

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF CONSUMER ADVOCATE

555 Walnut Street, 5th Floor, Forum Place
Harrisburg, Pennsylvania 17101-1923
(717) 783-5048
800-684-6560

FAX (717) 783-7152
consumer@paoca.org

December 30, 2015

Rosemary Chiavetta, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
Harrisburg, PA 17120

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

Dear Secretary Chiavetta:

Please find enclosed for filing the Office of Consumer Advocate's Exceptions to the Recommended Decision in the above-referenced proceeding.

Copies have been served as indicated on the enclosed Certificate of Service.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Erin L. Gannon".

Erin L. Gannon
Senior Assistant Consumer Advocate
PA Attorney I.D. # 83487
E-Mail: EGannon@paoca.org

Attachment

cc: Honorable Marta Guhl
Honorable Christopher P. Pell

Certificate of Service

*215107

CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Advocate's Exceptions to the Recommended Decision in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 30th day of December 2015

SERVICE BY E-MAIL & INTER-OFFICE MAIL

Gina L. Lauffer
Carrie B. Wright
Bureau of Investigation & Enforcement
Pa Public Utility Commission
400 North Street,
Harrisburg, PA 17101

SERVICE BY EMAIL & FIRST CLASS MAIL, POSTAGE PAID

Carl Shultz, Esquire
Daniel Clearfield, Esquire
Eckert Seamans Cherin & Mellott LLC
213 Market Street 8th Floor
Harrisburg, PA 17101

Sharon Webb
Office of Small Business Advocate
Suite 202, Commerce Building
300 N. Second Street
Harrisburg, PA 17101

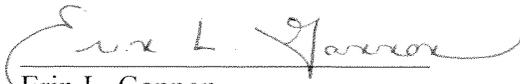
Adeolu A. Bakare, Esquire
McNees Wallace & Nurick, LLC
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166

Abby Pozefsky, Esq.
Chief Administrative Officer and
General Counsel
Philadelphia Gas Works
800 W. Montgomery Ave.
Philadelphia, PA 19122

Michael Panfil, Esquire
Environmental Defense Fund
1875 Connecticut Ave., N.W.
Washington, D.C. 20009

John Finigan, Esquire
Environmental Defense Fund
128 Winding Brook Lane
Terrace Park, OH 45174

Joseph Otis Minott, Esquire
Ernest Logan Welde, Esquire
Clean Air Council
135 S. 19th Street, Suite 300
Philadelphia, PA 19103



Erin L. Gannon
Senior Assistant Consumer Advocate
PA Attorney I.D. # 83487
E-Mail: EGannon@paoca.org

Darryl Lawrence
Senior Assistant Consumer Advocate
PA Attorney I.D. #93682
Email: DLawrence@paoca.org

215109

Counsel for
Tanya McCloskey, Acting Consumer
Advocate
Office of Consumer Advocate
555 Walnut Street, 5th Floor
Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

EXCEPTIONS OF THE
OFFICE OF CONSUMER ADVOCATE

Erin L. Gannon
Assistant Consumer Advocate
PA Attorney I.D. #83487

Counsel for:
Tanya J. McCloskey
Acting Consumer Advocate

Office of Consumer Advocate
555 Walnut Street, 5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152

DATED: December 30, 2015

TABLE OF CONTENTS

I. INTRODUCTION 1

II. EXCEPTIONS 3

OCA Exception No. 1: The ALJs Erred in Finding That PGW Met the Burden for Waiver of the 5% Cap and Increasing the DSIC Rate to 7.5%. 3

 A. Alternative Sources of Funding 4

 B. The Evidence Does Not Support a Finding That the DSIC Rate Should Be Immediately Increased to 7.5% 7

OCA Exception No. 2: The ALJs Erred in Finding That the DSIC Rate Should Be Increased to 10% for Reconciliation. 16

OCA Exception No. 3: The ALJs Erred by Not Applying the Correct Standard for Allowing PGW to Annualize and Levelize the DSIC Rate and Not Requiring PGW to Mitigate Potential Harm to Customers 18

 A. Standard for Granting Waiver 18

 B. Conditions on Granting Waiver 19

III. CONCLUSION 22

TABLE OF CITATIONS

Page(s)

Statutes

66 Pa. C.S. §§ 1350-1360 1

66 Pa. C.S. § 1352(a) 13

66 Pa. C.S. § 1352(a)(6)..... 10, 13

66 Pa. C.S. § 1352(a)(7)..... 10, 19

66 Pa. C.S. § 1352(b) 1, 9

66 Pa. C.S. § 1353(a) 12-13, 19

66 Pa. C.S. § 1356..... 15

66 Pa. C.S. § 1357(a)(1)(ii)..... 1, 18

66 Pa. C.S. § 1357(a)(3)..... 19

66 Pa. C.S. § 1358(a)(1)..... *passim*

66 Pa. C.S. § 1358(e)(3)..... 23

66 Pa. C.S. § 1359(c) 11, 13

Regulations

52 Pa. Code § 69.2703 5

52 Pa. Code § 121.2 12

52 Pa. Code § 121.5 12

Administrative Orders

Implementation of Act 11 of 2012,

Docket No. M-2012-2293611, Final Implementation Order (Aug. 2, 2012) *passim*

Other Authorities

Inquiry into Philadelphia Gas Works’ Pipeline Replacement Program,

Report (issued Apr. 21, 2015)..... 6

Stratified Management and Operations Audit,

Docket No. D-2015-2468141, Audit Report (Oct. 22, 2015) 4, 5, 7, 21

I. INTRODUCTION

Act 11 of 2012 amended Chapter 13 of Title 66 of the Public Utility Code to grant the Commission authority to allow utilities to implement a Distribution System Improvement Charge (DSIC), which permits recovery of certain reasonable and prudent capital costs incurred to repair, improve or replace eligible property. 66 Pa. C.S. §§ 1350-1360 (effective Apr. 16, 2012). Act 11 also provided several consumer protections, including the requirement that (1) the DSIC may not exceed 5% of amounts billed to customers, (2) utilities must be in compliance with their approved long-term infrastructure improvement plan (LTIIP), 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)(1)(ii).

Philadelphia Gas Works (PGW or Company) wants the Commission to waive all three of these protections. Specifically, the Company 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 LTIIP 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.¹ Conversely, if the Company under collects, it wants authority to charge customers above 7.5%, up to 10% of a customer's distribution bill.

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

¹ Initially, PGW requested waiver of paying interest on over-collections but in response to testimony opposing that proposal, it withdrew that proposal. PGW St. 2R at 3.

that PGW has not met the standard for waiver of the 5% DSIC cap because there are non-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 provisions of Act 11 to allow the Company to charge an annualized, levelized DSIC rate there should be conditions on the waiver to mitigate the harm to customers. Specifically, (1) PGW should not have unfettered discretion whether or not to make an adjustment to reduce over or under-collections each quarter, (2) any pre-collected DSIC revenue should be required to be spent on DSIC projects or returned to customers and (3) the Company should expand its efforts to enroll customers in Budget Billing to mitigate the impact of higher DSIC charges on winter bills.

On December 11, 2015, the Office of Administrative Law Judge issued the Recommended Decision (R.D.) of Administrative Law Judges Christopher P. Pell and Marta Guhl. The ALJs recommended approving PGW's requested waivers without modification. R.D. at 105-06. The ALJs also recommended that the Company make a formal request of the City of Philadelphia to waive its City fee, which would provide funds that the Company could choose to apply to additional infrastructure investment. R.D. at 106.

The OCA respectfully submits the following Exceptions to the Recommended Decision of ALJs Pell and Guhl.

II. EXCEPTIONS

OCA Exception No. 1: The ALJs Erred in Finding That PGW Met the Burden for Waiver of the 5% Cap and Increasing the DSIC Rate to 7.5%.
R.D. at 14-71; OCA M.B. at 8-24; OCA R.B. at 2-13.

The ALJs correctly determined the standard for granting a waiver of the 5% DSIC cap, which is provided in Section 1358(a)(1):

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)(1); R.D. at 15. The Commission has clarified that it will grant a waiver of the 5% cap “if necessary” to ensure and maintain safe and reliable service. Implementation of Act 11 of 2012, Docket No. M-2012-2293611, Final Implementation Order at 41 (Aug. 2, 2012) (Final Implementation Order). The ALJs further noted, correctly, that the availability of alternative sources of funding should be considered in determining whether a waiver is necessary. The ALJs stated:

The 5% DSIC cap is in place to protect customers from excessive charges. Since this provision affords utility customers protections from excessive charges, we find it reasonable that one factor to be considered when determining if granting waiver of the DSIC cap is necessary is whether or not there are other funding sources available in lieu of increasing the DSIC cap. Only by considering the availability of alternative funding sources can we ensure that utility customers are protected from excessive charges, and that a grant of the waiver is warranted.

R.D. at 16. The ALJs did not correctly apply the standard to the evidence, however, in reaching their conclusion that a waiver of the 5% cap to increase the DSIC cap to 7.5% is warranted.

PGW’s rates are already very high compared with other Pennsylvania utilities and approximately one-third of PGW’s customers are considered low income, which is nearly double the number of low income customers for the average natural gas distribution company. OCA M.B. at 12-15; OCA St. 1 at 19. The ALJs correctly rejected arguments by PGW that customers

will not be impacted by a DSIC rate increase because bills (due to lower gas costs) are expected to be lower in 2016 than in 2013.² R.D. at 57; OCA St. 1S at 11. The ALJs' conclusion that raising DSIC rates is unavoidable, however, is not correct. ALJ Pell and Guhl stated:

[C]onsidering the age of the mains that have to be replaced and the upward trend in leaks on the mains, we find that the inevitable increase that these customers will have to pay is necessary to guarantee the safety of those customers.

R.D. at 58. The record shows that it is not inevitable or necessary for customers to pay an increased DSIC rate because (1) PGW has alternative sources of funding available, (2) the Company may not be able to safely and efficiently ramp up investment by an incremental \$11 million and (3) the Company has not filed for or received approval of a Long Term Infrastructure Investment Plan (LTIP) supporting a DSIC rate higher than 5%.

A. Alternative Sources of Funding

The OCA, OSBA and PICUG identified several possible sources of internally generated funds (IGF) that could offset additional DSIC recovery. See OCA M.B. at 10-12; OCA R.B. at 4-8. The ALJs were persuaded by PGW's arguments that these funds are already being used, are needed to fund non-DSIC items, or would otherwise put PGW's financial health at risk. R.D. at 55-56. Moreover, the ALJs found that, consideration of these other funding sources would make the DSIC review a "full rate case analysis." Id.

² PGW also argued that customers in "deep poverty" will not see any increase from the DSIC because they will likely be enrolled in the Company's CRP program, in which customers pay a fixed rate based on their income rather than on the actual level of the bill. PGW R.B. at 19. According to the Company's recent audit report, however, while one-third of PGW's customers are considered low income, only 13% of customers are on the CRP program. Stratified Management and Operations Audit, Docket No. D-2015-2468141, Report at 440 (Oct. 22, 2015) (Audit Report); OCA R.B. at 18.

Moreover, the Company ignores that PGW's non-CRP customers pay the portion of the actual bill that CRP customers do not pay, which means that non-CRP customers will pay the DSIC increase that is not paid for by CRP customers. Audit Report at 441. Thus, low income customers who are not enrolled in CRP and all non-CRP customers will pay the DSIC rate increase and the impact on their bills is greater than PGW calculates.

First, consideration of alternative sources of funding does not turn the DSIC review into a base rate review. Indeed, the Commission determines whether PGW's DSIC should be reset to zero in a given quarter based on its review of PGW's rate levels and financial condition pursuant to the standards set forth in its policy statement at 52 Pa. Code § 69.2703. Final Implementation Order at 43. Pursuant to the policy statement, relevant factors include internal generation of funds (IGF) to fund construction. It is entirely consistent with Commission policy and Orders, thus, for other sources of funding to be considered before charging ratepayers a 7.5% DSIC. As the ALJs correctly concluded on page 16 of the Recommended Decision, it is not possible to determine whether a waiver of the 5% cap is warranted unless the availability of alternative funding sources is considered.

Second, the OCA identified over \$23 million in non-DSIC funding sources that could be used in whole or in part for infrastructure repair and replacement rather than increasing rates by another \$11 million as proposed by PGW. OCA St. 1S at 7-8. The evidence does not support the ALJs conclusion that \$0 are available to offset the proposed DSIC rate increase.

For example, the record shows that, on August 18, 2015, PGW completed a revenue bond refunding that decreases the Company's annual debt service by \$3.2 million. OCA St. 1 at 10 (citing OCA-I-12). Auditors identified an 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.³ OCA St. 1S at 7-8. According to the Company, all of those funds "are already spoken for and are being utilized to pay for increases in the remainder of PGW's operating construction

³ The Audit Report indicated that additional reductions in costs and increases in revenue sources exist 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).

budgets and other expense hikes.” PGW M.B. at 26 (citing Tr. 68). 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 also acknowledges 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. 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). The ALJs, however, accepted PGW’s argument that reducing cash on hand would increase the Company’s risk. R.D. at 70. Similarly, the ALJs accepted the Company’s claim that short-term financing is not a possible source to fund incremental infrastructure investment because it would reduce its liquidity. R.D. at 71. The record shows, however, that PGW is in a relatively strong financial position. See OCA M.B. at 6-7; OSBA St. 1 at 6. According to the Staff Report, the Company’s debt to total capital 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.

With regard to a possible waiver or grant back of all or a portion of PGW’s \$18 million annual payment to the City of Philadelphia, the ALJs state that they “do not believe that having the Company make a formal request for the City to waive the \$18 million payment will have any affect and there is nothing that we can do to force the City’s hand in this matter.” R.D. at 70-71. The record shows, however, that there is no reasonable basis to prejudge the City’s response to a

formal request because a new administration will take office at the beginning of January 2016. Tr. 85, 89. The Company acknowledges that the City has granted back the payment in 2004, 2005, 2006, 2007, 2008, 2009 and 2010. PGW St. 3R at 10; OCA St. 1S at 8. The record also shows that the Company has yet to make a formal request.⁴ Tr. 85.

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. OCA R.B. at 8 (citing OSBA St. 1 at 5-6). The Company's service territory has the highest percentage of households in "deep poverty" of any large city in the United States. OCA St. 1 at 19. Yet, PGW has turned to ratepayers as the first and only source of funding and sought waiver of protections afforded them by Act 11. For all of the reasons discussed above and in the OCA's briefs, the ALJs' conclusion that the Company can bear none of the incremental infrastructure investment within current base rates – and ratepayers must fund 100% through an increased DSIC – is not reasonable or supported by the evidence. Accordingly, the OCA submits that the Commission should deny PGW's request for waiver and approval to increase the DSIC cap to 7.5%.

B. The Evidence Does Not Support a Finding That the DSIC Rate Should Be Immediately Increased to 7.5%.

1. The ALJs Failed to Consider Evidence Showing PGW May Not Be Able to Safely Ramp Up By an Incremental \$11 Million.

The ALJs state that increasing the cap to 7.5% will "allow the Company an opportunity to ensure that it can properly spend the additional \$11 million in DSIC funds in a manner that is

⁴ The OCA notes that the ALJs "encouraged" PGW to make ongoing, formal requests to the City to waive the Company's \$18 million payment. R.D. at 57, 106. The ALJs state that "[s]hould the City grant the request, PGW can use additional funds to further expedite main replacement." *Id.* at 57. The ALJs fail to direct the Company to reduce the DSIC rate if the waiver is granted, however, despite the fact that \$18 million would eliminate the need for a DSIC rate increase for almost two years. Moreover, as discussed in the following Section and in the OCA's Briefs, the Company is not even sure it can safely and efficiently spend an incremental \$11 million - let alone additional amounts.

both prudent and cost effective.” R.D. at 70. The ALJs fail to recognize that PGW seeks approval, not only to raise the cap, but to *immediately* increase the DSIC rate to recover an additional \$11 million annually.⁵ PGW St. 2 at 8. There will, therefore, be no opportunity to ensure that PGW will cost-effectively and prudently accelerate infrastructure investment before it begins charging ratepayers a 7.5% DSIC rate.

The ALJs appear to conclude that it is unlikely that PGW could *not* spend the additional money on infrastructure because their current replacement rate is slower than other utilities. R.D. at 54, 58. The record shows, however, that the most PGW has spent on DSIC-eligible infrastructure projects in a 12-month period to-date is \$18.5 million, nearly half of the \$33 million it proposes to spend in 2016. OCA St. 1S at 5-6. The Company has identified its own concerns with increasing the level of main replacements: the effect on commerce, traffic congestion and noise, and the availability of qualified contractors to perform the work. OCA St. 1 at 6 (citing PGW St. 1 at 14-15). With regard to contractors, OCA witness Everette noted that the Company’s service territory is within close proximity to PECO, PSE&G and South Jersey Gas. Each of those large natural gas utilities is accelerating infrastructure replacement and is in competition with PGW for qualified contractors. OCA St. 1 at 8. The same is true for neighboring water and wastewater utilities that are accelerating infrastructure investment, *e.g.*, Philadelphia Water Department, Aqua Pennsylvania.

Thus, contrary to the conclusion reached by the ALJs, it is *not* a foregone conclusion that PGW will be able to safely ramp up its infrastructure replacement by \$11 million.

⁵ As discussed in OCA Exception No. 3, *infra*, Company proposes to “set the DSIC on an annualized basis to recover the eligible costs incurred as part of the accelerated replacement program of \$33 million, using a levelized charge each month, instead of being reimbursed based on a calculation of actual costs for eligible property placed in service in the previous quarter.” PGW St. 2 at 8.

2. Act 11 and Commission Regulations Do Not Allow PGW to Increase the DSIC Rate to 7.5% without a Revised LTIIIP Supporting the Incremental Spending.

Along the same lines, the ALJs conclude that justifying a 7.5% DSIC rate and an incremental \$11 million in spending would be “helpful,” they do not interpret the lack of a revised LTIIIP to be “fatal” to PGW’s request for waiver of the 5% cap and increase to 7.5%.

R.D. at 54-55, 71. The ALJs state:

Although it would certainly be helpful to justify additional collections and expenditures, the Code does not specifically require the utility to submit a revised LTIIIP before requesting a waiver. In this instance, we will not infer such a requirement. Considering that PGW’s current LTIIIP indicates that it will take PGW 86 years to complete gas main replacement in Philadelphia, we are fairly certain that PGW will be able to demonstrate how it specifically plans to spend an additional \$11 million per year in mains replacement.

R.D. at 54-55. The ALJs are correct, that Section 1358(a)(1) does not specifically state that a revised, supporting LTIIIP be reviewed and approved prior to requesting a waiver of the DSIC rate cap. The OCA submits, however, that for all provisions of Act 11 to be given effect, a supporting LTIIIP is required.

First, if a utility is not able to charge an existing DSIC without an approved, supporting LTIIIP, under the Act, it cannot charge *an even higher* DSIC without an approved, supporting LTIIIP. 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”).

Second, the revised LTIIIP is part of the demonstration of necessity of the waiver under Section 1358(a)(1). The Commission cannot determine whether the incremental DSIC revenue is necessary for purposes of granting a waiver of the statutory 5% DSIC cap if PGW does not demonstrate that its specific plan for use of the proposed funds will “ensure and maintain

adequate, efficient, safe, reliable and reasonable service.”⁶ 66 Pa. C.S. § 1358(a)(1). The Company does not propose to provide its specific plan until it files an amended LTIP, which may not be until fifteen (15) days after the entry of the Commission’s Order. R.D. at 106; PGW St. 1R at 5-6. Only after the Commission has determined that the plan for spending an additional \$11 million meets the requirements of Act 11 will it know whether funding of the plan is necessary to meet the statutory requirement for waiver.⁷ The Commission and interested parties,

⁶ The purpose of the DSIC is not to accelerate for acceleration’s sake. Tr. 103-04. If it were, virtually any increase in funding could be shown to accelerate infrastructure improvements. See PICGUG M.B. at 6. The Company bears the burden of providing its specific plan for use of the additional funds, which is not satisfied by the mere assertion that more pipe will be replaced faster. OCA witness Everette stated:

It is inappropriate to collect surcharge revenues from ratepayers with neither a plan nor approval in place to ensure that the additional spending will be cost-effective, prudent and safely performed. PGW should not be permitted to increase the DSIC rate prior to approval of an LTIP that shows how the increased revenues will be spent.

...

The LTIP is necessary to properly prioritize the Company’s spending and to establish that PGW can safely increase construction to support its proposed spending increase.

OCA St. 1S at 2-3; Tr. 104. *Inter alia*, PGW 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 demonstrated 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.

⁷ The standards for approval of an LTIP and waiving the 5% DSIC cap are the same. Section 1352 requires an LTIP to show:

(6) The manner in which the replacement of aging infrastructure will be accelerated and how the repair, improvement or replacement will ensure and maintain adequate, efficient, safe, reliable and reasonable service.

(7) If the plan is not adequate and sufficient to ensure and maintain adequate, efficient, safe, reliable and reasonable service, the commission shall order a new or revised plan.

66 Pa. C.S. § 1352(a)(6), (7). Likewise, Section 1358(a)(1) provides:

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)(1).

therefore, should have the benefit of knowing how the Company proposes to expend an additional \$11 million *before* PGW is permitted to increase the DSIC rate.

Third, Act 11 precludes recovery of costs for projects that were not performed by qualified contractors.⁸ 66 Pa. C.S. § 1359(c). Section 1359(c) dictates that costs are not eligible for recovery in the DSIC rate unless they are performed or inspected by qualified employees or contractors. By PGW's admission, however, the Company will not make this demonstration until it files a revised LTIP.⁹ If the Commission adopts the ALJs' recommendation, the revised LTIP will not be filed until after the fact. Note that, unlike other utilities, PGW proposes to charge customers *before* it performs the projects funded by the incremental \$11 million. Thus, in order to reconcile Sections 1358(a)(1) and 1359(c), the only means to protect customers from pre-paying the costs of future projects that are not performed by qualified contractors is for the Commission to review the Company's revised LTIP *before* allowing a waiver and DSIC rate increase.

Finally, the Commission's regulations regarding LTIPs *require* utilities to have a supporting, approved LTIP in place as a condition of DSIC recovery. 52 Pa. Code § 121.

⁸ Section 1359(c) of Act 11 provides:

Work on projects to repair, improve or replace eligible property that is not performed by qualified employees or contractors or inspected by the utility's qualified personnel shall not be eligible for recovery of a distribution system improvement charge.

66 Pa. C.S. § 1359(c).

⁹ PGW witness Murray recognized that there may be changes to its existing workforce management plans and training programs necessitated by the increased DSIC spending. PGW St. 1R at 8. He stated:

The revised LTIP will show how the additional workload proposed by accelerated replacement is achievable. The revised LTIP will include provisions for the use of staff and/or subcontractor crews to perform main replacements and will explain how PGW will be able to increase spending to the proposed level...

Id.

Subsection 121.2 defines a “major modification” to the LTIP as one that increases the total estimated cost of the LTIP by more than 20%. 52 Pa. Code § 121.2, 121.5. PGW proposes to increase the cost of its LTIP by 50%. Accordingly, the Company must have an approved LTIP that supports a \$33 million spending plan *before* it can charge customers a 7.5% DSIC rate.

The ALJs appear to accept the premise that the Company’s existing LTIP is sufficient, until a revised LTIP is submitted for review. R.D. at 71. By this reasoning, the Commission must extrapolate that the information in the existing LTIP will more or less apply to the incremental \$11 million. This fails to consider that the revised plan will be based on new benchmarking and prioritization studies and the risk assessment established in a revised Distribution Integrity Management Plan (DIMP). PGW St. 1R at 5-7; Tr. 40-41; OCA St. 1 at 4-5; see OCA M.B. at 17-18.

I&E witness Cooper Smith echoed the OCA’s concerns regarding PGW’s current LTIP, which she stated is “most likely inaccurate and, at best, incomplete.” I&E St. 2 at 7. Ms. Cooper Smith stated that a revised DIMP is needed that adequately assigns risk rankings based on available data and documents threats to its pipeline. Id. at 6-8. Because it is not informed by a revised, compliant DIMP, Ms. Cooper Smith stated that PGW’s LTIP could lead to exorbitant expenditures for pipe replacement and fail to reduce risk and increase public safety as expected of the mitigation plan. I&E St. 2 at 8. I&E witness Cooper Smith emphasized the importance of updating the DIMP and LTIP before the Company misspends funds; however, her testimony also provides further support for the OCA’s point – that the existing LTIP cannot support recovery of an incremental \$11 million from ratepayers.

Act 11 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); see also 66 Pa. C.S. §§ 1352(a)(6), 1353(a), 1358(a)(1), 1359(c). 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); Final Implementation Order at 41. This requirement is not addressed by filing an LTIP after the costs are already collected in the DSIC rate. PGW’s requested waiver of the 5% DSIC cap and immediate increase to 7.5% should be denied.

3. Approval to Charge More Than a 5% DSIC Should Not be Permitted, Until a Supporting LTIP Is Approved – Even If the Commission Approves a Waiver Now.

While the ALJs recognize that PGW’s failure to file to submit a revised LTIP before increasing the DSIC rate charged to customers is not “ideal,” they do not recommend delaying approval of the DSIC waiver and increase until that filing is made and considered. R.D. at 53-54, 70. The ALJs rely on PGW’s proposal 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. As discussed in the prior section, it is inconsistent with the Act for customers – many of whom are in deep poverty – to pay higher rates before it is determined whether the Company’s additional \$11 million spending is possible, prudent, cost-effective and safely performed. OCA St. 1S at 11; see Tr. 60-61.

Waiting to increase the DSIC rate above 5% does not prevent PGW from accelerating infrastructure replacement in 2016. The OCA has shown that the Company can spend more dollars on infrastructure improvement through the use of non-DSIC sources of funding. PGW M.B. at 19. The evidence also shows that more dollars are available within the current 5% DSIC

because PGW historically has not spent the full \$22 million supported by its current LTIP.¹⁰ See Section I.A, *supra*; OCA St. 1S at 6. The evidence also casts doubt on whether PGW even *could* spend the entire \$11 million 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.

Thus, for all of the reasons discussed here and in the prior sections, even if the Commission determines that PGW has met the standards for granting a waiver of the 5% cap, the Company should not be permitted to charge more than 5% until an LTIP showing PGW's ability and specific plan for cost-effectively and safely spending the incremental amount is filed and approved.

4. The Commission Should Require Quarterly Reports Showing That Accelerated Work Is Being Performed Safely and Effectively.

On pages 67 to 69 of the Recommended Decision, the ALJs summarize the OCA's recommendation that the PGW 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 submits that this information will help to address the concern that acceleration is being performed by qualified personnel and that the condition of infrastructure is improving as a result of the Company's efforts. See OCA M.B. at 22-24; OCA St. 1at 9.

The ALJs did not adopt the OCA's recommendation but provide no discussion of this point. In the summary of the OCA's position, however, the ALJs mention PGW's argument that similar reporting requirements have not been placed on any other gas or electric utility with a

¹⁰ The most PGW has ever spent on DSIC Infrastructure in a 12-month period is \$18,536,584. In 2015, PGW only spent \$15.8 million. OCA St. 1S at 4-5; PGW St. 2R at 6; Tr. 105. PGW's spending reached the 5% cap in only one quarter since July 2013. OCA St. 1S at 5.

DSIC. R.D. at 68; PGW St. 1R at 9-10. As explained by OCA witness Everette, however, no other utility with a DSIC has proposed such fundamental changes to the operation of the Act 11

DSIC. OCA St. 1S at 4. She stated:

As noted in my direct testimony, PGW itself has expressed concern over its ability to retain sufficient qualified contractors to complete projects at the proposed level of spending. Accompanied with the fact that the incidence of leaks has not improved since the implementation of the DSIC, it is appropriate for the Company to evaluate and report on the performance of its contractors as well as on the progress of main replacement and leak trends. PGW's reference to other gas and electric utilities is not relevant because no other gas or electric utility has received approval to increase the DSIC rate to 7.5%, particularly under the circumstances previously described. Nor has any other utility sought to recover costs before plant is in service. Nor has any other utility proposed to increase DSIC recovery by one-half on the first day of its increased DSIC. The other utilities ramp up their spending and recovery, which gradually increases their DSIC rate. Because of PGW's levelization proposal, the DSIC rate will increase by one-half on the first day.

OCA St. 1S at 4.

PGW also opposed the OCA's reporting requirement on the basis that the reports will not be useful because the Annual Asset Optimization Plan "should provide all the relevant information for the Commission and other parties to evaluate whether PGW is on track with plans to attract and train qualified operators, etc." PGW St. 1R at 9-10. Review of PGW's 2014 and 2015 AAOPs shows, however, that the reports address only the categories of main replacements. OCA St. 1S at 4-5. Although PGW has stipulated that, going forward, it will include some information on training and qualifications (PGW and I&E Exh. 1), it makes no commitment that its future AAOPs will include information about how leaks and breaks are trending and how PGW explains the trends.

The OCA also pointed out that asset optimization plans are required only once per year. 66 Pa. C.S. § 1356. 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, interested parties will be able to timely identify issues.

Accordingly, the OCA requests that the Commission adopt its proposed reporting requirements if it allows PGW to increase its DSIC rate above 5% and recover costs before plant is in service. Specifically, the Company should be required to provide regular reports about its training efforts, the qualifications of contractors being utilized and how those contractors are performing, as well as updates on the condition of the three categories of mains being replaced, how leaks are trending and how PGW explains the trends. If PGW files an AAOP or LTIIP that includes the required information, the OCA submits that no report for that quarter is necessary.

OCA Exception No. 2: The ALJs Erred in Finding That the DSIC Rate Should Be Increased to 10% for Reconciliation.
R.D. at 72-80; OCA M.B. at 24-26; OCA R.B. at 14-16.

The ALJs recommendation to allow PGW to increase its DSIC rate to 10% inclusive of reconciliation should be denied because it is not supported by the evidence. The ALJs based their decision on PGW's claim that, without the additional 2.5%, undercollections would force the Company to reduce its construction budget below \$33 million. In addition, while the ALJs recognize that the annualization and levelization will reduce under collections, they recommend allowing the additional 2.5% to eliminate all risk that there will be undercollection.

The standard for increasing the DSIC rate above the statutory 5% cap, however, is whether it is "necessary" to ensure safe, adequate and reasonable service. 66 Pa. C.S. § 1358(a)(1). It is not "necessary" for purposes of Section 1358(a)(1) for PGW to eliminate 100% of its risk simply because it uses cash flow ratemaking. The Company has already proposed – and the ALJs recommend adopting – other mechanisms to reduce PGW's risk. R.D. at 105-06;

PGW St. 2 at 10-12. First, PGW proposes to annualize and levelize the DSIC rate. Company witness Dybalski stated: “PGW believes that levelization will result in smaller under collections which otherwise would continually have to be recovered from customers over time.” *Id.* at 11. Second, PGW proposes 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, to mitigate over or under collections. PGW St. 2 at 10-11. It is unreasonable to give PGW additional preferred treatment compared to rate base/rate of return utilities. Ms. Everette explained:

every other utility that has a DSIC at 5% or 7.5% manages its over and under-collections within that threshold, *i.e.* the cap is inclusive of over and under-collections. Unlike other proposals by PGW that are directly and narrowly tied to its unique situation, all utilities are subject to reconciliation of their DSIC recovery. All utilities have seasonal usage variations and have seasonal limitations on construction. PGW has proposed other mechanisms to avoid significant DSIC rate fluctuations inherent in its cash-basis DSIC – levelization/annualization and the ability to mitigate under and over collections by adjusting the DSIC rate in any quarter. No other utilities will have those benefits because they cannot waive the requirements of Act 11. It is unnecessary to also allow PGW an additional 2.5% increase.

OCA St. 1 at 16-17.

The OCA and OSBA witnesses showed that PGW’s undercollections have historically been small and are expected to be even smaller.¹¹ 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. The Company’s own testimony, thus, shows the lack of “necessity” for a further 2.5% increase in the DSIC rate cap. The harm of increasing the DSIC rate by up to 2.5%, *double* the current maximum DSIC rate, far outweighs the benefit of avoiding “*de minimus*” undercollections. See

¹¹ OSBA witness Knecht showed that, in fact, PGW over-recovered costs from July 2013 to September 2015. OSBA St. 1S at 12.

OCA St. 1 at 17 (citing PGW St. 2 at 12). The ALJs recommendation should be reversed; PGW should not be permitted to increase the DSIC rate by 2.5% for the purpose of avoiding undercollection.

OCA Exception No. 3: The ALJs Erred by Not Applying the Correct Standard for Allowing PGW to Annualize and Levelize the DSIC Rate and Not Requiring PGW to Mitigate Potential Harm to Customers.
R.D. at 80-103; OCA M.B. at 27-32; OCA R.B. at 16-19.

Section § 1357 provides that the DSIC shall be calculated to recover only the costs of eligible property that has:

Been placed in service during the three-month period ending one month prior to the effective date of the distribution improvement system charge.

66 Pa. C.S. § 1357(a)(1)(ii). PGW asks the Commission to waive this statutory requirement so that PGW can annualize and levelize the DSIC rate. PGW St. 2 at 6. Specifically, the Company proposes to “set the DSIC on an annualized basis to recover the eligible costs incurred as part of the accelerated replacement program of \$33 million, using a levelized charge each month, instead of being reimbursed based on a calculation of actual costs for eligible property placed in service in the previous quarter.” PGW St. 2 at 8.

The OCA submits that the ALJs did not apply the correct standard in determining whether or not to grant the waiver and that, if granted, the waiver should be conditioned on the Company taking additional steps to mitigate potential harm to customers.

A. Standard for Granting Waiver

The ALJs determined that PGW met the standard for waiving the requirements of the Act by showing that waiver is in the public interest and will result in just and reasonable rates. R.D. at 80-81. The OCA agrees that this standard applies but submits that the means to establish whether this standard has been met for a waiver of Act 11 is to show that the waiver will ensure

and maintain adequate, efficient, safe, reliable and reasonable service. This is the showing that Section 1358(a)(1) requires for waiver of the 5% DSIC cap and it appears three times in Act 11, which indicates its importance. 66 Pa. C.S. §§ 1352(a)(7), 1353(a), 1358(a)(1).

B. Conditions on Granting Waiver

The requirement that eligible property to be placed in service before it can be recovered in the DSIC rate is one of the consumer protections that accompany DSIC recovery, like the rate cap.¹² 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.* at 14-15.

The ALJs did not require PGW to fulfill these conditions in order to charge customers for plant investment that – absent a waiver – would not yet be eligible for DSIC recovery. 66 Pa. C.S. § 1358(a)(1); R.D. at 102-03. The ALJs determined that PGW’s proposal “will not allow for diversion of DSIC revenues for another purpose.” They reasoned that the requirement to refund DSIC revenues with interest and the filing of quarterly billing and spending reports are sufficient to hold PGW accountable. R.D. at 102. The problem is that, simply tracking the dollars is not sufficient. As a cash flow company, if PGW is not required to designate the dollars collected through the DSIC for future DSIC spending or refund, nothing prevents the utility from

¹² 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).

diverting the amounts for other purposes and seeking relief from the Commission to address the shortfall.

The OCA's second concern with PGW's annualization and levelization proposal is 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. OCA R.B. at 17; Tr. 56-57, 59; OCA M.B. at 30-31. PGW offered a compromise in its Main Brief. 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. 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.¹³ PGW St. 2 at 10; PGW St. 2R at 8; Tr. 51-52.

The ALJs seem to agree with this compromise. They state:

We also find that PGW's proposal, to make adjustments to the DSIC when there are material differences between projected and actual billed amounts or when there are material changes to the construction budget during the year for the accelerated replacement, to be reasonable. Utilizing the 2% is consistent with Commission regulations regarding known and measurable changes in gas costs during the effective period of an annual levelized rate previously approved by the Commission, and provides a suitable guideline in this instance. Moreover, we agree that the DSIC should remain relatively level throughout the year in order to pass costs equally to all customers.

R.D. at 102 (footnotes omitted). Yet, the ALJs recommend that the Company's request for levelization/annualization be implemented "as proposed in its Petition." R.D. at 103. The OCA submits that, instead, the Commission should adopt PGW's modification to its proposal, that the

¹³ 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.

Company will adjust the DSIC percentage by October 1 if projected total billings and expenditures for the remainder of the year indicated that a material (plus or minus 2%) over or undercollection is likely to develop.

With regard to the OCA's recommendation that the Company do more to enroll customers in budget billing, the ALJs recognized that less than 25% of PGW's customers are currently enrolled in budget billing and that a high number of customers are low income, but found no evidence to show that the Company's remaining customers are not aware of the Budget Billing program. R.D. at 102-03; PGW St. 2R at 8-9. They also state that the OCA did not quantify the number of customers who are not choosing or not required to enroll in budget billing. R.D. at 103. First, the record contains all the necessary information to quantify this number. PGW has approximately 475,000 residential customers. Audit Report at 389. More than seventy-five percent of those customers are not enrolled in budget billing. PGW St. No. 2-R, at 8-9. That equates to approximately 355,000 residential customers. Given the large percentage of residential customers who 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.

Moreover, 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. It will further those goals if the Company makes efforts to levelize the entire bill for residential customers, not just the surcharge percentage. OCA St. 1 at 13. Charging a flat DSIC *rate*, however, does not translate into a flat or more predictable *bill*.

The record shows that even if the DSIC rate is levelized, customers who pay higher bills in the winter, *i.e.* are not on budget billing or the CRP program, will see an increase in the DSIC amount charged in the winter months.¹⁴ OCA St. 1 at 13. Increasing awareness of the budget billing option may provide some relief for these customers. Accordingly, the OCA recommends that the Commission adopt the OCA's recommendation and require PGW to do more to enroll customers in budget billing.

In summary, for each of the reasons discussed here and in the OCA's briefs, 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) adjust the DSIC percentage by October 1 if projected total billings and expenditures for the remainder of the year indicated that a material (plus or minus 2%, approximately \$600,000) over or undercollection is likely to develop and will also consider making adjustments in earlier quarters and (3) do more to enroll customers in budget billing.

III. CONCLUSION

For the reasons set forth above, and in the OCA's Main and Reply Briefs, the OCA respectfully submits that the ALJs erred in their recommendation to approve PGW's proposed waiver petition as proposed. The OCA submits that the Company should have an approved LTIP in place supporting incremental investment above 5% before the Commission determines whether to waive the 5% cap and that PGW's proposal to increase the DSIC cap to 10% for reconciliation should be denied. If the Commission allows PGW to increase its DSIC rate above 5% and recover costs before plant is in service, the OCA submits that the Commission should

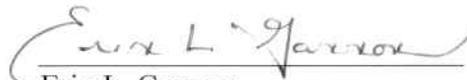
¹⁴ The 7.5% rate applied to a variable monthly distribution bill still results in a varying final bill. For example, 7.5% times a \$100 winter distribution bill results in a \$7.50 additional charge while 7.5% times a \$25 summer distribution bill results in a \$1.87 additional charge.

require regular reports about PGW's training efforts, the qualifications of contractors being utilized and how those contractors are performing, updates on the condition of the three categories of mains being replaced, how leaks are trending and how PGW explains the trends.

The OCA also submits that if PGW is granted the necessary waivers to levelize and annualize the DSIC rate, the Commission should condition approval on the Company designating revenues that are pre-collected from the DSIC for DSIC spending, adjusting the DSIC percentage for material (plus or minus 2%) over or undercollections 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 OCA submits that the proposed tariff supplement accompanying PGW's Petition should be rejected, consistent with the OCA's recommendations.

Respectfully Submitted,



Erin L. Gannon
Senior Assistant Consumer Advocate
PA Attorney ID No. 83487
Email: EGannon@paoca.org

Counsel for:
Tanya J. McCloskey
Acting Consumer Advocate

Office of Consumer Advocate
555 Walnut Street, 5th Floor
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152
Dated: December 30, 2015
215069