

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Philadelphia Gas Works for :  
Approval of a Distribution System : Docket No. P-2015-2501500  
Improvement Charge :

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REPLY BRIEF OF THE  
OFFICE OF CONSUMER ADVOCATE

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## I. INTRODUCTION

On November 13, 2015, the parties to this proceeding filed their Main Briefs regarding Philadelphia Gas Works' (PGW or the Company) request that the Commission waive statutory requirements for Distribution System Improvement Charges (DSIC). Act 11 of the Public Utility Code requires that (1) the DSIC may not exceed 5% of amounts billed to customers for distribution service, (2) utilities be in compliance with their approved long-term infrastructure improvement plan (LTIP) in order to charge a DSIC, and (3) utilities may only charge customers for plant that is in service. 66 Pa. C.S. §§ 1358(a)(1), 1352(b), 1357(a)(ii).

PGW seeks approval to begin charging customers on January 1, 2016 an annualized amount of the total costs of improvements that it plans to make sometime during the calendar year – \$33 million or 7.36%. After the fact, PGW proposes to file and seek approval of an LTIP that supports this level of spending. If the Company does not spend as much as projected or revenue is different than what was assumed in calculating the DSIC rate, PGW will reconcile and refund the over-collection in April 2017, as long as 16 months after customers were overcharged.<sup>1</sup> Conversely, if the Company under collects, it wants authority to charge customers above 7.5%, up to 10% of a customer's distribution bill. PGW, the Bureau of Investigation & Enforcement (I&E) and the Environmental Defense Fund (EDF) argue in their Main Briefs that the Company's Petition should be approved with limited modifications and clarifications.

Through witnesses and briefs, the Office of Consumer Advocate (OCA), Office of Small Business Advocate (OSBA) and the Philadelphia Industrial and Commercial Gas Users Group (PICGUG) have demonstrated that PGW's Petition should be denied as filed. They have shown that PGW has not met the standard for waiver of the 5% DSIC cap because there are non-

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<sup>1</sup> Initially, PGW requested waiver of the statutory requirement to pay interest on over-collections but withdrew that proposal. PGW St. 2R at 3; 66 Pa. C.S. § 1358(e)(3).

ratepayer sources of funding available and because it is not reasonable or permissible for customers to pay a higher DSIC before providing support for the additional spending. The OCA, OSBA and PICGUG have shown that PGW's cash flow methodology does not legally or factually warrant an additional increase to raise the overall DSIC cap to 10%. The OCA has also shown that if the Commission waives Act 11 to allow the Company to charge an annualized, levelized DSIC rate that there should be conditions on the waiver to mitigate the harm to customers.

The OCA discussed many of the arguments forwarded by PGW (and echoed by I&E and EDF) in its Main Brief and will not repeat those arguments here. Failure to discuss a particular point or argument in this Reply Brief should not be interpreted as agreement with that point or argument. Also, the OCA will not address each separate finding of fact or conclusion of law advanced by PGW, I&E and EDF. Since many of the findings of fact or conclusions of law rest on the interpretations of the Act forwarded by those parties, each must fall as must their interpretation of Act 11. Likewise, the OCA will not address the specific tariff changes proposed in the tariff appended to PGW's Petition. To the extent they are inconsistent with the OCA's position, the proposed changes should be rejected.

## **II. REPLY ARGUMENT**

### **A. PGW Has Not Met Its Burden for Approval of the Grant of a Waiver of the 5% Cap.**

To be very clear, no party has opposed acceleration of mains replacement by PGW pursuant to an approved plan found to be reasonable, cost effective and designed to ensure and maintain efficient, safe, adequate, reliable and reasonable service to consumers. 66 Pa. C.S. § 1352(a); 52 Pa. Code §§ 121.1-121.5. That does not absolve PGW, however, of its statutory responsibility to (1) show ratepayers that there is no other reasonable source of funding to

support acceleration and (2) provide the necessary plan demonstrating, with specificity, how the incremental funds will be used to “ensure and maintain adequate, efficient, safe, reliable and reasonable service.” Id.; 66 Pa. C.S. §§ 1301, 1353(b)(3), 1358(a)(2), 1358(b); Implementation of Act 11 of 2012, 299 PUR4th 367, 390 (Pa. PUC 2012) (Final Implementation Order). The Company has failed in both regards and, therefore, not met the standard for waiver.

PGW counters that it is not required to pursue other options in order make a showing that a DSIC increase above 5% is necessary. PGW M.B. at 24-25. In the alternative, it argues that none of the alternative means of funding are viable, even those suggested by the Commission’s Staff Report and its Stratified Management Audit. PGW M.B. at 25-30. As discussed below, the other parties have provided persuasive evidence that the Company has several means available to fund some or all of the \$11 million and, moreover, that the PGW has not credibly or reasonably pursued them.<sup>2</sup>

With regard to the statutory requirement to have an approved, supporting LTIP as a precondition of recovering the incremental \$11 million through the DSIC rate, PGW makes the circuitous argument that it is possible to make a showing that DSIC funds are needed without knowing what they are needed for. The Company proposes to rectify matters after the fact by making its showing before it spends the funds. PGW M.B. at 22-23. For the ratepayers who will pay the costs up front, however, the harm is already done. They will pay higher rates before the Company’s plans have been reviewed and approved by the Commission.<sup>3</sup> The OCA will address this evidence and also explain why the proposed Stipulation with I&E does not satisfy the

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<sup>2</sup> See OCA M.B. at 9-12; OSBA Brief at 8-11; PICGUG Brief at 8-13.

<sup>3</sup> See OCA M.B. at 15-20; PICGUG Brief at 8-13.

statutory requirements for having an approved LTIP in place *before* charging a DSIC in excess of 5%. PGW M.B. at 19-22.

Finally, PGW argues that waiting for approval of an LTIP will prevent it from further accelerating main replacements. PGW M.B. at 19. The evidence shows, however, that it is unlikely that PGW can spend \$33 million in 2016 and even assuming it could, it has other means to fund further acceleration until it is permitted to raise the DSIC rate above 5%.<sup>4</sup>

### 1. Alternative Sources of Funding

PGW argues that nothing in Act 11 requires a utility to prove that it cannot fund the infrastructure improvement from its existing base rates or from other sources. It alleges that recovery of eligible costs through the DSIC “is no different than PGW recovery of eligible natural gas costs through its [Gas Cost Rate (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.” PGW M.B. at 24-25. Both arguments are incorrect.

First, the Commission has recognized the applicability of Section 1301 of the Public Utility Code to PGW’s rates and, likewise, its applicability to DSIC rates. Pa. PUC v. Philadelphia Gas Works, Docket No. R-00061931, Order at 9-10 (Sept. 28, 2007); Petition of Columbia Gas of Pa., Inc. for Approval of a DSIC, 2014 Pa. PUC LEXIS 93, \*42. Pursuant to its Policy Statement regarding ratemaking procedures and consideration for PGW, relevant factors for determining just and reasonable rate levels include “available short term borrowing capacity and internal generation of funds (IGF) to fund construction.” 52 Pa. Code § 69.2703. Thus, in order to show that a DSIC rate above 5% is “necessary” for purposes of Act 11, the

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<sup>4</sup> OCA M.B. at 9-12, 18-20; OSBA Brief at 8-11; PICGUG Brief at 8-13.

Company must demonstrate that other funding options have been explored and are not available to support the necessary construction. OCA St. 1S at 7-8; see PICGUG M.B. at 6-8.

Second, the DSIC does differ from the GCR because it was established under Act 11. Unlike Section 1307(f), which addresses gas costs not included in base rates and used to meet annual demands, Act 11 includes specific measures to limit the recovery of infrastructure costs through the DSIC. 66 Pa. C.S. §§ 1358(b)(3) (earnings cap), 1357(a)(1) (rate cap). The very fact that there is a statutory cap on the amount that can be recovered through the surcharge is an indication that the General Assembly intended for utilities to demonstrate that available sources of base rate funding were being properly utilized and that there are no reasonable alternatives to the requested waiver.<sup>5</sup> 66 Pa. C.S. § 1357(a)(1); see OSBA M.B. at 7.

PGW argues that, if the Commission does determine that other funding sources should be considered in determining whether or not to waive the 5% cap, none of the alternatives are reasonable. PGW M.B. at 25-30. To put this assertion in perspective, the OCA identified over \$23 million<sup>6</sup> in other funding sources that could be used in whole or in part instead of the \$11

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<sup>5</sup> As OSBA witness Knecht stated:

To Mr. Golden's point about the intent of Act 11, I would think that if the Legislature had intended to allow utilities to recover all infrastructure replacement costs regardless of ratepayer impact or the utility's financial condition, it would not have established restrictions on the magnitude of the DSIC charge.

OSBA St. 1S at 1.

<sup>6</sup> OCA witness Everette identified the following potential sources of funding:

In addition to a waiver of the \$18 million annual payment to the City, possible IGF to offset DSIC recovery includes the \$3.2 million annual debt service decrease from the revenue bond refunding that was completed on August 18, 2015 and the estimated \$2.2 million in annual savings, plus a one-time savings of approximately \$1.1 million, that could be generated by implementation of the recommendations identified in PGW's recent Stratified Management and Operations Audit Report.

million that the Company wants to charge customers. PGW claims, however, that none of those funds can be used to offset any part of the \$11 million that it proposes to charge ratepayers. According to the Company, all of those funds (excluding the City payment) “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.” PGW M.B. at 26.

Although the Company emphasizes its budget increases, it does recognize that there have been expense reductions and other cost savings since its last base rate case. Id.; tr. 68-70. The Company has acknowledged that there are funding sources other than a base rate increase, which it would consider if the Commission does not approve a 7.5% DSIC. OCA St. 1 at 10 (citing PGW response to OSBA I-4).

Some of those other funding sources may include reducing cash on hand by \$11 million. See PICGUG M.B. at 9-11. This option was identified in a 2015 report prepared by I&E, the Commission’s Bureau of Technical Utility Services, and the Commission’s Bureau of Audits. Inquiry into Philadelphia Gas Works’ Pipeline Replacement Program, Report at 4-7 (issued Apr. 21, 2015) (Staff Report). PGW opposes this recommendation, arguing that the Company needs to have more cash on hand at year end to maintain its current, mid-level bond rating.<sup>7</sup> PGW M.B. at 27; PGW St. 3R at 4-5. The fact is, however, that PGW is in a relatively strong financial position. OSBA St. 1 at 6. According to the Staff Report, the Company’s debt to total capital

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OCA St. 1S at 7-8 (\$18 + \$3.2 + \$2.2 = \$23.4 million). The Audit Report indicated that additional reductions in costs and increases in revenue sources within PGW resulting from implementation of the audit recommendations, which could not be quantified for purposes of the report. Stratified Management and Operations Audit, Docket No. D-2015-2468141, Audit Report at 10-11 (Oct. 22, 2015).

<sup>7</sup> On cross-examination, however, PGW witness Golden acknowledged that the report he relied on in making that claim was not specific to PGW or the gas industry. Tr. 83-84.

ratio is projected to continue to improve and its interest-coverage ratio appears well above two times, which is above the Company's 1.5-times requirement. Id.; Staff Report at 44, 49.

In fact, OSBA witness Knecht showed that the Company can "readily" finance \$11 million using internally generated funds and temporary financing mechanisms without incurring any deterioration in its financial ratios until at least FY2018. OSBA St. 1 at 4. This, too, is consistent with the Staff Report, which recommended that PGW explore issuing new debt to fund acceleration of its main replacement program. Staff Report at 44, 49-51. The Company argues that the issuance of debt would move PGW's debt to total capitalization ratios in the wrong direction. PGW M.B. at 27-28. OSBA witness Knecht rebutted this claim by evaluating the impact of his recommendations on the Company's financial ratios, which "demonstrated that the future levels remained superior to PGW's current situation." OSBA St. 1S at 3, Table Exhibit IEc-2.

Another potential source of funding is a waiver or grant back of all or a portion of PGW's \$18 million annual payment to the City of Philadelphia. OCA St. 1 at 10-11; see OCA M.B. at 10-12. In its Brief, PGW argues that there is no reason to make a formal request to the City because the City is already "aware" of and has rejected the suggestion. PGW M.B. at 30. The record shows, however, PGW witness Golden's first and only communication with the City on this matter was a phone call on the eve of hearings to a single City Deputy Director. According to Mr. Golden, the contact told him that "it would not be something they would do through the term of this Administration." Tr. 85. Mr. Golden acknowledged that a new administration will take office at the beginning of January 2016. Tr. 89. There is no reasonable basis to prejudge the new administration's decision.

PGW's final argument is that the \$18 million should not be waived by the City because it represents the only available return on the City's investment. PGW M.B. at 30. PGW says this is similar to requiring the shareholders of an investor-owned utility to expend their funds to modernize facilities without being able to receive a return on and of those funds from ratepayers.

Id. As OSBA witness Knecht pointed out, however, this "would only be comparable if the City had contributed the equity in the business." OSBA St. 1S at 11. He explained:

In my limited experience with PGW over the past 15 years, I do not believe the City has made any such equity contributions. As I demonstrated in my direct testimony, the improvement in PGW's financial condition over the past six years has resulted from ratepayer provided equity. Under the logic of Mr. Golden's statement, the City of Philadelphia would appear to demand that ratepayers provide all of the equity needed by the Company to operate in a financially prudent manner, and would then require ratepayers to pay the City a return on the equity that the ratepayers themselves have contributed.

Id.

The bottom line is that ratepayers have increased PGW's (owner's) equity by \$210 million since 2009 and are expected to increase equity by an additional \$380 million by 2021.

OSBA St. 1 at 6. Mr. Knecht explained:

Table IEC-1 also shows that the impact of the acceleration of mains replacement with the proposed DSIC changes would result in an even greater improvement in PGW's financial status. By 2021, the DSIC changes will add an additional \$67 million to city equity, further reduce the debt ratio, and further improve financial coverage ratios. From a financial perspective, the Company's proposal in this proceeding has the appearance of a program designed to benefit the shareholder, rather than an effort to sensibly finance a mains replacement program.

OSBA St. 1 at 5. For all of the reasons discussed above and in the OCA's Main Brief, the Company's position that it can bear none of the incremental infrastructure investment within current base rates – and ratepayers must fund all through an increased DSIC – is not credible or reasonable. Accordingly, PGW's request for waiver of the 5% DSIC cap should be denied.

## 2. LTIP Supporting an Incremental \$11 Million

The Company wants approval to raise rates before it has provided any specific demonstration that the proposed incremental acceleration or associated spending will “ensure and maintain adequate, efficient, safe, reliable and reasonable service.” 66 Pa. C.S. § 1358(a)(1). PGW recognizes that it is required to file a petition to modify its existing LTIP “in order to set out a plan to expend the additional dollars made available by the increase of the DSIC to 7.5%.” PGW M.B. at 20. The Company argues, however, that it can meet the statutory standard for waiving the 5% DSIC cap without filing or receiving approval of a new LTIP. For purposes of increasing the DSIC rate above 5%, PGW contends that it is only required to show that increased DSIC funding will accelerate its main replacement rates. *Id.* at 16-17, 23. Under such a standard, virtually any increase in funding could be shown to accelerate infrastructure improvements. *See* PICGUG M.B. at 6.

The Act is clear that an approved plan to accelerate infrastructure investment in a reasonable, safe and cost-effective manner is required to support recovery of costs through the DSIC. 66 Pa. C.S. §§ 1352(a)(6), 1353(a). To satisfy the statutory standard for waiver of the 5% cap, the Company must identify what “at risk” mains will be replaced with the incremental funds and tie its prioritization to maintaining adequate, efficient, safe, reliable and reasonable service. 66 Pa. C.S. §§ 1352(a)(6), 1358(a)(1); Final Implementation Order at 41. PGW has not met this standard because, *inter alia*, it has not yet identified “the types and sizes of at risk main it proposes to target with the increased revenues,” determined how it will prioritize replacements or shown how it intends to train staff and contractors “and otherwise demonstrate that it will have qualified personnel available to accomplish the accelerated main replacement” it seeks to have authorized. *See* PGW M.B. at 9-10.

The Company suggests that its existing LTIP is sufficient because it does not anticipate any “material” changes in the new LTIP. PGW M.B. at 23. In other words, the Commission must extrapolate that the information in the existing LTIP will more or less apply to the incremental \$11 million. First, whether or not the Company’s plans change materially, it has an evidentiary, statutory and regulatory burden to provide an LTIP that accounts for the incremental \$11 million in order to increase the DSIC above 5%. 66 Pa. C.S. §§ 1352, 1353, 1357; 52 Pa. Code §§ 121.1-121.5. Second, the record shows that there will be changes. The amended LTIP will be based on new benchmarking and prioritization studies and the risk assessment established in a revised Distribution Integrity Management Plan (DIMP), both of which are anticipated to be complete in the November to December 2015 timeframe. PGW St. 1R at 5-7; Tr. 40-41; OCA St. 1 at 4-5; see OCA M.B. at 17-18.

Further, according to I&E witness Cooper Smith, PGW’s current LTIP is “inaccurate, and possibly incomplete.” I&E St. 2 at 7-8. Ms. Cooper Smith testified that the LTIP “should be resolved immediately, to ensure that any additional DSIC monies are not misspent.” Id. at 8. In its Main Brief, I&E also discussed the impact of the DIMP on the amended LTIP:

I&E witness Terri C. Cooper Smith, an engineer within I&E’s Gas Safety Division, expressed multiple concerns about deficiencies in PGW’s DIMP and its impact upon any revised LTIP filed by PGW in conjunction with its Petition. As Ms. Cooper Smith explained, federal regulations require PGW’s DIMP to identify risks to its pipeline facilities and to create a plan to mitigate such risks. Ms. Cooper Smith additionally notes that PGW determines its pipeline replacements by risk and through the ranking of various type of pipeline, and then determines the pipe replacement based on the highest risk ranking. Compliance with a DIMP is necessary because the regulations were created by the Pipeline and Hazardous Materials Safety Administration to reduce reportable incidents, which include leaks from corrosion and third party damages.

According to Ms. Cooper Smith, the Gas Safety Division performed PGW’s most recent DIMP inspections on January 28, January 29, February 5, 6, and 17, 2015, and again on March 4, 2015. These inspections resulted in a finding that PGW was in violation of two Federal Regulations. As a result of its findings, the Gas

Safety Division issued a non-compliance letter to PGW on May 7, 2015 notifying PGW that it was out of compliance.

...  
Although PGW responded to the Gas Safety Division by the stated deadline, it remained non-compliant because it failed to file a revised DIMP which adequately assigns risk rankings based on available data and which documents threats to its pipeline threats. Ms. Cooper Smith further explained that because PGW's LTIP is driven by its DIMP, if PGW's DIMP remains non-compliant, it will hinder PGW's ability to conduct a successful replacement program, as the LTIP would be inaccurate or incomplete.

I&E M.B. at 18-20 (citing I&E St. 2 at 6-8) (emphasis added). For all of these reasons, PGW cannot use its existing LTIP to show that waiver of the DSIC cap is necessary.

PGW and I&E characterize filing an amended LTIP as a "timing" issue. PGW M.B. at 19-22; I&E M.B. at 21. I&E states:

In an ideal world, PGW would have presented a revised LTIP either prior to or simultaneously with its Petition, and DSIC recovery would not occur until approval of that LTIP.

I&E M.B. at 21. PGW and I&E argue that any timing issues are addressed by the Company's commitment that it will not spend any of the incremental revenues prior to approval of its amended LTIP. PGW M.B. at 22-23; I&E M.B. at 2-23. The problem is that PGW still wants to collect the incremental revenues from ratepayers prior to approval of its amended LTIP. PGW St. 1R at 6-7, 10. Until the Commission has reviewed the amended LTIP and determined that the Company's plan for the \$11 million properly prioritizes the Company's spending and establishes that PGW can safely increase construction to support its proposed acceleration, the Commission has no basis to make the finding that a waiver of the 5% DSIC cap is necessary for purposes of Section 1358(a)(1).<sup>8</sup> See OCA M.B. at 15-22. If a utility is not able to charge an

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<sup>8</sup> PGW and I&E presuppose approval of the amended LTIP but the record shows that a number of issues must be reviewed and considered. For example, PGW has actually experienced an increased incidence of leaks and breaks between 2013 and 2014, under the current LTIP. PGW St. 1 at 5-9. An engineer from the Commission's Gas Safety Division testified that PGW's current LTIP is "inaccurate, and possibly incomplete." I&E St. 2 at 7-8.

existing DSIC without an approved, supporting LTIP, under the Act, it cannot charge *an even higher* DSIC without an approved, supporting LTIP. 66 Pa. C.S. § 1352(b) (“The regulations shall ensure that a distribution system improvement charge shall terminate if the commission determines that the utility is not in compliance with the approved plan”).<sup>9</sup>

Moreover, Section 1353(a) is clear that a utility may only recover from customers “the 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). The Act’s key mechanism for ensuring that the costs are reasonable and prudent is the requirement that the costs be included in an approved LTIP. 66 Pa. C.S. § 1352(a). This requirement is not addressed by filing an LTIP after the costs are already collected in the DSIC rate.

### **3. Compliance with Act 11 Does Not Oblige PGW to Delay Further Acceleration**

PGW argues that if it has to wait until the amended LTIP is approved, it will miss the winter heating season and collect only 44% of the incremental annual revenue and be unable to accelerate main replacement in 2016. PGW M.B. at 19. To be clear, the cause of the delay is that PGW does not anticipate filing an LTIP until January of 2016. Act 11 is not a stumbling block – it is the means that PGW chose to pursue to fund additional acceleration. In a base rate case, if PGW wants to increase rates, it has to affirmatively demonstrate the reasonableness of every element of its claim to show that its proposed rates are just and reasonable *before* rates are increased. 66 Pa. C.S. § 1301; Pa. PUC v. Philadelphia Gas Works, 2001 PaPUC LEXIS 103;

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<sup>9</sup> PGW and I&E’s argument is circuitous – it is not possible to make a showing that DSIC funds are needed without knowing what they are needed for. PGW proposes to rectify this failure after the fact, by making its required showing before it spends the funds. But customers – many of whom are in deep poverty – have already paid higher rates *before* the Company’s plans were reviewed and approved by the Commission. OCA St. 1S at 11; see Tr. 60-61.

Public Advocate v. Philadelphia Gas Comm'n, 544 Pa. 129, 674 A.2d 1056 (1996); 52 Pa. Code §§ 53.52, 53.53. Likewise, in a Gas Cost Rate (GCR) case, the Company presents detailed information to the Commission to support its projections before the new GCR takes effect. 66 Pa. C.S. § 1307(f); 52 Pa. Code § 53.64. For the DSIC, utilities are required to have an approved LTIP supporting that level of spending in order for the Commission to consider recovery in rates. 66 Pa. C.S. §§ 1352, 1353.

Further, contrary to its assertion, if PGW does not collect the full \$11 million through the DSIC in 2016, that does not prevent the Company from accelerating infrastructure replacement by \$11 million through the use of other sources of funding.<sup>10</sup> PGW M.B. at 19. Moreover, as discussed in the OCA's Main Brief, there is no assurance that the entire \$11 million can be spent in the first year. The Company has recognized that there will be a ramp up period and the necessity to properly train contractors. PGW St. 1R at 2. PGW's spending reached the 5% cap in only one quarter since July 2013. OCA St. 1S at 5. Therefore, in order for PGW to spend at a level that reaches the 7.5% annualized, levelized DSIC the Company has proposed, it would have to significantly increase spending during the construction season, even beyond the difference in spending between a 5% and 7.5% DSIC. *Id.* OCA witness Everette also stated:

The most PGW has ever spent on DSIC Infrastructure in a 12 month period was \$18,536,584,<sup>11</sup> which is \$3.5 million, or 16% less than the \$22 million approved by its [current] LTIP.

OCA St. 1S at 6. In 2015, PGW only spent \$15.8 of the \$22 million that it was authorized to spend. OCA St. 1S at 4-5; PGW St. 2R at 6; Tr. 105.

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<sup>10</sup> See Section I.A.1, *supra*.

<sup>11</sup> The expenditures totaling \$18,536,584 occurred in November 2013, May 2014 and August 2014.

**4. PGW's Proposal to Increase the DSIC to 10% for Reconciliation Should Be Rejected.**

PGW also seeks approval to charge up to 10% of distribution bills, as needed, to avoid undercollections. PGW M.B. at 31-32. In its Main Brief, PGW argues that if this additional 2.5% is not allowed, PGW could be “forced to either reduce construction in a given year or not fully collect under-collections from the past year.” *Id.* at 32. First, the Company has not met the statutory standard for increasing the cap to 10% because the increase does not represent *additional* infrastructure spending. 66 Pa. C.S. § 1358(a)(1); OCA St. 1 at 16.

Second, the OCA and OSBA witnesses showed that PGW's calculations showing a historical under-collection of \$4,101,365 are not consistent with annual reconciliations the Company has filed with the Commission and, in fact, PGW over-recovered costs from July 2013 to September 2015. OCA St. 1S at 5-6; OSBA St. 1S at 12. PGW witness Dybalski confirms that the current under collection is small: “I would note that the current “e” factor to recover an under collection is *de minimus* – .30%.” PGW St. 2 at 12.

PGW counters that – if all of PGW's proposed modifications to the DSIC are adopted, PGW could no longer carry forward under-collections from a prior period and recover them in the next year. PGW M.B. at 32. One of the Company's rationales for levelizing and annualizing its rates, however, is its belief that “levelization will result in smaller under collections which otherwise would continually have to be recovered from customers over time.” PGW St. 2 at 10. Thus, undercollections have historically been small and are expected to be even smaller.

PGW also fails to note that its proposed modifications to the DSIC include the ability to adjust the DSIC rate up or down in any quarter to account for changes to its accelerated construction budget or the difference between projected and actual billed amounts, for the

purpose of mitigating over or under collections. PGW St. 2 at 10-11. Thus, the proposed, additional measure is not warranted.

For the foregoing reasons and as discussed on pages 24 to 26 of the OCA's Main Brief, PGW has not carried its burden of showing that an additional increase to the DSIC rate for reconciliation purposes is necessary or proper. The Company's proposal to increase the DSIC rate up to 10% for reconciliation should be denied.

### **5. OCA Reporting Recommendation**

In addition to conditioning waiver of the DSIC cap on the Commission's approval of an amended LTIP, the OCA recommends that the Company be required to provide quarterly reports about its training efforts, the qualifications of contractors being utilized and how those contractors are performing. OCA St. 1 at 9. The reports should also include updates regarding the condition of the three categories of mains being replaced, how leaks and broken mains are trending and how PGW explains the trends. Id. The OCA's response to the testimony by the Company's witnesses regarding these recommendations is provided in on pages 22 to 24 of the OCA's Main Brief.

PGW did not specifically address the OCA's recommendation in its Main Brief, however, the Company discusses other reporting that it proposes to provide. PGW M.B. at 40-41. The Company proposes to provide I&E, on a quarterly basis:

- (1) all quarterly reconciliation updates and shall agree to honor all appropriate requests for back-up information and
- (2) for three years, 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. Id.

Id.; PGW and I&E Exh. 1. In its future AAOPs, PGW has proposed to include information on its success in training qualified staff and contractors to satisfy the goals of its LTIP generally and the portion of its main replacement program funded by the incremental \$11 million specifically.

The OCA supports the Company's proposal to provide this information and recommends three additional requirements, consistent with its testimony. First, the information that PGW commits to provide in future AAOPs should be provided quarterly. Given PGW's proposals to increase the DSIC rate by more than 50% before the Company actually further accelerates replacement and then to nearly double its historic spending, it is appropriate for PGW to provide updates more often than once per year, particularly during the initial year. In this way, the Commission and interested parties will be able to timely identify issues.

Second, the Company should provide quarterly information about the condition of mains being replaced, how leaks and broken mains are trending and how PGW explains the trends. This information will help to address the concern that the condition of infrastructure is improving as a result of the Company's efforts. OCA St. 1 at 9.

The OCA notes that if PGW files an AAOP or LTIP that includes the required information, no report for that quarter is necessary.

**B. OCA's Recommended Conditions on Annualization and Levelization**

Section 1357(a)(1)(i) requires eligible property to be placed in service before it can be recovered in the DSIC rate. 66 Pa. C.S. § 1357(a)(1)(i). This is one of the consumer protections included in Act 11 in recognition that DSIC allows recovery without the prudence review required for other capital costs. PGW argues that waiver of this statutory provision is warranted because the "used and useful" principle is part of the rate base/rate of return construct and is not applicable to a cash flow municipal utility like PGW. PGW M.B. at 36.

As it is used in Act 11, however, the requirement that plant be in service prior to rate recovery is one of the consumer protections that accompanies DSIC recovery, like the rate cap.<sup>12</sup> If this protection is eliminated, the OCA recommends that steps should be taken to mitigate any potential harm to customers. OCA St. 1 at 12-15. Specifically, the OCA recommends that PGW (1) put accounting controls in place to ensure that DSIC revenues that are collected in advance of DSIC-eligible spending are designated for this purpose and available, (2) update the DSIC rate each quarter to reflect changes in projected construction costs and projected quarterly revenues and (3) do more to enroll customers in budget billing. *Id.*

In response to the OCA's recommendation that Company be required to update the DSIC rate each quarter to reflect changes in projections, PGW offers a compromise. PGW M.B. at 42.

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).

PGW M.B. at 42. As explained in the OCA's Main Brief, the OCA's concern was that the Company did not want any limitation on its discretion whether to make an adjustment, even if changes in projected spending or revenues met its own criteria for materiality. Tr. 56-57, 59; OCA M.B. at 30-31. The OCA submits that PGW's compromise is a reasonable one, with the expectation that in earlier quarters, the Company will elect to make adjustments to mitigate against a significant over collection.<sup>13</sup> PGW St. 2 at 10; PGW St. 2R at 8; Tr. 50-51.

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<sup>12</sup> As noted in the OCA's Main Brief, the General Assembly included the requirement that costs be incurred prior to recovery in rates in Act 11 without exception for PGW even though another provision of the Act specifically recognized PGW's unique ratemaking methodology. 66 Pa. C.S. § 1357(a)(3).

<sup>13</sup> As stated by OCA witness Everette: "PGW should not collect from ratepayers any more than it can spend in the rate period to avoid unnecessarily and unreasonably burdening customers." OCA St. 1S at 11.

In response to the OCA's recommendation that the Company do more to enroll customers in budget billing, PGW objects on the basis that the record does not suggest that customers are not aware of its budget billing program or that the program itself should be modified.

The record does support the OCA's recommendation. PGW has over 500,000 customers. Audit Report at 6. PGW identified approximately 120,000 customers, or fewer than one-quarter, on budget billing. PGW St. 2R at 8-9. While one-third of PGW's customers are considered low income, only 13% of customers are on the CRP program. Audit Report at 440. Given the number of customers whose are not choosing or required to enroll in budget billing, it is reasonable for the Company to make additional efforts to ensure that eligible customers are aware of the program and have the informed option to enroll.

PGW supports its proposal to levelize and annualize the DSIC on the argument that customers want predictable bills. OCA St. 1 at 13 (citing PGW's Waiver Petition). Likewise, I&E argues that allowing PGW to bill a flat DSIC rate each month will result in more predictable bills that are easier to understand. I&E M.B. at 29. If those are the Company's goals, then it should also make efforts to levelize the entire bill for residential customers. OCA St. 1 at 13.

Finally, increasing awareness of the budget billing option may provide some relief for customers who are paying higher winter bills and will see an increase in the DSIC charged in the winter months if the DSIC is levelized. OCA St. 1 at 13.

For each of the reasons discussed here and in the OCA's Main Brief, the OCA recommends that waivers should not be granted to allow annualization and levelization unless PGW is required to (1) designate revenues that are pre-collected from the DSIC for DSIC spending, (2) update the DSIC every quarter to ensure that the DSIC reflects the most recent

projected annual construction costs and projected quarterly revenues and (3) do more to enroll customers in budget billing. OCA M.B. at 29-32.

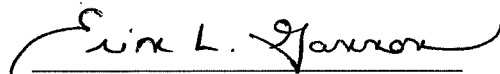
### III. CONCLUSION

For the reasons set forth above, and in the OCA's Main Brief, the OCA submits that PGW's proposed 7.5% DSIC rate should be denied as filed. The Company should be required to have an approved LTIP in place supporting incremental investment above 5% before the Commission determines whether to waive the 5% cap. PGW's proposal to increase the DSIC cap to 10% for reconciliation should be denied.

The OCA submits that if PGW is granted the necessary waivers to levelize and annualize the DSIC rate, it must be conditioned on the Company designating revenues that are pre-collected from the DSIC for DSIC spending, providing quarterly updates and engaging in additional efforts to enroll customers in budget billing. PGW should be required to pay interest on over-collections, consistent with 66 Pa. C.S. § 1358(e)(3).

Finally, the proposed tariff supplement accompanying PGW's Petition should be rejected, consistent with these recommendations.

Respectfully Submitted,



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