satisfy City Council's objectives for the future ownership, oversight, and operation of PGW.

Concentric Energy Advisors, Inc.

Philadelphia Gas Works

Statements of Revenues and Expenses
Years ended August 31
(Thousands of U.S. dollars)

	2013	2012	2011
Operating Revenues			
Gas Revenues			
Non-Heating	35,262	37,054	51,437
Gas Transport Service	37,078	29,324	28,700
Heating	602,814	562,009	669,131
Total Gas Revenues	675,154	628,387	749,268
Appliance and Other Revenues	8,333	8,240	8,400
Other Operating Revenues	9,984	8,356	8,611
Total Operating Revenues	693,471	644,983	766,279
Natural Gas	255,501	233,713	330,932
Gross Margin	437,970	411,270	435,347
Total Operating Expenses Before Depreciation	277,468	276,450	271,793
Depreciation	45,912	45,045	43,629
Less Depreciation Expense Included in Operating Expenses Above	4,870	4,870	4,714
Total Depreciation	41,042	40,175	38,915
Total Operating Expenses	574,011	550,338	641,640
Operating Income	119,460	94,645	124,639
Interest and Other Income	1,147	4,659	4,348
Income Before Interest Expense	120,607	99,304	128,987
Interest Expense			
Long-Term Debt	49,655	53,012	57,225
Other	10,740	16,824	18,884
Allowance for Funds Used During Construction	(430)	(292)	(427)
Total Interest Expense	59,965	69,544	75,682
Excess of Revenues Over Expenses	60,642	29,760	53,305

Philadelphia Gas Works

Balance Sheets

Years ended August 31

(Thousands of U.S. dollars)

Assets	2013	2012	2011
Utility Plant, At Original Cost			
In Service	1,951,546	1,894,129	1,856,303
Under Construction	44,409	53,851	40,555
Total Utility Plant, At Original Cost	1,995,955	1,947,980	1,896,858
Less Accumulated Depreciation	840,968	822,330	785,780
Utility Plant, Net	1,154,987	1,125,650	1,111,078
Restricted Investment Funds			
Sinking Fund, Revenue Bonds	105,280	105,312	112,038
Capital Improvement Program	44,055	88,838	122,332
Workers' Compensation Escrow Fund	2,597	2,597	2,596
Health Insurance Escrow Fund	3,223	3,222	-
Total Restricted Investment Funds	155,155	199,969	236,966
Current Assets			
Cash and Cash Equivalents	100,933	75,826	105,386
Accounts Receivable	97,749	81,997	98,925
Gas Inventories, Materials, and Supplies	80,234	81,086	85,993
Other Current Assets and Deferred Debits	16,196	26,939	35,523
Total Current Assets	295,112	265,848	325,827
Noncurrent Assets			
Unamortized Bond Issuance Costs	15,736	17,417	24,585
Other Assets and Deferred Debits	33,097	30,996	30,640
Total Noncurrent Assets	48,833	48,413	55,225
Accumulated Fair Value of Hedging Derivatives	12,059	34,712	25,360
Unamortized Losses on Reacquired Debt	44,868	53,241	62,039
Total Assets	1,711,014	1,727,833	1,816,495

Philadelphia Gas Works

Balance Sheets (continued)
Years ended August 31
(Thousands of U.S. dollars)

Liabilities	2013	2012	2011
Long-Term Debt			
Revenue Bonds	1,033,976	1,086,502	1,166,992
Current Liabilities			
Current Portion of Revenue Bonds	52,406	30,545	50,549
Accounts Payable	59,379	57,127	55,893
Customer Deposits	2,305	2,449	2,869
Other Current Liabilities	9,107	10,265	12,098
Accrued Accounts			
Interest, Taxes, and Wages	14,823	15,555	17,476
Distribution to the City	3,000	3,000	3,000
Total Current Liabilities	141,020	118,941	141,885
Other Liabilities	177,431	206,445	197,878
Total Liabilities	1,352,427	1,411,888	1,506,755
Net Position			
Excess of Net Investment in Capital Assets	112,660	97,442	15,869
Restricted	111,100	111,131	114,634
Unrestricted	134,827	107,372	179,237
Total Net Position	358,587	315,945	309,740
Total Liabilities and Net Position	1,711,014	1,727,833	1,816,495

APPENDIX II: PGW'S AUTOMATIC RATE ADJUSTMENT RIDERS, CHARGES AND SURCHARGES

The following is a complete list of PGW's automatic rate adjustment riders, charges and surcharges that are currently in the PGW Gas Service Tariff No. 2.

Rate Name	Rate Code	Description/Notes
Gas Cost Rate	GCR	• Tracks PGW's gas costs, and may be increased or decreased from time to time to reflect gas cost changes. • The Company's rate is subject to quarterly adjustments for recovery of the GCR. • Net over billings (or under billings) in prior periods are applied as a debit (or credit) to future gas cost rates.
Revenue Reconciliation Adjustment Rider	RRA	• Equal to the annual margin in excess of the cost of natural gas to provide the service projected to be realized from interruptible sales under Boiler and Power Plant Service, Load Balancing Service, and Cogeneration Service in the period September 1, 2002, to August 31, 2003, and the transportation charge revenue from transportation service provided pursuant to the pilot rate schedule IT-P.
Senior Citizen Discount	SCD	• A 20 percent reduction in monthly charges for gas service for senior citizens who satisfy certain conditions. • Enrollment in this program was closed September 1, 2003.
Migration/Reverse Migration Rider	MRM	• Established to provide a method for recovery of net over/under collected gas costs from customers who switch between firm retail sales service and transportation service, or switch between firm retail sales service and interruptible retail sales service.
Exit Fee Rider	EFR	• A five-year fee that may be applied to customers moving from firm to interruptible service.
Merchant Function and Gas Procurement Charges	MFC	• A volumetric charge applied to firm sales service customers that is included in the "price to compare." • Based on the gas cost rate multiplied by a fixed uncollectible percentage established in PGW's last general base rate proceeding.

Restructuring and Consumer Education Surcharge	RCE	• Applied to all volumes of gas delivered. • Costs are PAPUC-approved costs that PGW has or will incur to meet the requirements of the Natural Gas Choice and Competition Act and applicable PAPUC regulations, order and other regulatory requirements, other than those costs pertaining to universal service and energy conservation programs. • Reconciled annually based on actual over/under recoveries.
Efficiency Cost Recovery Surcharge	ECR	• Applicable to all volumes of gas delivered. • Costs are approved energy efficiency program costs. • Quarterly reconciled based on actual over/under recoveries. • The costs related to customers other than low-income residential customers are tracked and recovered separately from the following firm customer rate classes if that class is served by the energy efficiency program: (a) residential and public housing customers on Rate GS; (b) commercial customers on Rate GS; (c) industrial customers on rate GS; (d) municipal customers on rate MS; and (e) the Philadelphia Housing Authority. • The Enhanced Low Income Retrofit Program costs are recovered through the Universal Services Surcharge.
Universal Services and Energy Conservation Surcharge[102]	USS	• Applicable to all volumes of gas delivered. • Recovers: (1) discounts provided to customers pursuant to the CRP; (2) discounts provided to customers pursuant to the Senior Citizen Discount; (3) the costs of the Conservation Works Program and the Enhanced Low Income Retrofit Program; and (4) for customers entering the CRP on or after September 1, 2003, past due arrearages forgiven pursuant to the CRP/CAP Program Design Stipulation. • Adjusted quarterly.
Other Post Employment Benefit Surcharge	OPEB	• Applicable to all volumes of gas delivered. • Recovers the amounts necessary to fund PGW's OPEB obligations. • Adjusted annually.

102 Note, the APA referred to this surcharge as the "Universal Services and Customer Education Surcharge (USS)" whereas the PGW Gas Service Tariff No. 2 refers to this surcharge as the "Universal Service and Energy Conservation Surcharge."

Special Provision – Air Conditioning Rider	SPI or ACR	• Applicable to retail customers with directly or indirectly-fired gas cooling equipment of a minimum capacity.
Special Provision – Compressed Natural Gas Rider	SP2 or CNG	• The rate is the same as Rate GS. • Retail services provided under this rate are dispensed on a liquid gallon basis but billed on a Mcf basis.
Emergency/ Unauthorized Use Gas Rider	SP3 or EUR	• Offered to interruptible customers when gas would otherwise not be available under their rate schedules.
Weather Normalization Adjustment Clause	WNA	• Applied to volumes used for heating purposes during the period October 1 through May 31. • Results in a positive or negative adjustment to rates depending on whether the heating season was colder or warmer than normal (based on the heating season at the time of PGW's last base rate case).
Distribution System Improvement Charge	DSIC	• To recover the reasonable and prudent costs incurred to repair, improve, or replace eligible property that is completed and placed in service and recorded between rate cases and to provide PGW with the resources to accelerate the replacement of aging infrastructure. • Excludes the costs of extending facilities to serve new customers. • Adjusted quarterly. • The DSIC is equal to recoverable costs divided by projected quarterly revenues for distribution service.

APPENDIX III: PGW'S BASE RATES

The following are PGW's base rate classes, per the PGW Gas Service Tariff No. 2.

Rate Name	Rate Code	Description
General Service	GS	• Applicable to all retail sales service or transportation service for residential, Public Housing Authority, commercial, and industrial customers.
Municipal Service	MS	• Applicable to all retail sales service or transportation service for properties owned or occupied by the City or the Board of Education. • Not available to commercial tenants.
Philadelphia Housing Authority Service	PHA	• Applicable to all retail sales service or transportation service for multiple dwelling residential buildings containing 10 or more units, owned and operated by the Philadelphia Housing Authority, where cooking will be performed exclusively with gas and where gas service will be supplied through one or more single point metering arrangements.
Boiler and Power Plant Service	BPS	• Available for customers with alternate fuel capability. • Service agreement required with minimum of 2,500 Mcf/year. • Interruptible service.
Load Balancing Service	LBS	• Available for industrial and commercial establishment and multi-family residential buildings for seasonal gas use. • Service agreement required with minimum of 5,000 Mcf/year. • Interruptible service.
Daily Balancing Service	DB	• Service offered to suppliers serving Rate IT customers who can manage their businesses without the use of gas during periods of curtailment or interruption. • Available to self-transporters or suppliers licensed by the PAPUC who meet certain credit requirements.
Interruptible Transportation Service	IT	• Service offered to interruptible customers who can manage their businesses without the use of gas during periods of curtailment or interruption. • Available to commercial and industrial customers.

Rate Name	Rate Code	Description
Gas Transportation Service – Firm Service	GTS	• Only available to customers who utilized this service on or before September 1, 2003.
Gas Transportation Service – Interruptible	GTS	• Only available to customers who utilized this service on or before September 1, 2003.
Cogeneration Service	CG	• Available to commercial and industrial customers using any form of combined cooling, heating and power production where there is sequential production of electrical energy and thermal energy from the same fuel source by a qualifying facility. • Interruptible service.
Developmental Natural Gas Vehicle Service – Firm Service	NGVS	• Provided to any customer for exclusive purpose of compressing the gas for use as motor vehicle fuel. • Uninterruptible (*i.e.*, firm) service.
Developmental Natural Gas Vehicle Service – Interruptible	NGVS	• Provided to any customer for exclusive purpose of compressing the gas for use as motor vehicle fuel. • Interruptible service.
Liquefied Natural Gas Service	LNG	• Available at PGW's sole discretion where the customer is able to arrange for the transportation of LNG via truck from PGW's LNG facilities.

APPENDIX IV: THE CITY'S HIGH-LEVEL COMPARISON OF FINAL BIDS

Project Sixers **PRIVILEGED AND CONFIDENTIAL**

BID COMPARISON

THIS IS A HIGH LEVEL SUMMARY OF THE KEY PROVISIONS OF EACH BIDDER'S FINAL BID, HOWEVER, A SUBSTANTIAL AMOUNT OF ADDITIONAL ANALYSIS WAS PERFORMED. PLEASE CONSULT THE APA AND BID PACKAGES FOR FURTHER INFORMATION.

	Issue/Category	14-6009 CH (UIL)	14-6009 EJ	14-6009 AR	14-6009 ED
1.	**Purchase Price**	$1,860,000,000	$1,836,000,000	$1,720,000,000	$1,700,000,000
2.	**Level of Material Edits to City's Initial APA**	Light	Light	Heavy	Heavy
3.	**Certainty of Closing; City's Recourse Against Buyer**	**Financing**: Buyer has committed equity and debt financing. If Buyer cannot obtain the financing, Seller can force UIL to close or sue for substantial money damages. **Quality of Commitments**: UIL's debt commitment is predominantly from Morgan Stanley, an internationally recognized financial institution and infrastructure lender. The commitment letters are strong and suggest certainty.	**Financing**: Bidder and Parent (both shell companies) had committed equity and debt financing. To the extent all closing conditions were met and the City was ready to close, but Bidder/Parent could not obtain the financing or decided not to close, the City's sole remedy was to pursue a claim against two third-party guarantors for up to a maximum recovery of only $15M. **Quality of Commitments**: The equity and debt commitments provided by Bidder were strong, as the guarantor was a subsidiary of an internationally recognized financial entity with a strong balance sheet.	**Financing**: Bidder and Parent (both shell companies) had committed equity and debt financing. To the extent all closing conditions were met and the City was ready to close, but Bidder/Parent could not obtain the financing or decided not to close, the City's sole remedy was to pursue a claim against Bidder for $86M (however, Bidder was not a capitalized entity and had no assets, making the collection of such amount uncertain). **Quality of Commitments**: The commitments provided by Bidder were drafted well and were contractually binding, but the confidence that such equity investors would have the capital and commit the capital at closing was not certain, particularly with respect to the equity investors. Additionally, Bidder's initial commitment	**Financing**: Bidder is a large, publicly traded company with sufficient cash and access to equity and debt. If Bidder could not obtain financing or decided not to close, the City would have a claim against a large, public company with substantial assets. **Quality of Commitments**: Strong corporate balance sheet.

BID COMPARISON

THIS IS A HIGH LEVEL SUMMARY OF THE KEY PROVISIONS OF EACH BIDDER'S FINAL BID, HOWEVER, A SUBSTANTIAL AMOUNT OF ADDITIONAL ANALYSIS WAS PERFORMED. PLEASE CONSULT THE APA AND BID PACKAGES FOR FURTHER INFORMATION.

	Issue/Category	14-6009 CH (UIL)	14-6009 EJ	14-6009 AR	14-6009 ED
				letters were contractually insufficient and Bidder continued to add equity holders to the investor group. Bidder's commitment letters would expire on 8/31/2014.	
4.	**Employee Retention**	Maintain the current workforce level for three years, provided that UIL does not have to replace employees that voluntary terminate/retire so long as the workforce level does not drop below **1,350**.	Maintain the current workforce level for three years, provided that Bidder would not have to replace employees that voluntary terminate/retire so long as the workforce level did not drop below **1,300**.	For three years, Bidder would not terminate union employees, except in accordance with the CBA, provided, that Bidder received PUC approval of rate recovery in future base rate filings for expenses associated with such employees. No commitment to non-union employee retention.	Bidder would only commit to employing an aggregate number of union employees equivalent to the number of employees who accepted offers of employment at closing for two years, less the number of employees that resigned, retired, or were terminated for cause.
5.	**Environmental Liability Assumption**	UIL assumed all environmental liabilities, whether known or unknown, occurring pre- or post-Closing and whether on a City-owned site or a third party site.	Same offer as UIL.	Bidder only agreed to assume "prudently incurred" environmental liabilities on sites owned by third parties. Bidder did agree to assume all environmental liabilities on City-owned properties.	Bidder only agreed to assume environmental liabilities on current City-owned properties and liabilities on the formerly-owned properties so long as the City disclosed the liabilities at signing (shifting the burden to the City).
6.	**Indemnification**	UIL is requiring the City to indemnify for breaches of reps and warranties, but not for the reps and warranties relating to environmental, labor/employment and	Same offer as UIL.	Same offer as UIL.	Bidder did not agree to the City's proposal and offered an indemnity package that was significantly less favorable to the City.

THIS IS A HIGH LEVEL SUMMARY OF THE KEY PROVISIONS OF EACH BIDDER'S FINAL BID, HOWEVER, A SUBSTANTIAL AMOUNT OF ADDITIONAL ANALYSIS WAS PERFORMED. PLEASE CONSULT THE APA AND BID PACKAGES FOR FURTHER INFORMATION.

	Issue/Category	14-6009 CH (UIL)	14-6009 EJ	14-6009 AR	14-6009 ED
		benefits. The City need not pay claims until the Buyer's losses reach $20M and the City only has exposure up to $100M for breaches of reps and warranties. The Buyer has to bring a claim within 12 months.			
7.	**Operational Experience**	UIL is a publicly traded utility with significant expertise and experience in both natural gas operation and integration of acquisitions.	The deal team included a natural gas utility operator as a minority partner.	None.	Bidder is a natural gas utility operator.
8.	**Labor Unions**	All of UIL's operating companies have unionized workforces. UIL has a strong relationship with its local bargaining units affiliated with the Utility Workers Union of America: The United Illuminating Company Local 470-1, units 1 and 2, and Connecticut Natural Gas Corporation Local 380. UIL verbally indicated that it would seek a long-term (4 or 5 years) contract with Local 686, which would bring its union workforce in line with UIL's other benefits and wages.	Bidder's minority partner has a history of working collaboratively with organized labor, as unions represent a meaningful component of the its employee base. Bidder verbally indicated it would seek a 1 or 2-year extension of the current CBA with Local 686 with flexible work rule changes to be sought, but no change to current benefits.	Not Applicable.	A meaningful component of Bidder's employee base is unionized.
9.	**Diversity, Social Programs and**	UIL maintains a list of qualified MWDBE contractors	Bidder committed to convening a Diversity Advisory	Bidder made no firm commitments with regard to	Bidder made no specific commitments beyond adhering

BID COMPARISON

THIS IS A HIGH LEVEL SUMMARY OF THE KEY PROVISIONS OF EACH BIDDER'S FINAL BID, HOWEVER, A SUBSTANTIAL AMOUNT OF ADDITIONAL ANALYSIS WAS PERFORMED. PLEASE CONSULT THE APA AND BID PACKAGES FOR FURTHER INFORMATION.

Issue/Category	14-6009 CH (UIL)	14-6009 EJ	14-6009 AR	14-6009 ED
Community Plans	(34 minority-owned and 95 women-owned businesses). Twenty-four MBE and 45 WBE businesses received contracts in 2013. UIL indicated intention to support numerous social programs and initiatives, including creating a new education partnership, investing in specific job training and placement, implementing a work re-entry program, developing a program to support economic development and utilization of existing gas infrastructure, and establishing an urban renewal initiative that would redevelop properties adjacent to or near existing gas facilities. UIL's current workforce is well diversified, both from a race and gender perspective.	Committee, creating an internal steering committee, and developing a minority recruitment program and workforce development and training program to advance minority employees. Bidder planned to apply MWDBE policies to all external spending and not just large contracts. Bidder contributed $940,000 to a charity supporting MWDBE businesses. Bidder's workforce is not nearly as diverse as UIL's current workforce.	MWDBE efforts other than to operate as an equal opportunity employer and comply with all applicable local, state and federal laws governing hiring, contracting and sourcing. No diversity statistics given no current operations.	to its existing policies with regard to its MWDBE efforts.

Note: Bidder #14-6009 CL submitted a final proposal on January 31, 2014. Due to the substantially lower value of the offer ($1,400,000,000), to be most cost effective, the City did not undertake a comprehensive analysis of each deal point, and negotiation with each Bidder did not progress.

APPENDIX V: VALUATION METHODOLOGIES

A. DCF Analysis

The DCF analysis measures the value of PGW by calculating the present value of cash flows that are expected to be derived from PGW in the future. The basic DCF formula is:

$$PV = \sum \frac{E_i}{(1+k)^i}$$

Where:

PV = present value
E_i = the expected amount of cash flow in period i
k = the discount rate or cost of capital

Using this approach, Concentric developed a 30-year forecast of cash flows for PGW and discounted those cash flows back to a valuation date of August 31, 2014. In order to develop a forecast of expected cash flows, Concentric began with PGW's five-year financial forecast of revenues and expenses for fiscal year 2015 through fiscal year 2019 and, based on our analyses of historical trends in growth rates and assumptions regarding the continuation of those trends into the future, Concentric applied escalation rates to specific line items to forecast data through August 31, 2044.

For PGW's forecasted revenues, Concentric assumed a three-year base rate freeze as committed to by UIL in the APA. Following the three-year rate freeze period, Concentric analyzed the expected return earned by UIL on its utility investment (*i.e.*, the earned ROE) in each year of the forecast. If UIL's earned ROE in a single year was projected to fall more than 1.00 percent (*i.e.*, 100 basis points) below the regulatory authorized ROE assumed in the valuation of 9.75 percent or if UIL's earned ROE in three consecutive years was projected to fall more than 0.50 percent (*i.e.*, 50 basis points) below the assumed authorized ROE in each year, then Concentric assumed that UIL would file a rate case that would result in UIL being provided with sufficient revenues from rates to earn its regulatory authorized ROE in the following year.

Since PGW's five-year financial forecast is based on municipal ownership, Concentric also incorporated certain incremental cost items that are expected to be incurred by a privately-held

PGW. Specifically, Concentric incorporated corporate income and non-income taxes (*i.e.*, BIRT, property taxes, and the City's Use & Occupancy Tax).

Concentric also incorporated assumptions regarding cost savings (*i.e.*, "synergies") that may be achievable by a buyer of PGW. Specifically, Concentric applied a range of synergies of zero percent to 28.0 percent, consistent with the range applied by Lazard in its Cost/Benefit Analysis. Concentric assumed that a buyer of PGW would retain 100 percent of the synergies achieved during the three-year base rate freeze, and subsequent to the base rate freeze period, Concentric assumed that realized synergies would improve PGW's ability to earn its authorized return on equity and thus defer and/or reduce the need to seek rate relief.

Concentric estimated the discount rate to apply to forecasted cash flows by developing a weighted average cost of capital ("WACC") that is reflective of the costs of equity and debt for investor-owned natural gas utilities. Using two standard approaches for estimating the ROE for utility companies (*i.e.*, an alternate form of the DCF analysis and the capital asset pricing model), Concentric estimated an after-tax ROE of between 9.00 percent and 10.50 percent. Concentric estimated a pre-tax cost of debt of 4.40 percent based on prevailing debt rates for highly rated utilities as indicated by the Moody's A-rated Utility Bond Index.[103] In order to estimate the capital structure, Concentric considered the range of capital structures employed by a proxy group of eight comparable natural gas utilities, which have generally ranged between 40.0 percent and 60.0 percent equity.

For the period after the end of Concentric's forecast horizon (*i.e.*, 2044), Concentric estimated a terminal value for PGW, which represents the continuing value of the entity beyond the period in which Concentric forecasted cash flows. Concentric estimated the terminal value of PGW using three approaches. First, Concentric applied a range of earnings before interest, taxes, depreciation and amortization ("EBITDA") multiples to the expected EBITDA generated by PGW in fiscal year 2044. Concentric developed a range of EBITDA multiples based on the comparable trading multiples analysis discussed below. Second, Concentric applied a range of price-to-earnings ratios to the expected earnings generated by PGW in fiscal year 2044. The range of price-to-earnings ratios

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[103] The average S&P and Moody's credit ratings for the proxy group of eight natural gas LDCs used to estimate the cost of equity discussed below is A- and A2, respectively.

was also derived from the comparable trading multiples analysis discussed below and Concentric included the expected balance of debt in 2044 in order to estimate the terminal enterprise value of PGW. Finally, Concentric applied the Gordon Growth Model, or perpetual growth model, to the expected earnings in fiscal year 2044, assuming perpetual growth at the rate of inflation (*i.e.*, 2.30 percent). The Gordon Growth Model provides a terminal value price by assuming that the asset being valued will grow in perpetuity at a constant rate. A detailed list of key assumptions used in Concentric's DCF analysis is provided in the following figure:

Figure 18: DCF Analysis Assumptions

GENERAL		
Valuation Date	August 31, 2014	
Forecast Horizon	30 years (September 1, 2014 to August 31, 2044)	
Fiscal Year	September 1 to August 31	
Inflation Rate	2.30% per year	
REVENUES	**FY 2015 TO FY 2019**	**FY 2020 TO FY 2044**
Non-Heating	PGW's Five-Year Forecast	-2.48% per year (FY 2013 to FY 2019 Compound annual growth rate ("CAGR"))
Gas Transport Service	PGW's Five-Year Forecast	2.30% per year
Heating	PGW's Five-Year Forecast	1.79% per year (FY 2013 to FY 2019 CAGR)
DSIC	• Eligible plant additions of \$22 million per year • Depreciation rate of 2.05% per year • Pre-tax rate of return	Same
Revenue Enhancement	Revenue required to set earned ROE equal to authorized ROE of 9.75% when the earned ROE is more than 100 basis points below the authorized ROE in prior year (beginning in FY 2018 after three-year base rate freeze) or more than 50 basis points below the authorized ROE for a consecutive three-year period	Same
Appliance and Other Revenues	PGW's Five-Year Forecast	Prior year escalated by 1.00%
EXPENSES	**FY 2015 TO FY 2019**	**FY 2020 TO FY 2044**
Natural Gas	PGW's Five-Year Forecast	Year-over-year percent change of the total of non-heating, gas transport service and heating revenues

Gas Processing	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Field Services	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Distribution	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Collection and Account Management	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Provision for Uncollectible Accounts	PGW's Five-Year Forecast	5.00% of non-heating and heating revenues and revenue enhancement
Customer Service	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Marketing	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Administrative and General	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Health Insurance	PGW's Five-Year Forecast	Prior year escalated by 5.00%
Capitalized Fringe Benefits	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Capitalized Administrative Charges	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Environmental	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Pensions	PGW's Five-Year Forecast (excluding amortization of unfunded liability)	Prior year escalated by 0.50% (FY 2013 to FY 2022 CAGR of normal cost per Aon Hewitt)
Other Postemployment Benefits	PGW's Five-Year Forecast	Prior year escalated by 5.00%
Employment Taxes	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Property Tax	• Total property assessment of $38.7 million ($2015) per Office of Property Assessment adjusted for inflation • Tax rate of 2.10%	Same
Use and Occupancy Tax	• Total property assessment of $38.7 million ($2015) per Office of Property Assessment adjusted for inflation less exemption of $177,000 per property • Tax rate of 1.13%	Same
Tax Depreciation	• Basis equal to calculated valuation • 20-year Modified Accelerated Cost Recovery System ("MACRS")	Same
Corporate Income Taxes	• State income tax rate of 9.99% • Federal income tax rate of 35.0% • Effective tax rate of 41.49%	Same

Business Income and Receipts Tax (Gross Receipts)	• Only applies to gross receipts generated by PGW's Parts & Labor Plan less gross receipts associated with net income exemption (see below) • Tax rate of 0.1415%	Same
Business Income and Receipts Tax (Net Income)	• Only applies to net income generated by PGW's Parts & Labor Plan • PGW's management estimated profit margin for Parts & Labor Plan at 6.00% of gross receipts • $75,000 of net income not subject to tax (increases to $100,000 in 2016) • Tax rate of 6.41% in 2015 decreasing to 6.25% by 2019	• Only applies to net income generated by PGW's Parts & Labor Plan • PGW's management estimated profit margin for Parts & Labor Plan at 6.00% of gross receipts • $100,000 of net income not subject to tax • Tax rate of 6.20% in 2020 decreasing to 6.00% by 2023 and thereafter
SYNERGIES	**EXPENSE LEVELS IN THE "MODERATE SYNERGIES CASE"**	**EXPENSE LEVELS IN THE "INDUSTRY BENCHMARK SYNERGIES CASE"**
Gas Processing	86.0% of base expense	72.0% of base expense
Field Services	86.0% of base expense	72.0% of base expense
Distribution	86.0% of base expense	72.0% of base expense
Collection and Account Management	86.0% of base expense	72.0% of base expense
Provision for Uncollectible Accounts	No reduction of base expense	No reduction of base expense
Customer Service	86.0% of base expense	72.0% of base expense
Marketing	86.0% of base expense	72.0% of base expense
Administrative and General	86.0% of base expense	72.0% of base expense
Health Insurance	86.0% of base expense	72.0% of base expense
Capitalized Fringe Benefits	No reduction of base expense	No reduction of base expense
Capitalized Administrative Charges	No reduction of base expense	No reduction of base expense
Environmental	86.0% of base expense	72.0% of base expense
Pensions	No reduction of base expense	No reduction of base expense
Other Postemployment Benefits	No reduction of base expense	No reduction of base expense
Employment Taxes	86.0% of base expense	72.0% of base expense

CAPITAL EXPENDITURES	**FY 2015 TO FY 2019**	**FY 2020 TO FY 2044**
Gas Processing	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Distribution	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Field Services	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Fleet Operations	PGW's Five-Year Forecast	Prior year escalated by 2.30%
Other Departments	PGW's Five-Year Forecast	Prior year escalated by 2.30%

DISCOUNT RATE	
After-Tax Cost of Equity	9.00% to 10.50% (increments of 0.25%) based on results of a discounted cash flow analysis and a capital asset pricing model applied to a proxy group of natural gas distribution utilities as of June 30, 2014
Pre-Tax Cost of Debt	4.40% based on Moody's A-rated Utility Bond Index as of June 30, 2014
Equity Component of Capital Structure	40.0% to 60.0% (increments of 5.00%) based on eight-quarter average for a proxy group of natural gas distribution utilities as of March 31, 2014
Debt Component of Capital Structure	60.0% to 40.0% (increments of 5.00%) based on eight-quarter average for a proxy group of natural gas distribution utilities as of March 31, 2014
Pre-tax weighted average cost of capital ("PTWACC")	8.79% to 12.53% based on the parameters discussed above (*After-Tax Cost of Equity / (1 – Effective Tax Rate) x Equity Component of Capital Structure + Pre-Tax Cost of Debt x Debt Component of Capital Structure*)
After-tax weighted average cost of capital ("ATWACC")	5.14% to 7.33% based on the parameters discussed above (*After-Tax Cost of Equity x Equity Component of Capital Structure + Pre-Tax Cost of Debt x (1 – Effective Tax Rate) x Debt Component of Capital Structure*)
Proxy Group	• AGL Resources Inc. • Atmos Energy Corporation • New Jersey Resources Corporation • Northwest Natural Gas Company • Piedmont Natural Gas Company, Inc. • South Jersey Industries, Inc. • Southwest Gas Corporation • WGL Holdings, Inc.

TERMINAL VALUE	
EBITDA Multiple	• Comparable transactions analysis produces a range of results from 9.25x to 12.25x (first quartile to third quartile results) • Comparable trading multiples analysis produces a range of results from 9.00x to 13.60x (first quartile to third quartile results) • Median of overall range of 9.00x to 13.60x (*i.e.*, 11.30x) applied to EBITDA in FY 2044
Price-to-Earnings Ratio	• Comparable trading multiples analysis produces a range of results from 16.15x to 17.90x • Median (*i.e.*, 17.00x) applied to net income in FY 2044 • Includes estimate of outstanding debt in FY 2044
Gordon Growth Model	$\frac{Free\ Cash\ Flow_{FY\ 2044} * (1 + 2.30\%)}{ATWACC - 2.30\%}$

Figures 19, 20, and 21 below present the results of Concentric's DCF analysis. Each chart contains three vertical bars indicating the range of results for each terminal value methodology. The middle section of each bar represents results based on discount rates incorporating costs of equity between 9.50 percent and 10.00 percent and equity ratios between 45.0 percent and 55.0 percent. Concentric places greater emphasis on the results represented by the middle section of each bar in our overall consideration of valuation. The outer sections of each bar represent the minimum to maximum results.

Figure 19: DCF Analysis – Excluding Synergies

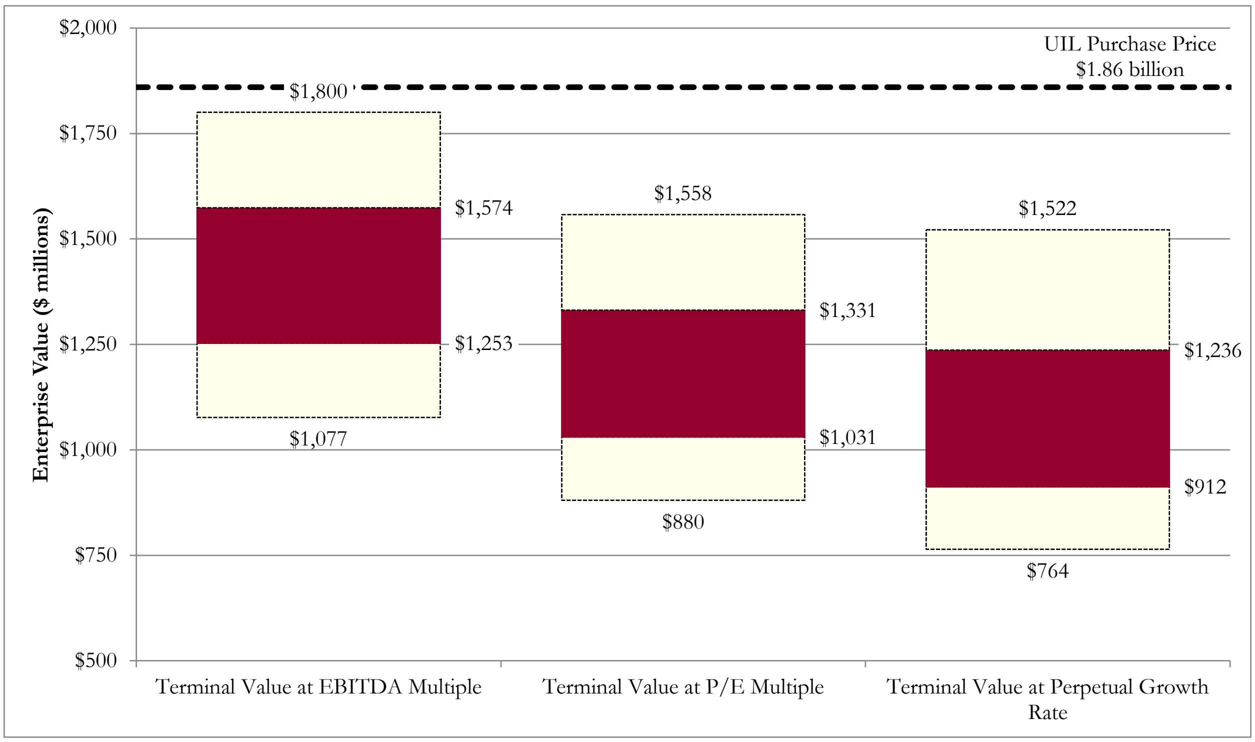


Figure 20: DCF Analysis – Including 14.0 Percent Synergies

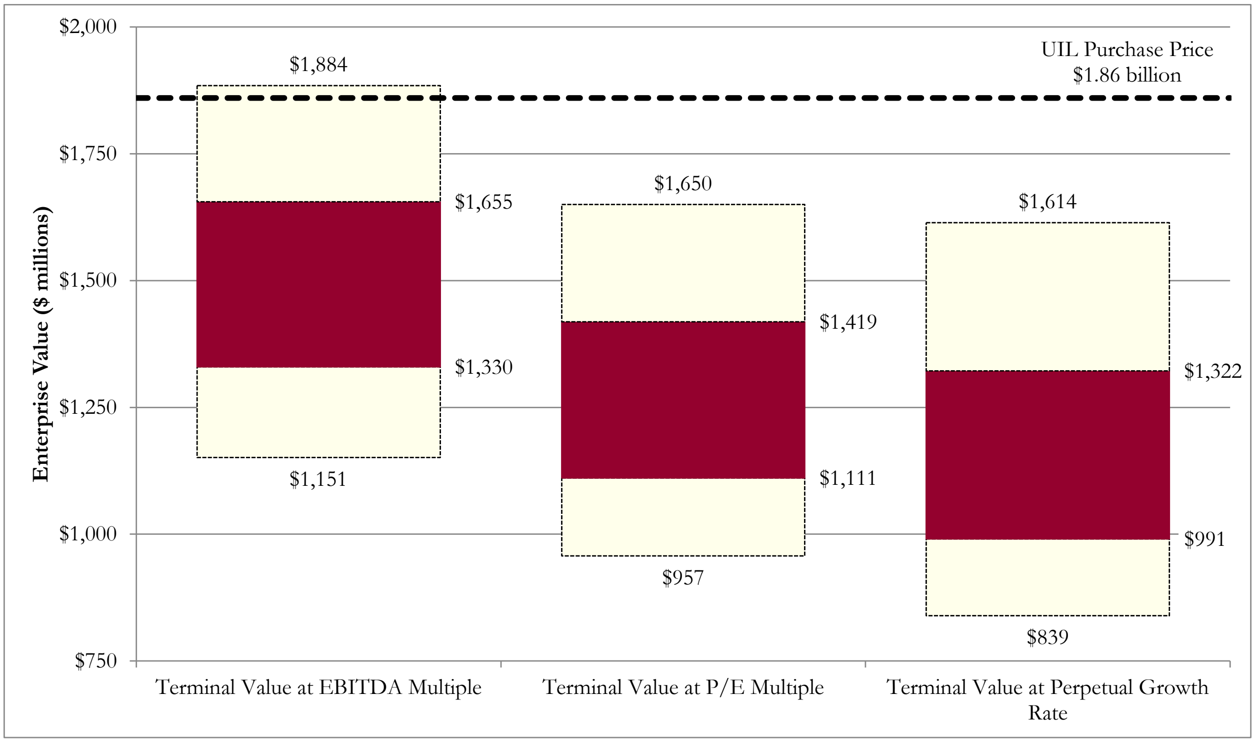
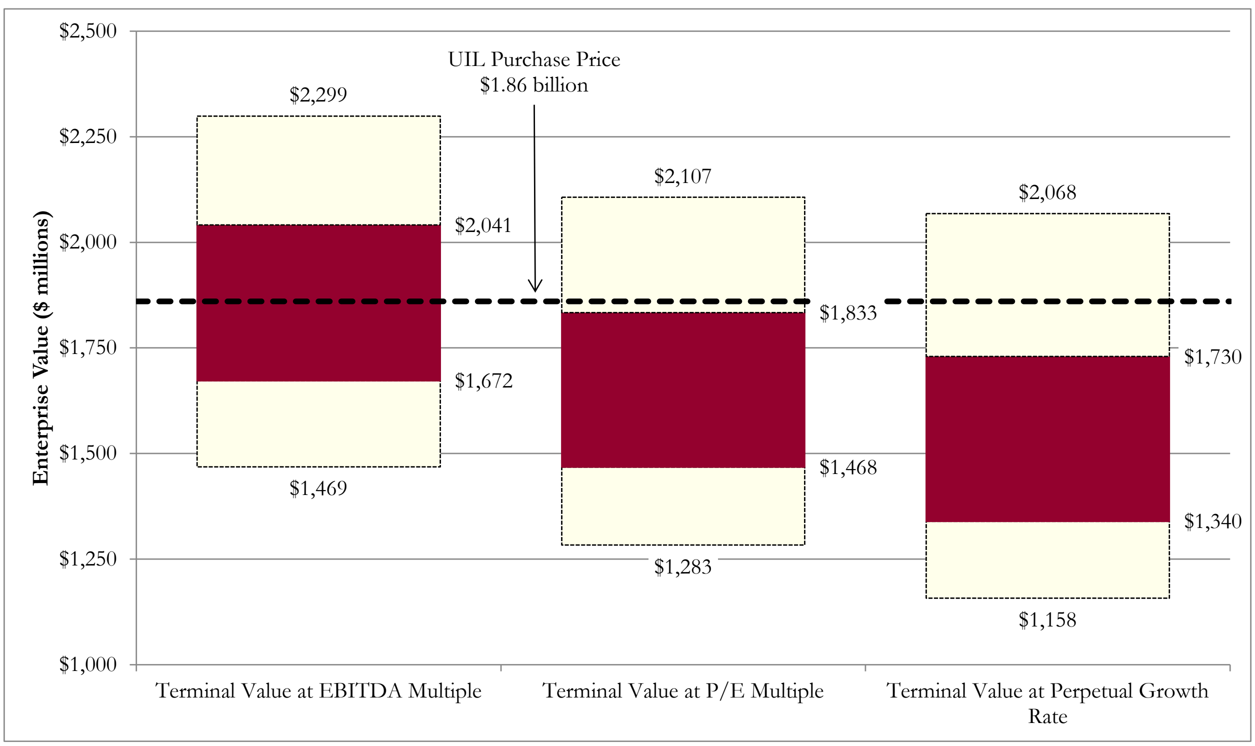


Figure 21: DCF Analysis – Including 28.0 Percent Synergies



B. Comparable Transactions

The comparable transactions analysis provides an estimate of the value of PGW by considering the value indicated by recent sales of comparable companies and assets in the market. In order to determine the implied value of PGW based on the comparable transactions analysis, Concentric reviewed certain transactions involving the acquisition of natural gas LDCs over the past ten years in the United States. Concentric excluded transactions that were known to have had terms that were not based on then-current market conditions or that were skewed by anomalous factors. The following page presents the list of transactions and implied valuation multiples considered by Concentric. Starting with the transaction value of each deal, Concentric calculated transaction value as a multiple of EBITDA for the most recent 12-month period as of the announcement date of the transaction and transaction value as a multiple of the ending balance of net property, plant and equipment ("PP&E") for the most recent 12-month period as of the announcement date of the transaction. Figure 23 contains a graphical representation of the implied values of PGW produced by the comparable transactions analysis. The chart contains two vertical bars indicating the range of results for each valuation multiple considered by Concentric. The middle section of each bar represents the first to third quartile results upon which Concentric places greater emphasis in our overall consideration of value. The outer sections of each bar represent the minimum to maximum results.

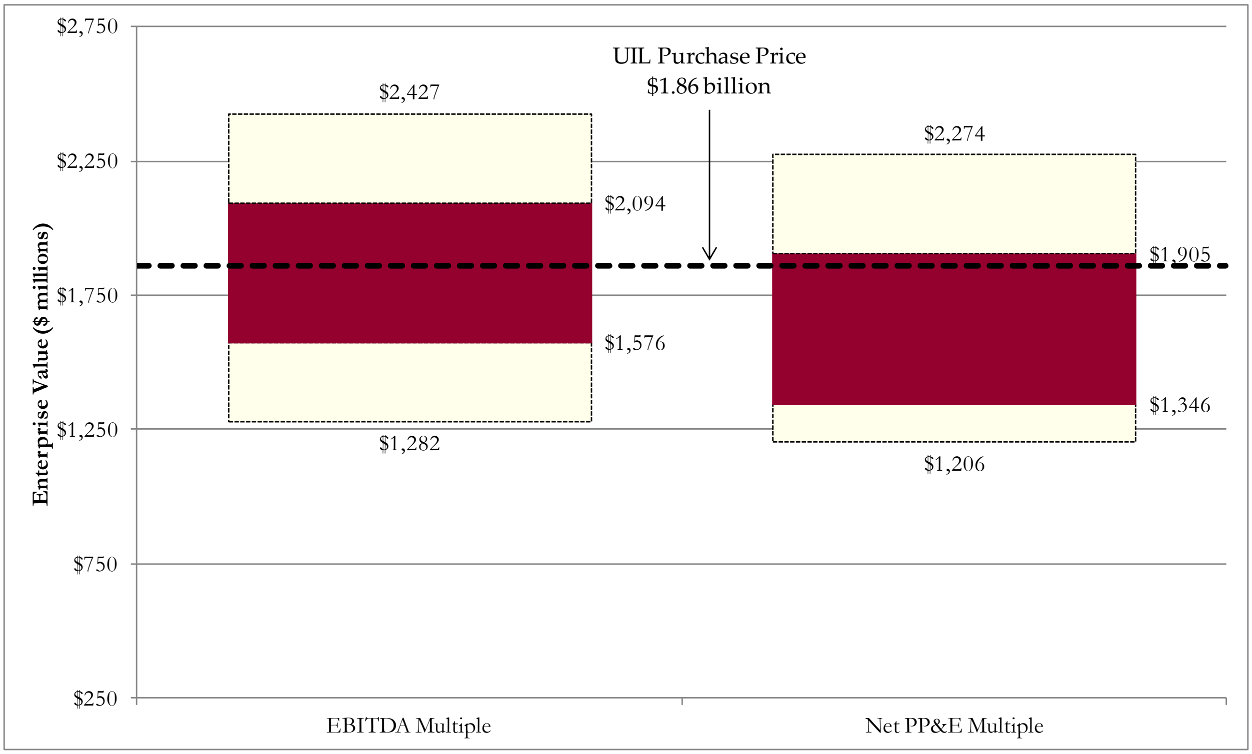
Figure 22: Comparable Transactions Analysis

Acquiror	Target	Announced Date	Closed Date	Transaction Value ($MM)	EBITDA Multiple	Net PP&E Multiple
UIL Holdings Corporation	**Philadelphia Gas Works**	**3/2/2014**	**Pending**	**1,860**	10.90	1.52
Laclede Group, Inc.	Albama Gas Corporation	4/5/2014	Pending	$1,600	12.77	1.82
TECO Energy, Inc.	New Mexico Gas Company	5/25/2013	Pending	$950	12.72	1.85
Algonquin Power & Utilities Corporation	New England Gas Company	2/11/2013	12/20/2013	$74	7.51	0.98
SteelRiver Infrastructure Partners, LP	Equitable Gas Company LLC and Equitable Homeworks LLC	12/20/2012	12/17/2013	$740	9.16	1.13
Laclede Group, Inc.	Missouri Gas Energy and New England Gas Company	12/14/2012	9/1/2013	$1,035	12.75	1.53
Algonquin Power & Utilities Corporation	Atmos Energy Corporation (Georgia assets)	8/8/2012	4/1/2013	$141	9.40	N/A
Algonquin Power & Utilities Corporation	Atmos Energy Corporation (Missouri, Illinois, Iowa assets)	5/12/2011	8/1/2012	$124	9.32	1.10
Algonquin Power & Utilities Corporation	Granite State Electric Company and EnergyNorth Natural Gas Inc.	12/8/2010	7/3/2012	$285	10.56	N/A
AGL Resources Inc.	Nicor Inc.	12/6/2010	12/9/2011	$3,099	9.21	1.05
UIL Holdings Corporation	Berkshire Gas Company, Connecticut Natural Gas Corporation and Southern Connecticut Gas Company	5/25/2010	11/16/2010	$1,296	8.98	0.99
Chesapeake Utilities Corporation	Florida Public Utilities Company	4/17/2009	10/28/2009	$151	9.51	N/A
Babcock & Brown Infrastructure Fund North America LP	Peoples Natural Gas Company	7/1/2008	2/1/2010	$780	7.99	1.35
MDU Resources Group, Inc.	Intermountain Gas Company	7/1/2008	10/1/2008	$327	8.88	1.70
Continental Energy Systems, LLC	Public Service Company of New Mexico (natural gas operations)	1/12/2008	1/30/2009	$620	12.33	1.39
SourceGas LLC	Arkansas Western Gas Company	11/19/2007	7/1/2008	$224	*22.49*	1.63
Cap Rock Energy Corporation	SEMCO Energy, Inc.	2/22/2007	11/9/2007	$817	10.90	1.38
WPS Resources Corporation	Peoples Energy Corporation	7/8/2006	2/21/2007	$2,463	*18.96*	N/A
MDU Resources Group, Inc.	Cascade Natural Gas Corporation	7/8/2006	7/2/2007	$466	9.54	1.36
National Grid USA	New England Gas Company (Rhode Island assets)	2/15/2006	8/24/2006	$575	12.09	0.99
UGI Corporation	PG Energy Inc.	1/26/2006	8/24/2006	$580	11.41	1.14
WPS Resources Corporation	Aquila, Inc. (Michigan natural gas operations)	9/21/2005	4/1/2006	$270	10.79	1.64
WPS Resources Corporation	Aquila, Inc (Minnesota natural gas operations)	9/21/2005	7/1/2006	$288	14.23	1.52
AGL Resources Inc.	NUI Corporation	7/14/2004	11/30/2004	$691	9.59	1.10
Atmos Energy Corporation	TXU Gas Company	6/17/2004	10/1/2004	$2,470	13.45	1.47
				Count	**22.00**	**20.00**
				Max	**14.23**	**1.85**
				Mean	**10.59**	**1.36**
				Median	**10.07**	**1.37**
				Min	**7.51**	**0.98**

Source: Concentric Energy Advisors, Inc. and SNL Financial LC

Excluded

Figure 23: Comparable Transactions Analysis



C. Trading Multiples

Similar to the comparable transactions analysis, Concentric also considered the results of a comparable trading multiples analysis. Concentric considered several market multiples for eight publicly-traded natural gas utilities used to develop the discount rate for the DCF analysis. Specifically, Concentric considered the following four market multiples and applied them to PGW's estimated earnings, sales, book value and EBITDA for fiscal year 2014 to determine the implied value of PGW: (1) forward price-to-earnings ratio; (2) price-to-sales ratio; (3) price-to-book ratio; and (4) enterprise value-to-EBITDA. The following page presents the list of publicly-traded natural gas utilities and market multiples considered by Concentric, followed by a graphical representation of the implied values of PGW produced by the comparable trading multiples analysis. The chart contains four vertical bars indicating the range of results for each trading multiple considered by Concentric. The middle section of each bar represents the first to third quartile results upon which Concentric places greater emphasis in our overall consideration of value. The outer sections of each bar represent the minimum to maximum results.

None of the comparable transactions or trading multiples utilized in the analyses is identical to PGW. Accordingly, an indication of value derived from comparable analyses is not entirely mathematical in nature; rather it involves judgment concerning factors that could affect the market value of the publicly-traded natural gas utilities selected for the analysis.

Figure 24: Comparable Trading Multiples Analysis

Company	Ticker	Market Cap ($MM)	Enterprise Value ($MM)	Forward P/E Multiple	Price/ Sales Multiple	Price/ Book Multiple	Enterprise Value/ EBITDA Multiple
AGL Resources Inc.	GAS	$5,942	$10,492	14.52	1.17	1.58	8.42
Atmos Gas Corporation	ATO	$4,740	$7,365	17.36	1.07	1.60	9.48
New Jersey Resources Corporation	NJR	$2,063	$2,950	13.95	0.56	2.14	12.74
Northwest Natural Gas Company	NWN	$1,178	$2,014	18.98	1.54	1.54	9.18
Piedmont Natural Gas Company, Inc.	PNY	$2,695	$4,345	18.79	1.90	2.05	12.08
South Jersey Industries, Inc.	SJI	$1,828	$2,897	16.68	2.34	2.17	20.43
Southwest Gas Corporation	SWX	$2,478	$3,798	17.59	1.27	1.71	7.49
WGL Holdings, Inc.	WGL	$2,044	$2,941	16.95	0.78	1.75	16.21
	Max	**$5,942**	**$10,492**	**18.98**	**2.34**	**2.17**	**20.43**
	Mean	**$2,871**	**$4,600**	**16.85**	**1.33**	**1.82**	**12.00**
	Median	**$2,271**	**$3,374**	**17.16**	**1.22**	**1.73**	**10.78**
	Min	**$1,178**	**$2,014**	**13.95**	**0.56**	**1.54**	**7.49**

Source: Bloomberg Professional and SNL Financial LC

Figure 25: Comparable Trading Multiples Analysis