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September 1, 2015

**Via Electronic Filing**

Rosemary Chiavetta, Secretary  
PA Public Utility Commission  
P.O. Box 3265  
Harrisburg, PA 17105-3265

Re: Petition of Philadelphia Gas Works for Waiver of Provisions of Act 11 to Increase the Distribution System Improvement Charge Cap and to Permit Levelization of DSIC Charges, Docket No. P-2015-XXXXXXX

Dear Secretary Chiavetta:

Oh behalf of Philadelphia Gas Works ("PGW") enclosed for filing please find its Petition of for Waiver of Provisions of Act 11 to Increase the Distribution System Improvement Charge Cap and to Permit Levelization of DSIC Charges. Copies of the above filing have been served in accordance with the attached Certificate of Service.

Sincerely,



Daniel Clearfield

DC/lww  
Enclosure

cc: Cert. of Service w/enc.

**CERTIFICATE OF SERVICE**

I hereby certify that this day I served a copy of PGW's Petition for Waiver of Provisions of Act 11 to Increase the Distribution System Improvement Charge Cap and to Permit Levelization of DSIC Charges upon the persons listed below in the manner indicated in accordance with the requirements of 52 Pa. Code Section 1.54.

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Daniel Clearfield, Esq.

Dated: Sept. 1, 2015

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PETITION OF PHILADELPHIA GAS :  
WORKS FOR WAIVER OF PROVISIONS : Docket No. P-2015-\_\_\_\_\_  
OF ACT 11 TO INCREASE THE :  
DISTRIBUTION SYSTEM :  
IMPROVEMENT CHARGE CAP AND TO :  
PERMIT LEVELIZATION OF DSIC :  
CHARGES :

**PETITION OF PHILADELPHIA GAS WORKS  
FOR WAIVER OF PROVISIONS OF ACT 11 TO INCREASE THE  
DISTRIBUTION SYSTEM IMPROVEMENT CHARGE CAP AND  
TO PERMIT LEVELIZATION OF DSIC CHARGES**

Pursuant to Sections 1358(a) and 2212(c) of the Public Utility Code, 66 Pa. C.S. §§ 1358(a), 2212(c), and 52 Pa. Code 5.41, Philadelphia Gas Works (“PGW” or “Company”) respectfully submits this Petition requesting the Public Utility Commission (“PUC” or “the Commission”) to: (i) waive the current Distribution System Improvement Charge (“DSIC”) cap of 5% of distribution revenues, a) approve a 2½ percentage point increase in the maximum allowed DSIC from 5% to 7.5% (not including reconciliation), and b) approve a total, 10% cap including any reconciliation recovery, for service rendered on or after January 1, 2016; (ii) waive or suspend the requirements of Act 11 of 2012 (“Act 11”) so as to permit PGW to use an annual, levelized charge as the basis for establishing a DSIC, subject to subsequent true-up for PGW’s actual experience; (iii) waive the requirements of Act 11 to exempt PGW from the requirement of paying interest on DSIC overcollections; and (iv), authorize the filing, on one day’s notice, of a) a revised Long Term Infrastructure Improvement Plan (“LTIIIP”) and b) the attached proposed PGW tariff supplement codifying these changes (attached hereto as “Attachment A”).

In support of approval of the relief requested, PGW states as follows:

## **I. Introduction and Summary**

As part of its ongoing commitment to the safety and reliability of its natural gas distribution system, PGW has determined that it would be prudent to accelerate the pace of its “at risk” distribution mains, currently 66% of its 3,024 miles of main. PGW has historically removed 18 miles of high risk cast iron main each year, financed from funds provided from its base rates, and, since 2013, has been replacing another seven miles of cast iron main, financed through its DSIC, currently capped at 5% of PGW’s distribution revenues. PGW’s current DSIC charge is also restricted to the recovery of plant placed into service in the prior quarter, which creates large swings in the allowable charge and has resulted in PGW not being able to fully utilize the DSIC at the 5% level. In part because of these restrictions, PGW currently projects that, if it maintains its current pace, it will take 86 years to complete the process of removing all of its cast iron main from its system.

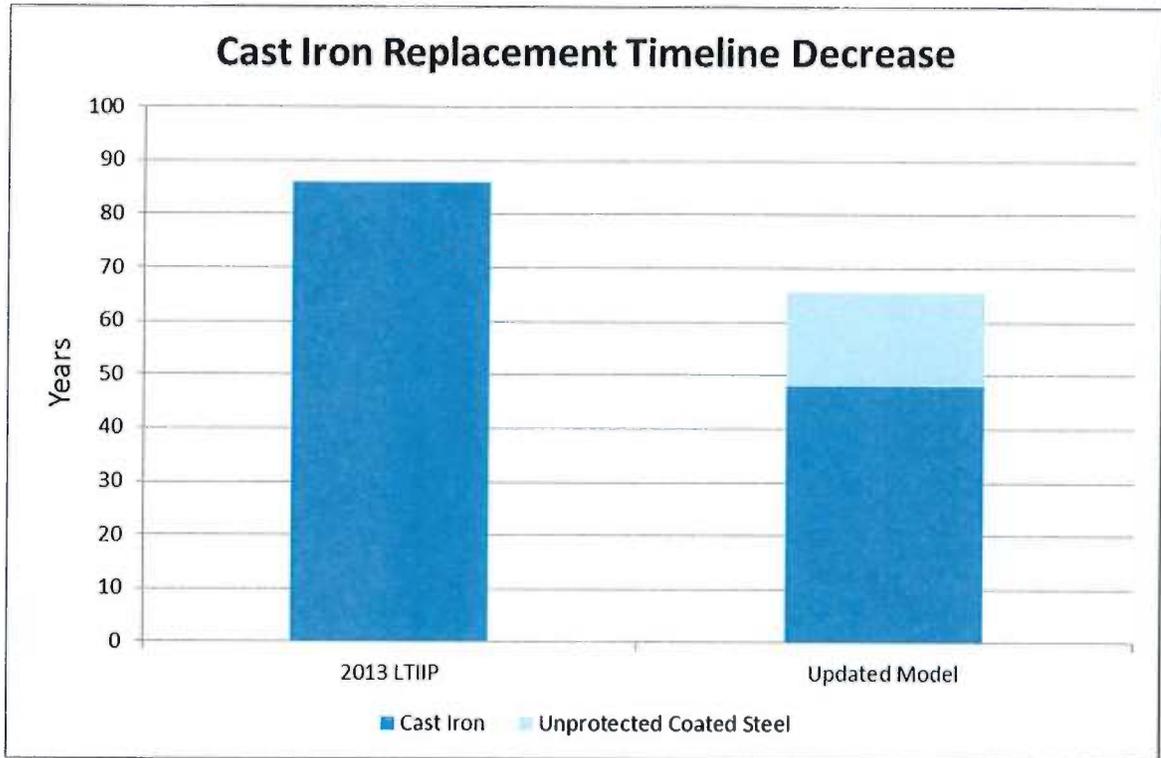
A growing consensus has developed that PGW should attempt to further expedite the removal of its at risk main. Most importantly, the Staff of the PUC issued a Report on PGW’s main replacement efforts (“PUC Staff Report”) which strongly recommended that PGW consider steps, such as increasing the current DSIC cap above its current 5% level and levelizing its DSIC charge.<sup>1</sup> Similarly, Philadelphia City Council recently suggested that PGW consider speeding up the pace of cast iron main removal by increasing its DSIC charge to 7.5%.

Accordingly, and after carefully considering the matter, PGW has determined to seek waivers from the PUC to permit it to increase its DSIC cap (and its subsequent annual main replacement) to an amount representing 7.5% of its annual distribution revenues (exclusive of any reconciliation amount). PGW believes there is ample justification for increasing its DSIC

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<sup>1</sup> *Staff Report: Inquiry into Philadelphia Gas Works’ Pipeline Replacement Program*, dated April 21, 2015 (“PUC Staff Report”).

spending to speed up its main replacement. A main replacement program at a 7.5% level is estimated to retire PGW’s inventory of cast iron mains from the current 86 years, based on the projection in its current LTIP to 48 years.<sup>2</sup>



This represents a 44% reduction in the timeline for cast iron main replacement. Such an expedited pace should produce the following reliability, safety and cost benefits:

- Reduction of leaks and the concomitant risk of serious incidents from those leaks, compared to PGW’s likely experience without acceleration;
- Reduction of breakage repairs and future breakage repair costs, again, compared to the costs it would incur absent acceleration;
- Reductions in leak maintenance and repair on the facilities being removed from service; and
- Reductions in the levels of unaccounted-for gas compared to the “non-accelerated” level.

<sup>2</sup> The timeline to replace all cast iron and unprotected coated steel would be 65 years, as this graphic depiction shows.

In sum, an accelerated main replacement program will, over time, reduce risk and costs, compared to that which PGW would experience if it did not accelerate its program, and result in more adequate, efficient, safe, reliable and reasonable natural gas distribution service.

PGW has also elected to follow another recommendation of the PUC Staff in its Report on PGW: levelizing and annualizing the DSIC charge. Currently, PGW is restricted in the amount of DSIC charges it can bill in any quarter to the amount of facilities it actually places into service in the prior quarter. This creates wide swings in PGW's DSIC charge because natural gas plant installation is cyclical in nature, with a large amount being placed into service in warmer months and very little being placed into service in the winter months. Because of the "placed in service in the last quarter rule," PGW has been able to bill the full 5% only twice in the last nine quarters, since the initiation of the DSIC in 2013.<sup>3</sup>

A levelized DSIC would permit PGW to charge a flat 7.5% of distribution revenues each month, regardless of the amount of main it successfully replaced in the prior quarter. PGW is proposing that, after a year is over, its billings would be reconciled with its actual installation experience over that year, and customers would either be credited for any over collection, or billed for any under collection. Permitting such levelization will allow PGW to bill at the maximum amount permitted by the cap, which has not occurred under the current regime, and will result in more predictable bills for customers.<sup>4</sup>

Funding PGW's proposed accelerated main replacement program through these changes in its DSIC is reasonable. One of the principal goals of the DSIC when it was enacted by the

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<sup>3</sup> See, paragraph 39, *infra*.

<sup>4</sup> PGW is also requesting that Act 11's requirement to pay interest on overcollections be waived. See, paragraphs 55-60, *infra*.

General Assembly was to help fund accelerated main replacement for natural gas companies. DSIC funding also permits PGW to use a “pay as you go” funding mechanism that avoids adding to PGW’s outstanding debt and is less expensive for ratepayers. The value of accelerated distribution infrastructure improvement provides substantial benefits to customers today and well into the future with more adequate, efficient, safe, reliable and reasonable natural gas distribution service. The incremental impact on the average residential customer bill is less than 2% annually, or less than two dollars per month.<sup>5</sup>

Accordingly, PGW respectfully urges the Commission to approve these waiver requests and to permit PGW to adjust its existing DSIC tariff as requested. Once this Petition is granted, PGW will: (i) file the attached tariff supplement on one day’s notice, for service rendered on or after January 1, 2016; and (ii) file an amended LTIP that will specify the types and sizes of at risk main it proposes to remove with the increased DSIC revenues. The priority of replacement will focus first on high risk facilities, based on PGW’s Distribution Integrity Management Program risk scores.

Supporting this Petition are the following:

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|----------------|--|
| Attachment “A” | Supplement No. 85 to Pa PUC No. 2.   |
| Attachment “B” | Notice to Customers.   |
| Exhibit 1      | PGW St. 1 – Testimony of Daniel Murray, Senior Vice President Customer Affairs and Operations (with verified statement). |
| Exhibit 2      | PGW St. 2 – Testimony of Kenneth S. Dybalski, Director – Gas Planning and Rates (with verified statement).               |

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<sup>5</sup> PGW St. 2 (Exh. 2 hereto) at 7.

## II. Background

1. PGW is a city natural gas distribution operation as defined in the Public Utility Code, 66 Pa. C.S. § 102. PGW manages a distribution system of approximately 6,000 miles of gas mains and service lines<sup>6</sup> supplying approximately 500,000 customers in the City and County of Philadelphia.

2. The names, addresses and telephone number of PGW's counsel are:

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3. On February 14, 2012, Act 11 was signed into law. That Act authorizes the establishment of a DSIC to provide for the timely recovery of reasonable and prudent costs incurred to repair, improve or replace eligible property in order to ensure and maintain adequate, efficient, safe, reliable and reasonable service.<sup>7</sup> The provisions of Act 11 were codified in Chapter 13 of the Public Utility Code.<sup>8</sup>

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<sup>6</sup> There are no customer-owned service lines in the PGW territory. Service lines are also referred to as services.

<sup>7</sup> 66 Pa. C.S. § 1353(a).

<sup>8</sup> 66 Pa. C.S. §§ 1350 - 1360. On August 2, 2012, the Commission issued its Final Implementation Order establishing procedures and guidelines to carry out the ratemaking provisions of Act 11. *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611, Final Implementation Order entered Aug. 2, 2012 ("Final

4. Certain statutory limitations are included in Act 11. Specifically, absent a PUC waiver, a natural gas utility's DSIC may not exceed 5% of the amount billed to customers under the utility's applicable distribution rates.<sup>9</sup> Additionally, Act 11 provides that the DSIC will: (i) change each quarter;<sup>10</sup> (ii) be calculated to recover the fixed cost of eligible property that has been placed in service during the prior quarter;<sup>11</sup> and (iii) will be reset to zero as of the effective date of new base rates that provide for prospective recovery of the annual costs previously recovered under the DSIC.<sup>12</sup>

5. Act 11 and the Commission's Regulations<sup>13</sup> also required PGW to submit a LTIIIP in order to be qualified to recover eligible improvement costs through a DSIC.

*PGW's Prior LTIIIP and DSIC Filings*

6. In order to qualify to begin to charge a DSIC, PGW filed an LTIIIP with the Commission on December 3, 2012, which was approved on April 4, 2013.<sup>14</sup> PGW's

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Implementation Order"). The Final Implementation Order is a policy statement setting forth how the Commission intends to interpret Act 11 in future adjudications and rulemakings. See *Petition of PPL Electric Utilities Corporation For Approval of a Distribution System Improvement Charge*, PUC Docket No. P-2012-2325034, Recommended Decision dated July 25, 2014 at 18-19, modified (on other grounds) in part by Opinion and Order entered April 9, 2015.

<sup>9</sup> 66 Pa. C.S. § 1358(a)(1).

<sup>10</sup> See 66 Pa. C.S. §§ 1353(b)(i)(iv), 1354(3), 1357(a)(2), 1357(b)(3) (relating to quarterly updates of the DSIC). See also footnote 11, *infra*.

<sup>11</sup> 66 Pa. C.S. §§ 1357(a)(1)(ii), (a)(2), (b)(1).

<sup>12</sup> 66 Pa. C.S. § 1358(b)(1).

<sup>13</sup> The Commission adopted final regulations related to Long-Term Infrastructure Improvement Plans in December 2014. 52 Pa. Code §§ 121.1 to 121.8; Review of Long-Term Infrastructure Improvement Plan, 44 Pa.B. 7809, 7856 (December 20, 2014). It is within the discretion of the Commission to grant waiver of the requirements contained in its Regulations. See 52 Pa. Code §§ 1.91, 5.43.

<sup>14</sup> *Petition of Philadelphia Gas Works for Approval of its Long-Term Infrastructure Improvement Plan*, PUC Docket No. P-2012-2337737, Opinion and Order entered on April 4, 2013 ("LTIIIP DSIC Order"). In this Order, the PUC tentatively approved PGW's DSIC but directed certain changes in the proposed tariff, which were subsequently approved.

Commission-approved LTIIIP describes the process of evaluating, improving, and replacing its distribution related facilities and equipment, the plans to continue accelerated investments under this process, and the categories and estimated cost of DSIC-eligible property that PGW expects to install over a five-year period (2013 to 2017). PGW's LTIIIP proposed that it would advance the replacement of high risk, cast iron main by adding to its historical "18 mile" program.

7. PGW identified the following property in its LTIIIP for replacement: (i) 12 inch and smaller high pressure main (High Pressure [HP] or 10-35 psig); (ii) 30 inch high pressure main (HP or 10-35 psig); and (iii) 8 inch and smaller low to intermediate pressure main (LP/IP or 4.5 inches WC to 5 psig).

8. PGW filed its initial DSIC Petition on January 18, 2013. PGW's DSIC was finally approved on May 9, 2013.<sup>15</sup> PGW's DSIC compliance tariff, Supplement No. 62 to Gas Service Tariff – Pa P.U.C. No. 2, went into effect June 1, 2013.<sup>16</sup> Pursuant to the Commission's Final DSIC Order, and Supplement No. 62, PGW was authorized to bill customers up to 5% of its non-gas revenues, currently approximately \$22 million annually, to fund the expedited replacement of its cast iron main. The Commission's DSIC Order acknowledged that PGW's DSIC would collect 100% of the cost of the facilities to be replaced on a "pay-as-you-go" basis.<sup>17</sup> The Commission's Order also directed that PGW's DSIC be calculated quarterly, and reflect only the cost of facilities which were placed into service in the previous quarter.<sup>18</sup>

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<sup>15</sup> *Petition of Philadelphia Gas Works for Approval of a Distribution System Improvement Charge*, PUC Docket No. P-2012-2337737, Opinion and Order entered on May 9, 2013 ("Final DSIC Order").

<sup>16</sup> *Petition of Philadelphia Gas Works for Approval of a Distribution System Improvement Charge*, PUC Docket No. P-2012-2337737, Secretarial Letter dated June 4, 2013; *Petition of Philadelphia Gas Works for Approval of a Distribution System Improvement Charge*, PUC Docket No. P-2012-2337737, Secretarial Letter dated June 10, 2013.

<sup>17</sup> LTIIIP DSIC Order at 13-14.

<sup>18</sup> LTIIIP DSIC Order at 36; Final DSIC Order at 4-6.

*Legal Background*

9. By its terms, the provisions of Act 11 may be waived or suspended by the Commission. Section 1358 of the Public Utility Code grants the Commission the legal authority to establish a maximum allowable DSIC at a percentage higher than 5% “in order to ensure and maintain adequate, efficient, safe, reliable and reasonable service.” Section 1358(a) states:

[T]he distribution system improvement charge may not exceed 5% of the amount billed to customers under the applicable rates of the wastewater utility or distribution rates of the electric distribution company, natural gas distribution company or city natural gas distribution operation. The commission may upon petition grant a waiver of the 5% limit under this paragraph for a utility in order to ensure and maintain adequate, efficient, safe, reliable and reasonable service.<sup>19</sup>

10. Further, under Section 2212 of the Public Utility Code, the Commission “upon request of [PGW], may suspend or waive the application to [PGW] of any provision of [the Public Utility Code], including any provision of [Chapter 22 (relating to Natural Gas Competition)] other than [Section 2212].”<sup>20</sup>

**III. Waiver Of 5% Limitation And Authorization for Higher Maximum Allowable DSIC**

11. Pursuant to Section 1358(a) of the Public Utility Code, PGW requests a waiver of the DSIC limitation (or cap) of 5% of billed distribution revenues and approval to increase the maximum allowable DSIC, as discussed herein.

12. In the time that it has been in place (since June, 2013), the DSIC has been an integral tool in enabling PGW to expedite the repair and replacement of aging infrastructure, by removing cast iron main from inventory. PGW’s current baseline main replacement program has

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<sup>19</sup> 66 Pa. C. S. § 1358(a)(2).

<sup>20</sup> 66 Pa. C.S. § 2212.

historically removed 18 miles of cast iron main annually, with the costs of this replacement reflected in PGW's base rates. Under its approved LTIP and DSIC, PGW can seek recovery for expenditures above the cost of the base line program on a "pay-as-you-go" basis."<sup>21</sup> As noted, that accelerated replacement corresponds to a maximum expenditure of \$22 million annually.

13. PGW's base line, 18 mile per year program and its DSIC funded accelerated main replacement program resulted in PGW removing approximately 22.5 miles of cast iron main from service in 2013 and 28 miles of cast iron main in 2014. PGW also removed two miles of unprotected coated steel main in 2014.

14. PGW's 2013 LTIP estimated that, utilizing a 5% DSIC, and assuming 2% inflation, PGW's cast iron main removal would be expedited to 88 years (no estimate of the removal date for unprotected steel was made).

15. While PGW's accelerated efforts, made possible by the implementation of its DSIC, have been widely acknowledged to be a positive step in improving the safety and reliability of its distribution system, a growing consensus has developed that more should be done, if possible.

16. Most importantly, on April 21, 2015, the Staff of the PUC issued a seminal Report entitled: "*Staff Report: Inquiry into Philadelphia Gas Works' Pipeline Replacement Program.*" The PUC Staff Report suggested that it would be in the public interest for the rate of "at risk" mains (characterized by the Staff as consisting of all cast iron and non-cathodically protected steel) be accelerated, rather than maintain the status quo.<sup>22</sup> The Staff Report contained

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<sup>21</sup> The term "pay-as-you-go" means that PGW includes in its DSIC the full cost of the main replacement in the year in which the expenditure is incurred. As a result, PGW does not include any cost associated with the replaced main (e.g., depreciation) in its base rates in subsequent years.

<sup>22</sup> PUC Staff Report at 4.

a comprehensive analysis of PGW's current "at risk" main inventory and its status vis-à-vis other natural gas distribution utilities:

most NGDCs plan to replace cast iron in 13 to 22 years; however, PGW's Long Term Infrastructure Improvement Plan (LTIIP) filed with the Commission, at Docket No. P-2012-2337737, shows an 88-year replacement rate. . . . Across Pennsylvania, NGDCs are developing aggressive strategies to remove unprotected steel and cast iron from service in order to reduce system risk, enhance safety and reinforce system reliability. PGW should implement a similarly aggressive main-replacement strategy given the information presented in this report with respect to the Company's total leaks, hazardous leaks, main breaks, miles of cast iron, miles of unprotected steel, age of mains, number of inside meter sets, bare steel services and main replacement rate forecasts. The highlights are summarized below:

- In 2013, PGW had approximately 3,024 miles of gas main, comprised of 1,501 miles of cast iron pipeline and 493 miles of unprotected steel. Therefore, 66 percent of PGW's distribution system is comprised of at-risk main.
- PGW has more than double the miles of cast iron than any other NGDC and its system accounts for approximately half of the total cast iron mains in Pennsylvania.
- PGW's gas mains are some of the oldest in the state, with more than 1,170 miles installed pre-1940.
- PGW discovered more than 6,200 leaks in 2013 and more than 7,600 leaks in 2014.
- PGW had a total of 3,122 hazardous leaks on its mains and services in 2013, which is more than double any other NGDC. PGW's total hazardous leaks increased to 3,448 in 2014.
- Of the total 3,122 hazardous leaks in 2013, Table 10 shows that 1,072 were hazardous main leaks. The other large NGDCs had an average of 273 hazardous main leaks; therefore, PGW had nearly four times the state average of hazardous main leaks for the other NGDCs in 2013.
- From 2013 to 2014, PGW experienced a 78-percent increase in cast iron main breaks from approximately 297 cast iron main breaks in 2013 to 529 in 2014.

The facts above highlight the challenges facing the current PGW distribution system serving Philadelphia. Removal of at risk pipe is important, considering that PGW provides service in an urban environment with high population density and a vast amount of paved ground cover, which can lead to gas leaks migrating to buildings and potentially catastrophic results. While other NGDCs in the Commonwealth plan to remove cast iron pipe in 13 to 22 years, PGW's LTIP indicates an 88-year replacement rate . . . . Although PGW increased its rate of main replacement in 2014, its replacement period is still more than twice the rest of the Pennsylvania NGDCs. The other large NGDCs are replacing at-risk pipe in an aggressive time period, and PGW should be no different. Staff maintains that safety should not be compromised; therefore, PGW's objective should be to strive to replace its at-risk pipe at a rate closer to the average rate of the other Pennsylvania NGDCs.

17. The PUC Staff Report's suggested principal means of achieving an acceleration of the pace of replacement of at risk mains was to increase PGW's DSIC above the current 5% cap.<sup>23</sup>

18. Recognizing the need for PGW to continue to improve the distribution infrastructure and provide adequate, efficient, safe, reliable and reasonable service, the Philadelphia City Council has also expressed an interest in PGW increasing the maximum allowable DSIC to 7.5%.<sup>24</sup> In a letter to Mayor Nutter, dated October 27, 2014, City Council recommended that PGW submit a petition to the Commission to increase the DSIC to 7.5%.<sup>25</sup> Philadelphia City Council continues to review and approve PGW's capital budget.

19. The advisability of advancing the replacement of aging piping and other facilities has been acknowledged in several national reports. For example, in 2011, the United States

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<sup>23</sup> *Id.* at 5, 35-42.

<sup>24</sup> In a letter to Mayor Nutter, dated October 27, 2014, City Council recommended that PGW submit a petition to the Commission to increase the DSIC to 7.5%. PUC Staff Report, Appendix A.

<sup>25</sup> *Id.*

Department of Transportation<sup>26</sup> and the Pipeline and Hazardous Materials Safety Administration issued a Call to Action to accelerate the repair, rehabilitation, and replacement of the highest-risk pipeline infrastructure.<sup>27</sup> The United States Department of Energy also has issued a recent report encouraging the modernization of natural gas infrastructure.<sup>28</sup> These (and other) reports have concluded that replacing aging cast iron pipe is critical to a cleaner economy and a safer, more efficient natural gas distribution system.<sup>29</sup>

20. In light of these various recommendations, PGW proposes, as suggested by the PUC Staff, to accelerate its replacement of at risk mains beyond that permitted by its existing DSIC. To do so PGW requests the Commission waive the current DSIC limitation (or cap) of 5% of billed distribution revenues and increase the cap to 7.5%, exclusive of under collections, for service rendered on or after January 1, 2016. In addition, PGW has determined to pursue another recommendation of the PUC Staff and request the ability to submit a “levelized” annual DSIC.<sup>30</sup> Each of these requested modifications in PGW’s current DSIC Tariff is discussed below.<sup>31</sup>

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<sup>26</sup> *The State of the National Pipeline Infrastructure*, US Department of Transportation, (2011), [http://opsweb.phmsa.dot.gov/pipelineforum/docs/Secretarys%20Infrastructure%20Report\\_Revised%20per%20PHC\\_103111.pdf](http://opsweb.phmsa.dot.gov/pipelineforum/docs/Secretarys%20Infrastructure%20Report_Revised%20per%20PHC_103111.pdf).

<sup>27</sup> Pipeline Replacement Updates: “Background” and “Cast and Wrought Iron Inventory”, Pipeline and Hazardous Materials Safety Administration, (April 17, 2014), [http://opsweb.phmsa.dot.gov/pipeline\\_replacement/](http://opsweb.phmsa.dot.gov/pipeline_replacement/)

<sup>28</sup> *Factsheet: An Initiative to Help Modernize Natural Gas Transmission and Distribution Infrastructure*, US Department of Energy, (July 29, 2014), <http://energy.gov/articles/factsheet-initiative-help-modernize-natural-gas-transmission-and-distribution>.

<sup>29</sup> *See, e.g., American Pays for Gas Leaks: Natural Gas Pipeline Leaks Cost Consumers Billions*, Report for US Senator Edward J. Markey [of Massachusetts], (released August 1, 2013), [http://www.markey.senate.gov/documents/markey\\_lost\\_gas\\_report.pdf](http://www.markey.senate.gov/documents/markey_lost_gas_report.pdf).

<sup>30</sup> PGW is also requesting that the PUC waive the requirement that it pay interest on DSIC overcollections. *See*, paragraphs 5, 55-60, *infra*.

<sup>31</sup> The PUC Staff Report contained several other recommendations for potential funding for accelerated main replacement. PGW has determined that it would not be prudent or feasible to reduce its level of year end

*Increasing DSIC Cap to 7.5% Exclusive of Reconciliation*

21. A DSIC capped at 7.5% would permit PGW to spend approximately \$33 million annually to expedite its existing main replacement program, or approximately \$11 million more than the maximum currently permitted. At PGW's current replacement cost per mile, the additional dollars would result in PGW removing from service all of its existing cast iron main in 48 years. This represents a 44% decrease in the timeline to replace cast iron main compared to PGW's current 86 year projection, based on its LTIIP.<sup>32</sup>

22. The DSIC statute gives the PUC the authority to authorize DSIC charges that exceed the 5% baseline cap "in order to ensure and maintain adequate, efficient, safe, reliable and reasonable service." PGW submits that advancing PGW's replacement of at risk mains by increasing its DSIC plainly meets this standard.

23. First, and most obviously, acceleration of cast iron main replacement is consistent with the strong encouragement to do so that the Commission Staff and others have provided. As the PUC Staff Report pointed out, PGW's percentage of cast iron and unprotected steel main in its system is among the largest of any natural gas distribution company.<sup>33</sup> While there are many

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cash to \$75 million (Recommendation No. 4) as PGW's current level of year-end cash has been a major factor in obtaining an upgrade in its bond rating. In fact, rating agencies have suggested that PGW should actually raise its year end cash balance goals to \$125 million or more. PGW is in the process of evaluating the consolidation of facilities (Recommendation No. 7) and any savings will be used to offset other cost increases and, ultimately rolled into base rates in PGW's next base rate case. Recommendations Nos. 5 (waive all or a portion of the \$18 million fee) and 6 (streamline corporate governance) are items that could only be effectuated by the City of Philadelphia and Philadelphia City Council; consequently, they are not within PGW's power to implement. PGW is considering issuing new debt in the future (Recommendation No. 3), but it will be used to finance other construction or to continue to support in part PGW's historical 18 mile program that is financed by base rates. PGW must be extremely cautious about issuing excessive amounts of debt as its debt to total capital ratio already stands at approximately 70% – far higher than most NGDCs.

<sup>32</sup> PGW St. 1 (Exh. 1 hereto) at 10. An increased DSIC percentage would also permit PGW to expedite the removal of its unprotected steel main. Removal of PGW's inventory of unprotected steel would require an additional 17.4 years, such that all of PGW's "at risk" main would be removed in 65.6 years.

<sup>33</sup> PUC Staff Report at 3.

reasons for PGW’s level, including the age of its distribution system, PGW’s highly urban and dense service territory and the fact that its distribution system is almost entirely low pressure, PGW concurs in the view that the acceleration of PGW’s at risk mains would be the most prudent course.<sup>34</sup>

24. In addition, accelerating the replacement of “at risk” main will have the following positive effects on its system:

- Reducing leaks and the concomitant risk of serious incidents from those leaks, compared to what PGW is likely to experience without acceleration;
- Reducing breakage repairs and future breakage repair costs, again, compared to the costs PGW would incur absent acceleration;
- Reducing leak maintenance and repair on the facilities being removed from service; and
- Improving pressure and reducing levels of unaccounted-for gas.<sup>35</sup>

25. With respect to reducing PGW’s currently experienced level of leaks and leak repair, as the attached testimony of PGW Senior Vice President Dan Murray explains, despite PGW’s efforts to accelerate the replacement of at risk main, its annual leak incidence has continued to go up.<sup>36</sup> The following chart is illustrative of PGW’s recent leak experience. As can be seen, cast iron main of all diameters and pressures have seen a significant increase in leaks.<sup>37</sup>

<b>Cast/Iron Total</b>						
Leaks Repaired						
<b>Main Material</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>

<sup>34</sup> PGW St. 1 (Exh. 1 hereto) at 5.

<sup>35</sup> *Id.* at 12.

<sup>36</sup> PGW St. 1 (Exh. 1 hereto) at 5-6.

<sup>37</sup> *Id.* at 8.

Cast/Iron Total	2157	1793	2162	1986	2265	2826
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26. PGW has also experienced an increase in the number of broken cast iron mains, increasing from around 325 in 2009 to over 500 in 2014.<sup>38</sup>

27. As Mr. Murray points out, PGW believes that the increased incidence of leaks and breaks is reflective of many factors, including recent periods of severe weather and frost levels in the Philadelphia region. But one important factor appears to be the increasing age of a majority of its distribution facilities.<sup>39</sup> Importantly, and as the Commission is aware, PGW provides service in an urban environment with high population density and a vast amount of paved ground cover, which can lead to gas leaks migrating to buildings. This means that urban NGDCs like PGW have a greater need to try to take steps to reduce leaks. Removing at risk mains more quickly and replacing them with materials that are less susceptible to leaks would appear to be the best way to do this.<sup>40</sup>

28. In PGW's opinion, an accelerated main replacement program will reduce risk and costs, compared to that which PGW would experience if it did not accelerate its program and should reduce PGW's total main related risk and cost experience over time.<sup>41</sup>

29. Increasing the maximum DISC to 7.5% will facilitate an additional \$11 million annually in DSIC-eligible capital expenditures.<sup>42</sup> This will provide PGW with additional capital annually to increase the replacement of its at risk main from inventory. If its Petition is granted,

<sup>38</sup> PGW St. 1 (Exh. 1, hereto) at 9.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* Importantly, because of the continued aging of the PGW system, total leaks – and the associated costs of repairs are not likely to go down on an absolute basis in the short term.

<sup>42</sup> PGW St. 1 (Exh. 1 hereto) at 11.

PGW intends to file a revised LTIIP setting forth the specific types of at risk main it proposes to address with the increased DSIC funding. PGW will employ its Distribution Integrity Management Program to identify the high risk facilities that will be prioritized for removal with additional DSIC funds.

30. PGW will continue to review its DSIC-financed main replacement program from year to year to determine whether it would be prudent to request additional increases in its DSIC spending. PGW has elected to begin with an increase of 2.5% in excess of the initial cap in order to gain experience with an expedited program. PGW has not previously engaged in this level of annual construction and, before moving to even more aggressive levels, it needs to be able to assess a number of factors, including the effect on commerce, traffic congestion, and noise, especially in the more congested areas of the City, and the availability of qualified contractors to perform the work. Once it gains this data it will consider whether it would be prudent to accelerate the pace of its main replacement even further.<sup>43</sup>

31. Funding accelerated pipeline replacement via the DSIC is reasonable and in the public interest. The Commission has recognized that the DSIC was enacted by the General Assembly to provide utilities with a streamlined structure by which to finance the accelerated replacement of aging infrastructure.<sup>44</sup> The revenue generated by DSIC is restricted, by its nature, to eligible infrastructure projects. The DSIC will be a dollar-for-dollar recovery of prudent expenses incurred for improving reliability to customers. PGW's "pay-as-you-go" method is the least costly to customers, compared to the issuance of long term bonds. That being said, PGW's

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<sup>43</sup> PGW St. 1 (Exh. 1 hereto) at 14-15.

<sup>44</sup> For example, the Commission in its Final Implementation Order states that it "expects that the long-term plan filed along with the DSIC petition will reflect and maintain an *acceleration* of infrastructure replacement over the utility's historic level of capital improvement, *consistent with the statutory requirements*." Final Implementation Order at 24.

approved LTIIP contains a number of measures to ensure that it is implemented in a cost-effective manner, including utilizing a competitive bidding process for all relevant aspects of the program and prioritizing high risk main which tend to be the most likely to leak and/or break, thus reducing maintenance costs compared to that which the Company would experience if it did not accelerate its replacement program.

32. In addition, the incremental cost to customers is small when compared to the noticeable benefits. The value of accelerated distribution infrastructure improvement is substantial, benefiting customers today and well into the future with adequate, efficient, safe, reliable and reasonable natural gas distribution service. The incremental impact on an average residential customer bill is just a few dollars per month:

<b>INCREMENTAL IMPACT – AVERAGE RESIDENTIAL HEATING CUSTOMER BILL</b>	
DISC	7.50%
Customer Impact (\$) - Year	\$19.80
Customer Impact (\$) - Month	\$1.65
Customer Impact (%)	1.7%

Based on 83 MCF per year and June 2015 rates.<sup>45</sup>

33. For PGW, DSIC funding is especially appropriate because it permits PGW to use a “pay as you go” funding mechanism that avoids adding to PGW’s outstanding debt and is less expensive for ratepayers. The DSIC’s automatic adjustment feature assures that ratepayers will pay only for the amount that PGW actually replaces – no more and no less– and is therefore fair to both the Company and its customers.

<sup>45</sup> PGW St. 2 (Exh. 2 hereto) at 6. Mr. Dybalski’s testimony also shows the (smaller) customer impacts for other rate classes.

34. Accordingly, PGW respectfully requests that the Commission authorize PGW to file the attached tariff supplement increasing the DSIC cap from 5% to 7.5% (exclusive of reconciliation) and begin to bill customers at the 7.5% level.<sup>46</sup>

*Waivers So As To Permit Levelization And Annualization Of DSIC-Eligible Costs*

35. Second, and pursuant to 2212(c) of the Public Utility Code, PGW requests a waiver or suspension of the requirements of Act 11 so as to permit PGW to bill an annualized amount to customers representing 7.5% of PGW's distribution revenues, subject to true up and reconciliation, as explained in more detail below.

36. As noted, Act 11 provides that the DSIC will change each quarter and be calculated to recover the fixed cost of eligible property that has been placed into service during the prior quarter.<sup>47</sup> In the Commission's Order authorizing PGW's DSIC it directed that PGW calculate the charge quarterly, and reflect only the cost of facilities which were placed into service in the previous quarter.<sup>48</sup>

37. The DSIC for investor-owned utilities, consistent with the "used and useful" rule that applies to them, is calculated to recover the fixed cost of eligible property that has actually been placed in service during the prior quarter, and increases gradually from quarter to quarter.<sup>49</sup>

38. That has not been PGW's experience. PGW's current DSIC structure does not result in a steadily increasing revenue stream. PGW's current DSIC structure has resulted, and

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<sup>46</sup> PGW's proposal for a total cap on DSIC inclusive of the reconciliation, proposed at 10% is discussed below.

<sup>47</sup> LTIIP DSIC Order at 29.

<sup>48</sup> *Id.*

<sup>49</sup> See footnotes 10 and 11, *supra*.

will continue to result in, significant DSIC fluctuations – which vary throughout a year.<sup>50</sup>

PGW's DSIC is further impacted by seasonal usage variations. PGW's current DSIC structure has further resulted, and will continue to result in, PGW's lowest DSIC being applied during the highest sales volume quarter. This leads to PGW billing less annual DSIC revenue than intended.<sup>51</sup> In some quarters, the value of facilities it places into service was in excess of the existing cap, requiring PGW to delay billing for main replacement expenditures actually expended.<sup>52</sup>

39. This means that in some quarters PGW's billings to recover expenditures to replace cast iron main is lower – in some cases, far lower – than 5% of PGW's distribution revenues. Not only does this result in a DSIC that is difficult for customers to understand and for PGW to administer, but also means that PGW will not be able to fully bill at the cap level, whether 5% or 7.5%. The following table shows PGW's experienced DSIC as a percentage of its distribution revenues<sup>53</sup>:

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<sup>50</sup> PUC Staff Report at 36, Table 26.

<sup>51</sup> PGW St. 2 (Exh. 2 hereto) at 8-9.

<sup>52</sup> *Id.* at 8.

<sup>53</sup> *Id.* at 9.

<u>PGW DSIC – HISTORICAL BILLINGS AS % OF DISTRIBUTION REVENUE</u>	
7/1/2015	1.64%
4/1/2015	2.09%
1/12015	2.24%
10/1/2014	5.00%
7/1/2014	5.00%
4/1/2014	2.60%
1/1/2014	4.34%
10/1/2013	4.14%
7/1/2013	3.02%

40. The PUC Staff Report recognized this problem and suggested that PGW should seek to levelize and annualize its billings for DSIC-eligible costs.<sup>54</sup> Staff noted that, ideally, DSIC billings should remain relatively level throughout the year in order to pass costs equally to all customers, regardless of seasonal usage patterns. The Staff recommended that PGW seek a waiver of any statutory provision that would restrict its ability to levelize and annualize its DSIC-eligible charges.

41. PGW proposes to bill customers a uniform amount each quarter, designed to collect the projected DSIC funded construction budget, up to a maximum of 7.5% of distribution revenues (currently \$33 million) over twelve months. The annual DSIC will remain in place for the period from January through December. In order to mitigate a material over or under collection:

- PGW may make quarterly adjustments to the annualized DSIC for the difference between projected and actual billed amounts.
- PGW may make quarterly adjustments to account for changes to the construction budget during the year for the accelerated replacement program.

<sup>54</sup> PUC Staff Report at 5-6, 42-44.

– These proposed adjustments will not increase the DSIC above 7.5%, of distribution revenues, exclusive of reconciliation.

42. Any under or over collection from the previous year resulting from a difference between the projected and actual DSIC construction expenditures will be calculated in an annual reconciliation based upon actual billed DSIC revenues and DSIC recoverable costs.<sup>55</sup> PGW's proposal is that the DSIC may be increased an additional 2.5% (up to 10%) in order to recover any under collection amount. Any under or over collection will be reconciled and filed by January 31 of each year and will be billed or credited from April 1 to March 31 each year.

43. As noted by the PUC Staff in its Report, levelizing and annualizing PGW's DSIC structure will enable PGW to reduce the replacement timelines and will further achieve the intent of both PGW's approved LTIP and Act 11 itself by permitting PGW to actually bill an amount equating to 7.5% of its distribution revenues to be used for main replacement. The PUC Staff Report calculated that levelization and annualization would permit PGW to fully bill the 7.5% of revenue cap.<sup>56</sup>

44. Levelizing and annualizing PGW's DSIC structure will also (i) improve rate stability, provide a more predictable bill for customers, (ii) provide more predictable cash flow for PGW, even with seasonal usage variations, and (iii) is consistent with the way in which PGW accounts for its other major automatic adjustment clause – the Gas Cost Rate.<sup>57</sup>

45. The cost to customers of levelization and annualization is small when compared to the noticeable benefits. Levelization doesn't increase the amount that PGW bills to ratepayers

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<sup>55</sup> At present, the annual reconciliation of the DSIC results in a lag in which recoverable costs for the months of September to December are not included in the current year annual reconciliation. Accordingly, in the first year, the 'annual' reconciliation will have 16 months of recoverable costs due to this lag.

<sup>56</sup> PUC Staff Report at 43.

<sup>57</sup> *Id.*

for accelerated main replacement on an absolute basis – it permits PGW to bill customers for main replacement in a more timely manner. PGW believes that levelization will result in smaller under collections which otherwise would continually have to be recovered from customers over time.

46. For the reasons set forth herein, pursuant to Section 2212(c) of the Public Utility, PGW requests a waiver of the statutory requirements that the DSIC (i) change each quarter<sup>58</sup>; and (ii) be calculated to recover the fixed cost of eligible property that has been placed in service during the prior quarter,<sup>59</sup> so as to allow PGW to recover annualized costs through the DSIC.

47. The Commission has previously employed the discretion the Legislature has afforded it in regulating PGW in order to waive other sections of the Public Utility Code that plainly did not fit for a municipal utility regulated on a cash flow rather than a return on rate base basis, as those requirements are established in Section 2212 (the provisions of which may not be waived).<sup>60</sup> PGW respectfully submits that the circumstances are similar here. The requirement that the DSIC only reflect investment already placed into service was to recognize that investor owned utilities generally are not permitted to earn a return on facilities prior to them being placed into service and becoming “used and useful.”<sup>61</sup> As a cash flow company, PGW’s revenue

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<sup>58</sup> See 66 Pa. C.S. §§ 1353(b)(i)(iv), 1354(3), 1357(a)(2), 1357(b)(3) (relating to quarterly updates of the DSIC). See also footnote 11, *infra*.

<sup>59</sup> 66 Pa. C.S. §§ 1357(a)(1)(ii), (a)(2), (b)(1); § 1358(b)(1).

<sup>60</sup> See, e.g., *PUC v. PGW*, PUC Docket No. R-2008-2073938, Reconsideration Opinion and Order entered March 26, 2009 (relating to the grant of several waivers, including waiver of portions of 66 Pa. C.S. § 1308(e), to the extent necessary to give full effect to the rate relief, conditions and directives set forth in the Commission’s prior order).

<sup>61</sup> See footnote 11, *supra*. PGW notes that this is a renewed waiver request to allow PGW to recover annualized and levelized costs through the DSIC. As part of its original DSIC Petition, PGW requested the use of projected annualized costs in its original DSIC Petition. At that time, certain parties objected to PGW’s request. The Commission concluded that, at that time, PGW had not presented sufficient legal or factual basis for a waiver or suspension of the applicable statutory provisions. PGW’s actual experience

requirement is not set on a rate of return/rate base basis, and requiring a “placed into service” rule is inconsistent with the requirements of Section 2212 that PGW be regulated on a cash flow basis as it adds to PGW’s cash flow requirements.<sup>62</sup>

*Mechanics of the PGW DSIC and Reconciliation*

48. As noted above, PGW requests that it be permitted to modify its DSIC tariff so that if an under collection of the annual DSIC billings occur (at 7.5% of distribution revenues) PGW will be authorized (as part of the annual reconciliation process) to implement a total DSIC charge higher than 7.5%. This will permit PGW to adjust the DSIC for under collections while still billing customers 7.5% of its distribution revenues for main replacement. In order to maintain a maximum parameter, PGW proposes that the maximum allowable DSIC shall not exceed 10% of distribution revenues. This proposal will not impact the rules for the annual reconciliation audit or the treatment of over collections.

49. Raising the DSIC cap above 7.5% is reasonable to permit the recovery of under collections. If revenues received from the DSIC reconciliation were counted against the 7.5% cap PGW could face months where it would not be able to fully bill amounts it is hoping to spend on main replacement.

50. As a point of reference, PGW’s current “e” factor to recover an under collection, and the level it expects to be in effect on January 1, 2016, is .30%<sup>63</sup>; therefore PGW’s total DSIC percentage would be 7.64%.

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with its unique DSIC structure and circumstances are now being presented as compelling reasons to justify the waiver or suspension of the subject provisions of the Public Utility Code.

<sup>62</sup> See, 66 Pa. C.S. § 2212(e).

<sup>63</sup> PGW St. 2 (Exh. 2 hereto) at 13.

51. There are adequate checks in place to assure that PGW's total DSIC billing levels will be reasonable. PGW's infrastructure expenditures are reviewed and approved by the City, the Philadelphia Gas Commission and Philadelphia City Council in the form of its capital budget. Moreover, in addition to PUC review of PGW's five year LTIIP, PGW is required, in its Asset Optimization Plan annually to report to the PUC the nature and amount of its DSIC expenditures for the prior year, as well as the amount it expects to incur in the future. Finally, PGW's proposed 10% total cap will provide additional protection to customers that the total charge for DSIC will never exceed a specific maximum.

52. As noted, the Company will seek recovery of approximately \$33 million annually through the DSIC surcharge with a cap at 7.5% (exclusive of reconciliation).

53. The proposed annual recovery and spending amount of approximately \$33 million is within the newly proposed 7.5% cap. The amount billed to PGW customers for distribution service, as determined on an annualized basis, is \$450 million. Seven and one half percent (7.5%) of this annualized distribution revenue is approximately \$33.75 million.<sup>64</sup>

54. Under the tariff, and as it does today, PGW will calculate the DSIC surcharge using the formula  $DSIC = (DSI + e) / PAR$ , where DSI represents recoverable yearly costs, "e" stands for the amount calculated under the annual reconciliation feature, and PAR is the projected annual revenue from distribution services for the year during which the charge will be collected.

*Waiver of Interest Requirement*

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<sup>64</sup> PGW St. 2 (Exh. 2 hereto) at 10.

55. While PGW is proposing to continue to utilize the DSIC calculation formula presently in its Tariff, it proposes that the Commission waive the current requirement that PGW pay interest on overcollections.

56. Under Act 11, utilities are required to pay interest at the residential mortgage rate on any overcollections that are returned via the reconciliation mechanism.<sup>65</sup>

57. PGW requests that the Commission utilize its authority pursuant to 2212(c) of the Public Utility Code to waive Act 11's requirement to pay interest at the residential mortgage rate on overcollections.

58. Waiving interest on overcollections is also reasonable in light of the fact that any interest remitted will reduce PGW's cash flow, which will increase its cash deficiency and revenue requirement in its next base rate proceeding. Moreover, if levelization and annualization of PGW's DSIC is not approved, when interest is calculated on an over collection, PGW will be paying interest in the winter when DSIC revenues (sales) are the highest and recoverable costs are generally the lowest. This will result in large interest costs on an over collection in the winter months (Jan-Mar).

59. PGW will continue to bill its customers for the DSIC on a "bills rendered" basis, and the surcharge will be expressed as a volumetric charge per Ccf carried to two (2) decimal places and will be applied to total customer usage.

60. As it is today, the DSIC will be applied equally to all customer classes as a volumetric charge and will be at or below the 7.5% cap (exclusive of reconciliation) for each class. The volumetric charge will produce, over 12 months, the \$33 million that PGW plans to spend on its accelerated main replacement program.

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<sup>65</sup> 66 Pa. C. S. § 1358 (e)(3).

#### **IV. Expedited Approval**

61. PGW is proposing that the Commission approve PGW's DSIC in an expedited manner so that the charge becomes effective on January 1, 2016. If the Commission determines to investigate PGW's DSIC tariff, PGW respectfully requests that the Commission permit the tariff to be placed into effect, subject to investigation. As the DSIC is a fully reconcilable automatic adjustment charge, any modifications can be made on a going forward basis, subject to refund.

62. PGW has served copies of this Petition on the main parties that participated in PGW initial DSIC filing including: the Pennsylvania Office of Consumer Advocate, the Pennsylvania Office of Small Business Advocate, the Commission's Bureau of Investigation and Enforcement, and the Philadelphia Industrial and Commercial Gas Users Group. In addition, PGW has provided to its firm customers a bill insert explaining the changes in PGW's proposed DSIC tariff, as explained herein (Attachment "B"). If the Commission concludes that additional notice is necessary, PGW will provide such additional notices as the Commission may direct.

#### **V. Conclusion**

WHEREFORE, PGW respectfully requests that the Commission:

- a) waive the current Distribution System Improvement Charge ("DSIC") cap of 5% of distribution revenues;
- b) approve a 2½ percentage point increase in the maximum allowed DSIC from 5% to 7.5% (not including reconciliation) for service rendered on or after January 1, 2016;
- c) approve the use of an annual, levelized charge as the basis for establishing a DSIC, subject to subsequent true-up for PGW's actual annual, 12-month experience<sup>66</sup>, with a total cap (including any undercollection recovery) of 10%;

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<sup>66</sup> The first reconciliation for calendar year 2015 will include 16-months.

- d) waive or suspend the requirements of Act 11 of 2012 (“Act 11”) so as to allow PGW to recover costs through the DSIC on an annualized and levelized basis;
- e) waive or suspend the requirements of Act 11 of 2012 (“Act 11”) to exempt PGW from the requirement to pay interest on DSIC over recoveries;
- f) authorize the filing, on one day’s notice, of the proposed PGW tariff supplement codifying these changes (attached hereto as “Attachment A”);
- g) direct PGW to file an amended Long Term Infrastructure Improvement Plan for Commission approval, setting forth the additional at risk main PGW proposes to remove from service as a result of the increase in PGW’s DSIC cap and billings, as set forth herein; and
- g) Take any other action deemed to be in the public interest.

Respectfully submitted,



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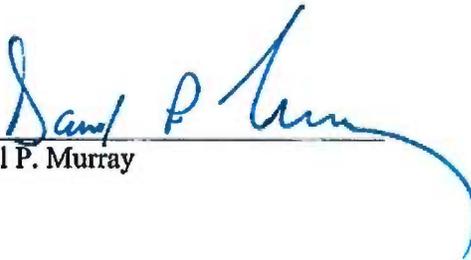
800 W. Montgomery Ave.

Philadelphia, PA 19122

Dated: September 1, 2015

VERIFICATION

I, Daniel P. Murray, hereby state that: (1) I am the Senior Vice President of Customer Affairs and Operations for Philadelphia Gas Works; (2) the facts above set forth in the foregoing document are true and correct (or are true and correct to the best of my knowledge, information and belief); and (3) that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

  
Daniel P. Murray

# Attachment A

**PHILADELPHIA GAS WORKS**  
**GAS SERVICE TARIFF**



Issued by: Craig White  
President and CEO

PHILADELPHIA GAS WORKS  
800 West Montgomery Avenue  
Philadelphia, PA 19122

List of Changes Made by this Tariff Supplement

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (“DSIC”) Page Nos. 151-153)

Changes the DSIC cap from 5.0% to 7.5% (exclusive of reconciliation)

Provides for levelized DSIC charge at 7.5% each month (not including reconciliation)

Clarifies reconciliation calculation and process

Effective January 1, 2016, the DSIC percentage increases from ~~1.642-24%~~ to 6.1%.

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## DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

In addition to the net charges provided for in this Tariff, a charge of ~~1.647.64~~1.647.64% will apply consistent with the Commission Order dated May 9, 2013 at Docket No. P-2012-2337737 approving the DSIC and subsequent Commission orders modifying the terms and conditions of the DSIC. (D)

### 1. General Description

**A. Purpose:** To recover the reasonable and prudent costs incurred to repair, improve, or replace eligible property which is completed and placed in service and recorded in the individual accounts, as noted below, between base rate cases and to provide the Utility with the resources to accelerate the replacement of aging infrastructure, to comply with evolving regulatory requirements. The costs of extending facilities to serve new customers are not recoverable through the DSIC.

**B. Eligible Property:** The DSIC-eligible property will consist of the following:

- Piping (account 376);
- Couplings (account 376);
- Gas services lines (account 380) and insulated and non-insulated fittings (account 378);
- Valves (account 376);
- Excess flow valves (account 376);
- Risers (account 376);
- Meter bars (account 382);
- Meters (account 381);
- Unreimbursed costs related to highway relocation projects where a natural gas distribution company or city natural gas distribution operation must relocate its facilities; and
- Other related capitalized costs.

**C. Effective Date:** The initial DSIC will become effective upon one (1) day notice after submission of a compliance tariff in compliance with commission order.

### 2. Computation of the DSIC

**A. Calculation:** The initial DSIC shall be calculated to recover the fixed costs of eligible plant additions that have not previously been reflected in the Utility's rates and have been or are projected to be placed in service during the three-month period ending one month prior to the effective date of the initial DSIC. (C)  
~~The DSIC will be update don July 1, 2013 and on a quarterly basis thereafter to reflect eligible plan additions that have not previously been reflected in the Utility's rates and will have been placed in service during the three-month period ending one month prior to the effective date of each DSIC update in the calendar year in which the DSIC is charged. The DSIC charge shall be levelized so that, on an annual basis it will collect the recoverable costs for eligible plant additions that have been or are anticipated to be placed in service during the calendar year. DSIC charges shall be reconciled and may be adjusted on a calendar quarter basis for: 1) actual experienced sales volumes; and 2) revisions to projected DSIC eligible capital expenditures.~~

(D) – ~~De~~Increase; (C) - Change

<del>Effective Date of Change</del>	<del>Date to which Quarterly Reconciliation Applies DSIC-Eligible Plant Additions Reflected</del>
July 1	March 1 through May 31
October 1	June 1 through August 31
January 1	September 1 through November 30
April 1	December 1 through February 28*

\* or February 29 in years when there are 29 days in February

**B. Recoverable Costs:** The recoverable costs shall be amounts reasonably expended or incurred to purchase and install eligible property and associated financing costs, if any, including debt service, debt service coverage, and issuance costs.

**C. Application of DSIC:** The DSIC will be expressed as a percentage carried to two decimal places and will be applied to the total amount billed to each customer for distribution service under the Utility's otherwise applicable rates and charges. To calculate the DSIC, the annual recoverable costs ~~recoverable costs associated with all property eligible for cost recovery under the DSIC and to be placed into service during the calendar year in which the DSIC is being charged three-month period ending one month prior to the effective date of the initial DSIC and, thereafter, the DSIC update or this amount will be divided by the Utility's projected revenues for distribution services (including all applicable clauses and riders) for the quarterly annual period during which the charge will be collected.~~ (C)

**D. Formula:** The formula for calculation of the DSIC is as follows:

$$DSIC = \frac{DSI + e}{PARQR}$$

Where:

DSI = Projected Recoverable annual costs (defined in Section B. directly above)

e = the amount calculated under the annual reconciliation feature or Commission audit, as described below.

PARQR = Projected quarterly annual revenues for distribution service (including all applicable clauses and riders) including any revenue from existing customers plus netted revenue from any customers which will be gained or lost by the beginning of the applicable service period.

~~Revenues will be determined as one-fourth (1/4) of projected annual revenues.~~

**3. Quarterly Updates:** Supporting data for each quarterly update will be filed with the Commission and served upon the Commission's Bureau of Investigation and Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate and the Bureau of Audits at least ten (10) days prior to the effective date of the update. (C)

#### 4. Customer Safeguards

**A. Cap:** The DSIC is capped at ~~5.075~~5% of the amount billed to customers for distribution service (including all applicable clauses and riders), exclusive of amounts billed for annual reconciliation pursuant to the "e" factor set forth above, as determined on an annualized basis. The total DSIC (including amounts billed pursuant to the "e" factor) shall be capped at 10% of the amount billed to customers for distribution service (including all applicable clauses and riders). (C)

(C) - Change

**B. Audit/Reconciliation:** The DSIC is subject to audit at intervals determined by the Commission. Any cost determined by the Commission not to comply with any provision of 66 Pa C.S. §§ 1350, *et seq.*, shall be credited to customer accounts. The DSIC is subject to annual reconciliation based on a reconciliation period consisting of the twelve months ending December 31 of each year. The annual reconciliation shall be filed on January 31 of the next year. The revenue received under the DSIC for the reconciliation period will be compared to the Company's eligible costs for that period. The difference between revenue and costs will be recouped or refunded, as appropriate, in accordance with Section 1307(e), over a one-year period commencing on April 1 of each year. ~~If DSIC revenues exceed DSIC-eligible costs for the reconciliation period, such over-collections will be refunded with interest. Interest on over-collections and credits will be calculated at the residential mortgage lending specified by the Secretary of Banking in accordance with the Loan Interest and Protection Law (41 P.S. §§ 101, *et seq.*) and will be refunded in the same manner as an over-collection. Interest will not be applied on either overcollections or undercollections.~~

(C)

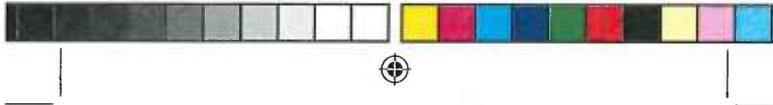
**C. New Base Rates:** The DSIC will be reset at zero upon application of new base rates to customer billings that provide for prospective recovery of the remaining costs (if any) that had previously been recovered under the DSIC. Thereafter, only the costs of new eligible plant additions that have not previously been reflected in the Utility's rates will be reflected in the quarterly updates of the DSIC.

**D. Customer Notice:** Customers shall be notified of changes in the DSIC by including appropriate information on the first bill they receive following any change. An explanatory bill insert shall also be included with the first billing.

**E. All customer classes:** The DSIC shall be applied equally to all customer classes, except that the Company may reduce or eliminate the DSIC to any customer with competitive alternatives and customers having negotiated contracts with the Company, if it is reasonably necessary to do so.

(C) - Change

# Attachment B



## PHILADELPHIA GAS WORKS

# Notice of Proposed Distribution System Improvement Charge Increase

### To Our Customers:

Philadelphia Gas Works (PGW or the Company) has filed a request with the Pennsylvania Public Utility Commission (PUC) to permit it to increase the maximum charge permitted under its Distribution System Improvement Charge (DSIC) from 5% to 7.5% of distribution revenues, and to make other technical changes. If granted, these changes would increase your distribution charge and is proposed to go into effect as of January 1, 2016. PGW's current DSIC, which was approved by the PUC in 2013 after the Pennsylvania General Assembly passed Act 11 of 2012, was designed to encourage the modernization of natural gas system infrastructure (e.g. pipes serving customers). Increasing the DSIC from 5% to 7.5% will fund an increased level of pipe replacement. This increase will help PGW ensure and maintain adequate, efficient, safe, reliable and reasonable service. This notice describes the Company's rate request, the PUC's role, and what actions you can take.

The Company has requested an annual rate increase of approximately \$11 million for distribution service charges in excess of the amount currently authorized in its DSIC. If PGW's entire request is approved, the total bill for a typical General Service (GS) Residential Heating Customer using 83 thousand cubic feet (Mcf) of natural gas per year would increase from \$99.78 to \$101.43 per month or by approximately 1.7%.

The total bill for a typical GS Commercial Heating Customer using 363 Mcf of natural gas per year would increase from \$350.46 to \$355.77 per month or by approximately 1.5%.

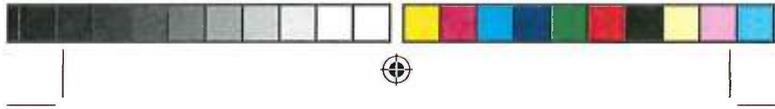
The total bill for a typical GS Industrial Heating Customer using 943 Mcf of natural gas per year would increase from \$905.95 to \$919.62 per month or by approximately 1.5%.

The total bill for a typical Municipal Service (MS) Heating Customer using 1,273 Mcf of natural gas per year would increase from \$1,040.95 to \$1,055.10 per month or by approximately 1.4%.

The total bill for a typical Philadelphia Housing Authority (PHA) Heating Customer using 677 Mcf of natural gas per year would increase from \$607.69 to \$616.50 per month or by approximately 1.4%.

To find out your customer class or how the requested change may affect GS, MS and PHA bills, contact PGW at 215-235-1000 or review the Basic Charges section of your PGW bill. A sample PGW bill including an explanation of sections and charges is available in the Customer Care section of PGW's website at <http://www.pgworks.com>. The rates requested by PGW may be found in PGW Gas Service Tariff Number 2 – Supplement No. 85, which is available in the About Us section of PGW's website. You may examine the material filed with the PUC, which explains the requested change and the reasons for it.

Please see reverse side



A copy of this material is available on PGW's blog at <http://www.pgworks.com/blog>, and is kept at PGW's Main Office at 800 W. Montgomery Avenue, Philadelphia, PA, and can be reviewed Monday through Friday from 9 a.m. to 5 p.m. Upon request, the Company will send you a statement of reasons for the filed changes in PGW Gas Service Tariff Number 2 – Supplement No. 85 explaining why the Company requested the rate change.

### **The PUC's Role**

The state agency which approves rates for public utilities is the PUC. The PUC will examine the requested rate change and can prevent existing rates from changing until it investigates and/or holds hearings on the request. The Company must prove that the requested rates are reasonable. After examining the evidence, the PUC may grant all, some, or none of the request or may reduce existing rates.

The PUC may change the amount of the rate change requested by the utility for each customer class. As a result, the rate charged to you may be different than the rate the Company requested.

### **Actions You Can Take**

There are three ways to challenge a requested rate change:

1. **You can file a formal complaint.** If you want a hearing before a judge, you must file a formal complaint. By filing a formal complaint, you assure yourself the opportunity to take part in hearings about the rate change request. If no formal complaints are filed, the PUC may grant all, some or none of the request without holding a hearing before the judge.
2. **You can send the PUC a letter telling why you object to the requested rate change.** Sometimes there is information in these letters that makes the PUC aware of problems with the Company's service or management. This information can be helpful when the PUC investigates the rate request.

Send your letter or request for a formal complaint form to the Pennsylvania Public Utility Commission, Post Office Box 3265, Harrisburg, PA 17105-3265. Complaint forms can also be accessed at the PUC Website in Adobe Acrobat Format: [http://www.puc.state.pa.us/general/onlineforms/pdf/official\\_complaint\\_form\\_final.pdf](http://www.puc.state.pa.us/general/onlineforms/pdf/official_complaint_form_final.pdf)

3. **You can be a witness at a public input hearing.** Public input hearings are held if the PUC opens an investigation of the Company's rate change request and if there are a large number of customers interested in the case. At these hearings you have the opportunity to present your views in person to the PUC judge hearing the case and the Company representatives. All testimony given "under oath" becomes part of the official rate case record. These hearings are held in the service area of the Company. Please look for Public Notice of the time and place of hearings.

For more information call the PUC at 1-800-692-7380. You may leave your name and address so you can be notified of any public input hearings that are scheduled in this case.

Philadelphia Gas Works  
800 W. Montgomery Avenue  
Philadelphia, PA 19122  
215-235-1000



30691-I-0081

# Exhibit 1

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

DIRECT TESTIMONY OF

**DANIEL P. MURRAY**

ON BEHALF OF  
PHILADELPHIA GAS WORKS

Docket No. P-2015-\_\_\_\_\_

Revisions To PGW Distribution System Improvement Charge

September 1, 2015

1 **I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND CURRENT POSITION WITH PGW.**

3 A. My name is Daniel P. Murray. My position with PGW is Senior Vice President of  
4 Customer Affairs and Operations.

5 **Q. PLEASE SUMMARIZE YOUR BACKGROUND AND EXPERIENCE.**

6 A. I received a Bachelor of Science degree in business management from Providence  
7 College in 1997. I was appointed the Senior Vice President of Customer Affairs and  
8 Operations in December 2012. Prior to this position, I held the following positions at  
9 PGW: Vice President Customer Affairs, Director of Resource Management for Field  
10 Operations, and Director of Special Projects. Prior to joining PGW in 2006, I was a  
11 Senior Manager in the utility practice of Accenture, a global management consulting  
12 company.

13 **Q. HAVE YOU EVER PROVIDED TESTIMONY BEFORE THIS COMMISSION?**

14 A. No.

15 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

16 A. PGW is petitioning the Commission to increase the 5% cap on the Company's  
17 Distribution System Improvement Charge ("DSIC"). The purpose of my testimony is to:  
18 (i) explain how PGW plans to accelerate the replacement of "at risk"<sup>1</sup> cast iron and  
19 unprotected steel gas main, if PGW's request is granted; and (ii) show how the  
20 Company's proposed further acceleration will enhance system safety and reliability, is

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<sup>1</sup> I use the term "at risk" to mean PGW's cast iron and unprotected steel mains. Consistent with PGW's Distribution Integrity Management Plan ("DIMP"), PGW determines the priority of removal of at risk main based on the risk ranking of the various categories of main, as set forth in its DIMP.

1 cost-effective and will ensure and maintain adequate, efficient, safe, reliable and  
2 reasonable service and is therefore in the public interest.

3 **II. BACKGROUND**

4 **Q. PLEASE PROVIDE A GENERAL DESCRIPTION OF PGW'S GAS**  
5 **DISTRIBUTION SYSTEM.**

6 A. PGW's gas distribution system serves more than 500,000 customers in Southeastern  
7 Pennsylvania in the County and City of Philadelphia using approximately 3,000 miles of  
8 natural gas mains, 66% of which are at risk, as well as some 3,000 miles of service lines  
9 ("services"). PGW's at risk mains are composed of 49% cast iron and 17% unprotected  
10 coated steel. The Company's services are made up of 75% plastic and protected coated  
11 steel, 20% bare steel and 5% unprotected coated steel.

12 **Q. WHAT IS THE AGE PROFILE OF PGW'S DISTRIBUTION SYSTEM?**

13 A. Like most utilities in the Northeast region of the country, PGW has hundreds of miles of  
14 mains that have been under ground for many decades and will require replacement in  
15 order to maintain safe and reliable service.

16 **Q. DOES PGW HAVE IN PLACE A PROGRAM TO REPLACE OLDER MAINS?**

17 A. Yes. PGW has had main replacement programs in effect for more than 17 years. Over  
18 that time PGW has replaced and/or removed approximately 300 miles of cast iron and  
19 156,000 steel services with plastic and protected coated steel. Currently, as a part of its  
20 standard operations within base rates, PGW is removing small diameter cast iron main of  
21 all sizes at a rate of about 18 miles per year. In addition, as part of its current LTIP and

1 DSIC, PGW is replacing additional cast iron main at a rate of about 7 miles of cast iron  
2 main per year.<sup>2</sup>

3 **Q. HOW DOES PGW IDENTIFY MAINS THAT SHOULD BE REPLACED?**

4 A. PGW employs traditional risk management analysis programs, benchmarking  
5 analyses/studies and the Company's Main Replacement Prioritization model. Also,  
6 PGW's replacement program is informed by its experience from recent incidents at PGW  
7 and other natural gas distribution companies ("NGDCs"). The tools that the Company  
8 used to formulate its LTIP include PGW's Distribution Integrity Management Program  
9 ("DIMP"), the Advantica Benchmarking Analysis, Risk Analysis and Model,  
10 Replacement Analysis and Computerized Main Prioritization and Ranking Program.

11 **Q. PLEASE DESCRIBE PGW'S CURRENT LTIP.**

12 A. PGW's LTIP was approved on April 4, 2013.<sup>3</sup> PGW's Commission-approved LTIP  
13 describes the process of evaluating, improving, repairing and replacing its distribution  
14 related facilities and equipment, the plan to continue accelerated investments under this  
15 process, and the categories and estimated cost of DSIC-eligible property that PGW  
16 expects to install over a five-year period (2013 to 2017). PGW's LTIP proposed that it  
17 would advance the replacement of high risk, cast iron main by adding to its existing "18  
18 mile" program.

19 PGW has identified the following property in its LTIP for replacement: (i) 12  
20 inch and smaller high pressure main (High Pressure [HP] or 10-35 psig); (ii) 30 inch high

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<sup>2</sup> Fluctuations in annual mileage will occur because the average cost per mile can vary based upon numerous factors, such as the size of the pipeline being replaced, the cost of construction and inflation.

<sup>3</sup> *Petition of Philadelphia Gas Works for Approval of its Long-Term Infrastructure Improvement Plan*, PUC Docket No. P-2012-2337737, Opinion and Order entered on April 4, 2013.

1 pressure main (HP or 10-35 psig); and (iii) 8 inch and smaller low to intermediate  
2 pressure main (LP/IP or 4.5 inches WC to 5 psig).

3 **Q. HOW WAS THE CURRENT PACE OF ACCELERATED REPLACEMENT**  
4 **ESTABLISHED?**

5 A. The scope and pace of the accelerated main replacement program was determined by the  
6 amount of funds available to PGW from its 18 mile program funded in base rates and its  
7 approved LTIIP and DSIC. The current maximum allowable DSIC percentage (5%)  
8 places a limitation (or cap) on the amount of accelerated replacement of Phase I cast iron  
9 mains that can be funded through the DSIC mechanism.

10 **III. ACCELERATED REPLACEMENT**

11 **Q. HAS THERE BEEN ANY SUGGESTION THAT PGW SHOULD DO MORE TO**  
12 **INCREASE THE RATE OF REPLACEMENT?**

13 A. Yes. While PGW's accelerated efforts made possible by the implementation of its DSIC  
14 have been widely acknowledged to be a positive step in improving the safety and  
15 reliability of its distribution system, a growing consensus has developed that more should  
16 be done, if possible. Calls for further acceleration have come both at the national and the  
17 local level.<sup>4</sup> Most notably, the PA PUC Staff issued a Report recommending that PGW  
18 find ways to further accelerate the replacement of at risk mains.<sup>5</sup>

19 **Q. PLEASE EXPLAIN PGW'S REACTION TO THESE RECOMMENDATIONS.**

20 A. In light of these various recommendations, PGW has determined to attempt to accelerate  
21 its replacement of at risk mains beyond that permitted by its existing DSIC. In order to  
22 accomplish this, PGW is requesting an increase in the current DSIC limitation (or cap) of

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<sup>4</sup> A summary of some of those recommendations appears at paragraphs 16-19 of PGW's Petition that is being filed with my testimony.

<sup>5</sup> *Staff Report: Inquiry into Philadelphia Gas Works' Pipeline Replacement Program*, dated April 21, 2015.

1 5% of billed distribution revenues to 7.5%, exclusive of reconciliation, for service  
2 rendered on or after January 1, 2016. In addition, PGW has determined to pursue another  
3 recommendation of the PUC Staff and request the ability to submit a “levelized” annual  
4 DSIC.

5 **Q. CAN YOU EXPLAIN THE JUSTIFICATION FOR FURTHER ACCELERATING**  
6 **THE RATE OF REPLACEMENT ?**

7 A. There are a number of factors that justify further acceleration of replacement of at risk  
8 mains for PGW, several of which were mentioned in the PUC Staff Report. Most  
9 notably, the percentage of cast iron and unprotected steel mains in PGW's distribution  
10 system remains among the highest of any NGDC. PGW's high percentage of at risk  
11 mains is due to many factors, including the overall age of the system, the logistic  
12 difficulty of main replacement in a highly urban environment and reducing the risks  
13 associated with gas leaks by configuring its distribution system as almost entirely low  
14 pressure (under one pound of pressure per square inch). Nonetheless, in the last several  
15 years, an industry and regulatory consensus has developed that replacing at risk mains  
16 should be accomplished as quickly as reasonably possible, and PGW fully supports this  
17 view.

18 **Q. ARE THERE ADDITIONAL, PGW SPECIFIC FACTORS THAT SUPPORT**  
19 **THIS VIEW?**

20 A. Yes. Another factor supporting acceleration is the upward trend in leaks on PGW's  
21 distribution system.

22 **Q. PLEASE EXPLAIN THE UPWARD TREND IN LEAKS.**

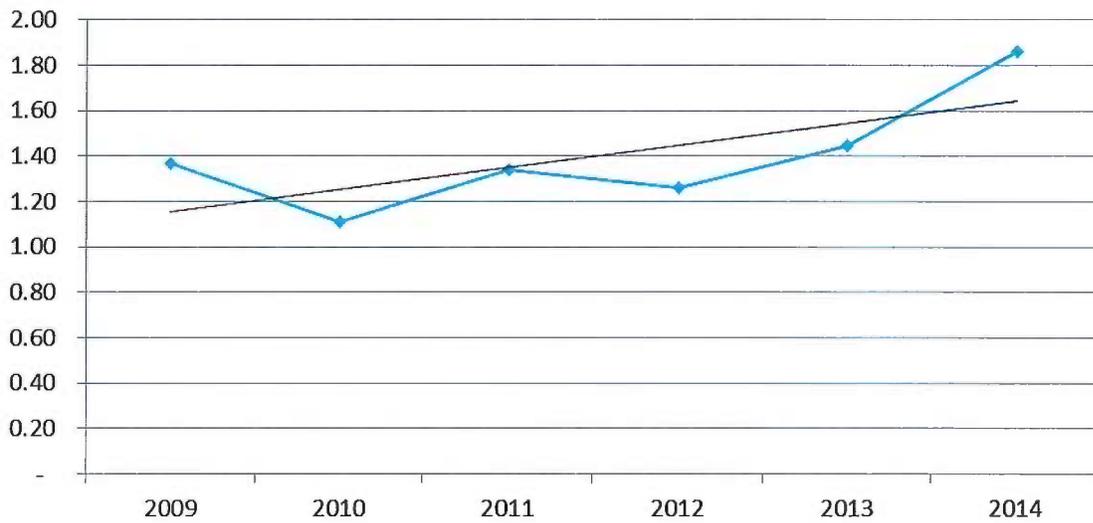
23 A. Even with its base rate and the current, DSIC funded accelerated replacement programs,  
24 PGW has experienced an increase in the number of leaks requiring repair resulting from

1 natural forces or corrosion on its cast iron and unprotected coated steel mains. Cast iron  
2 mains of all diameters and pressures have seen the most significant increase in leaks.

<b>LP / IP - Cast Iron Total</b>						
Leaks Repaired						
<b>Main Material</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Cast Iron	2,032	1,622	1,934	1,801	2,040	2,582

3

### LP & IP Cast Iron - Leaks per Mile



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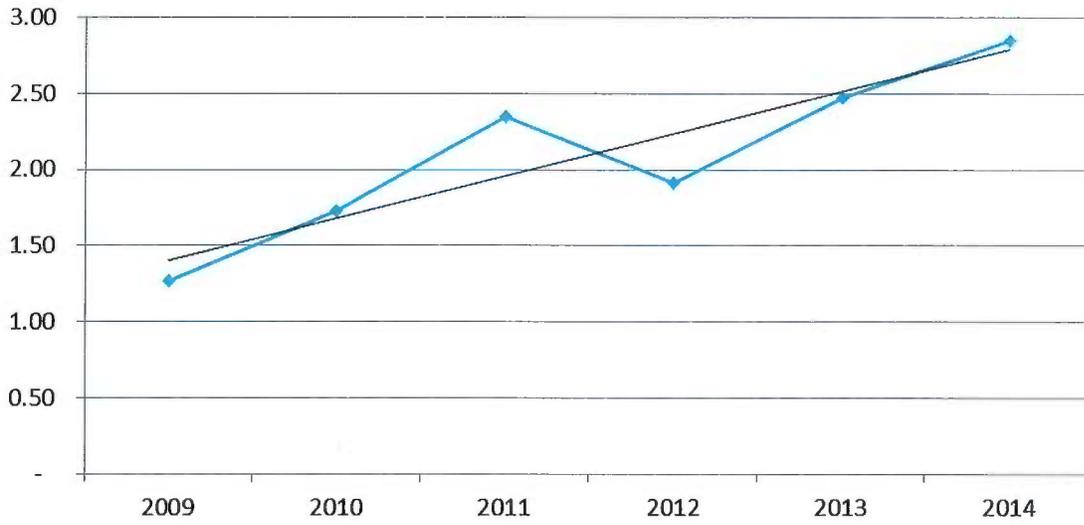
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1

HP - Cast Iron Total						
Leaks Repaired						
Main Material	2009	2010	2011	2012	2013	2014
Cast Iron	125	171	228	185	225	244

2

### HP Cast Iron - Leaks per Mile



3

4

1

The figures for cast iron main in total are as follows:

<b>Cast/Iron Total</b>						
Leaks Repaired						
Main Material	2009	2010	2011	2012	2013	2014
Cast/Iron Total	2157	1793	2162	1986	2265	2826

2

3

Though not as significant, PGW is also experiencing an increase in the leaks

4

requiring repair on its unprotected coated steel mains mainly due to corrosion.

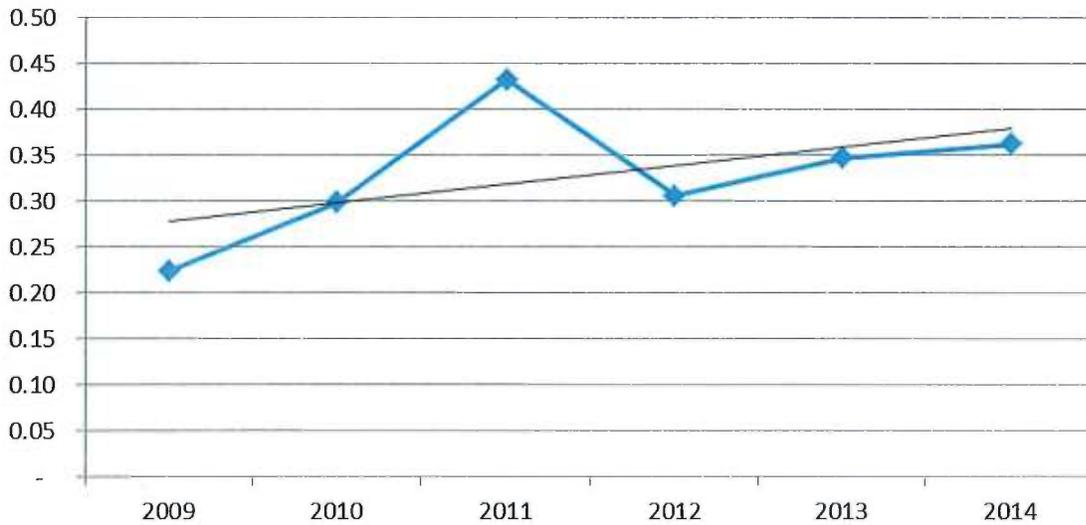
5

<b>STEEL - Total</b>						
Leaks Repaired						
Main Material	2009	2010	2011	2012	2013	2014
Unprotected, Coated Steel	112	149	215	152	171	178

6

7

### Unprotected Steel - Leaks per Mile

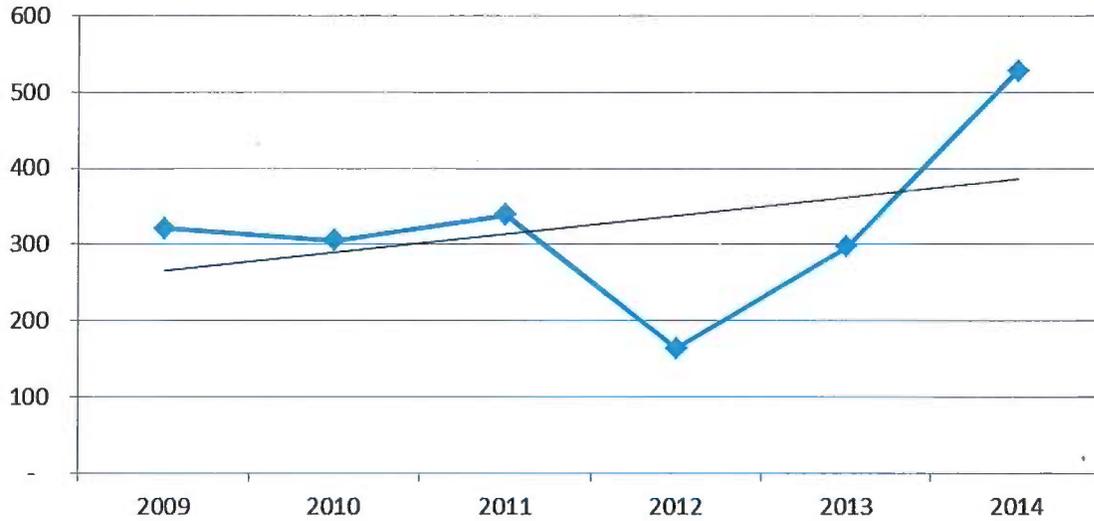


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1 PGW has also experienced an increase in the number of broken cast iron mains.

### Cast Iron Broken Mains



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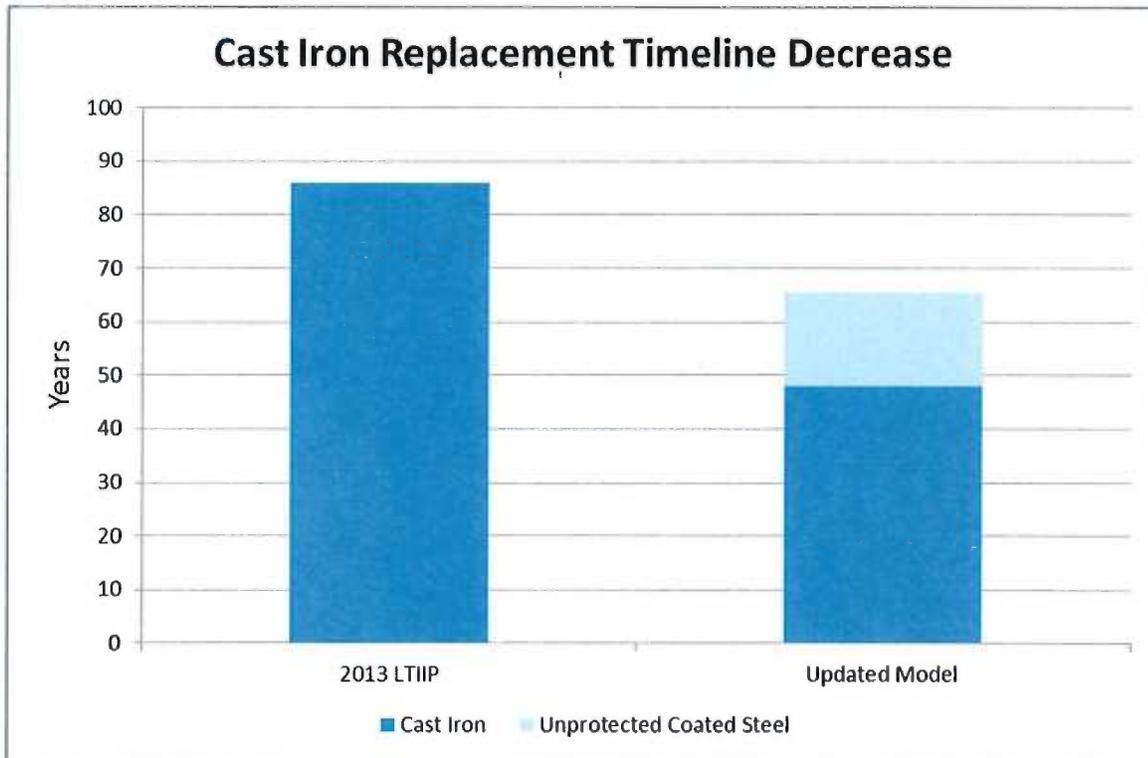
16

PGW believes that the increased incidence of leaks and breaks is reflective of two primary factors: severe weather that lead to significant depth and fluctuations in frost levels underground in the Philadelphia region, and the increasing age of a majority of its distribution facilities. Importantly, and as the Commission is aware, PGW provides service in an urban environment with high population density and a vast amount of paved ground cover, which can lead to gas leaks migrating to buildings. This means that urban NGDCs like PGW have a greater need to try to take steps to reduce gas leaks. Removing high risk mains more quickly and replacing them with materials that are less susceptible to leaks and breaks would appear to be the best way to reduce such risks.

These factors, some of which were referenced in the PUC Staff Report, have led PGW to the conclusion that increasing the pace of replacement of at risk mains beyond PGW's current plan would be the best way to improve its leak and broken main experience over time.

1 **Q. WOULD PGW'S PROPOSALS INCREASE THE RATE OF REPLACEMENT?**

2 A. Yes. PGW intends to further accelerate replacements if additional funds are available  
3 under the DSIC. Such funds would be dedicated, as the current DSIC funds are  
4 dedicated, to accelerated distribution facility replacement. If PGW's proposals are  
5 approved, PGW expects that the timeline to replace all the cast iron main in the system  
6 would decrease from its current projection of 86 years to 48 years.<sup>6</sup> This represents a  
7 44% decrease in the timeline to replace cast iron main compared to PGW's current 86  
8 year projection, based on its projection in its LTIP.  
9



10  
11

12 **Q. IS THE PROPERTY PROPOSED TO BE REPLACED ELIGIBLE PROPERTY**  
13 **UNDER ACT 11?**

<sup>6</sup> The timeline for replacing all cast iron and unprotected steel would be 65 years.

1 A. Yes. The property proposed to be replaced, as described above, is generally  
2 characterized as piping, couplings and valves and are DSIC-eligible under Section 1351  
3 of Act 11.<sup>7</sup> Importantly, when and if the PUC approves PGW's request to increase its  
4 DSIC financed main replacement to 7.5%, PGW will file an amendment to its current  
5 LTIP seeking Commission approval of its specific plan for use of these additional funds.  
6 That amendment will, of course, be subject to PUC review and approval. PGW will  
7 employ its DIMP to identify the order of main replacement, focusing initially on main  
8 that rank as "high risk" in its DIMP, and then moving to lower risk facilities.

9 **Q. HOW MUCH MORE WOULD PGW BE ABLE TO SPEND IF THE DSIC CAP**  
10 **WERE INCREASED TO 7.5%?**

11 A. For calendar year 2016, PGW projects that a 7.5% cap would permit it to expend \$11  
12 million over and above what the Company spends for its current DSIC financed and base  
13 rate replacement programs. I would also note that PGW plans to continue to fund the  
14 accelerated main replacement program through the DSIC on a pay-as-you-go basis; any  
15 limitation on DSIC recovery for these expenditures will result in a corresponding  
16 reduction of the scope of the accelerated main replacement program.

17 **Q. HOW WILL THESE ADDITIONAL COSTS BE RECOVERED?**

18 A. As Mr. Dybalski explains in his testimony, these additional expenditures will be  
19 recovered through the Company's DSIC tariff.

20 **Q. IN YOUR OPINION, WOULD THE PROPOSED ACCELERATION HELP PGW**  
21 **TO ENSURE AND MAINTAIN ADEQUATE, EFFICIENT, SAFE, RELIABLE**  
22 **AND REASONABLE SERVICE ?**

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<sup>7</sup> 66 Pa. C.S. § 1351. PGW also plans to replace other DSIC-eligible property including the unprotected bare and unprotected coated steel services and meter sets associated with the removed cast iron mains, and the related eligible property includes gas service lines, fittings, risers, meter bars and meters with attached automatic meter reading devices.

- 1 A. Yes, further acceleration will contribute to:
- 2 a) Reducing leaks and the concomitant risk of serious incidents from those
- 3 leaks, compared to what PGW is likely to experience without acceleration;
- 4 b) Reducing breakage repairs and future breakage repair costs, again,
- 5 compared to the costs it would incur absent acceleration;
- 6 c) Reducing leak maintenance and repair on the facilities being removed
- 7 from service; and
- 8 d) Reducing leaks will result in levels of unaccounted-for gas (again,
- 9 compared to the amounts PGW would experience absent acceleration).

10 By replacing its highest risk pipe, PGW expects to decrease the number of leaks

11 requiring repair on the system, and as a result provide safer and more reliable service to

12 its customers. Reducing the number of leaks will reduce the time and money that PGW

13 would otherwise have to expend to repair those leaks compared to what PGW would have

14 to expend if it did not accelerate its main replacement program. In addition, it should be

15 noted that natural forces is the highest ranking threat in PGW's DIMP. As a result, the

16 quantity of both leaks and main breaks will be impacted by instances of severe weather

17 and frost levels. However, as the riskiest main are replaced the long term trends for both

18 leaks and main breaks are expected to demonstrate a decrease. Therefore, while I am not

19 asserting that the total amount PGW must expend on leak repair will necessarily go down

20 in absolute terms, over time the cost imposed on ratepayers should be lower than it

21 otherwise would have been absent the accelerated replacement.

22 Simply put, using the DSIC to raise additional revenue for pipeline replacement

23 will help PGW ensure and maintain adequate, efficient, safe, reliable and reasonable

1 service. The purpose of the DSIC is to pay for infrastructure improvement and  
2 replacement of aging infrastructure. The revenue generated by the DSIC is restricted, by  
3 its nature, to eligible infrastructure projects. The DSIC will be a dollar-for-dollar  
4 recovery of prudent expenses incurred for improving reliability to customers. PGW's  
5 "pay-as-you-go" method is the least costly to customers, compared to the issuance of  
6 long term bonds. That being said, PGW's approved LTIIIP contains a number of  
7 measures to ensure that it is implemented in a cost-effective manner, including utilizing a  
8 competitive bidding process for all relevant aspects of the program.

9 **Q. DOES PGW HAVE ADDITIONAL INTERNAL PROCESSES IN PLACE TO**  
10 **ENSURE THAT ITS MAIN REPLACEMENT PROGRAM WILL HELP IT TO**  
11 **MAINTAIN SAFE AND RELIABLE SERVICE?**

12 A. Yes. PGW also relies on its DIMP as a comprehensive process that requires PGW to  
13 undertake an assessment of its entire distribution system. PGW's DIMP identifies,  
14 evaluates and prioritizes threats to the distribution system and helps the Company  
15 identify the most appropriate measures to address any identified risks. As noted, if its  
16 petition to increase the DSIC cap is granted the Company will file a modified LTIIIP  
17 showing the proposed revised schedule of main replacement and the specific types of  
18 facilities that will be replaced. Those revisions will be made in accordance with PGW's  
19 current DIMP.

20 **Q. WOULD THE PROPOSED FURTHER ACCELERATION BE IN THE PUBLIC**  
21 **INTEREST?**

22 A. Yes. As noted, PGW's proposals would continue the Company's efforts to improve the  
23 safety and reliability of its infrastructure. Replacing cast iron pipe contributes to a safer,  
24 more reliable, and more efficient natural gas distribution system. PGW's approved LTIIIP  
25 and DIMP prioritize replacement based on risk. Accelerating this replacement will result

1 in safer infrastructure in a shorter time frame, by decreasing leaks and main breaks as a  
2 result of natural forces which could lead to serious incidents, breakage repairs and future  
3 breakage repair costs. These results are in the public interest.

4 **Q. WOULD THE PROPOSED FURTHER ACCELERATION BE COST**  
5 **EFFECTIVE ?**

6 A. Yes. The property proposed would be replaced under PGW's approved LTIP, as  
7 revised. The Company has taken a number of steps to ensure that the LTIP is  
8 implemented in a cost-effective manner. First, the program will be funded on a pay-as-  
9 you-go basis to avoid the issuance of long term debt and the negative consequences that  
10 would follow from such a course. This "pay-as-you-go" approach reduces costs for  
11 customers and prevents adverse effects to PGW's cash flow, debt to total capitalization  
12 ratio and bond ratings. Second, PGW will continue to employ its Main Prioritization  
13 Model used in its DIMP to identify the priority of replacement that should be utilized.  
14 Replacing higher risk main should reduce future breakage repair costs because the  
15 accelerated replacement program will reduce breakage repairs in comparison to what  
16 PGW would experience if it did not accelerate its replacement. In addition, the Company  
17 will use a competitive bidding process that seeks to add new contractors for planning,  
18 procurement and construction to create a larger bidding pool and more competitive bid  
19 prices.

20 **Q. DOES PGW HAVE PRESENT PLANS TO INCREASE THE DSIC CAP ABOVE**  
21 **7.5%**

22 A. PGW will continue to review its DSIC-financed main replacement program from year to  
23 year to determine whether it would be prudent to request additional increases in its DSIC  
24 spending. PGW has elected to begin with an increase of 2.5% in excess of the initial cap  
25 in order to gain experience with an expedited program. PGW has not previously engaged

1 in this level of annual construction and, before moving to even more aggressive levels, it  
2 needs to be able to assess a number of factors, including the effect on commerce, traffic  
3 congestion, and noise, especially in the more congested areas of the City, and the  
4 availability of qualified contractors to perform the work. Once it gains this data it will  
5 consider whether it would be prudent to accelerate the pace of its main replacement even  
6 further.

7 **Q. DOES PGW HAVE A WORKFORCE MANAGEMENT PLAN TO ENSURE**  
8 **THAT THE PROPOSED IMPROVEMENTS AND REPLACEMENT WORK IS**  
9 **PERFORMED IN A COST-EFFECTIVE, SAFE AND RELIABLE MANNER?**

10 A. Yes. As part of its baseline main replacement plan, PGW currently has departmental  
11 structures and qualified staff in place for the prioritization, design, contracting, execution  
12 and cost control of main replacement projects. The Planning Section is responsible for  
13 prioritization of main replacement projects, design and permitting, cost estimates and bid  
14 package preparation. The Supply Chain Department administers the procurement  
15 functions such as contractor solicitation, bidding and contract management. Third party  
16 contractors are qualified by PGW's Supply Chain Department on the basis of financial  
17 fitness, safety performance, minority participation and training records. The  
18 Construction Section is in charge of the execution of these contracts. This group  
19 manages the project, schedules, monitors and evaluates the overall program and the  
20 associated costs. Contractors excavate, install, test and backfill new mains under the  
21 direct supervision of a qualified PGW construction inspector, who is required to confirm  
22 that the work meets all safety, performance and contractual standards.

23 **Q. DOES PGW HAVE TRAINING PROGRAMS IN PLACE TO ENSURE THAT**  
24 **WORK IS PERFORMED IN A SAFE AND EFFICIENT MANNER?**

1 A. Yes. PGW has a dedicated Training Section that provides classroom, simulated and field  
2 training and testing for its personnel to ensure that employees meet standards established  
3 by the United States Department of Transportation (“USDOT”) and the gas safety  
4 regulations and orders of the Commission. The Company has in place a Natural Gas  
5 Pipeline System Operator Qualification Plan (“Plan”) to train and qualify employees in  
6 the USDOT’s Pipeline Safety Regulations at 49 CFR 192 Subpart N. This Plan ensures  
7 safe and efficient natural gas service by establishing objective criteria related to required  
8 qualifications for all persons performing safety-sensitive operations and maintenance  
9 tasks on PGW’s system. The Plan ensures that employees are able to perform assigned  
10 tasks, recognize and respond appropriately to abnormal operating conditions, and  
11 maintain necessary records to administer the plan.

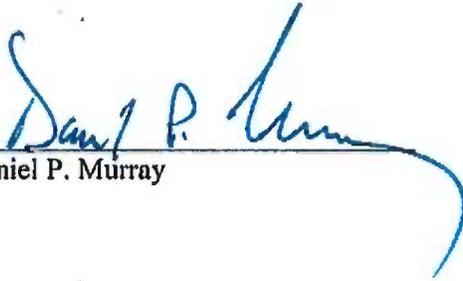
12 **III. CONCLUSION**

13 **Q. Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

14 A. Yes.

**VERIFICATION**

I, Daniel P. Murray, hereby state that: (1) I am the Senior Vice President of Customer Affairs and Operations for Philadelphia Gas Works; (2) the facts above set forth in the foregoing document are true and correct (or are true and correct to the best of my knowledge, information and belief); and (3) that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

  
Daniel P. Murray

# Exhibit 2

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

DIRECT TESTIMONY OF

**KENNETH S. DYBALSKI**

ON BEHALF OF  
PHILADELPHIA GAS WORKS

Docket No. P-2015-\_\_\_\_\_

Revisions To PGW Distribution System Improvement  
Charge

September 1, 2015

1 **I. INTRODUCTION**

2

3 **Q. PLEASE STATE YOUR NAME AND POSITION WITH THE COMPANY.**

4 A. My name is Kenneth S. Dybalski. My position is Director - Gas Planning &  
5 Rates, at Philadelphia Gas Works.

6 **Q. HOW LONG HAVE YOU HELD THIS POSITION?**

7 A. I have been the Director - Gas Planning & Rates since 2006 and prior to that I was  
8 the Manager of Gas Planning from 2001 to 2006.

9 **Q. WHAT ARE YOUR VARIOUS JOB RESPONSIBILITIES?**

10 A. In my present position, I am responsible for developing and coordinating short  
11 and long term planning of gas demand, gas supply, raw material expense and  
12 revenue; overseeing the preparation of sales, sendout, revenue and fuel expense  
13 projections; developing peak day/hour load projections; overseeing the  
14 development of the various filings before the Pennsylvania Public Utility  
15 Commission ("Commission or PUC") and Philadelphia Gas Commission,  
16 including the quarterly and annual Gas Cost Rate ("GCR") filings; preparing the  
17 Integrated Resource Planning Report; and providing supporting documentation for  
18 gas costs related to PGW's Operating Budget before the Philadelphia Gas  
19 Commission.

20 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.**

21 A. I hold a BS and an MBA from Temple University in Philadelphia, Pennsylvania.

1 **Q. HAVE YOU EVER PROVIDED TESTIMONY BEFORE THIS**  
2 **COMMISSION?**

3 A. Yes. I submitted testimony on behalf of PGW in several proceedings, including  
4 the Petition of Philadelphia Gas Works for Approval of a Distribution System  
5 Improvement Charge (Docket No. P-2012-2337737).

6 **Q. WHAT TOPIC ARE YOU ADDRESSING IN YOUR DIRECT**  
7 **TESTIMONY?**

8 A. My testimony addresses the proposed revisions to the Distribution System  
9 Improvement Charge (“DSIC”) to reflect an increase from 5% to 7.5% (exclusive  
10 of reconciliation), as well as the rate impact of the proposed increase. I will also  
11 discuss: (i) PGW’s proposal to charge a levelized DSIC; (ii) the mechanics of  
12 PGW’s proposed reconciliation mechanism and the proposal to establish a 10%  
13 total cap for the DSIC including reconciliation; (iii) the proposed modifications to  
14 PGW’s tariff to accommodate these proposals; and (iv) PGW’s proposal to waive  
15 the requirement to charge interest on overcollections.

16 **II. BACKGROUND**  
17

18 **Q. PLEASE DESCRIBE PGW’S CURRENT DSIC.**

19 A. The DSIC has been an integral tool in enabling PGW to replace at risk  
20 infrastructure by removing primarily cast iron main from inventory. PGW’s DSIC  
21 was approved on May 9, 2013.<sup>1</sup> PGW’s DSIC compliance tariff, Supplement No.  
22 62 to Gas Service Tariff – Pa P.U.C. No. 2, went into effect June 1, 2013.<sup>2</sup>

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<sup>1</sup> *Petition of Philadelphia Gas Works for Approval of a Distribution System Improvement Charge*, PUC Docket No. P-2012-2337737, Opinion and Order entered on May 9, 2013 (“Final DSIC Order”).

<sup>2</sup> *Final DSIC Order; Petition of Philadelphia Gas Works for Approval of a Distribution System Improvement Charge*, PUC Docket No. P-2012-2337737, Secretarial Letter dated June 4, 2013;

1 PGW's Commission-approved DSIC tariff<sup>3</sup> includes, among other things,  
2 a 5% cap on the total amount of revenue that may be billed through PGW's  
3 DSIC.<sup>4</sup> PGW's DSIC bills 100% of the cost of the facilities to be replaced on a  
4 "pay-as-you-go" basis.<sup>5</sup> The Commission's Order approving PGW's DSIC also  
5 directed that its DSIC be calculated quarterly, and reflect only the cost of facilities  
6 which were placed into service in the previous quarter.<sup>6</sup>

7 **Q. WHAT IS THE PURPOSE OF THE DSIC?**

8 A. Generally, the purpose of the DSIC is to allow utilities to recover costs associated  
9 with incremental repairs, improvements and replacement of eligible property,  
10 which costs have not been reflected in the utility's rates or rate base, or will not be  
11 reflected, until those costs may be included in a future rate case, in order to ensure  
12 and maintain adequate, efficient, safe, reliable and reasonable service. PGW uses  
13 its DSIC in this way to recover a portion of its accelerated at risk main  
14 replacement program.

15 **Q. ARE THERE STATUTORY LIMITATIONS ON THE DSIC?**

16 A. Yes, certain statutory limitations are included in Act 11, the Act that authorized  
17 the DSIC mechanism. Specifically, absent a waiver, the DSIC may not exceed  
18

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*Petition of Philadelphia Gas Works for Approval of a Distribution System Improvement Charge*,  
PUC Docket No. P-2012-2337737, Secretarial Letter dated June 10, 2013.

<sup>3</sup> PGW Gas Service Tariff, Pa. PUC No. 2, Eighth Revised Page 151 to Second Revised Page 153.

<sup>4</sup> PGW Gas Service Tariff, Pa. PUC No. 2, Eighth Revised Page 151 and Fourth Revised Page 152.

<sup>5</sup> *Petition of Philadelphia Gas Works for Approval of its Long-Term Infrastructure Improvement Plan*, PUC Docket No. P-2012-2337737, Opinion and Order entered on April 4, 2013 at 13-14 ("LTIP DSIC Order"). In this Order, the PUC tentatively approved PGW's DSIC but directed certain changes in the proposed tariff, which were subsequently approved.

<sup>6</sup> LTIP DSIC Order at 36; Final DSIC Order at 4-6.

1 5% of the amount billed to customers under the applicable distribution rates of the  
2 natural gas distribution utility or city natural gas distribution operation.<sup>7</sup>

3 Additionally, Act 11 provides that the DSIC will: (i) change each quarter;<sup>8</sup> (ii) be  
4 calculated to recover the fixed cost of eligible property that has been placed in  
5 service during the prior quarter;<sup>9</sup> and (iii) will be reset to zero as of the effective  
6 date of new base rates that provide for prospective recovery in base rates of the  
7 annual costs previously recovered under the DSIC.<sup>10</sup>

8 PGW's DSIC contains all these consumer protections, although, because  
9 PGW uses a "pay as you go" method of billing for DSIC costs, its DSIC will not  
10 be reset to zero on the effective date of a new base rate case because its DSIC  
11 expenditures will be recovered in the year in which they are included in the DSIC  
12 (not considering the reconciliation of prior year costs, which will be recovered in  
13 the separate reconciliation mechanism and not in base rates).

14 **III. WAIVER OF 5% LIMITATION**

15  
16 **Q. PLEASE DESCRIBE PGW'S PROPOSAL FOR A NEW MAXIMUM**  
17 **ALLOWABLE PERCENTAGE LIMITATION.**

18 A. PGW is requesting that the Commission (i) waive the current DSIC cap of 5% of  
19 billed distribution revenues; and (ii) approve a 2½% increase in the maximum  
20 allowed DSIC from 5% to 7.5% (not including reconciliation) for service rendered  
21 on or after January 1, 2016.

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7 66 Pa. C.S. § 1358(a)(1).

8 See 66 Pa. C.S. §§ 1353(b)(i)(iv), 1354(3), 1357(a)(2), 1357(b)(3) (relating to quarterly updates of  
the DSIC). See also footnote 9, *infra*.

9 66 Pa. C.S. §§ 1357(a)(1)(ii), (a)(2), (b)(1).

10 66 Pa. C.S. § 1358(b)(1).

1           This proposal is consistent with the Staff Report of the PUC issued (on  
2           April 21, 2015) entitled: “*Staff Report: Inquiry into Philadelphia Gas Works’*  
3           *Pipeline Replacement Program* (hereinafter “PUC Staff Report”). The PUC Staff  
4           Report’s suggested principal means of achieving an acceleration of the pace of  
5           replacement of at risk mains was to increase PGW’s DSIC above the current 5%  
6           cap.<sup>11</sup>

7   **Q.   HOW WILL PGW CALCULATE THE DSIC SURCHARGE?**

8   A.   A DSIC capped at 7.5% (exclusive of reconciliation) would permit PGW to spend  
9           approximately \$33 million annually to expedite its existing main replacement  
10          program, or an increase of approximately \$11 million over the maximum  
11          currently permitted under the 5% cap.

12 **Q.   HOW WILL DSIC BE APPLIED TO CUSTOMER BILLS?**

13 A.   PGW will bill its customers for the DSIC on a “bills rendered” basis, and the  
14          surcharge will be expressed as a percentage carried to two (2) decimal places and  
15          will be applied to the total amount billed to each customer for distribution  
16          services.

17               The DSIC will be applied equally to all customer classes as a percentage  
18               and will be at or below the 7.5% cap for each class, exclusive of reconciliation.  
19               The percentage charge will produce, over 12 months, the \$33 million that PGW  
20               projects to spend on its accelerated main replacement program in 2016.

21 **Q.   PLEASE DESCRIBE THE RATE IMPACTS UPON CUSTOMERS.**

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<sup>11</sup> PUC Staff Report at 5, 35-42.

- 1 A. The proposed further acceleration would have the following incremental impact  
 2 on the average customer bills:

<u>Incremental Impact – Average Residential Heating Customer Bill</u>	
DISC	7.50%
Customer Impact (\$) - Year	\$19.80
Customer Impact (\$) - Month	\$1.65
Customer Impact (%)	1.7%

Based on 83 MCF per year and June 2015 rates.

<u>Incremental Impact – Average Commercial Heating Customer Bill</u>	
DISC	7.50%
Customer Impact (\$) - Year	\$63.63
Customer Impact (\$) - Month	\$5.30
Customer Impact (%)	1.5%

Based on 363 MCF per year and June 2015 rates.

<u>Incremental Impact – Average Industrial Heating Customer Bill</u>	
DISC	7.50%
Customer Impact (\$) - Year	\$163.99
Customer Impact (\$) - Month	\$13.67
Customer Impact (%)	1.5%

Based on 943 MCF per year and June 2015 rates.

3

4 **IV. LEVELIZATION AND ANNUALIZATION**

5

6 **Q. HOW WILL THE DSIC CHARGE BE APPLIED TO CUSTOMERS'**  
 7 **BILLS?**

- 8 A. PGW is proposing that its DSIC be levelized and annualized.

9 **Q. PLEASE EXPLAIN WHY PGW IS PROPOSING TO LEVELIZE AND**  
 10 **ANNUALIZE ITS DSIC ELIGIBLE COSTS.**

- 11 A. PGW's experience with the quarterly adjustments of the DSIC appears to have  
 12 been quite different from the experience of investor-owned utilities. I would note  
 13 that, for investor-owned utilities, the DSIC increases gradually and progressively

1 each quarter.<sup>12</sup> The DSIC for investor-owned utilities, and consistent with the  
2 “used and useful” rule that applies to their ratemaking, is calculated to recover the  
3 fixed cost of eligible property that has been placed in service during the prior  
4 quarter.<sup>13</sup>

5 That has not been PGW’s experience. PGW’s current, non-levelized  
6 DSIC structure does not result in a steadily increasing revenue stream. PGW’s  
7 current DSIC structure has resulted, and will continue to result in, significant  
8 DSIC fluctuations – which vary throughout the year.<sup>14</sup> PGW’s DSIC is further  
9 impacted by seasonal usage variations. PGW’s current DSIC structure has further  
10 resulted, and, if it remains unlevelized, will continue to result in, PGW’s lowest  
11 DSIC being applied during the highest sales volume quarter. This leads to PGW  
12 billing less annual DSIC revenue than intended in some months and, in other  
13 months, being unable to bill for the total value of the amount it has placed into  
14 service. In some quarters PGW’s billings through the DSIC have been lower than  
15 5% of PGW’s distribution revenues, and in others, its total expenditures amounted  
16 to as much as 7% of distribution revenues (although it nonetheless only billed  
17 5%). Not only does this result in a DSIC that is difficult for customers to  
18 understand and for PGW to administer, but also makes it very likely that PGW  
19 will not be able to timely bill all funds available at the cap level, whether 5% or

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<sup>12</sup> PUC Staff Report at 35, Table 25.

<sup>13</sup> See footnotes 8 and 9, *supra*.

<sup>14</sup> PUC Staff Report at 36, Table 26.

1 7.5%. The history of PGW's DSIC revenue billing, as a percentage of distribution  
2 revenues, is as follows:

<b>PGW DSIC – HISTORICAL BILLINGS AS % OF DISTRIBUTION REVENUE</b>	
7/1/2015	1.64%
4/1/2015	2.09%
1/12015	2.24%
10/1/2014	5.00%
7/1/2014	5.00%
4/1/2014	2.60%
1/1/2014	4.34%
10/1/2013	4.14%
7/1/2013	3.02%

3  
4 The PUC Staff Report recognized this problem and suggested that PGW seek to  
5 levelize and annualize its DSIC-eligible costs.<sup>15</sup> Staff noted that, ideally, the  
6 DSIC should remain relatively level throughout the year in order to pass costs  
7 equally to all customers, regardless of seasonal usage patterns. For this reason,  
8 Staff recommended that PGW seek a waiver of the applicable statutory provision  
9 so that it could seek to levelize and annualize its DSIC-eligible costs.

10 **Q. PLEASE DESCRIBE PGW'S PROPOSAL.**

11 A. PGW is proposing to set the DSIC on an annualized basis to recover the eligible  
12 costs incurred as part of the accelerated replacement program of \$33 million,  
13 using a levelized charge each month, instead of being reimbursed based on a  
14 calculation of actual costs for eligible property placed in service in the previous  
15 quarter. I would note that PGW already utilizes an annualization/levelization  
16

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<sup>15</sup> PUC Staff Report at 5-6, 42-44.

1 approach for recovery of its natural gas costs through its Gas Cost Rate.

2 As I stated earlier, in calendar year 2016, PGW's DSIC eligible  
3 accelerated replacement program will be \$33 million each year. The amount  
4 billed to PGW customers for distribution service, as determined on an annualized  
5 basis, is \$450 million. Five percent (5%) of this annualized distribution revenue  
6 is approximately \$22.5 million. Seven and one-half percent (7.5%) of this  
7 annualized distribution revenue is approximately \$33.75 million. Thus, PGW's  
8 proposed annual spending of \$33 million in 2016 is within the proposed 7.5%  
9 DSIC cap, exclusive of reconciliation.

10 **Q. WHAT IS THE JUSTIFICATION FOR WAIVING THE PROVISION OF**  
11 **ACT 11 LIMITING RECOVERY BY THE AMOUNT OF FACILITIES**  
12 **INSTALLED IN THE PRIOR QUARTER?**

13 A. The waiver is justified on the basis of the specific regulatory requirements  
14 imposed on PGW by the General Assembly in Section 2212 of the Public Utility  
15 Code. In Section (2212(e)), a cash flow rate making method is required to be  
16 used for PGW. PGW's cash flow ratemaking methodology does not limit PGW  
17 revenue requirement to a return on used and useful property and instead is based  
18 on establishing adequate cash flow levels, among other things. Levelizing will  
19 help to ensure that the DSIC billing process will not create cash flow issues for  
20 PGW. Therefore, permitting a levelized DSIC is consistent with the guidance  
21 provided by the General Assembly for applying this waiver authorization.

22 **Q. WHEN WOULD THE NEW 7.5% DSIC CAP TAKE EFFECT?**

23 A. The effective date of the proposed tariff is January 1, 2016, subject to  
24 Commission approval. The DSIC (up to 7.5%, exclusive of reconciliation) will be

1 set annually in the January 1 filing and will be based on the projected annual  
2 recoverable DSIC costs divided by projected annual non-fuel revenues.

3 **Q. HOW WILL PGW CALCULATE THE QUARTERLY AMOUNT?**

4 A. Under the tariff, PGW will calculate the DSIC surcharge using the formula DSIC  
5 = (DSI + e) / PAR, where DSI represents projected recoverable yearly costs, “e”  
6 stands for the amount calculated under the annual reconciliation feature or  
7 Commission audit, and PAR is the projected annual revenue for distribution  
8 services for the year during which the charge will be collected (“non-gas”  
9 revenues).

10 **Q. DOES PGW PROPOSE TO MAKE ANY QUARTERLY ADJUSTMENTS**  
11 **TO THE DSIC CHARGE?**

12 A. Yes. The annual DSIC (up to 7.5%, exclusive of reconciliation) will remain in  
13 place for the period from January through December. In order to mitigate a  
14 material over or under collection:

15 – PGW may make quarterly adjustments to the annualized DSIC for  
16 the difference between projected and actual billed amounts.

17 – PGW may make quarterly adjustments to account for changes to  
18 the construction budget during the year for the accelerated replacement  
19 program.

20 – These proposed adjustments will not increase the DSIC above  
21 7.5%, exclusive of reconciliation.

22 **Q. PLEASE DESCRIBE THE BENEFITS OF LEVELIZING AND**  
23 **ANNUALIZING THE DSIC?**

24 A. As the PUC Staff Report stated, levelizing and annualizing PGW’s DSIC  
25 structure will:

- 1           –       Improve rate stability and create a more predictable cash flow for  
2           PGW, even with seasonal usage variations.
- 3           –       Compared to its experience to date, levelization and annualization  
4           should facilitate the required amount of DSIC revenue for the amount of  
5           DSIC-eligible capital expenditures.
- 6           –       Will enable PGW to reduce the replacement timelines and will  
7           further achieve the intent of not only PGW's approved LTIP but also Act  
8           11 itself.

9           I agree. In addition, levelization permits PGW to bill customers for main  
10          replacement in a more timely manner. PGW believes that levelization will result  
11          in smaller under collections which otherwise would continually have to be  
12          recovered from customers over time.

13   **V.    ANNUAL RECONCILIATION**

14   **Q.    HOW WILL THE UNDER COLLECTION MECHANISM WORK?**

15   A.    The recovery of over or under collections for PGW shall continue to occur based  
16          upon the operation of an automatic adjustment clause. Specifically, PGW  
17          requests that it be permitted to modify its DSIC tariff so that if an under collection  
18          of the authorized billings under the 7.5% cap occurs, PGW will be permitted (as  
19          part of the annual reconciliation process in the subsequent year) to implement a  
20          DSIC higher than 7.5%, so as to permit PGW to adjust the DSIC for said  
21          undercollections. As a consumer protection against an unanticipated total charge,  
22          PGW is proposing that the total maximum allowable DSIC (both the base charge  
23          and the reconciliation) shall not exceed 10% of distribution revenues. This  
24          proposal will not impact the rules for the annual reconciliation audit or the  
25          treatment of over collections.

1 Raising the DSIC above 7.5% to account for reconciliation is reasonable to  
2 permit the recovery of undercollections. If the DSIC cap was not structured in  
3 this way (i.e., not including reconciliation) PGW could be forced with having to  
4 reduce its annual billings for main replacement to insure that the total DSIC  
5 charge, net of reconciliation stayed under the 7.5% cap. I would note that the  
6 current “e” factor to recover an under collection is de minimus – .30%.

7 **Q. HOW WILL THE COMMISSION BE ASSURED THAT PGW’S TOTAL**  
8 **DSIC BILLINGS WILL BE REASONABLE NOTWITHSTANDING THE**  
9 **TOTAL 10% CAP?**

10 A. There are adequate checks in place to assure that PGW’s total DSIC billing levels  
11 will be reasonable. PGW’s infrastructure expenditures are reviewed and approved  
12 by the City, the Philadelphia Gas Commission and Philadelphia City Council in  
13 the form of its capital budget. Moreover, in addition to PUC review of PGW’s  
14 five year LTIP, PGW is required, in its Asset Optimization Plan annually to  
15 report to the PUC the nature and amount of its DSIC expenditures for the prior  
16 year, as well as the amount it expects to incur in the future. Finally, PGW’s  
17 proposed 10% total cap will provide additional protection to customers that the  
18 total charge for DSIC will never exceed a specific maximum

19 **Q. PLEASE EXPLAIN THE MECHANICS OF THE ANNUAL**  
20 **RECONCILIATION?**

21 A. Any under or over collection from the previous year will be calculated in an  
22 annual reconciliation based on actual billed DSIC revenues and DSIC recoverable  
23 costs during each month of the calendar year. At present, the annual  
24 reconciliation of the DSIC results in a lag in which recoverable costs for the  
25 months of September to December are not included in the current year annual

1 reconciliation. Note that in the first year, the ‘annual’ reconciliation will have 16  
2 months of recoverable costs due to this lag. For any under collection, the DSIC  
3 may be increased by an additional 2.5% (up to 10%) in order to recover the under  
4 collection. Any under or over collection will be reconciled and filed by January  
5 31 of each year and will be billed or credited from April 1 to March 31 each year.

6 PGW will provide quarterly filings (on the calendar quarters) with the  
7 projected recoverable costs for the year plus any under or over collection amount  
8 from the annual reconciliation. These total projected recoverable annual costs  
9 will be divided by the projected annual revenues in the January 1 filing to  
10 determine the DSIC.

11 **VI. TARIFF REVISIONS**

12  
13 **Q. HAVE YOU PREPARED A PROPOSED TARIFF SUPPLEMENT**  
14 **SETTING FORTH CHANGES IN PGW’S CURRENTLY APPROVED**  
15 **DSIC SUPPLEMENT?**

16 A. Yes. The Tariff Supplement, Supplement No. 85 to PA PUC Tariff No. 2 is  
17 attached as Attachment A to PGW’s Petition. This tariff supplement makes the  
18 changes in the existing DSIC tariff to implement the increased cap and to utilize a  
19 levelized DSIC collection. As part of the approval of PGW’s petition the PUC  
20 will be asked to authorize PGW to file this tariff supplement (as modified by the  
21 Commission order) on one day’s notice, for service rendered on or after January 1,  
22 2016. I would note that the DSIC rate that appears in Supplement No. 85 reflects  
23 a DSIC billed at 7.34% plus an “e” factor of .30% to reflect the collection of an  
24 existing under collection.

1 **VII WAIVER OF INTEREST PROVISION**

2

3 **Q. IS PGW PROPOSING ANY OTHER CHANGES TO ITS EXISTING DSIC**  
4 **TARIFF?**

5 A. PGW is also proposing that the Commission utilize its authority in section  
6 2212(c) of the Public Utility Code to waive Act 11's requirement to pay interest at  
7 the residential mortgage rate on overcollections.

8 **Q. WHAT IS THE JUSTIFICATION FOR THE PROPOSAL TO WAIVE**  
9 **THE INTEREST REQUIREMENT?**

10 A. Waiving interest on overcollections is again, consistent with the regulatory  
11 scheme required by Section 2212. Any interest remitted will reduce PGW's cash  
12 flow, which will, in turn, increase its cash deficiency in its next base rate  
13 proceeding. Moreover, if levelization and annualization of PGW's DSIC is not  
14 approved, when interest is calculated on an over collection, PGW will be paying  
15 interest in the winter when DSIC revenues (sales) are the highest and recoverable  
16 costs are generally the lowest. This will result in rather large interest costs on an  
17 over collection as the winter months (Jan-Mar) weighting in the interest  
18 calculation is the highest number of months.

19 **Q. ARE THERE CUSTOMER PROTECTIONS BUILT INTO PGW'S**  
20 **PROPOSED DSIC TARIFF?**

21 A. As noted, PGW proposes that the total maximum DSIC, including reconciliation,  
22 may not be higher than 10% of its distribution revenues. If PGW determines to  
23 further accelerate its main replacement financed through DSIC it will file another  
24 petition to do so.

25 **Q. HAS PGW PROVIDED ANY NOTICE OF THIS FILING TO**  
26 **CUSTOMERS?**

1 A. Yes. PGW has provided a Notice to all of its firm customers. The Notice began  
2 to appear in the customer bills for the September billing cycle and is attached to  
3 PGW's DSIC Petition.

4 In addition, PGW has served copies of this Petition on the main parties  
5 that participated in PGW's initial DSIC filing.

6 **VI. CONCLUSION**

7

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

9 A. Yes.

**VERIFICATION**

I, Kenneth S. Dybalski, hereby state that: (1) I am the Director - Gas Planning & Rates for Philadelphia Gas Works; (2) the facts above set forth in the foregoing document are true and correct (or are true and correct to the best of my knowledge, information and belief); and (3) that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

  
Kenneth S. Dybalski