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November 13, 2015

**Via Electronic Filing**

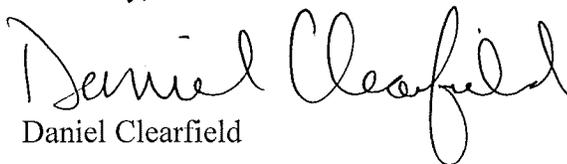
Rosemary Chiavetta, Secretary  
PA Public Utility Commission  
P.O. Box 3265  
Harrisburg, PA 17105-3265

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-2015-2501500

Dear Secretary Chiavetta:

Oh behalf of Philadelphia Gas Works ("PGW") enclosed for filing please find its Main Brief with regard to the above-referenced matter. Copies of the above filing have been served in accordance with the attached Certificate of Service.

Sincerely,

  
Daniel Clearfield

DC/lww  
Enclosure

cc: Hon. Christopher P. Pell w/enc.  
Hon. Marta Guhl, w/enc.  
Cert. of Service w/enc.

**CERTIFICATE OF SERVICE**

I hereby certify that this day I served a copy of PGW's Main Brief 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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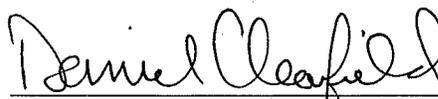
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Dated: November 13, 2015

  
Daniel Clearfield, Esq.

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PETITION OF PHILADELPHIA GAS :  
WORKS FOR WAIVER OF PROVISIONS : Docket No. P-2015-2501500  
OF ACT 11 TO INCREASE THE :  
DISTRIBUTION SYSTEM :  
IMPROVEMENT CHARGE CAP AND TO :  
PERMIT LEVELIZATION OF DSIC :  
CHARGES :

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**PHILADELPHIA GAS WORKS'  
MAIN BRIEF**

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## I. INTRODUCTION AND STATEMENT OF THE CASE

A growing consensus has developed that Philadelphia Gas Works (“PGW” or “Company”) should attempt to further accelerate the removal of its “at risk” distribution main.<sup>1</sup> Most importantly, the Staff of the Pennsylvania Public Utility Commission (“Commission” or “PUC”) issued a Report on PGW’s main replacement efforts<sup>2</sup> which strongly recommended that PGW consider steps, such as increasing the current Distribution System Improvement Charge (“DSIC”) cap above its current 5% level and levelizing its DSIC charge. 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 submitted the above-captioned Petition requesting that the PUC: (i) waive the current DSIC cap of 5% of distribution revenues, a) approve a 2½ percentage point increase in the maximum allowed DSIC expenditures 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;<sup>3</sup> (ii) waive or suspend the requirements of Act 11 of 2012 (“Act 11”) so as to permit PGW to use an annualized, levelized charge as the basis for establishing a DSIC, subject to subsequent true-up

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<sup>1</sup> The term “at risk” means 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.

<sup>2</sup> *Staff Report: Inquiry into Philadelphia Gas Works’ Pipeline Replacement Program*, dated April 21, 2015 (“PUC Staff Report”).

<sup>3</sup> PGW is proposing that the Commission approve the above-described changes to PGW’s DSIC in an expedited manner so that the charge becomes effective as soon as possible after the Commission’s approves PGW’s Petition and as close to January 1, 2016 as possible.

for PGW's actual experience; and (iii) authorize the filing, on one day's notice, of a PGW tariff supplement codifying these changes.<sup>4</sup>

PGW submits that the key issue raised by its Petition is whether the Company needs to further advance the pace of its "at risk" main replacement in order to maintain the safety, reliability and adequacy of its natural gas distribution system. All parties appeared to agree with the PUC Staff Report that accelerating the pace of replacing PGW's 1,964 miles of cast iron and unprotected<sup>5</sup> steel would be prudent to make the system safer, more reliable and more efficient. PGW's testimony showed that over time, accelerated replacement should reduce leaks and breaks and reducing costs of maintenance and repair, redounding to the benefit of ratepayers and the environment.

PGW's proposal for addressing the need to accelerate its "at risk" main replacement consists of: 1) increasing its DSIC – currently with a cap of 5% of distribution revenues, or \$22 million a year – to \$33 million (7.5% of distribution revenues); and 2) levelizing and annualizing the DSIC charge, so that PGW can actually bill up to the total cap in each year and then expend all of the \$33 million on main replacement. In order to assure that PGW will actually be able to bill and expend the full \$33 million, PGW is proposing that any under-collection of DSIC revenues (compared to actual, DSIC eligible capital expenditures) would not count against the 7.5% cap. To provide some upper limit, however, PGW is proposing that its under collection amount could not exceed 2.5% of distribution revenues, creating a total DSIC cap of 10%. PGW will provide quarterly updates and has committed to filing for a modification to its DSIC

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<sup>4</sup> PGW's Petition also requested that the PUC waive the statutory obligation to pay interest on DSIC charge over-collections when those amounts are returned to ratepayers, but PGW subsequently withdrew this request. PGW St. 2-R at 3; PGW/I&E Exh. 1 (Stipulation).

<sup>5</sup> The term "unprotected" refers to steel distribution main that is not cathodically protected.

percentage if its DSIC-funded construction budget changes, or if it projects that it will experience an over or under collection, when either of those factors results in a change, up or down, of more than 2% of DSIC billings (\$660,000).

PGW further is proposing that within 15 days of the PUC approval of its accelerated main replacement plan it will file a petition to modify and amend its current Long-Term Infrastructure Improvement Plan (“LTIIIP”), consistent with PUC regulations, in which PGW will update its current plan to take account of the additional funding levels resulting from the 7.5% cap, with the priorities guided by recently completed independent benchmarking and prioritization studies, and, most importantly, by the risk assessment set forth in its Distribution Integrity Management Plan (“DIMP”), after that Plan has been revised to respond to issues raised by the PUC’s Bureau of Gas Safety (“BGS”).

PGW projected that the implementation of this plan starting in January, 2016 (or as soon as possible after a PUC order approving PGW’s Petition) would result in PGW’s cast iron main being completely replaced in almost half the currently projected time (48 years compared to the present 86 years).

Importantly, PGW and the Bureau of Investigation and Enforcement (“I&E”) reached an agreement on the implementation of PGW’s proposal and the requested waivers.<sup>6</sup> That stipulation stated that PGW’s Petition should be granted by the PUC, subject to modification, and sets forth a procedure and timeline so that PGW can begin to bill the higher DSIC percentage in January 2016 (crucially important for PGW to bill the full \$33 million in 2016) while holding off actually spending the additional \$11 million until an LTIIIP is approved by the Commission. If in the unlikely event PGW’s LTIIIP is not approved by the Commission, PGW

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<sup>6</sup> PGW/I&E Exh. 1 (Stipulation).

will refund the DSIC over-collection back to ratepayers with interest. This procedure ensures that PGW will be able to expedite “at risk” main replacement in calendar year 2016 while assuring that customers will not be inappropriately billed.

The PGW/I&E agreement also requires PGW to include a plan in its modified LTIIP showing how PGW intends to acquire and train staff and contractors to be able to accomplish the additional main replacement. It also obligates PGW to provide information on how it is meeting its accelerated main replacement goals as well as its staffing and training needs in both its Annual Asset Optimization Plan (“AOP”) and in quarterly reports. This assures that the Commission will be able carefully monitor PGW’s expenditure of the additional DSIC funding and how PGW is meeting its replacement goals, and to take action as needed.

Despite the fact that the PGW/I&E agreement includes and/or addresses all of the elements prescribed by Act 11, the Commission’s regulations, and the Commission’s policies for a DSIC, and provides adequate tracking safeguards, the OCA and OSBA nonetheless submitted testimony opposing PGW’s proposal. While they claimed that they were not opposed to PGW accelerating its main replacement program, they insisted that PGW should not be able to use the DSIC to fund the additional expenditures and instead it should be forced to rely on its existing rates, additional long term borrowing or even the statutorily mandated City Payment for funding, and raised other objections that, if adopted would delay PGW’s accelerated main replacement proposal or force it to incorporate its request into some future base rate case. PGW submits that Act 11 does not contemplate that a utility seeking a waiver of the 5% cap would have to prove that it could not otherwise find funding for accelerated main replacement from other sources or savings. Moreover, refusing now to fund accelerated main replacement with DSIC means that accelerated main replacement will not occur until, at the very earliest, PGW could increase its

base rates to provide such funding. Such an approach would not only cause an unacceptable delay in the acceleration process, but also ignores the fact that as an automatic adjustment clause mechanism, the DSIC is a fairer means of funding accelerated cast iron main replacement for PGW and its customers. Accordingly, in order to permit PGW to immediately begin the process of accelerating its main replacement, and achieving the reduced risks and costs over time that such an acceleration will bring, the Petition, as modified by PGW's agreement with I&E, should be granted.

## **II. PROCEDURAL HISTORY**

On September 1, 2015, PGW filed the subject Petition with the Commission. The Petition included (as Attachment "A") Supplement No. 85 to PGW Gas Service Tariff Pa PUC No. 2, reflecting proposed modifications to the DSIC provisions of its Tariff (pages 151-153 of the Tariff), setting forth the revisions necessary to implement PGW's Petition. PGW also submitted the Direct Testimony of Daniel Murray, Senior Vice President Customer Affairs and Operations (PGW Statement No. 1) and the Direct Testimony Kenneth S. Dybalski, Director – Gas Planning and Rates (PGW Statement No. 2).

The Office of Consumer Advocate ("OCA") filed a Notice of Intervention, Public Statement, an Answer and a formal Complaint to PGW's Petition on September 17, 2015. The OCA Complaint was docketed at C-2015-2504092. On September 18, 2015, I&E filed an Answer to PGW's Petition. On September 21, 2015, the Office of Small Business Advocate ("OSBA") filed an Answer, Verification, Public Statement, Notice of Appearance, and Notice of Intervention to PGW's Petition. That same day, the Philadelphia Industrial and Commercial Gas Users Group ("PICGUG") also filed an Answer to PGW's Petition.

In accordance with a Prehearing Conference Order dated September 30, 2015, PGW, I&E, OCA, OSBA, and PICGUG submitted prehearing memoranda to the presiding officers on

October 1, 2015. A prehearing conference was held on October 2, 2015. Counsel for PGW, I&E, OCA, OSBA, and PICGUG participated. The Prehearing Order dated October 5, 2015 established the procedural and briefing schedule for, and the procedures applicable to this proceeding.

On October 13, 2015, the Environmental Defense Fund (“EDF”) filed a Petition to Intervene. Counsel of record for EDF, filed a Notice of Appearance and a Motion for Admission Pro Hac Vice. By Order dated October 29, 2015, EDF’s Petition to Intervene and the related Motion for Admission Pro Hac Vice were granted.

The non-Company parties of record submitted testimony as follows: OCA submitted the Direct Testimony of Ashley E. Everette (OCA Statement No. 1); I&E submitted the Direct Testimony of Rachel Maurer (I&E Statement No. 1), the Direct Testimony of Terri C. Cooper Smith (I&E Statement No. 2), and the Direct Testimony of Robert Horensky (I&E Statement No. 3); and OSBA submitted the Direct Testimony and Exhibits of Robert D. Knecht (OSBA Statement No. 1). In addition, EDF filed the Direct Testimony of Simi Rose George. On October 26, 2015, I&E filed a Motion to Strike or exclude the testimony of EDF’s witness. By Order dated October 30, 2015, the presiding officers granted I&E’s Motion to Strike the testimony of EDF’s Witness.

PGW submitted rebuttal testimony, on October 29, 2015, of Daniel Murray (PGW Statement No. 1-R), Kenneth S. Dybalski (PGW Statement No. 2-R) and Joseph F. Golden, Jr., Executive Vice President and Acting Chief Financial Officer (PGW Statement No. 3-R).

The non-Company parties of record submitted surrebuttal testimony, on November 3, 2015, as follows: OCA submitted the Surrebuttal Testimony of Ashley E. Everette (OCA

Statement No. 1-S); and OSBA submitted the Surrebuttal Testimony and Exhibits of Robert D. Knecht (OSBA Statement No. 2).

On November 2, 2015, the Clean Air Council (“CAC”) filed a Petition to Intervene in this proceeding. By Order dated November 4, 2015, the presiding officers granted CAC’s Petition.

An evidentiary hearing was held on November 5, 2015. During the hearing, PGW presented its witnesses’ rejoinder testimony, and also made its witnesses available for cross-examination by the other parties. OCA also presented its witness for cross-examination. The testimony and accompanying exhibits (if any) of the witnesses for PGW, I&E, OSBA and OCA were each entered into the record. Rejoinder exhibits sponsored by PGW witnesses Murray (PGW Exh. DMP-1) and Golden (PGW Exh. JFG-2) were also admitted into the record. The agreement between PGW and I&E (dated November 4, 2015) was admitted into the record as PGW/I&E Exh. 1 (“Stipulation”).

This Main Brief is being submitted in accordance with Briefing Order dated November 6, 2015.

### **III. BURDEN OF PROOF**

Section 332(a) of the Public Utility Code places the burden of proof upon the proponent of any request for relief.<sup>7</sup> As the party seeking the grant of waivers by the Commission, PGW bears the burden of proving by a preponderance of the evidence that it is entitled to relief. The term “preponderance of the evidence” means that one party has presented evidence which is more convincing, by even the smallest amount, than the evidence presented by the other party.<sup>8</sup>

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<sup>7</sup> 66 Pa. C.S. § 332(a).

<sup>8</sup> *Lehigh Valley Transp. Servs. v. PUC*, 56 A.3d 49, 56 fn. 6 (Pa. Commw. Ct., 2012).

#### **IV. WAIVER OF THE 5% LIMITATION AND AUTHORIZATION FOR HIGHER MAXIMUM ALLOWABLE DSIC**

##### **A. Summary Of PGW's Position**

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.<sup>9</sup> 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 approximately another seven miles of cast iron main, financed through its DSIC, currently capped at 5% of PGW's distribution revenues.<sup>10</sup>

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 as long as 86 years to complete the process of removing all of its cast iron main from its system.

A main replacement program at a 7.5% level is estimated to reduce the time needed 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>11</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;

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<sup>9</sup> PGW St. 1 at 2.

<sup>10</sup> PGW St. 1 at 1-3.

<sup>11</sup> PGW St. 1 at 10. The timeline to replace all cast iron and unprotected coated steel would be 65 years, as the graphic depiction shows on page 10 of PGW St. 1.

- 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.

Accordingly, PGW has shown that its plan will “ensure and maintain adequate, efficient, safe, reliable and reasonable service” for PGW and, therefore, it has met all the requirements for waiver of the 5% DSIC cap set forth in Act 11 and an increase to 7.5%.

PGW has also shown that it is in the public interest to waive the provisions of Act 11 that requires a DSIC utility to only bill for plant placed in service in the prior quarter. As a cash flow regulated utility with no rate base it is more appropriate to levelize and annualize the DSIC charge so that PGW can bill customers at a uniform 7.5% level throughout the year. This will enable PGW to actually bill the full \$33 million that is currently produced by a 7.5% charge, thereby permitting PGW to meet its acceleration projections.

PGW also meets the statutory and regulatory requirements for modifying its LTIIIP. As agreed to in a Stipulation between PGW and I&E, within 15 days of a PUC order approving PGW’s waiver request, PGW will file a petition to modify its existing LTIIIP. That amended LTIIIP, after consultation with the PUC’s BGS, shall *inter alia*:

- (a) Identify how PGW proposes to expend the increased DSIC revenues, including identifying the types and sizes of at risk main PGW proposes to target with the increased revenues;
- (b) Utilize PGW’s Distribution Integrity Management Program (“DIMP”) risk scores, as modified by PGW to respond to issues raised by the PUC’s Gas Safety Division’s Non-Compliance letter to PGW dated May 7, 2015; and
- (c) Provide a plan showing how PGW intends to train staff and contractors to meet the Operator Qualification requirements of 49 CFR Subpart N

and to otherwise demonstrate that it will have qualified personnel available to accomplish the accelerated main replacement authorized by the PGW Petition.<sup>12</sup>

PGW also agreed that it would not begin to expend the additional funds made available by increasing the DSIC cap to 7.5% unless and until the PUC approves its petition to modify its LTIIIP.

The arguments by some of the intervening parties in opposition to this plan are misplaced. There is no reason to hold off permitting PGW to begin billing at the 7.5% level until PGW's revised LTIIIP receives PUC approval (as argued by OCA). Waiting until the PUC approves PGW's modified LTIIIP to permit PGW to bill the additional \$11 million will likely mean that PGW's 2016 expedited main replacement will be reduced by almost 50%. Moreover, the PGW/I&E agreement fully protects customers from any unwarranted charges. PGW shall file an amended LTIIIP within 15 days of a PUC order and will not begin to expend the additional DSIC funds until the LTIIIP is approved by the Commission. This approach is consistent with the law and PUC regulations and properly balances the universal desire for PGW to begin its accelerated main replacement as soon as possible while still providing reasonable and adequate protections for customers. If PGW amended LTIIIP is not approved by the PUC for some reason, PGW will pay every penny of the increased DSIC billings back to customers with interest.

Similarly, the arguments of the OCA and OSBA that PGW should accelerate its main replacement but should find some other pot of money to fund the additional capital expenditures is inconsistent with the DSIC law itself and unreasonable. These claims ignore the fact that any "cost savings" that PGW has been able to squeeze from its existing base rates (last set in 2010) are needed to fund increases in expenses that have occurred in that time as well as a \$68 million

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<sup>12</sup> PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1.B.1.

annual non-DSIC construction budget, which is projected to grow even larger in 2016. Other schemes, such as issuing short or long term debt to fund the accelerated replacement would either create unnecessary financial risk for the Company or would be more costly to ratepayers – or both. Finally, as the Commission is well aware, it is not legally authorized to force the City of Philadelphia to give up its \$18 million yearly City Fee, the only compensation that the City receives for owning the Gas Works. All of these arguments should be rejected.

### **B. Standard For Granting The Waiver**

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>13</sup>

Further, 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 of the Public Utility Code.<sup>14</sup> Section 2212 provides, in relevant part, that the Commission “upon request of [PGW], may suspend or

<sup>13</sup> 66 Pa. C. S. § 1358(a)(2) (emphasis added).

<sup>14</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).

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>15</sup> Such waivers are guided by long standing and fundamental principles of Pennsylvania public-utility regulation jurisprudence, including that any granted waivers, will be just and reasonable and in the public interest.

### **C. Has PGW Met Standard For Waiver Of The 5% Cap?**

#### **1. Introduction**

PGW has met the standard to waive the 5% limitation and to set a higher maximum allowable DSIC. Act 11 establishes that a waiver may be granted if it will “ensure and maintain adequate, efficient, safe, reliable and reasonable service.”<sup>16</sup> Both the PUC Staff Report<sup>17</sup> and the record compiled here has recognized the need for PGW to accelerate its main replacement program in order to improve the safety and reliability of its distribution system.

Having satisfied the waiver standard in Act 11, the only question facing the Commission is the level of the higher maximum allowed DSIC. As explained in greater detail below it is reasonable to raise the DSIC to 7.5% (exclusive of reconciliation) for DSIC expenditures and permit a higher level of DSIC to permit the recovery of under collections. Provided that the total DSIC, inclusive of reconciliation, is capped at 10%.

#### **2. All Parties Have Agreed (Or Have Not Expressed Opposition) To PGW Further Accelerating Its Main Replacement Program**

Recognizing the importance of further accelerating the replacement of PGW’s “at risk” distribution infrastructure, PGW’s request to accelerate its current DSIC funded, main

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<sup>15</sup> 66 Pa. C.S. § 2212.

<sup>16</sup> 66 Pa. C.S. § 1358(a)(1).

<sup>17</sup> PUC Staff Report at 32-34.

replacement has been supported (or at least not opposed) by all the parties in the proceeding.<sup>18</sup>

Most importantly, PGW and I&E have agreed to the following stipulation in which I&E agreed that PGW's proposed 7.5% DSIC should be approved:

Subject to the additional provisions and modifications set forth herein, the Stipulating Parties recommend and agree to the approval by the [PUC] of PGW's Petition for Waiver of Provisions of Act 11 to Increase the DSIC Cap to 7.5% (not including reconciliation), to set a cap including reconciliation of 10%, to permit levelization and annualization of DSIC Charges, and to permit PGW to begin to bill customers at the revised level, on or after January 1, 2016 ("PGW Petition"), and agree that the proposed waivers of portions of 66 Pa. C.S. §§ 1358 and 2212(c) should be granted.<sup>19</sup>

In addition to I&E, OSBA witness Knecht stated that both he and OSBA support the acceleration of PGW's existing obsolete main replacement program<sup>20</sup> and the OCA witness appeared to support the acceleration of "at risk" main.<sup>21</sup>

Among the most important evidence supporting the need to accelerate PGW's current, main replacement program can be found in the PUC Staff Report. As acknowledged in the testimony of Mr. Murray,<sup>22</sup> that Report listed several reasons for recommending further acceleration:

Most NGDCs plan to replace cast iron in 13 to 22 years; however, PGW's Long Term Infrastructure Improvement Plan (LTIIIP) filed with the Commission, at Docket No. P-2012-2337737, shows an 88-year [now 86 year] replacement rate.

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<sup>18</sup> In addition to I&E, OSBA and OCA, both the Environmental Defense Fund (EDF Petition to Intervene at 7-8) and the Clean Air Council, (CAC Pet. to Intervene at 2) stated their support for PGW's Petition.

<sup>19</sup> PGW/I&E Exh. 1 (Stipulation) at ¶ 1.

<sup>20</sup> OSBA St. 1 at 3.

<sup>21</sup> Tr. 102-103. ("Q: So do you agree that further acceleration of PGW's at-risk main replacement program will make its distribution system safer and more reliable? A: I think that's likely. ... I don't disagree that replacing mains should – would decrease leaks, it's just that we need to have the correct prioritization in order to decrease the leaks throughout the time the period. Q: So you support the further acceleration. You're still wanting to see how we're going to prioritize that? A: Correct.").

<sup>22</sup> PGW St. 1 at 5; PGW St. 1-R at 3-4.

\* \* \*

- 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 ...1,072 were hazardous main leaks. The other large NGDCs had an average of 273 hazardous main leaks ... .
- 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.<sup>23</sup>

The consensus view that PGW should accelerate its main replacement program was supported by additional evidence on the record. PGW witness Murray testified as follows:

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

A. There are a number of factors that justify further acceleration of replacement of at risk mains for PGW, several of which were mentioned in the PUC Staff Report. Most notably, the percentage of cast iron and unprotected steel mains in PGW's distribution system remains among the highest of any NGDC. PGW's high percentage of at risk mains is due to many factors, including the overall age of the system, the logistic difficulty of main replacement in a highly urban environment and reducing

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<sup>23</sup> PUC Staff Report at 32-34. The PUC Staff Report is consistent with the industry consensus, which recognizes the need to advance the replacement of aging piping and other facilities in order to enhance the safety and reliability of gas distribution systems. See PGW St. 1-R at 4. Several national reports are cited by PGW witness Murray. *Id.*

the risks associated with gas leaks by configuring its distribution system as almost entirely low pressure (under one pound of pressure per square inch). Nonetheless, in the last several years, an industry and regulatory consensus has developed that replacing at risk mains should be accomplished as quickly as reasonably possible, and PGW fully supports this view.

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

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

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

A. Even with its base rate and the current, DSIC funded accelerated replacement programs, PGW has experienced an increase in the number of leaks requiring repair resulting from natural forces or corrosion on its cast iron and unprotected coated steel mains. Cast iron mains of all diameters and pressures have seen the most significant increase in leaks.

\* \* \*

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

<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>
Cast/Iron Total	2,157	1,793	2,162	1,986	2,265	2,826

Though not as significant, PGW is also experiencing an increase in the leaks requiring repair on its unprotected coated steel mains mainly due to corrosion.

<b>STEEL - 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>
Unprotected, Coated Steel	112	149	215	152	171	178

Mr. Murray testified that while the incidence of leaks was attributable to both severe weather as well as the increasing age of a majority of its distribution facilities, 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 leaks.<sup>24</sup> He explained further:

[F]urther acceleration will contribute to:

- a) Reducing leaks and the concomitant risk of serious incidents from those leaks, compared to what PGW is likely to experience without acceleration;
- b) Reducing breakage repairs and future breakage repair costs, again, compared to the costs it would incur absent acceleration;
- c) Reducing leak maintenance and repair on the facilities being removed from service; and
- d) Reducing leaks will result in levels of unaccounted-for gas (again, compared to the amounts PGW would experience absent acceleration).

By replacing its highest risk pipe, PGW expects to decrease the number of leaks requiring repair on the system, and as a result provide safer and more reliable service to its customers. Reducing the number of leaks will reduce the time and money that PGW would otherwise have to expend to repair those leaks compared to what PGW would have to expend if it did not accelerate its main replacement program. In addition, it should be noted that natural forces is the highest ranking threat in PGW's DIMP. As a result, the quantity of both leaks and main breaks will be impacted by instances of severe weather and frost levels. However, as the riskiest main are replaced the long term trends for both leaks and main breaks are expected to demonstrate a decrease. Therefore, while I am not asserting that the total amount PGW must expend on leak repair will necessarily go down in absolute terms, over time the cost imposed on ratepayers should be lower than it otherwise would have been absent the accelerated replacement.<sup>25</sup>

It appears plain from this evidence, as well as the conclusions of the PUC Staff Report, that acceleration of PGW's cast iron main replacement program is an important step in maintaining the safety, reliability and adequacy of PGW's distribution service. It also appears

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<sup>24</sup> PGW St. 1 at 9.

<sup>25</sup> PGW St. 1 at 12. Mr. Murray testified that, contrary to the suggestion of OCA witness Everette, (who has no relevant experience with gas main engineering) simply because PGW has not as yet experienced a reduction in the incidence of gas leaks, it would not be correct to conclude that replacing "at risk" gas mains will not reduce leak incidence in the long run. *Id.*; PGW St. 1-R at 4.

clear that these acceleration efforts should begin as soon as possible. The only way for PGW to be able to accomplish these goals is to authorize PGW to increase its DSIC to 7.5% and to begin to bill at that higher rate as soon as possible.<sup>26</sup>

**D. 7.5% Cap For DSIC Expenditures**

PGW's proposal to accelerate its "at risk" main replacement program is to increase its DSIC eligible expenditures from the current 5% to 7.5% (exclusive of reconciliation). This would produce another \$11 million in annual DSIC eligible replacements.<sup>27</sup> Mr. Murray explained:

PGW intends to further accelerate replacements if additional funds are available under the DSIC. Such funds would be dedicated, as the current DSIC funds are dedicated, to accelerated distribution facility replacement. If PGW's proposals are approved, PGW expects that the timeline to replace all the cast iron main in the system would decrease from its current projection of 86 years to 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 projection in its LTIIP.<sup>28</sup>

PGW's proposed increase to 7.5% (exclusive of reconciliation, which will be discussed in the next section) represents a reasonable acceleration of its main replacement program that properly considers the current effect on customer bills. PGW witness Dybalski showed that the effect on the average heating customer's bill of the DSIC alone would be *de minimus*. For residential heating customers the increase would amount to just \$1.65/month.<sup>29</sup> Indeed, when a

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<sup>26</sup> Importantly, while this issue will be discussed below in response to the contentions of OCA and OSBA, PGW submits that having presented evidence justifying further acceleration of its main replacement program as necessary in order to "ensure and maintain adequate, efficient, safe, reliable and reasonable service," there is no basis for insisting that PGW should find some other way to finance the necessary increase in the main replacement budget.

<sup>27</sup> PGW St. 1 at 11; PGW St. 2 at 5.

<sup>28</sup> PGW St. 1 at 10.

<sup>29</sup> PGW St. 2 at 6. The effect on the average heating customer bills for various classes is set out in Appendix A (Proposed Findings of Fact) at ¶¶ 91-93.

customer's total bill is considered, a customer will actually see a several hundred dollar decrease in his or her bill from the time that PGW's original, 5% DSIC went into effect.<sup>30</sup>

The proposed 7.5% level also recognizes the prudence of gaining experience with an increased level of main replacement.<sup>31</sup> While PGW is confident it can ramp up its replacements process to be able to expend the additional \$11 million annually,<sup>32</sup> Mr. Murray explained that the prudent course was to gain experience with main replacement at the \$33 million level and then, after analyzing the results of these increased efforts, consider whether it would be advisable for PGW to propose further acceleration.<sup>33</sup>

The increased main replacement will also be conducted in a cost effective manner.<sup>34</sup> As permitted by Act 11,<sup>35</sup> PGW will continue to finance its accelerated main replacement program on a "pay as you go" basis, which means that 100% of each dollar collected via the DSIC is used to pay for the replacement of cast iron main, with no associated long term costs (such as depreciation or borrowing costs) charged to ratepayers.<sup>36</sup> Both PGW witness Murray and Golden testified that the "pay as you go" method was the best approach for a cash flow regulated company such as PGW to finance infrastructure improvements and was the most cost effective

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<sup>30</sup> PGW St. 2-R at 10. In July, 2013 a residential heating customer using 83 Mcf would have been billed \$1427.70; when PGW's 7.5% DSIC cap goes into effect that same customer will be billed \$1217.16, or over \$210 less per year. *Id.*

<sup>31</sup> PGW St. 1 at 14-15.

<sup>32</sup> PGW St. 1-R at 11.

<sup>33</sup> PGW St. 1-R at 5-11.

<sup>34</sup> PGW St. 1 at 14-15.

<sup>35</sup> 66 Pa. C. S. § 1357(c) ("Utilities may file tariffs establishing a sliding scale of rates ...to provide for the recovery of the [return on and of] fixed costs of eligible property ... For [PGW] recoverable costs shall be amounts reasonably expended or incurred to purchase and install eligible property and associated finance costs, if any...")

<sup>36</sup> PGW St. 1 at 11-14.

for ratepayers.<sup>37</sup> PGW will also continue to utilize a competitive bidding process for all relevant aspects of the program.<sup>38</sup>

### **1. Timing Of DSIC Increase**

PGW proposed – and PGW and I&E also agreed – that PGW could begin to bill customers at the higher 7.5% level for bills rendered starting January 1, 2016 or on one day's notice, upon the entry of a PUC order granting PGW's petition. PGW explained that, due to the highly seasonal nature of PGW's billings, it was crucially important that it be permitted to begin billing at the 7.5% level as early in 2016 as possible in order to enable the Company to collect the full additional \$11 million made possible by the increase of the cap to 7.5%. PGW witness Dybalski explained that PGW bills some 47% of its total revenues in the January – March timeframe. Permitting PGW to begin to bill at the higher, 7.5% levelized level (subject to refund) is crucially important if PGW is actually going to be able to achieve its main replacement in the time period it has projected. If PGW must hold up billing at the additional 7.5% until PUC approval in May or June, for example, PGW will only be able to collect approximately 44% of the additional \$11 Million<sup>39</sup> and the first year of accelerated main replacement will be cut by more than one half.

### **2. Relationship To Filing Of Amended LTIP**

Consistent with Act 11 and the PUC's regulations, PGW filed and obtained approval for a LTIP when it submitted its original petition for a DSIC.<sup>40</sup> PGW's current LTIP provides a

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<sup>37</sup> PGW St. 1 at 11-14; PGW St. 3-R at 1-13.

<sup>38</sup> PGW St. 1 at 13.

<sup>39</sup> PGW St. 2-R at 4-5.

<sup>40</sup> PGW's approved LTIP is PGW Exh. DPM-1.

detailed analysis of the Company's "at risk" mains, and a prioritization analysis of its entire inventory, along with a detailed description of the resources PGW used to arrive at that prioritization.<sup>41</sup> The current LTIIP prioritized the removal of PGW's inventory of 12 inch and smaller high pressure ("HP"), 30 inch HP and 8 inch and smaller low and intermediate pressure in phase one of the replacement, with the remaining types and sizes of cast iron main scheduled for removal in Phases 2 through 5.<sup>42</sup> The amended plan will build upon this base and update its prioritization to account for the additional \$11 million per year of funds available for main replacement.<sup>43</sup>

PGW recognized in its Petition that it would need to file a petition to modify its existing LTIIP in order to set out a plan to expend the additional dollars made available by the increase of the DSIC to 7.5%. PGW did not file such a plan simultaneously with its DSIC Petition because: 1) any such filing would need to be informed by the specifics of the PUC order ruling on PGW's Petition (e.g., whether or not levelization was approved); and 2) PGW believed it more prudent to await the results of its Benchmarking and Prioritization studies.<sup>44</sup> The results of these independent studies (the preliminary results of which have been provided to PGW<sup>45</sup>), as well as the revisions to the current DIMP, being finalized between PGW and BGS, will result in a more focused, comprehensive LTIIP revision, building on the already extensive work done by PGW on cast iron main replacement prioritization in its current LTIIP.

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<sup>41</sup> PGW Exh. DPM-1.

<sup>42</sup> *Id.* at 13-14.

<sup>43</sup> Tr. 40-41; PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1.B.

<sup>44</sup> *Id.*; PGW St- 1-R at 5-7.

<sup>45</sup> Tr. 41-42.

In order to accommodate this necessary staging of: (1) a PUC order authorizing a higher DSIC, (2) the filing of proposed amended LTIP informed by that order and (3) a PUC order approving the amended LTIP, PGW and I&E agreed that PGW would begin to bill at 7.5% cap on or after January 1, 2016 (after a PUC order), but would not begin to expend the additional \$11 million resulting from the DSIC cap increase until the PUC approved PGW's amended LTIP. Specifically, PGW and I&E agreed that PGW's LTIP filing proposal should be approved with the following modifications:

(B)(1) By December 31, 2015, or fifteen (15) days after the entry of the PUC's Order approving PGW's Petition whichever is later, PGW shall submit a Petition to the PUC to amend its LTIP which will, inter alia,

(a) Identify how PGW proposes to expend the increased DSIC revenues, including identifying the types and sizes of at risk main PGW proposes to target with the increased revenues;

(b) Utilize PGW's Distribution Integrity Management Program ("DIMP") risk scores, as modified by PGW to respond to issues raised by the PUC's Gas Safety Division's Non-Compliance letter to PGW dated May 7, 2015; and

(c) Provide a plan showing how PGW intends to train staff and contractors to meet the Operator Qualification requirements of 49 CFR Subpart N and to otherwise demonstrate that it will have qualified personnel available to accomplish the accelerated main replacement authorized by the PGW Petition.

(2) To the extent feasible, PGW shall consult with I&E about the contents of its revised LTIP prior to its formal filing with the Commission.

(3) The Stipulating Parties will request that the PUC rule on PGW's Petition to Amend its LTIP on or before May 1, 2016.

(4) PGW agrees that it shall not undertake any main replacement made possible by the incremental DSIC funding (\$11 million) authorized by the PGW Petition unless and until the PUC has approved PGW's Amended LTIP.<sup>46</sup>

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<sup>46</sup> PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1.B.

The PGW/I&E Agreement affirms PGW's statement in its Petition that the petition to modify its LTIP it intends to file once its DSIC cap increase is approved will identify how PGW proposes to expend the increased DSIC revenues, including identifying the types and sizes of the "at risk" main PGW proposes to target, utilizing PGW's DIMP risk scores, after modification to accommodate any revisions as a result of discussions with BGS.<sup>47</sup> The LTIP will also provide a plan showing how PGW intends to train employees and contractors to meet the Operator Qualification requirements of 49 CFR Subpart N and to otherwise demonstrate that it will have qualified personnel available to accomplish the accelerated main replacement authorized by the PGW Petition. This will ensure that PGW has resources available to perform the increased level of main replacement.<sup>48</sup>

Importantly, PGW's formal agreement to defer undertaking projects that would be financed by the additional \$11 million until its LTIP is approved by the PUC ensures that no additional main replacement will occur unless and until the PUC has reviewed and approved its amended LTIP. If, for some reason, the PUC does not approve PGW's amended LTIP, PGW would not undertake the additional replacement and any additional amounts collected from ratepayers at the 7.5% level will be returned with interest at the residential mortgage lending rate, which is currently 5%.<sup>49</sup>

Notwithstanding this agreement, OCA witness Everette has insisted that PGW should not even be able to begin to bill at the 7.5% level until PGW has submitted and had approved an

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<sup>47</sup> PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1.B.

<sup>48</sup> PGW St. 1 at 14-15. Mr. Murray testified that PGW has mechanisms in place, including obtaining modifications in its Collective Bargaining Agreement to permit contractors to work on "live gas" that will allow the Company to address its additional staffing and training needs. Tr. 44-45.

<sup>49</sup> Department of Banking and Securities, *Maximum Lawful Rate of Interest for Residential Mortgages for the Month of November 2015*, 45 Pa. Bull. 6187, 6211 (October 17, 2015).

amended LTIP, even if this means that PGW's cast iron main replacement acceleration has to be put on hold.<sup>50</sup> OCA's position should be rejected. The PUC's regulations specifically contemplate the filing of a "petition for modification" whenever the utility proposes a "major modification"<sup>51</sup> of its LTIP and neither the regulations nor Act 11 makes the approval of such a petition a condition precedent for a waiver of the 5% DSIC cap. Moreover, the PGW/I&E agreed upon procedure of permitting PGW to begin to bill the higher DSIC in January, while holding off spending until an amended LTIP is approved, properly recognizes the need to expedite PGW's "at risk" main replacement as soon as possible while providing assurances that customers will not be inappropriately billed.

PGW fully expects that its proposal to modify its LTIP to include the additional spending made possible by raising the DSIC cap will be approved by the Commission in the same time frame that PGW's current LTIP was approved (4 months). PGW does not expect that the modifications that it will propose to its present and extensive Plan to be "dramatic;"<sup>52</sup> nor will the priorities for main replacement change materially.<sup>53</sup> However, and as noted, if for some unanticipated reason the PUC determines not to approve PGW's proposed modifications PGW will return every dollar billed to customers with interest at the residential mortgage rate, in the same way that PGW returns to ratepayers over-collections of its Gas Cost Rate ("GCR"), which

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<sup>50</sup> OCA St. 1 at 3, 6, 19-20; OCA St. 1-S at 2-3; Tr. 104-106.

<sup>51</sup> "Major modification" is defined as a "change to a utility's previously approved LTIP which meets at least one of the following criteria: ... (iii) Increases the total estimated cost of the LTIP by more than 20% .... 52 Pa. Code § 121.1.

<sup>52</sup> Tr. 41. ("[W]e don't expect it to be updated dramatically from what we have currently. It would just be updated with more recent information regarding the prioritization and benchmarking studies that we have going on currently.").

<sup>53</sup> *Id.* While OCA witness Everette seemed to anticipate that PGW's LTIP would require more major modification, she has no experience with gas planning or engineering, has not previously analyzed other LTIPs and did not evidence any detailed knowledge of PGW's existing LTIP. *See*, Tr. 98-102.

is also billed to customers based on estimates or projections of expenditures prior to the time that the expenditures are actually made.<sup>54</sup> The DSIC is no different.

**3. The Arguments Raised By Other Parties In Opposition To PGW's Proposed DSIC Increase To 7.5% Are Without Merit And Inconsistent With The Record Evidence**

Only the OCA and OSBA have opposed PGW's increasing its existing DSIC to 7.5% in order to accelerate PGW's main replacement program. While both claim to support the goal of further acceleration of the replacement of PGW's cast iron main inventory, both also claim that PGW should find some other source of funding such as "cost savings," additional short or long term borrowing, or appropriating the \$18 million City Payment to finance the increased expenditures.<sup>55</sup> These arguments are not only legally deficient, they would clearly increase PGW's financial risks, and would result in harm to the Company and its ratepayers.

As an initial matter, and as noted above, PGW believes that the OCA and OSBA insistence that the DSIC cap may be increased only if PGW demonstrates that there is no other means of financing further main replacement acceleration is inconsistent with Act 11. Act 11 established an automatic adjustment clause mechanism for the recovery of costs associated with installing "eligible property." A utility (including PGW) meeting the other requirements in the Act is authorized to bill customers up to 5% of its distribution revenues to finance accelerated infrastructure "repair, improvement and replacement" of eligible property. While the Act does require that a utility filing a petition to establish a DSIC have filed a base rate case within five years of the initial DSIC Petition, nowhere in Act 11 does it require that a utility prove that it cannot fund the infrastructure improvement from its existing base rates or from other sources.

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<sup>54</sup> Tr. 62; PGW St. 2 at 8-9.

<sup>55</sup> OCA St. 1 at 10-11, 20; OCA St. 1-S at 7-8; OSBA St. 1 at 2, 7-13; OSBA St. 2 at 4-5.

Moreover, Act 11 establishes an equally straightforward standard for a utility seeking an increase in the DSIC cap above 5%. That waiver may be granted if it will “ensure and maintain adequate, efficient, safe, reliable and reasonable service.”<sup>56</sup> By its terms, if this standard has been met (which in this case, PGW submits, it has) then the PUC is authorized to grant the increase in the DSIC to fund the accelerated infrastructure replacement. Recovery of eligible costs through the DSIC is no different than PGW recovery of eligible natural gas costs through its GCR. No party could successfully argue that PGW (or any gas utility) could not recover increased wholesale gas costs until it could show that it could not pay for such increases from its base rates.<sup>57</sup>

Accordingly, the PUC should not consider these arguments. However, if it chooses to do so, the Commission should conclude that they are without merit.

a. Other Sources Of Funding

OCA witness Everette claimed that because of the “significant burden” on ratepayers of the proposed increase in the DSIC from 5% to 7.5%, PGW should “explore other funding options . . . and other sources of internally generated funds.”<sup>58</sup> Ms. Everette pointed to such things as PGW’s recent bond refunding which reduced bond debt service by \$3.2 million<sup>59</sup> as well as certain “cost savings” identified in the PUC Management Audit.<sup>60</sup>

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<sup>56</sup> 66 Pa. C.S. § 1358(a)(1).

<sup>57</sup> Ms. Everette tried to argue that the provision in Act 11 which directs that the DSIC should be reset at zero if in any quarter the Commission makes a determination that the utility would be earning a return in excess of its allowed rate of return justifies an investigation into alternative funding sources (OCA St. 1-S at 7). But the procedure referenced is a separate process that would require an analysis of a utility’s existing rates. Moreover, for PGW, the Commission has indicated that it intends to simply “monitor” its rate levels with the DSIC. *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611, Final Implementation Order entered Aug. 2, 2012 (“Implementation Order”) at 42-43. If the Commission believes PGW’s rate levels are excessive for a cash flow company it can take a separate action to raise that issue; notably neither the PUC nor the OCA has not taken any such action.

<sup>58</sup> OCA St. 1 at 10.

<sup>59</sup> *Id.* at 10.

<sup>60</sup> OCA St. 1-S at 8, fn. 5.

But Mr. Golden explained that, to the extent that PGW experiences cost saving or other reductions in expenses, it must utilize them to offset corresponding increases in expenses and to fund capital improvements. Most importantly, he testified that since PGW's last rate case in 2010, PGW's capital budget (adjusted to remove DSIC-funded expenditures) had increased from around \$58 million to \$68 million, with that amount increasing to \$88 million in 2016.<sup>61</sup> He explained PGW's non-DSIC capital budget is used to maintain the rest of PGW's gas operations including gas processing, field services, meters, fleet operations, repairs to buildings, computers and the like. The non-DSIC budget not only includes PGW's original, 18 mile per year program but also the gas "services" associated with the DSIC funded program, since the Company voluntarily determined not to include that several million dollars of additional construction in its proposed DSIC recovery.<sup>62</sup> Thus, even if it were proper to consider whether PGW had alternative funding sources for the accelerated main replacement proposed by PGW's Petition, those cost savings are already spoken for and are being utilized to pay for increases in the remainder of PGW's operating construction budgets and other expense hikes.

OSBA witness Knecht makes a similar but slightly different argument than OCA, claiming first that PGW could finance the additional DSIC expenditures through internally generated funds or borrowing without any adverse financial effects on the Company.<sup>63</sup> Again, Mr. Golden showed that this claim was specious. Mr. Golden explained that PGW's current financial forecast shows that, even with the DSIC funding it is projected to have only about 65 days of cash on hand at fiscal year-end 2015. Funding \$11 million of accelerated main

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<sup>61</sup> Tr. 68.

<sup>62</sup> Tr. 70. A "service" is the line from the main to a customer's home. When PGW replaces a main in a street it replaces the associated services at the same time. PGW St. 1 at 11, n.7.

<sup>63</sup> OSBA St. 1 at 2, 4, 7-13.

replacement from internally generated funds (essentially, its current base rates) would reduce PGW's cash levels to 59 days of cash below the level Mr. Golden testified that is required for a "mid-range" financial strength company.<sup>64</sup> Funding from internal generation would also reduce the Company's coverages in FY 2015 to just 1.59 times (the minimum is 1.5X) and have a negative effect on its debt to total capitalization ratio.<sup>65</sup>

In response to Mr. Golden's testimony, Mr. Knecht suggested that, rather than utilize internally generated funds, the Company could "finance" the additional DSIC expenditures by using either short-term or long-term borrowing, and that all the PUC had to be concerned about was the next few years, until PGW filed another rate case.<sup>66</sup> Utilizing long-term bonds to fund the additional \$11 million of annual main replacement expenditure, Mr. Knecht also claimed, would be better for ratepayers and would have no adverse financial effect on the Company. None of these claims is correct.

Mr. Knecht's suggestion that financing additional DSIC expenditures with short-term debt is flawed. That analysis only makes projections for the next two years,<sup>67</sup> and fails to recognize that financing the proposed accelerated main replacement expenditures from short-term debt would seriously hamper PGW's short-term liquidity. PGW's short-term debt is limited to \$120 million. PGW projects that it will utilize almost \$80 million by fiscal year end 2016, leaving only about one-third of PGW's available commercial paper available as a cushion for working capital, emergencies or other contingencies. Moreover, financing the DSIC expenditure using long-term debt would add about \$200 million of long-term debt over the next 10 years, and

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<sup>64</sup> PGW St. 3-R at 5.

<sup>65</sup> *Id.*

<sup>66</sup> OSBA St. 2 at 2-3, 4, 6-9.

<sup>67</sup> *See* OSBA St. 1 at 2, 4; OSBA St. 2 at 4, 7-9.

move PGW's debt to total capitalization ratios in the wrong direction.<sup>68</sup> As Mr. Golden explained, utilizing long-term debt to finance accelerated main replacement when other options are available would not be viewed favorably by the bond rating agencies.<sup>69</sup> This is especially concerning when recognizing that PGW is already anticipating having to issue about \$250 million in bonds in 2016 and another \$100 million in 2020.<sup>70</sup> Considering that it was only a few years ago that PGW's cash balances were literally non-existent, it had a debt to total capitalization ratio of 85% and was rated just one grade above junk. Reducing financial flexibility and taking on added financial risks when a safer and more reasonable funding mechanism has been provided by the General Assembly would be grossly imprudent.

PGW also showed that Mr. Knecht's suggestion that financing additional DSIC expenditures with long-term debt would be cheaper for ratepayers as opposed to the current "pay as you go" method used by PGW (and approved by the PUC) was similarly flawed. Mr. Knecht failed to recognize that when PGW issues long-term debt, the cost to ratepayers is not only the debt service but the debt service coverage, calculated at 150% of the debt service.<sup>71</sup> He showed that when this additional 50% of costs is added to the debt service the annual escalation of debt service payments at 1.5 times coverage makes financing additional main replacement with long-term debt more expensive in less than 10 years.<sup>72</sup>

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<sup>68</sup> Tr. 76.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> PGW St. 3R at 9-10.

<sup>72</sup> *Id.* at 10. In surrebuttal Mr. Knecht insisted that Mr. Golden's calculations were incorrect in part because "they did not include the time value of money." However, Mr. Knecht failed to recognize that the PGW analysis also did not include annual escalation for inflation or other costs such as increased uncollectibles and assumed that the costs to be financed would remain static. Moreover, if instead one were to look at only the next few years' time value of money would not be a particularly relevant factor. Tr. 76-77.

b. Granting Back The City Fee

Finally, a considerable topic of conversation at the hearings was the insistence by several parties, including the OCA and OSBA that, rather than increase its DSIC, PGW should fund the accelerated main replacement using the \$18 million City Payment that PGW remits to its owner, the City of Philadelphia, as the City's sole compensation for owning over \$1.2 Billion in gas distribution assets. This argument is raised virtually every time PGW requests a rate order from the PUC and, as in the past, it must be rejected.<sup>73</sup>

Most of the parties appear to recognize that the Public Utility Code Section 2212(f), limits the authority of the Commission regarding PGW's \$18 million payment to the City. That Section provides as follows:

The Commission shall permit the city natural gas distribution operation to impose, charge or collect rates and charges as necessary to permit the city natural gas distribution operation to transfer or pay to the city that is the owner of the city natural gas distribution operation, on an annual basis, such amount as may be specified from time to time in the applicable ordinances of the city or agreement of the city approved by ordinances.<sup>74</sup>

The Commission is permitted to review and approve only that portion of the City payment that exceeds 110% of the amount authorized (\$18 million), if that were to occur but it has no ability to direct the City to waive (or grant back) its City Payment.<sup>75</sup>

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<sup>73</sup> Parties to PGW base rate proceedings have consistently raised concerns with the \$18 million payment to the City although the Pennsylvania Supreme Court and Commission decisions since at least PGW's 2001 base rate proceeding have made clear that the payment is constitutional, legally required to be included in rates and rationally related to the City's asserted equity in PGW. *See, e.g., PUC v. Philadelphia Gas Works*, PUC Docket No. R-00006042 Opinion and Order entered October 4, 2001 at 29-34. The Pennsylvania Supreme Court has determined that the \$18 million payment by PGW to the City represented a reasonable rate of return that was rationally related to the City's asserted equity in PGW. *Public Advocate v. Philadelphia Gas Commission*, 674 A. 2d 1056, 1059-60 (Pa. 1996).

<sup>74</sup> 66 Pa. C.S. § 2212(f).

<sup>75</sup> *Id.*

As Mr. Golden explained, it is solely within the power of the City of Philadelphia, PGW's owner, to determine whether or not the \$18 million payment is to be granted back.<sup>76</sup> While the City did grant back the \$18 million payment for a time in the mid-2000's, when PGW was in financial crisis. Those circumstances do not exist today.

But OCA argued that PGW should be forced to formally "ask" the City to grant back the City Fee. The record shows, however, that the City is well aware of the suggestion in the PUC Staff Report, as well as similar suggestions made by the witnesses in this proceeding to forego its sole compensation for owning the Gas Works and has considered and rejected them under the present circumstances. Mr. Golden testified that as recently as the day before the hearing in this proceeding – November 4, 2015 – he contacted the Deputy Finance Director of the City of Philadelphia and confirmed that the City was not interested in voluntarily waiving or granting back the City Fee at this time.<sup>77</sup> How some formal "petition" to PGW's owner would change the result is difficult to understand.

Because the City is the owner of the Gas Works, the City Fee is akin to a very modest return on the City's massive investment;<sup>78</sup> trying to appropriate it is similar to demanding that the shareholders of an investor-owned utility expend their funds to modernize facilities without being able to receive a return on and of those expended funds from ratepayers. Moreover, the City Fee goes to assist the City in paying for municipal services, services that are provided to the citizens of Philadelphia, almost all of whom are also PGW customers; demanding that the City use its City Fee to fund PGW operations is like "robbing Peter to pay Paul." There is no net gain to PGW ratepayers – who are also Philadelphia taxpayers.

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<sup>76</sup> PGW St. 3-R at 10-12.

<sup>77</sup> Tr. 85.

<sup>78</sup> See, footnote 73, *supra*.

### **E. 10% Cap For Reconciliation**

PGW proposes that the total maximum DSIC, including reconciliation, may not be higher than 10% of its distribution revenues.<sup>79</sup> Stated differently, PGW proposes that the DSIC may be increased up to an additional 2.5% (from 7.5% up to 10%) in order to recover any under-collection amount from prior year(s).<sup>80</sup> This proposal will not impact the rules for the annual reconciliation audit or the treatment of under- or over-collections.

PGW's proposed 10% total cap provides additional protection to customers that the total charge for DSIC will never exceed the specific maximum, while insuring that the expenditure/construction component of PGW's DSIC cannot exceed the 7.5% of PGW's distribution revenues.<sup>81</sup> As proposed, the only amounts that will exceed the 7.5% level will be amounts to recover under-collections for accelerated replacements made in the prior calendar year reconciliation.<sup>82</sup> Simply put, the percentage level between 7.5% and 10% is driven by the under-collections, if any, for accelerated replacements in the prior period. So, contrary to suggestions otherwise, this proposal does not automatically raise PGW's effective DSIC rate to 10%.<sup>83</sup>

It is reasonable to have an additional 2.5% cap to permit the recovery of under collections.<sup>84</sup> As explained herein, the proposed 7.5% is designed to capture the entire amount of the projected DSIC-funded construction budget for a calendar year. It does not include any amount for under-collection for accelerated replacements made in the prior period. In order to

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<sup>79</sup> PGW St. 2 at 13, 14; PGW St. 2-R at 1, 5-6.

<sup>80</sup> *Id.*

<sup>81</sup> Tr. 55; PGW St. 2-R at 5.

<sup>82</sup> *Id.*

<sup>83</sup> *See* OSBA St. 1 at 12-13; OCA St. 1 at 16-17.

<sup>84</sup> PGW St. 2 at 12.

permit PGW to recover any amount for under-collections, an additional percentage needs to be available. If an additional percentage is not made available for under-collections, PGW could be forced to either reduce construction in a given year or not fully collect under-collections from the past year.<sup>85</sup>

Both OCA and OSBA have suggested that under-collections from a prior period can be carried-forward and added to the DSIC in the next year.<sup>86</sup> That practice is followed by the investor-owned utilities under current DSIC rules. But, as explained above, that practice is not workable for PGW under the current proposals. If PGW's projected DSIC funded construction budget for a calendar year would be 7.5% of PGW's distribution revenue, then PGW would lack the ability to collect any under-collections in the next year, or it would have to reduce its DSIC-financed construction. Further, such delays in recovering its DSIC related expenditures will have a negative effect on PGW's cash flow.<sup>87</sup>

OCA suggested that the harm in raising the DSIC for under-collections outweighs the benefits.<sup>88</sup> But this claim fails to recognize PGW actual experience with under-collections in the past: PGW witness Dybalski explained, in great detail, that PGW has been unable to collect amounts spent in the past even after billing an under collection for almost twelve months.<sup>89</sup> And, as noted above, a percentage level or threshold needs to be set so as to permit PGW to recover under-collections in the future and PGW will be able to actually replace cast iron main at the \$33 million level each year.

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<sup>85</sup> Tr. 54; PGW St. 2 at 12.

<sup>86</sup> OCA St. 1 at 16-17; OSBA St. 1 at 12-13, 15.

<sup>87</sup> PGW St. 3-R at 4-7.

<sup>88</sup> OCA St. 1 at 17.

<sup>89</sup> Tr. 53-54; PGW St. 2 at 5-6.

Moreover, PGW does not expect that its under-collections will amount to \$11 million in any year; so far the under-collections have been modest.<sup>90</sup> But the cap was proposed merely to provide the Commission with an outer bound that would assure collection of the under-collection while still being reasonable.

## V. WAIVERS TO PERMIT LEVELIZATION AND ANNUALIZATION OF DSIC-ELIGIBLE COSTS

### A. Summary Of PGW's Position

PGW requests a waiver or suspension of the requirements of Act 11<sup>91</sup> 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 annual, 12-month experience.<sup>92</sup>

PGW's request to levelize and annualize the DSIC is consistent with a recommendation of the PUC Staff in the Staff Report on PGW. The PUC Staff Report recognized this problem and suggested that PGW should seek to levelize and annualize its billings for DSIC-eligible costs.<sup>93</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.

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<sup>90</sup> PGW St. 2 at 12. The current DSIC under-collection factor is just .3%. PGW St. 2 at 12. The under-collection for the first period may be larger as it will cover 16 months. *See* footnote 92, *infra*.

<sup>91</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); 66 Pa. C.S. §§ 1357(a)(1)(ii), (a)(2), (b)(1); § 1358(b)(1) (relating to recovery of the fixed cost of eligible property that has been placed in service during the prior quarter); and 66 Pa. C.S. § 1358(b) (relating to the change reset).

<sup>92</sup> The first reconciliation for calendar year 2015 will include 16-months. PGW St. 2 at 12-13. Any under or over collection from the previous year will be calculated in an annual reconciliation based on actual billed DSIC revenues and DSIC recoverable costs during each month of the calendar year. 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. Note that in the first year, the 'annual' reconciliation will have 16 months of recoverable costs due to this lag. *Id.*

<sup>93</sup> PUC Staff Report at 5-6, 42-44.

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.<sup>94</sup> This creates wide swings in PGW's DSIC billings 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.<sup>95</sup> Because it has had to follow the "placed in service in the last quarter" rule (a rule created for companies that are regulated – unlike PGW – on a used and useful/return on rate base standard), 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>96</sup>

A levelized DSIC would permit PGW to charge a flat percentage 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 (with interest), 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.

#### **B. Standard For Granting The Waivers For Levelization And Annualization**

The waivers for levelization and annualization are made pursuant to Section 2212 of the Public Utility Code.<sup>97</sup> As noted above in Section IV.B of this Brief, such waivers are guided by

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<sup>94</sup> 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. *See* footnote 91, *supra*. 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. *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") at 29.

<sup>95</sup> PGW St. 2-R at 9-10.

<sup>96</sup> PGW St. 2-R at 5-6.

<sup>97</sup> 66 Pa. C.S. § 2212.

long standing and fundamental principles of Pennsylvania public-utility regulation jurisprudence, including that any granted waivers, will be just and reasonable and in the public interest.<sup>98</sup> 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 of the Public Utility Code.

**C. Has PGW Satisfied The Standard For Granting Waivers Permitting Levelization And Annualization?**

PGW has satisfied the standard, under Section 2212, for granting waivers permitting levelization and annualization. I&E agrees with that conclusion.<sup>99</sup>

In addition, PGW notes that the other parties either support or do not directly oppose PGW's request for levelization and annualization. For example, (1) OCA generally agreed that an "annualized, levelized approach may be potentially reasonable for PGW because it is a cash-flow regulatory company," but wanted, *inter alia*, assurances that PGW would prioritize the incremental replacements and be able to perform the incremental work.<sup>100</sup> As described in more detail below in Section V.D of this Brief, OCA's concerns are satisfied by the PGW/I&E agreement; and (2) OSBA also did state an explicit challenge to levelization and annualization, but suggested an alternative methodology for implementing levelization and annualization. OSBA's suggested methodology should be rejected for the reasons set forth in Section V.D.2 of this Brief.

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<sup>98</sup> See, footnote 14, *supra*.

<sup>99</sup> See PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1-2.

<sup>100</sup> See OCA St. 1 at 12-15, 20; OCA St. 1-S at 8-9. Specifically, OCA explained: "The levelized approach would reduce the fluctuations in [PGW's] DSIC rate, making its DSIC more similar to that of other natural gas distribution utilities." OCA St. 1 at 13.

## 1. PGW's DSIC Experience

PGW's DSIC experience presents compelling reasons to justify the waiver of Act 11's "placed into service" rule. The requirement in Act 11 that a utility can bill for only the DSIC-eligible facilities actually placed into service in the prior quarter plainly does not fit PGW – as a municipal utility that is regulated on a cash flow (rather than a return of return/rate base) basis – for the following reasons:

First, the requirement that the DSIC only reflect investment already placed into service is not consistent with the rate-making concepts applicable to PGW. The requirement that the DSIC only reflect investment already placed into service apparently was to recognize that investor owned utilities generally are not permitted to earn a return on facilities prior to their being placed into service and becoming "used and useful."<sup>101</sup> As a cash flow company, PGW's revenue requirement is not set on a rate of return/rate base basis, but on a "cash flow basis."<sup>102</sup>

Second, DSIC was intended to result in a steadily increasing revenue stream. PGW's experience with the quarterly adjustments of the DSIC appears to have been quite different from the experience of investor-owned utilities.<sup>103</sup> For investor-owned utilities, the requirement that DSIC reflect the cost of eligible property that has actually been placed in service during the prior quarter results in a DSIC that increases gradually from quarter to quarter.<sup>104</sup> PGW's current

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<sup>101</sup> PGW St. 2 at 7. 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 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>102</sup> PGW St. 2 at 9.

<sup>103</sup> PGW St. 2 at 6-8.

<sup>104</sup> PGW St. 2 at 7.

DSIC structure does not result in a steadily increasing revenue stream. PGW's current DSIC structure has resulted, and will continue to result in, significant DSIC fluctuations – which vary throughout a year.<sup>105</sup> PGW's DSIC is further impacted by seasonal usage variations.<sup>106</sup> 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.<sup>107</sup> This leads to PGW billing less annual DSIC revenue than intended.<sup>108</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>109</sup> 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.<sup>110</sup> 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%.<sup>111</sup>

## 2. Public Interest And Other Considerations

PGW notes that, initially, the Commission did not approve the use of a levelized and annualized DSIC. However, at that time, the Commission left the door open for PGW to file a renewed waiver request to allow PGW to recover annualized costs through the DSIC.<sup>112</sup>

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<sup>105</sup> *Id.*; PUC Staff Report at 36, Table 26.

<sup>106</sup> PGW St. 2 at 7.

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*; PGW St. 2 at 8-9.

<sup>109</sup> *Id.* at 7-8.

<sup>110</sup> PGW St. 2 at 7.

<sup>111</sup> PGW St. 2 at 7-8.

<sup>112</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”) at 6 (“While PGW, as a [City Natural Gas Distribution Operation] CNGDO, may seek a waiver or suspension of provisions of Act 11 pursuant to Section 2212(c) of the Public Utility Code, we find that PGW has not provided legal or factual basis for a waiver or suspension of the applicable statutory provisions to allow

Presently, I&E supports the request and has pointed out that the request is consistent with the PUC Staff Report.<sup>113</sup>

That being said, nothing in the record suggests that waiver of the “placed into service” rule would be contrary to the public interest, would be unjust or unreasonable, would be discriminatory and/or would be contrary to Commission regulation or policy.

Here, the request for levelization and annualization will not impact the amount that PGW bills to ratepayers for accelerated main replacement on an absolute basis.<sup>114</sup> The requested waiver will merely permit further acceleration, which (as explained in greater detail herein) will enhance system safety and reliability, is cost-effective and will ensure and maintain adequate, efficient, safe, reliable and reasonable service.<sup>115</sup> In fact, the PUC Staff stated in its Report that 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 LTIIP and Act 11 itself by permitting PGW to actually bill an amount equating to 7.5% (exclusive of reconciliation) 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 permitted level of DSIC.<sup>116</sup>

Levelizing and annualizing PGW’s DSIC structure will (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

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PGW to recover annualized costs through the DSIC. Accordingly, we shall reject PGW’s request for a waiver that would allow use of annualized construction costs.” (emphasis added).

<sup>113</sup> I&E St. 1 at 3-5; PGW/I&E Ex. No. 1 (Stipulation) at ¶ 2.

<sup>114</sup> PGW St. 2 at 7.

<sup>115</sup> See I&E St. 1 at 3-5; PGW/I&E Ex. No. 1 (Stipulation) at ¶ 2.

<sup>116</sup> PUC Staff Report at 43.

other major automatic adjustment clause – the GCR.<sup>117</sup> This should result in smaller under collections which otherwise would continually have to be recovered from customers over time.<sup>118</sup>

**D. Implementation Of The Waivers For Levelization And Annualization**

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% (currently \$33 million), exclusive of reconciliation, of distribution revenues over twelve months.

**1. Calendar Year 2016**

PGW is proposing that its DSIC be levelized and annualized in calendar year 2016.<sup>119</sup> PGW and I&E reached an agreement as to starting levelization and annualization in calendar year 2016 (as soon as possible after a PUC order approving PGW’s Petition).<sup>120</sup> PGW’s increased levelized DSIC will begin to be charged after the PUC issues an order approving its DSIC increase and PGW submits its compliance filing. Nevertheless, PGW’s construction budget for accelerated main replacement is capped at \$33 million level.<sup>121</sup>

**2. Use Of Forecasted DSIC Spending**

The requested waiver for levelization and annualization will permit PGW to bill customers for main replacement in a more timely manner.<sup>122</sup> PGW proposes that the uniform amount be based on forecasted spending, i.e., PGW’s annual construction budget for accelerated

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<sup>117</sup> PGW St. 2 at 10-11.

<sup>118</sup> PGW St. 2 at 7.

<sup>119</sup> PGW St. 2 at 6-11; PGW St. 2-R at 7-10.

<sup>120</sup> PGW/I&E Ex. No. 1 (Stipulation) at ¶ 2.

<sup>121</sup> PGW St. 2 at 5.

<sup>122</sup> PGW St. 2 at 7-9, 11.

main replacement. Basing the uniform, levelized and annualized DSIC rate on forecasted DSIC eligible capital spending will provide revenue as the spending is occurring and would correspond with the “pay as you go” method of billing for DSIC and PGW’s cash flow methodology.<sup>123</sup>

Rather than forecasted spending, the OSBA proposed that PGW use a 12-month rolling average of historical capital spending.<sup>124</sup> That proposal should be rejected. The historic DSIC revenue is set based on the level of DSIC spending in the prior year’s period.<sup>125</sup> So, the use of historic data proposal would seem to perpetuate a gap between the period when capital spending is made and when revenue is provided for the spending.<sup>126</sup> In fact, the OSBA’s proposal would require that the uniform rate for calendar year 2016 (a) be based on the level of DSIC spending in a calendar year in which PGW’s DSIC was not levelized; and (b) not be reflective of the proposed increase from \$22 million to \$33 million in the first year of DSIC spending.<sup>127</sup> The OSBA witness gave no reason or supporting justification for this proposal, and it should be rejected.

### 3. Quarterly Reports And Adjustments

PGW is further proposing to review the uniform amount quarterly and adjust the percentage to account for these items. PGW and I&E reached agreement on the quarterly reports and adjustments.<sup>128</sup> That paragraph states that PGW will provide to I&E on a quarterly basis:

- (a) all quarterly reconciliation updates and shall agree to honor all appropriate requests for back-up information;

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<sup>123</sup> PGW St. 2-R at 8; PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1-2.

<sup>124</sup> OSBA St. 1 at 13-14; OSBA St. 2 at 12-13.

<sup>125</sup> PGW- St. 2-R at 9.

<sup>126</sup> PGW St. 2-R at 9-10.

<sup>127</sup> *Id.*

<sup>128</sup> PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1.D.

(b) for a period of three years from the date the PUC approves PGW's Amended LTIP (or a shorter time period by mutual, PGW/I&E agreement), the actual number of: a) personnel (by job description); and b) contractors that are OQ qualified to work on live gas, compared to the numbers for each identified in PGW's Amended, approved LTIP.<sup>129</sup>

PGW agreed that its quarterly reconciliation update will include the amount actually billed to customers in the quarter as well as the amount of actual main replacement placed in service during the quarter.<sup>130</sup> Rather than make a mandatory update/change to DSIC each quarter, PGW expects to adjust the DSIC levels for material differences to mitigate against a significant over or under collection.<sup>131</sup> During a year, PGW may (a) make an adjustment to the construction budget for the accelerated replacement program and (b) review the annualized DSIC percentage.<sup>132</sup> That process may lead to revisions and/or quarterly adjustments to the annualized DSIC percentage.<sup>133</sup> Revisions or adjustments would be made for the difference between projected and actual billed amounts, and to recognize changes to the construction budget during the year for the accelerated replacement.<sup>134</sup>

PGW expects that a material difference would be triggered by an increase or decrease in its projected DSIC-eligible costs of \$200,000 or more.<sup>135</sup> The use of a trigger for changes is comparable to the 2% change of known and measurable change which triggers a revision in gas costs.<sup>136</sup> But, PGW does not believe it is beneficial to update the DSIC every quarter to reflect

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*Id.*

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Tr. 56-58.

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*Id.*; PGW St. 2 at 10; PGW St. 2-R at 8.

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PGW St. 2 at 10; PGW St. 2-R at 8.

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Tr. 51-52; PGW St. 2-R at 8.

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PGW St. 2 at 10; PGW St. 2-R at 8.

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Tr. 56, 61-64.

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*See* 52 Pa. Code § 53.64(b).

the most recent projected annual revenues.<sup>137</sup> The costs of making the adjustments for *diminimus* differences in actual and projected amounts might outweigh the benefits of said adjustments.<sup>138</sup> This is consistent with the view of PUC Staff, which noted that, ideally, the DSIC should remain relatively level throughout the year in order to pass costs equally to all customers.<sup>139</sup>

Additionally, PGW should not be required to reconcile projections with actual amounts each quarter. In fact, the first quarter would never match the forecasts for the entire year. Quite simply, January and February are traditionally low construction months.<sup>140</sup> But, approximately 47% of its total revenues are billed in January, February and March.<sup>141</sup> Such facts make it impractical to update the levelization and annualization level for material changes in actual construction and revenue levels – until later in the year. PGW believes that it will have better information to make such adjustments for material changes by October 1.<sup>142</sup> PGW would be willing to commit to adjusting the DSIC percentage by October 1 if projected total billings and expenditures for the remainder of the year indicated that a material over or under-collection was likely to develop. The reasonable standard for materiality would be plus or minus 2% (approximately \$660,000).

To be clear, it should be noted that, PGW will be paying interest on over-collections. The fact that interest will be charged on over-collections provides customers with assurance that

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<sup>137</sup> Tr. 58-60; PGW St. 2-R at 8.

<sup>138</sup> PGW St. 2-R at 8.

<sup>139</sup> PUC Staff Report at 5-6, 42-44.

<sup>140</sup> Tr. 57-58.

<sup>141</sup> PGW St. 2-R at 4.

<sup>142</sup> Tr. 53-54, 59, 64.

PGW has an incentive to accomplish the pipeline replacement and infrastructure targets that it has set.<sup>143</sup>

#### **4. Audit And Reconciliation**

PGW notes that the request for levelization and annualization will not impact the audit and reconciliation process.<sup>144</sup> The PUC's Division of Audits conducts audits on the DSIC periodically, and an annual reconciliation audit is conducted to ascertain any over or under-collections.<sup>145</sup> The audit and reconciliation process work to ensure that dollars collected by the DSIC are used for "at risk" main replacement.<sup>146</sup> While the audit and reconciliation process does not explicitly require the segregation of funds, that process works to return to ratepayers (with interest) any amounts collected that are not spent on DSIC eligible projects described in PGW's LTIP, such as "at risk" main replacement, – for some reason.<sup>147</sup> That process does not permit any diversion of DSIC revenues for any other purpose. Accordingly, there is no need to further segregate DSIC revenues from other revenues.<sup>148</sup>

#### **5. OCA Proposal: Budget Billing Program**

OCA witness Everette has recommended that request for levelization and annualization be conditioned on PGW expanding its budget billing program.<sup>149</sup> This recommendation was

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<sup>143</sup> I&E Statement No. 1 at 5-7; PGW St. 2-R at 3; PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1.A.

<sup>144</sup> See PGW St. 2 at 11-13; PGW St. 2 at 7-11.

<sup>145</sup> PGW St. 2-R at 7; 66 Pa. C.S. § 1358(e).

<sup>146</sup> PGW St. 2-R at 7.

<sup>147</sup> PGW St. 2-R at 7-8.

<sup>148</sup> Tr. 52-53, 117-118; PGW St. 2-R at 7.

<sup>149</sup> Tr. 117; OCA St. 1 at 13, 15, 20; OCA St. 1-S, 8-9, 12.

made to ensure that eligible customers have an informed option to enroll in PGW's budget billing option.<sup>150</sup>

That recommendation should be rejected. Nothing in the record suggests that PGW's residential customers are not aware of PGW's budget billing program and/or a need to modify the budget billing program itself.

PGW customers take advantage of these programs based on eligibility and need/desire.<sup>151</sup> PGW has had a budget billing offering since before it came under PUC jurisdiction.<sup>152</sup> As of October 2015, it had over 42,000 customers in its (non-payment agreement) budget billing program.<sup>153</sup> In addition, virtually all payment agreement customers are required to enroll in budget billing and remit their monthly payment agreement amount in addition to its budget billing amount.<sup>154</sup>

## VI. CONCLUSION

For the reasons set forth above, PGW respectfully requests that the Commission grant waivers of portions of 66 Pa. C.S. §§ 1358 and 2212(c) and issue an order consistent with PGW's Petition, as modified in this Brief to:

- (i) waive the current 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) for construction purposes, and b) approve a total, 10% cap including any reconciliation recovery, both for service rendered on or after January 1, 2016;

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<sup>150</sup> OCA St. 1-S at 12.

<sup>151</sup> PGW St. 2-R at 8-9.

<sup>152</sup> PGW St. 2-R at 8.

<sup>153</sup> *Id.*

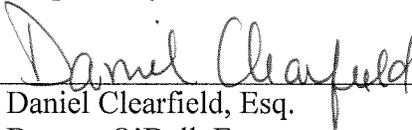
<sup>154</sup> PGW St. 2-R at 8-9.

(ii) waive or suspend the requirements of 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; **and**,

(iii) authorize the filing, on one day's notice, of a PGW tariff supplement attached as Attachment A to PGW's Petition, codifying these changes after the submission of a compliance tariff.

PGW is proposing that the Commission approve the above-described changes to PGW's DSIC in an expedited manner so that the charge becomes effective as soon as possible after the Commission's approves PGW's Petition and as close to January 1, 2016 as possible.

Respectfully submitted,



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Date: November 13, 2015

# Appendix A

**Philadelphia Gas Works'  
Proposed Findings of Fact**

**PGW**

1. PGW is a city natural gas distribution operation as defined in the Public Utility Code, 66 Pa. C.S. § 102. PGW Petition at ¶ 1.
2. PGW manages a distribution system of approximately 6,000 miles of gas mains and service lines<sup>1</sup> supplying approximately 500,000 customers in the City and County of Philadelphia. PGW Petition at ¶ 1; PGW Exh. DPM-1 (12/3/12 Long-Term Infrastructure Improvement Plan) at 7.
3. PGW's Commission-approved rates are established using the cash flow method of ratemaking. 66 Pa. C.S. § 2212(e); 52 Pa. Code §§ 69.2701 to 69.2703.

**Act 11**

4. On February 14, 2012, Act 11 was signed into law. Act 11 of February 14, 2012, P.L. 72.
5. Act 11 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. 66 Pa. C.S. § 1353(a).

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<sup>1</sup> There are no customer-owned service lines in the PGW territory. Service lines are also referred to as services.

6. Act 11 establishes a cap on the DSIC of 5% of distribution revenues. 66 Pa. C. S. § 1358(a)(2).

7. Act 11 further provides that 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. 66 Pa. C. S. § 1358(a)(2) (emphasis added).

8. The provisions of Act 11 were codified in Chapter 13 of the Public Utility Code. 66 Pa. C.S. §§ 1350 to 1360.

### **PGW LTIP**

9. PGW filed an LTIP with the Commission on December 3, 2012, which was approved on April 4, 2013. *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 (“LTIP DSIC Order”).

10. PGW’s Commission-approved LTIP 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 Exh. DPM-1.

11. PGW’s LTIP proposed that it would advance the replacement of high risk, cast iron main by adding to its historical “18 mile” program. PGW Exh. DPM-1 at 6, 10-11.

12. PGW identified the following property in its LTIP for replacement in Phase 1 of its plan: (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). PGW Exh. DPM-1 at 2, 5-6, 10-11.

13. PGW identified the remainder of its cast iron inventory for replacement in Phases 2 through 5 of its LTIP. PGW Exh. DPM-1 at 14.

### **PGW DSIC**

14. PGW filed its initial DSIC Petition on January 18, 2013. PGW's DSIC was finally approved on May 9, 2013. *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").

15. PGW's DSIC compliance tariff, Supplement No. 62 to Gas Service Tariff – Pa P.U.C. No. 2, went into effect June 1, 2013. *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.

16. 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.

- a. 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.  
LTIP DSIC Order at 13-14.

- b. 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. LTIP DSIC Order at 36; Final DSIC Order at 4-6.

### **PGW Pipeline Replacement Program**

17. PGW has historically removed 18 miles of high risk cast iron main each year, financed from funds provided from its base rates. PGW St. 1 at 1-3; PGW Exh. DPM-1 at 6, 10-11.

18. Since 2013, PGW has been replacing approximately another seven miles of cast iron main, financed through its DSIC, currently capped at 5% of PGW's distribution revenues. Specifically, PGW removed approximately 22.5 miles of cast iron main from service in Fiscal Year 2013, 28 miles of cast iron main in Fiscal Year 2014, and removed 29 miles in Fiscal Year 2015. PGW also removed two miles of unprotected coated steel main in 2014. PGW St. 1 at 1-3; PGW St. 1-R at 11.

19. PGW's current DSIC charge is restricted to the recovery of plant 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. PGW St. 2 at 7-8; LTIP DSIC Order at 29.

20. PGW's 2013 LTIP estimated that, utilizing a 5% DSIC (restricted to the plant placed into service in the prior quarter), and assuming 2% inflation, PGW's cast iron main removal would be expedited to 86 years (no estimate of the removal date for unprotected steel was made). PGW St. 1 at 10.

### **Further Acceleration**

21. 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. PGW St. 1 at 4; PGW St. 1-R at 4-5; PGW Petition at ¶ 15.

22. On April 21, 2015, the Staff of the PUC issued a seminal Report entitled: "*Staff Report: Inquiry into Philadelphia Gas Works' Pipeline Replacement Program*" ("PUC Staff Report").

23. 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. PUC Staff Report at 4. The Staff Report contained a comprehensive analysis of PGW's current "at risk" main inventory and its status vis-à-vis other natural gas distribution utilities. PUC Staff Report at 15-35.

24. 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. PUC Staff Report at 5, 35-42.

25. The PUC Staff Report also suggested that PGW request the ability to submit a "levelized" annual DSIC. PUC Staff Report at 5-6, 42-44.

26. 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%. Petition at ¶ 18; PUC Staff Report, Appendix A.

27. The advisability of advancing the replacement of aging piping and other facilities has been acknowledged in several national reports.

- a. In 2011, the United States Department of Transportation<sup>2</sup> and the Pipeline and Hazardous Materials Safety Administration (“PHMSA”) issued a Call to Action to accelerate the repair, rehabilitation, and replacement of the highest-risk pipeline infrastructure.<sup>3</sup>
- b. The United States Department of Energy also has issued a recent report encouraging the modernization of natural gas infrastructure.<sup>4</sup>
- c. These (and other) reports have all concluded that replacing aging cast iron pipe is critical to a cleaner economy and a safer, more efficient natural gas distribution system.<sup>5</sup>

PGW St. 1-R at 4; Petition at ¶ 19.

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<sup>2</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>3</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>4</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>5</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).

### **PGW Petition for Waiver and Stipulation**

28. 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 St. 1 at 2.

29. On September 1, 2015, PGW filed the subject Petition requesting that the Commission: (i) waive the current 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 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 over-collections; and (iv), authorize the filing, on one day’s notice, of a PGW tariff supplement codifying these changes.

30. PGW subsequently withdrew its request for an exemption from the requirement of paying interest on DSIC over-collections. PGW St. 2-R at 3; PGW/I&E Exh. 1 (Stipulation).

31. PGW and I&E reached an agreement on the implementation of the requested waivers. That agreement was memorialized in a Stipulation, which was admitted into the record. See PGW/I&E Exh. No. 1 (Stipulation).

### **Increasing Limitation to 7.5% for Expenditures Will Improve Safety and Reliability**

32. The PUC Staff Report recognized the need for PGW to accelerate its main replacement program in order to improve the safety and reliability of its distribution system:

Most NGDCs plan to replace cast iron in 13 to 22 years; however, PGW’s Long Term Infrastructure Improvement Plan (LTIP) filed with the Commission at Docket No. P-2012-2337737, shows an 88-year replacement rate.

\* \* \*

- 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 ... 1,072 were hazardous main leaks. The other large NGDCs had an average of 273 hazardous main leaks ... .
- 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.

PUC Staff Report at 32-34. See also, Staff Report at 3 (“Approximately 66 percent of [PGW’s] system is comprised of cast iron and unprotected steel, both of which are high-risk pipe that pose a potential threat to life and property in PGW’s service territory.”); *Id.* at 59 (“PGW’s cast iron and unprotected steel pipe are a threat to life and property.”); *Id.* at 15 (“PGW’s cast iron and unprotected steel pipe “poses significant safety concerns, because given the nature of PGW’s urban service territory, gas is more likely to migrate to a building and cause harm to life or property.”).

33. The evidence shows that further acceleration will contribute to:

- a) Reducing leaks and the concomitant risk of serious incidents from those leaks, compared to what PGW is likely to experience without acceleration;
- b) Reducing breakage repairs and future breakage repair costs, again, compared to the costs it would incur absent acceleration;
- c) Reducing leak maintenance and repair on the facilities being removed from service; and
- d) Reducing leaks will result in levels of unaccounted-for gas (again, compared to the amounts PGW would experience absent acceleration).

By replacing its highest risk pipe, PGW expects to decrease the number of leaks requiring repair on the system, and as a result provide safer and more reliable service to its customers. Reducing the number of leaks will reduce the time and money that PGW would otherwise have to expend to repair those leaks compared to what PGW would have to expend if it did not accelerate its main replacement program. In addition, it should be noted that natural forces is the highest ranking threat in PGW's DIMP. As a result, the quantity of both leaks and main breaks will be impacted by instances of severe weather and frost levels. However, as the riskiest main are replaced the long term trends for both leaks and main breaks are expected to demonstrate a decrease. Therefore, while I am not asserting that the total amount PGW must expend on leak repair will necessarily go down in absolute terms, over time the cost imposed on ratepayers should be lower than it otherwise would have been absent the accelerated replacement.

PGW St. 1 at 12.

34. OSBA witness Knecht and the OSBA support the acceleration of PGW's existing obsolete main replacement program. OSBA St. 1 at 3.

35. OCA witness Everette supports the acceleration of at risk main. Tr. 102-103.

36. EDF and CAC have also expressed support for PGW's Petition. EDF Petition to Intervene at 7-8; EDF Main Brief at 6-10; CAC Petition to Intervene at 2).

37. Under its proposals, PGW expects that the timeline to replace all the cast iron main in the system would decrease from its current projection of 86 years to 48 years. This represents a 44% reduction in the timeline for cast iron main replacement. PGW St. 1 at 10.

38. Increasing the DSIC limitation to 7.5% for expenditures (exclusive of reconciliation) will ensure and maintain adequate, efficient, safe, reliable and reasonable service. PGW St. 1 at 11-16; PGW St. 1-R at 3-5, 7-10; See also PGW/I&E Exh. No. 1 (Stipulation) at ¶¶ 1-2.

**Amended LTIIP**

39. PGW plans to file a petition to modify its existing LTIIP in order to set out a plan to expend the additional dollars made available by the increase of the DSIC to 7.5%. PGW St. 1 at 11.

40. PGW did not file such a plan simultaneous with its DSIC Petition because: 1) any such filing would need to be informed by the specifics of the PUC order ruling on PGW's Petition; and 2) PGW believed it would be more prudent to await the results of both its Benchmarking and Prioritization studies, both of which have only just been completed.

- a. The results of these independent reports (the preliminary results of which have been provided to PGW), as well as the revisions to the current DIMP, being finalized between PGW and BGS, will be the basis of the LTIIP revision. Tr. 41-42; PGW St- 1-R at 5-7.

41. PGW and I&E reached an agreement on the timing and procedure for filing an amended LTIIP:

(B)(1) By December 31, 2015, or fifteen (15) days after the entry of the PUC's Order approving PGW's Petition whichever is later, PGW shall submit a Petition to the PUC to amend its LTIP which will, inter alia,

(a) Identify how PGW proposes to expend the increased DSIC revenues, including identifying the types and sizes of at risk main PGW proposes to target with the increased revenues;

(b) Utilize PGW's Distribution Integrity Management Program ("DIMP") risk scores, as modified by PGW to respond to issues raised by the PUC's Gas Safety Division's Non-Compliance letter to PGW dated May 7, 2015; and

(c) Provide a plan showing how PGW intends to train staff and contractors to meet the Operator Qualification requirements of 49 CFR Subpart N and to otherwise demonstrate that it will have qualified personnel available to accomplish the accelerated main replacement authorized by the PGW Petition.

(2) To the extent feasible, PGW shall consult with I&E about the contents of its revised LTIP prior to its formal filing with the Commission.

(3) The Stipulating Parties will request that the PUC rule on PGW's Petition to Amend its LTIP on or before May 1, 2016.

(4) PGW agrees that it shall not undertake any main replacement made possible by the incremental DSIC funding (\$11 million) authorized by the PGW Petition unless and until the PUC has approved PGW's Amended LTIP.

PGW/I&E Exh. No. 1 (Stipulation) at ¶ 1.B.

42. Under the Stipulation, PGW will file an amended LTIP within 15 days of a PUC order and will not begin to expend the additional DSIC funds until the LTIP as approved by the Commission is consistent with the law and PUC regulations and properly balances the desire for PGW to begin its accelerated main replacement as soon as possible with reasonable and adequate protections for customers. PGW/I&E Exh. No. 1 (Stipulation) at ¶ 1.B.

43. Under the Stipulation, PGW agreed that it shall not undertake any main replacement made possible by the incremental DSIC funding (\$11 million) authorized by the

PGW Petition unless and until the PUC has approved PGW's Amended LTIP. PGW/I&E Exh. No. 1 (Stipulation) at ¶ 1.B(4).

44. As proposed, the increased level of main replacement will be performed in a safe and reasonable manner.

- a. PGW is confident it can ramp up its replacement process to be able to expend the additional \$11 million annually.
- b. In terms of the further expansion, PGW plans to gain experience with main replacement at the \$33 million level and then, after analyzing the results of these increased efforts, consider whether it would be prudent to propose further acceleration.

PGW St. 1-R at 5-11.

45. The increased level of main replacement will also be conducted in a cost effective manner. PGW St. 1 at 14-15. PGW will also continue to utilize a competitive bidding process for all relevant aspects of the program. PGW St. 1 at 13.

#### **Timing of Increased DSIC**

46. PGW and I&E agreed that PGW's Petition, as modified by the Stipulation, should be granted so as to permit PGW to begin to bill customers at the revised level, on or after January 1, 2016. PGW/I&E Exh. No. 1 (Stipulation) at ¶¶ 1-2.

47. Due to the highly seasonal nature of PGW's billings, PGW bills some 47% of its total revenues in the January – March timeframe. PGW St. 2-R at 4.

48. If PGW holds up billing at the additional 7.5% it will only be able to collect approximately 44% of the additional \$11 million in 2016 and PGW first year acceleration will be cut by almost one half. PGW St. 2-R at 4.

49. If PGW collects incremental DSIC funding (\$11 million) and that incremental funding was not approved by the PUC, PGW will pay the increased DSIC billings back to customers with interest at the rate prescribed by Act 11. PGW St. 1-R at 6.

50. The interest rate prescribed by Act 11 is the residential mortgage lending rate, which for November 2015 is 5%. 66 Pa. C.S. § 1358(c)(3); Department of Banking and Securities, *Maximum Lawful Rate of Interest for Residential Mortgages for the Month of November 2015*, 45 Pa. Bull. 6187, 6211 (October 17, 2015).

#### **Use Of Other Sources Of Funding**

51. Since PGW's last rate case in 2010, PGW's non-DSIC capital budget had increased from around \$58 million to \$68 million, with that amount increasing to \$88 million in 2016.

- a. PGW's non-DSIC capital budget is used to maintain the rest of PGW's gas operations including gas processing, field services, meters, fleet operations, repairs to buildings, computers and the like.
- b. The non-DSIC budget also includes the gas "services" associated with the DSIC acceleration, since the Company voluntarily determined not to include that several million dollars of additional construction in its proposed DSIC recovery.

Tr. 68-70.

52. PGW is not in the financial position that it could comfortably finance its proposed increase in DSIC-funded main replacement from its present base rates without threatening its current financial health. PGW. St. 3 at 2.

53. Funding DISC-eligible construction from internal generation would also reduce the Company's coverages in FY 2015 to just 1.59% (the minimum is 1.5%) and have a negative effect on its debt to total capitalization ratio. PGW St. 3 at 5.

54. Funding DISC-eligible construction from short-term financing would seriously hamper PGW's short-term liquidity. PGW's short-term debt is limited to \$120 million. Tr. 76; PGW St. 3-R at 7-8.

55. Funding DISC-eligible construction from long-term financing would have a deleterious effect on PGW's debt to total capitalization ratios, and would be more expensive than other funding options. PGW St. 3-R at 2, 8-11.

#### **Waiver of \$18 Million Payment By The City**

56. Section 2212(f) of the Public Utility Code does not authorize the Commission to interfere with the payment of the \$18 million City fee by PGW, and requires it to be collected in rates from customers. 66 Pa. C.S. § 2212(f).

57. City is well aware of the suggestion in the PUC Staff Report, as well as similar suggestions made by the witnesses in this proceeding to grant back the City Fee, and has considered and rejected them under the present circumstances. Tr. 85; PGW St. 3-R at 10-12.

- a. As recently as the day before the hearing in this case, PGW asked the City to voluntarily agree to grant back the City Fee to pay for accelerated main replacement and the City rejected the request. Tr. 85.

## Levelization And Annualization

58. PGW requests a waiver or suspension of the requirements of Act 11<sup>6</sup> 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 annual, 12-month experience.

59. PGW is currently 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. LTIIP DSIC Order at 29; *See* 66 Pa. C.S. §§ 1353(b)(i)(iv), 1354(3), 1357(a)(2), 1357(b)(3) (relating to quarterly updates of the DSIC); 66 Pa. C.S. §§ 1357(a)(1)(ii), (a)(2), (b)(1); § 1358(b)(1) (relating to recovery of the fixed cost of eligible property that has been placed in service during the prior quarter).

60. 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. PGW St. 2 at 7; PUC Staff Report at 36, Table 26.

61. Because it has had to follow 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. PGW St. 2-R at 5-6.

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<sup>6</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); 66 Pa. C.S. §§ 1357(a)(1)(ii), (a)(2), (b)(1); § 1358(b)(1) (relating to recovery of the fixed cost of eligible property that has been placed in service during the prior quarter); and, 66 Pa. C.S. § 1358(b) (relating to the charge reset).

62. The “placed in service in the last quarter rule” stems from the requirement that investor-owned utilities may only receive a return on property that is “used and useful” in providing public utility service. PGW St. 2-R at 6-7.

63. As a cash flow company, PGW’s revenue requirement is not set on a rate of return/rate base basis, but on a “cash flow basis. PGW St. 2 at 9.

64. PGW’s cash flow ratemaking methodology is inconsistent with this “placed in service” requirement. PGW St. 2-R at 5-9.

65. 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. PGW St. 2 at 7. This leads to PGW billing less annual DSIC revenue than intended. PGW St. 2 at 8-9; PGW St. 2 at 7.

66. 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. PGW St. 2 at 8; PGW St. 2 at 7. 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. PGW St. 2 at 7.

67. 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%. PGW St. 2 at 7-8.

68. As a cash flow regulated utility with no rate base it would be more appropriate to levelize and annualize the DSIC charge so that PGW can bill customers at a uniform 7.5% level

throughout the year. This will enable PGW to actually bill the full \$33 million that is currently produced by a 7.5% charge, thereby permitting PGW to meet its acceleration projections.

69. The requested waiver for levelization and annualization will permit PGW to bill customers for main replacement in a more timely manner. PGW St. 2 at 7-9, 11.

70. PGW proposes that the uniform amount be based on forecasted spending, i.e., PGW's construction budget for accelerated main replacement. PGW St. 2-R at 8; PGW/I&E Exh. No. 1 (Stipulation) at ¶ 1-2.

71. Basing the uniform, levelized and annualized DSIC rate on forecasted DSIC eligible capital spending will provide revenue as the spending is occurring and would correspond with the "pay as you go" method of billing for DSIC and PGW's cash flow methodology. PGW St. 2-R at 8; PGW/I&E Exh. No. 1 (Stipulation) at ¶ 1-2.

72. Levelizing and annualizing PGW's DSIC structure will: (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. PGW St. 2 at 10-11. This should result in smaller under collections which otherwise would continually have to be recovered from customers over time. PGW St. 2 at 7.

73. The first reconciliation for calendar year 2015 will include 16-months. Any under or over collection from the previous year will be calculated in an annual reconciliation based on actual billed DSIC revenues and DSIC recoverable costs during each month of the calendar year. 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.

Note that in the first year, the ‘annual’ reconciliation will have 16 months of recoverable costs due to this lag. PGW St. 2 at 12-13.

### **Quarterly Adjustments**

74. PGW expects to adjust the DSIC levels for material differences to mitigate against a material over or under collection. Tr. 56-58; PGW St. 2 at 10; PGW St. 2-R at 8.

75. During a year, PGW may (a) make changes to the construction budget for the accelerated replacement program and (b) review the annualized DSIC percentage. PGW St. 2 at 10; PGW St. 2-R at 8. That process may lead to revisions and/or quarterly adjustments to the annualized DSIC percentage. Tr. 51-52; PGW St. 2-R at 8.

76. Revisions or adjustments would be made for the difference between projected and actual billed amounts, and to recognize changes to the construction budget during the year for the accelerated replacement. PGW St. 2 at 10; PGW St. 2-R at 8.

77. PGW expects that a material difference would be triggered by an increase or decrease in its projected DISC-eligible costs of \$200,000. Tr. 56, 61-64.

### **Audit and Reconciliation**

78. PGW notes that the request for levelization and annualization will not impact the audit and reconciliation process. *See* PGW St. 2 at 11-13; PGW St. 2 at 7-11. *See* 66 Pa. C.S. § 1358(e).

79. The PUC’s Division of Audits conducts audits on the DSIC periodically, and an annual reconciliation audit is conducted to ascertain any over or under-collections. PGW St. 2-R at 7; 66 Pa. C.S. § 1358(e).

80. The actual revenue received under the DSIC for the reconciliation period is then compared to PGW's eligible DSIC revenues for that same period. The difference between actual and eligible revenue is recouped or refunded, as appropriate, in accordance with Section 1307(e) of the Code, over a one-year period commencing on April 1 of each year. PGW St. 1 at 4; PGW St. 2-R at 7-8.

81. The audit and reconciliation process work to ensure that dollars collected for cast iron main replacement are actually spent on cast iron main replacement. PGW St. 2-R at 7. While the audit and reconciliation process does not explicitly require the segregation of funds, that process works to return to ratepayers (with interest) any amounts collected that are not spent on cast iron main replacement – for some reason. PGW St. 2-R at 7-8.

82. The audit and reconciliation process does not permit any diversion of DSIC revenues for any other purpose. Tr. 52-53, 117-118; PGW St. 2-R at 7.

#### **Additional 2.5% for Reconciliation**

83. PGW proposes that the DSIC may be increased up to an additional 2.5% (from 7.5% up to 10%) in order to recover any under-collection amount from prior year(s). PGW St. 2 at 13, 14; PGW St. 2-R at 1, 5-6.

84. As proposed, the only amounts that will exceed the 7.5% level will be amounts related solely to recover under-collections for accelerated replacements made in the prior calendar year. Tr. 55; PGW St. 2-R at 5.

85. The percentage level between 7.5% and 10% is driven by the under-collections, if any, for accelerated replacements in the prior calendar year. Tr. 55. It is not related to construction in the current calendar year. Tr. 55. *See* OSBA St. 1 at 12-13; OCA St. 1 at 16-17.

86. If PGW's projected DSIC funded construction budget for a calendar year would be 7.5% of PGW's distribution revenue, then PGW would lack the ability to collect any under-collections in the next year, or it would have to reduce its DSIC-financed construction. Tr. 54; PGW St. 2 at 12.

### **PGW Budget Billing Program**

87. PGW has had a budget billing offering since before it came under PUC jurisdiction. PGW St. 2-R at 8.

88. As of October 2015, it had over 42,000 customers in its (non-payment agreement) budget billing program and as far as it knows, the program meets all PUC regulatory requirements and is adequately serving all customers who wish to avail themselves of it. PGW St. 2-R at 8.

89. PGW customers take advantage of these programs based on eligibility and need/desire. In addition, virtually all payment agreement customers are required to enroll in budget billing and remit their monthly payment agreement amount in addition to its budget billing amount. PGW St. 2 at 8-9.

90. Nothing in the record suggests that PGW's residential customers are not aware of PGW's budget billing program and/or a need to modify the budget billing program itself.

### **Projected Customer Impacts**

91. Increasing petitioner's DSIC to 7.5% (exclusive of reconciliation) will cause the average residential customer's annual bill to increase by approximately \$19.80. That annual amount equals \$1.65 per month. PGW St. 2 at 6.

92. Increasing petitioner's DSIC to 7.5% (exclusive of reconciliation) will cause the average commercial heating customer's annual bill to increase by approximately \$63.63. That annual amount equals \$5.30 per month. PGW St. 2 at 6.

93. Increasing petitioner's DSIC to 7.5% (exclusive of reconciliation) will cause the average industrial heating customer's annual bill to increase by approximately \$163.99. That annual amount equals \$13.67 per month. PGW St. 2 at 6.

94. When a customer's total bill is considered, a customer will actually see a several hundred dollar decrease in his or her bill from the time that PGW's original, 5% DSIC went into effect. PGW St. 2-R at 10.

#### **PGW's Next Base Rate Case**

95. PGW expects to file a base rate case that will go into effect in Fiscal Year 2017. PGW St. 3-R at 4.

96. As proposed, PGW's DSIC will not be reset to zero as of the effective date of new base rates. PGW St. 2 at 4. Cf. 66 Pa C.S. § 1358(b).

97. The roll-over into base rates for costs that were being collected in the DSIC but remain to be collected in base rates. See 66 Pa C.S. § 1358(b).

98. Because PGW's DSIC expenditures will be recovered in the year in which they are included in the DSIC (not considering the reconciliation of prior year costs, which will be recovered in the separate reconciliation mechanism and not in base rates), PGW will not have any costs in its DSIC that remain to be recovered in base rates. PGW St. 2 at 4.

# Appendix B

**Philadelphia Gas Works'  
Proposed Conclusions of Law**

1. The Commission has jurisdiction over the subject matter of, and the parties to, this proceeding.

2. PGW has the burden of proof in this case. 66 Pa. C.S. § 332(a). As the party seeking the grant of waivers by the Commission, PGW bears the burden of proving by a preponderance of the evidence that it is entitled to relief. The term “preponderance of the evidence” means that one party has presented evidence which is more convincing, by even the smallest amount, than the evidence presented by the other party. *Lehigh Valley Transp. Servs. v. PUC*, 56 A.3d 49, n. 6 (Pa. Commw. Ct. 2012).

3. An appropriately funded DSIC provides PGW with resources to address the problems presented by its aging distribution system in an orderly and comprehensive manner. 66 Pa. C.S. § 1353(a).

4. The Commission has statutory authority to approve a DSIC with a cap that exceeds 5% of billed revenues. 66 Pa. C.S. § 1358.

5. PGW’s proposals for a 2½ percentage point increase in the maximum allowed DSIC from 5% to 7.5% (not including reconciliation) for construction purposes, and a total, 10% cap including any reconciliation recovery, will “ensure and maintain adequate, efficient, safe, reliable and reasonable service.” *See* 66 Pa. C.S. § 1358.

6. Having satisfied the waiver standard in Act 11, PGW’s proposals for waiver of the 5% DSIC limitation should be granted. There is no requirement in Act 11 for the Commission to consider the issues raised by the other active parties. *See* 66 Pa. C.S. § 1358.

7. PGW has met its burden of proving, by a preponderance of the evidence, that its proposal for a 2½ percentage point increase in the maximum allowed DSIC from 5% to 7.5% (not including reconciliation) for construction purposes, will “ensure and maintain adequate, efficient, safe, reliable and reasonable service.” *See* 66 Pa. C.S. § 1358.

8. PGW has met its burden of proving, by a preponderance of the evidence, that its proposal for a total 10% cap, including any reconciliation recovery will “ensure and maintain adequate, efficient, safe, reliable and reasonable service.” *See* 66 Pa. C.S. § 1358.

9. The Commission has the legal authority to 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. 66 Pa. C.S. § 2212.

10. PGW has met its burden of proving, by a preponderance of the evidence, that its proposals for waivers of requirements of 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 annual, 12-month experience should be waived pursuant to the authority in Section 2212 of the Public Utility Code. *See* 66 Pa. C.S. § 2212.

11 PGW’s proposed DSIC, as modified by the terms and conditions of the Stipulation between PGW and I&E, includes and/or addresses all of the elements prescribed by Act 11, the Commission’s regulations, and the Commission’s policies for a DSIC.

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\* *See* 66 Pa. C.S. §§ 1353(b)(i)(iv), 1354(3), 1357(a)(2), 1357(b)(3) (relating to quarterly updates of the DSIC); 66 Pa. C.S. §§ 1357(a)(1)(ii), (a)(2), (b)(1); § 1358(b)(1) (relating to recovery of the fixed cost of eligible property that has been placed in service during the prior quarter); and 66 Pa. C.S. § 1358(b) (relating to the change reset).

# Appendix C

**Philadelphia Gas Works'  
Proposed Ordering Paragraphs**

**THEREFORE**

**IT IS RECOMMENDED:**

1. That the Petition Of Philadelphia Gas Works, as modified by the Stipulation between Philadelphia Gas Works and the Bureau of Investigation and Enforcement, is granted.

2. That waivers requested by Philadelphia Gas Works to waive the current DSIC cap of 5% of distribution revenues and approve: (1) a 2½ percentage point increase in the maximum allowed DSIC from 5% to 7.5% (not including reconciliation) for construction purposes; and (2) a total, 10% cap including any reconciliation recovery, both for service rendered on or after January 1, 2016, are granted and approved.

3. That waivers requested by Philadelphia Gas Works to waive or suspend the requirements of 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; are granted and approved.

4. That Philadelphia Gas Works shall place into effect a tariff supplement codifying these changes after the submission of a compliance tariff, on one day's notice.

5. That the formal Complaint filed by the Office of Consumer Advocate at Docket Number C-2015-2504092 is dismissed.

6. That the record in this case be marked closed.