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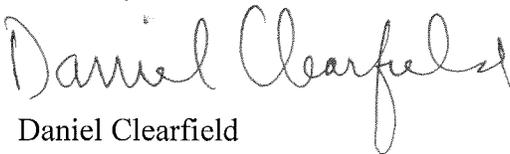
Rosemary Chiavetta, Secretary
PA Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Petition of Philadelphia Gas Works for Waiver of Provisions of Act 11 to Increase the Distribution System Improvement Charge Cap and to Permit Levelization of DSIC Charges, Docket No. P-2015-2501500

Dear Secretary Chiavetta:

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

Sincerely,



Daniel Clearfield

DC/lww
Enclosure

cc: Hon. Christopher P. Pell w/enc.
Hon. Marta Guhl, w/enc.
Cert. of Service w/enc.
Office of Special Assistants w/enc. (ra-OSA@pa.gov)

CERTIFICATE OF SERVICE

I hereby certify that this day I served a copy of PGW's Reply Exceptions upon the persons listed below in the manner indicated in accordance with the requirements of 52 Pa. Code Section 1.54.

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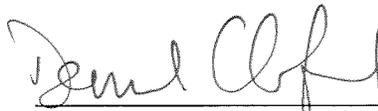
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Dated: January 11, 2016



Daniel Clearfield, Esq.

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Petition of Philadelphia Gas Works for Waiver :
of Provisions of Act 11 to Increase the : Docket No. P-2015-2501500
Distribution System Improvement Charge CAP :
and to Permit Levelization of DSIC Charges :

**REPLY EXCEPTIONS OF
PHILADELPHIA GAS WORKS**

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I. INTRODUCTION

Philadelphia Gas Works (“PGW” or “Company”) files these Reply Exceptions in response to the Exceptions filed by the Office of Consumer Advocate (“OCA”) and a group of six commercial customers (Philadelphia Industrial and Commercial Gas Users Group, known as “PICGUG”). The OCA and PICGUG are the only parties that continue to express opposition to PGW’s proposal to, *inter alia*, increase PGW’s Distribution System Improvement Charge (“DSIC”) by just \$11 million a year or about 1.6% of PGW’s intrastate revenues, and levelize and annualize its DSIC charge.¹ The Office of Small Business Advocate (“OSBA”) – that initially opposed PGW’s proposal – did not file Exceptions to the Recommended Decision issued by Administrative Law Judges Christopher P. Pell and Marta Guhl (“ALJs”) on December 7, 2015.

In a thoughtful and comprehensive opinion, the Recommended Decision recommended approval of PGW’s request to increase its DSIC charge to 7.5% (not including reconciliation), approved a total 10% cap including any reconciliation recovery, for service rendered on or after January 1, 2016,² and, using the Commission’s authority in Section 2212(b) of the Public Utility Code, waived the requirements of Act 11 of 2012 (“Act 11”) so as to permit PGW to use an annualized, levelized charge as the basis for establishing a DSIC, subject to subsequent true-up for PGW’s actual experience. It also authorized the filing, on one day’s notice, of a PGW tariff supplement codifying these changes.

¹ PGW Petition at 14. PGW’s total revenues, in Fiscal Year 2014, was \$759,136,000. *See* PGW’s Final Stratified Management and Operations Report, Docket No. D-2015-2468141 (dated August 2015) at Exh. V-3.

² PGW is proposing that the Commission approve the above-described changes to PGW’s DSIC in an expedited manner so that the charge becomes effective as soon as possible after the Commission approves PGW’s Petition. If the PUC adopts the Recommended Decision (“RD”) at its January 28 Public Meeting, PGW would file its compliance filing the next day, January 29, and seek authority to begin billing the higher DSIC percentage on and after February 1, 2016.

The Exceptions of OCA and PICGUG raise no new issues or arguments and simply repeat their arguments that were rejected by the ALJs in the Recommended Decision. They continue to oppose an increase in the maximum allowed DSIC from 5% to 7.5% (not including reconciliation) for main replacement purposes,³ and also oppose the establishment of a total, 10% cap including any reconciliation recovery.⁴ OCA continues to insist that, if a higher DSIC percentage is permitted it should go into effect only after the Pennsylvania Public Utility Commission (“Commission” or “PUC”) approves PGW’s amended Long Term Infrastructure Improvement Plan (“LTIIIP”). OCA even opposes PGW’s request that the DSIC charge be levelized so that it may bill at a level 7.5% each month (subject to end of year reconciliation of actual construction).⁵

These Exceptions should be denied. These parties insist that PGW should simply find another source to fund PGW’s proposed \$11 million per year of additional cast iron main replacement. Rather than the DSIC mechanism, they are seeking to have PGW use other sources of ratepayer money⁶ to fund the proposed accelerated replacement of PGW’s “at risk” mains. They claim that PGW should be forced to use its current base rates or to borrow the money to finance additional cast iron main replacement. But these parties simply ignore the record which shows that PGW is *already using* available internally generated funds from base rates to cover increases in costs since its last base rate case and to finance both its legacy, 18 mile cast iron main replacement program as well as its \$68 million(non-DSIC) capital budget, which has also

³ OCA Exception No. 1 and PICGUG Exception No. 1 are focused on the recommended approval of an increase in the maximum allowed DSIC to 7.5% (not including reconciliation) for construction purposes.

⁴ OCA Exception No. 2 and PICGUG Exception No. 2 are focused on recommended approval of a total, 10% cap including any reconciliation recovery.

⁵ OCA Exception No. 3.

⁶ PGW does not earn a return on its \$1.2 billion distribution system; its sole source of funding for operations is from ratepayers or by issuing bonds (the costs of which are also paid by ratepayers).

grown materially since the last base rate case. Moreover, issuing long term debt to fund the proposed additional construction would increase PGW's financial risk and actually impose more costs on ratepayers than funding from the DSIC. And appropriating PGW's year-end cash on hand to produce a one time, \$25 million fund, as PICGUG demands, would reduce its cash balances below the levels needed to maintain its current bond rating, create additional risk that PGW would run short of cash in an emergency and do nothing to create a stable funding source for a 48 year cast iron main replacement program. To the contrary, the record supports the need to accelerate PGW's current cast iron main replacement efforts and the appropriateness of using the DSIC mechanism to fund those efforts. PGW simply will not be able to accelerate its cast iron main replacement program and cut the projected replacement time almost in half (from 86 years to 48 years for cast iron main) without increasing its DSIC percentage.

OCA stands alone in opposing the levelization and annualization of PGW's DSIC. The thrust of OCA's opposition appears to stem from the misguided belief that additional customer protections are necessary.⁷ However, OCA's claims are based upon a misreading of the applicable legal standard and a failure to recognize that the additional conditions it is demanding have either been satisfied by PGW (i.e., accounting standards, triggers for quarterly updates) or lack any support in the record (i.e., additional budget billing).

Importantly, PGW and the Bureau of Investigation and Enforcement ("I&E") reached an agreement on the implementation of PGW's proposal and the requested waivers.⁸ The Stipulation recommended the approval of all of PGW's requests and permits PGW to expedite "at risk" main replacement in calendar year 2016 by allowing PGW to begin billing the higher

⁷ OCA Exception at 18-22, at Exception No. 3.B (OCA proposed conditions on granting waiver for levelization and annualization).

⁸ PGW/I&E Exh. 1 (Stipulation).

DSIC immediately after PUC approval, but not spending the additional funds on main replacement unless and until the PUC approves PGW's amended LTIP. The Agreements also provides reasonable reporting and tracking of PGW's main replacement progress and its success at providing necessary operator training. The I&E Stipulation resolves the key "customer protection" issues raised by OCA and PICGUG despite the failure of either of these parties to acknowledge this agreement. The Recommended Decision properly recognized that PGW's Petition to increase its DSIC percentage, as modified by its stipulation with I&E, meet the applicable statutory standards, is reasonable and in the public interest and should be approved by the Commission.

For all of the reasons expressed herein and in PGW's Briefs, PGW urges the Commission to deny the exceptions of OCA and PICGUG, grant the exceptions of PGW, and adopt the Recommended Decision with the exception of the ALJs' recommendation that the Commission require that it formally request the City of Philadelphia to waive its City Fee.

II. REPLY TO EXCEPTIONS

A. PGW MET THE STANDARD FOR WAIVER OF 5% LIMITATION AND FOR AUTHORIZING A 7.5% MAXIMUM ALLOWABLE DSIC FOR CONSTRUCTION (EXCLUSIVE OF RECONCILIATION)

For the reasons stated herein and in PGW's Briefs, the Commission should deny the exceptions of OCA and PICGUG to PGW's proposal to waive the current DSIC cap of 5% of distribution revenues and approve a 2½ percentage point increase in the maximum allowed DSIC expenditures from 5% to 7.5% (not including reconciliation).

1. PGW's Proposals, As Modified, Contain Sufficient Safeguards To Protect Ratepayers

OCA excepts to the ALJs' conclusion that PGW should be permitted to begin to charge the DSIC at 7.5% immediately after the PUC approves its Petition and claims that PGW should not be able to even begin to bill the higher DSIC until PGW has filed and obtained approval of an amended LTIIP.⁹ As explained in the Main Briefs and Reply Briefs,¹⁰ the PGW/I&E Stipulation¹¹ fully addresses the implementation concerns raised by OCA. In summary, the PGW/I&E agreed upon procedure permits PGW to begin to bill the higher DSIC in January, while holding off spending any of the additional funds billed until an amended LTIIP is approved, thus properly recognizing the need to expedite PGW's "at risk" main replacement as soon as possible while providing assurances that customers will not be inappropriately billed.

OCA's primary contention is that, despite the safeguards to which PGW and I&E have agreed, the Commission cannot grant an increase in the DISC cap without having first received and approved an amended LTIIP. That contention is simply wrong. It lacks a solid legal and factual basis for the reasons explained in PGW's Main Brief and PGW's Reply Brief.¹² Simply put, there is no legal requirement that a utility with an approved LTIIP in place must file for approval of an amended LTIIP before seeking to increase the DSIC cap, and OCA's Exception frankly admit this.¹³

OCA also strives to create the impression that the process of amending PGW's current LTIIP in order to accommodate the spending of an additional \$11 million per year will be

⁹ OCA Exception No. 1.

¹⁰ *See, e.g.*, PGW Main Brief at 19-31; PGW Reply Brief at 20-24.

¹¹ PGW/I&E Exh. 1 (Stipulation).

¹² PGW Main Brief at 19-24; PGW Reply Brief at 20-24.

¹³ OCA Exceptions at 9 ("The ALJs are correct, that Section 1358(a)(1) does not specifically state that a revised, supporting LTIIP be reviewed and approved prior to requesting a waiver of the DSIC rate cap.").

difficult or contentious.¹⁴ But as PGW explained in its Brief, the process of amending its current LTIP will be an incremental one, and will be fully coordinated with the Commission's Gas Safety Division.¹⁵ OCA's suggestions appear to flow from a lack of experience or expertise in gas distribution system infrastructure or safety issues and were properly rejected by the Recommended Decision.¹⁶

PGW has already explicitly agreed with I&E that its amended LTIP will contain a plan showing how PGW intends to both prioritize the additional DSIC funding to train employees and contractors to meet the Operator Qualification requirements of 49 CFR Subpart N and to otherwise demonstrate that it will have qualified personnel available to accomplish the accelerated main replacement authorized by the PGW Petition.¹⁷ Importantly, PGW has agreed not to spend any of the \$11 million unless and until its revised LTIP is approved by the PUC.

OCA claims that the 7.5% DSIC cannot begin to be billed until an amended LTIP is approved because "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."¹⁸ This is the first time OCA has suggested that PGW might use unqualified employees, but, of course, the claim is without merit. PGW has explicitly stated that its amended LTIP will contain a plan to "demonstrate that it will have qualified personnel available to accomplish the accelerated main replacement."¹⁹

¹⁴ OCA Exceptions at 8-14.

¹⁵ PGW Main Brief at 9-10, 19-24.

¹⁶ RD at 53-55.

¹⁷ RD at 54-55. PGW Main Brief at 22. Mr. Murray testified that PGW has mechanisms in place, including obtaining modifications to its Collective Bargaining Agreement to permit contractors to work on "live gas" that will allow the Company to address its additional staffing and training needs. Tr. 44-45.

¹⁸ OCA Exceptions at 11.

¹⁹ PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1.B.1.

OCA also claims there is a question about PGW's ability to ramp up construction, but this is based on a mischaracterization of the evidence. The segment of testimony cited by OCA refers to *future* efforts by PGW to perform construction *beyond* that requested level.²⁰ With respect to the requested level of additional cast iron main replacement, i.e., an additional \$11 million per year, the record shows that PGW's management team is confident that PGW can ramp up its replacements process to be able to expend the additional \$11 million annually.²¹

The timing concerns raised by OCA²² are fully addressed by the procedures that PGW and I&E have agreed to insure that PGW will not begin to expend the additional \$11 million resulting from the DSIC cap increase until the PUC approves PGW's amended LTIP.²³ The amended LTIP will address not only the mains to be replaced but also the resources available to perform the increased level of main replacement,²⁴ will show that the increased main replacement will be done in a cost effective manner²⁵ and, as noted above, by a qualified workforce.²⁶ PGW also agreed to provide post LTIP quarterly reports related to the accelerated

²⁰ *Accord*, PGW St. 1 at 14-15 "PGW has not previously engaged in this level of annual construction and, before moving to even more aggressive levels, it needs to be able to assess a number of factors, including the effect on commerce, traffic congestion, and noise, especially in the more congested areas of the City, and the availability of qualified contractors to perform the work. Once it gains this data it will consider whether it would be prudent to accelerate the pace of its main replacement even further." (emphasis added). *See also* Petition, at 17 (¶ 30) ("PGW will continue to review its DSIC-financed main replacement program from year to year to determine whether it would be prudent to request additional increases in its DSIC spending. PGW has elected to begin with an increase of 2.5% in excess of the initial cap in order to gain experience with an expedited program").

²¹ PGW St. 1-R at 2, 11. PGW witness Murray stated: "After a reasonable ramp up period, PGW is confident that, barring unforeseen circumstances, it will be able to meet its accelerated levels of work as defined in its revised LTIP. In any event, all funds collected via DSIC that are not expended on main replacement will be refunded with interest so there is no risk to ratepayers."

²² OCA Exceptions at 4, 7- 8 (Exception B.1 relating to the ability of PGW to perform accelerated construction), 13-14 (Exception B.3 relating to LTIP to support increased spending), 14-16 (Exception B.4 relating to reports on accelerated construction).

²³ PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1.B. *See* footnote 10, *supra*.

²⁴ PGW Main Brief at 21-22.

²⁵ PGW St. 1 at 14-15.

²⁶ PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1.B.

construction and to its use of qualified employees.²⁷ The agreed-upon reporting requirements will provide I&E with all of the information needed to ensure that additional construction is being performed consistent with the standards in Act 11.

The bottom line is that OCA's position would delay PGW's main replacement efforts with no reasonable justification. Creating additional delays in PGW's accelerated cast iron main replacement efforts is against the weight of all the evidence and opinion in the record, including OCA's own witness,²⁸ and runs counter to the PUC's Staff Report conclusions, as well as the general consensus that antiquated cast iron distribution mains in general, and PGW's in particular, need to be replaced as quickly as reasonably possible.²⁹ Since PGW has agreed to refund with interest any amounts collected from ratepayers at the higher DSIC level if the PUC delays or fails to approve PGW's amended LTIP, PGW customers would not be harmed in any way.³⁰ OCA has never articulated any harm to customers that implementation of PGW's proposal (as modified by the I&E Stipulation) would create – because there is none. OCA's position was properly rejected by the ALJs.

²⁷ PGW/I&E Ex. No. 1 (Stipulation) at ¶ 1.D.; PGW Main Brief at 41-43. That paragraph states that PGW will provide to I&E on a quarterly basis: “(a) all quarterly reconciliation updates and shall agree to honor all appropriate requests for back-up information; (b) for a period of three years from the date the PUC approves PGW's Amended LTIP (or a shorter time period by mutual, PGW/I&E agreement), the actual number of: a) personnel (by job description); and b) contractors that are OQ qualified to work on live gas, compared to the numbers for each identified in PGW's Amended, approved LTIP.” *Id.*

²⁸ RD at 20-23, 73; Tr. 105 (OCA witness Everette stated: “I'm not saying don't replace your cast iron mains. It's just that they should be done in a priority before they're charged to ratepayers.”).

²⁹ PGW Main Brief at 1, 14-17; Reply Brief at 1-3. I&E maintains that the goal for PGW, with its aging infrastructure, should be to replace its cast iron and bare steel pipe as quickly as it is safely possible to do so. RD at 74, *citing*, I&E Main Brief at 25-26.

³⁰ In the extremely unlikely event that the PUC does not approve PGW's LTIP, PGW has agreed that any amounts collected from customers for the increased DSIC that would have to be returned will be refunded with interest at the current Residential Mortgage Rate – currently 5.25% – which more than compensates customers for the time value of any funds collected. *See* PGW Main Brief at 22.

2. PGW’s Investigation Of Alternative Funding Sources Was Reasonable And Satisfies The Standard For Increasing The Maximum Allowed DSIC

OCA and PICGUG argue that, while PGW should nonetheless go forward with accelerated main replacement, it is not necessary to increase the DSIC cap to fund the additional expenditures because PGW allegedly has alternative sources of funding available that could be used for this purpose.³¹ They further argue that the existence of viable alternative sources of funding demonstrates that PGW failed to show that a waiver of the DSIC cap is necessary at this time. They are wrong. As explained in the Petition, PGW’s Brief, and below, other than the DSIC mechanism, there are no viable alternative sources of funding available for additional cast iron main replacement.

(a) Use of Internally Generated Funds Is Not A Viable Avenue For Funding Additional Cast Iron Pipeline Replacement

The OCA and PICGUG argue PGW could use the internally generated funds (“IGF”) that its current base rates are producing in order to fund additional main replacement. This argument is without merit.

Fundamentally, it is nonsensical to argue that PGW should be required to expend an additional \$11 million per year to improve the safety and efficiency of its distribution system but it should not be given a means to fund the incremental expenditures. If it is in the public interest to engage in the accelerated main replacement it would be grossly unfair to refuse to permit PGW to use the DSIC mechanism to fund the additional expenditures; this, after all, is precisely why the DSIC law was enacted by the General Assembly – to enable and encourage infrastructure modernization. Moreover, the record shows that PGW explored other options for

³¹ OCA Exceptions at 1-15; PICGUG Exceptions at 2-7.

funding cast iron main pipeline replacement, including internally generated funds (“IGF”).³² As the Recommended Decision found, IGF, from base rates is not a viable and available means for funding PGW’s proposed additional cast iron main pipeline replacement program.³³ Most importantly, to the extent that PGW has IGF, such funds are already spoken for: PGW’s IGF is already being used for PGW’s legacy, 18 mile per year main replacement program as well as the cost of construction for a variety of items necessary to maintain adequate service including maintaining PGW’s gas processing plants, field services and replacement of customer service lines.³⁴ PGW’s non-DSIC capital budget is some \$68 million in FY 2015 and is projected to grow to more than \$88 million in FY 2016.³⁵ PGW’s IGF is also being used to cover net increases in expenses since PGW’s last base rate case in 2010. Nothing in the record suggests that PGW’s use of IGF is unreasonable. Indeed, before these funds could reasonably be appropriated for main replacement purposes the Commission would be obligated to conduct a full analysis of the justness and reasonableness of PGW’s base rates, which, of course, has not taken place.

The OCA never responded to this evidence and failed to produce, or even cite, any evidence to show that IGF is an available and reasonable alternative to using the DSIC, or why the mechanism approved by the General Assembly to fund accelerated main replacement should not be used here. In fact, despite the acknowledgement that IGF is currently being used by PGW for capital construction projects and to cover increases in expenses since its last base rate case,³⁶ the OCA never discusses how PGW would replace the funding now being used for its overall

³² PGW Main Brief at 25-31; PGW Reply Brief at 6-16.

³³ *Id.*

³⁴ PGW Reply Brief at 9; Tr. 70.

³⁵ PGW Main Brief at 26; PGW Reply Brief at 8-9; Tr. 68; Exh. JFG-2.

³⁶ OCA Exceptions at 5-6.

construction program, or why it would make sense to put all those other programs to risk simply to avoid an extremely modest (1.6%) DSIC rate increase. OCA also fails to discuss how such a shift would affect PGW's financial standing and its current bond rating – so crucial to the financial health of the Company. As such, OCA's arguments are totally deficient and were properly rejected by the Recommended Decision.³⁷

(b) Reduction In Cash-On-Hand Is Not A Viable Avenue For Funding Additional Cast Iron Pipeline Replacement

PICGUG's exception claims that PGW could fund its accelerated cast iron main replacement program by simply using \$25 million of its cash on hand at the end of the year.³⁸ Putting aside the fact that this scheme could only produce enough dollars to fund the incremental 48 year cast iron main replacement program for roughly two years, the record shows that PGW's current cash on hand cannot be reduced without the risk of impacting PGW's financial wellbeing and its bond ratings. As a municipally owned, cash flow regulated company with very limited borrowing capability, PGW's cash balances are the principal means of assuring that it has sufficient funds to pay all of its obligations in a timely manner and can respond to contingencies. Thus, the level of non-borrowed year-end cash is a key factor in judging the adequacy of PGW's existing and established rates and keeping its year end cash at adequate levels is crucial to

³⁷ See RD at 40-43. OCA also makes a passing reference to funds that might be available as a result of implementing the PUC Stratified Management Audit. See OCA Exceptions at 5. However, OCA failed to note that one of the annual savings recommendations is beyond the capacity of PGW Management to address (Recommendation IV-1) and that the other annual savings recommendations, to the extent that PGW is implementing them, will only generate savings in the future. See PGW's Implementation Plan, Docket No. D-2015-2468141 at 45, 53, 61. The actual, extremely modest savings generated are slated for use in PGW's capital construction projects or to cover other expense increases and/or will be reflected in PGW's revenue requirement in PGW's next base rate request.

³⁸ PICGUG Exceptions at 3-5.

maintaining a positive financial position.³⁹ Joseph Golden, PGW's Chief Financial Officer, testified that reducing the level of year-end cash could risk a downgrade by rating agencies.⁴⁰ Reducing cash on hand by \$11 million would lower PGW's cash levels to 59 days of cash on hand.⁴¹ Mr. Golden explained that a downgrade was possible if PGW's cash on hand fell to that level. A reduction of \$25 million (the amount of reduction sought by PICGUG) would lower PGW's cash levels to about 50 days of cash on hand.⁴² By extension, the risk of downgrade would be even greater if PICGUG's recommendation was adopted.

In contrast to this evidence, neither OCA nor PICGUG offered any testimony or evidence to show that PGW could reduce cash on hand without jeopardizing its current bond rating or its financial flexibility. The only testimony on this point was by Mr. Golden, who did not support a reduction of cash on hand (PICGUG presented no testimony on any issue). Simply put, having only recently emerged from a full-scale financial crisis and having only recently improved its bond ratings, PGW would certainly not place its improved cash levels and its bond ratings in jeopardy in any way.

The OCA/PICGUG position on this issue is an amalgam of speculation and assumption without any apparent understanding of how important cash flow is to PGW. OCA argues that PGW is in a "relatively strong financial position."⁴³ But, OCA did not present any evidence on the impact of the proposed reduction on that financial position. Instead, OCA relies on statements in the Staff Report regarding projections of the Company's debt to total capital

³⁹ RD at 42; 52 Pa. Code § 69.2703 (a)(1) (" In determining just and reasonable rate levels for PGW, the Commission will consider, among other relevant factors: ... (1) PGW's test year-end and (as a check) projected future levels of non-borrowed year-end cash.").

⁴⁰ PGW St. 3-R at 5-7.

⁴¹ PGW St. 3-R at 5. \$95 million (\$106 million less \$11 million) divided by 59 days equals about \$1.61 million per day. *Id.*

⁴² \$81 million (\$106 million less \$25 million) divided by \$1.61 million per day equals 50.3 days.

⁴³ OCA Exceptions at 6 (emphasis added).

ratio.⁴⁴ But, the Staff Report does not contain any discussion on the impact of a reduction in cash on hand on PGW's financial position.⁴⁵ It follows that there is nothing in the record to show that reducing cash on hand is a viable means of funding a multi-year construction program.

PICGUG, instead of presenting testimony on this issue, claims that some of the documentary evidence that PGW witness Golden presented to support his opinion – the “Fitch Report” (which was attached to PGW witness Golden's testimony)⁴⁶ – does not contain any PGW specific analysis.⁴⁷ It then argues that there is no evidence showing that reducing cash on hand could be detrimental to PGW's financial position. In addition to being illogical, PICGUG's claim ignores Mr. Golden's testimony in which he provided not only PGW specific analysis but also explained that, based on his discussions with rating agencies, the required cash balances to which he testified as being needed are, in his view, what the agencies are looking for from PGW, since the Company is similar to the types of companies considered in the Fitch Report.⁴⁸ Accordingly, PICGUG's arguments are completely without merit and the ALJs clearly were right to reject them.⁴⁹

⁴⁴ OCA Exceptions at 6.

⁴⁵ See Staff Report at 6, 51-52.

⁴⁶ PGW St. 3-R at 4-5; Exhibit JFG-1, FitchRatings, U.S. Public Power Rating Criteria. The Fitch Report is a report from an investment rating service. *Id.*

⁴⁷ PICGUG Exceptions at 3-4. These Exceptions largely repeat the statements in PICGUG's Main Brief at 9-11.

⁴⁸ Tr. 83-84.

⁴⁹ OCA has also made a passing reference to the notion that PGW could simply issue more long-term debt to fund the accelerated cast iron main program. OCA Exceptions at 5. But PGW showed that funding the program through the issuance of long-term debt would not only be more expensive to ratepayers (because PGW would have to reflect in rates both the debt service and the required debt service coverage for the term of the bond (PGW Main Brief at 27-29) but would also worsen PGW's debt to total capitalization ratio which could have an effect on its bond rating. (PGW Main Brief at 27-29; PGW Reply Brief at 9-13).

(c) PGW Should Not Be Required To Formally Request That The City Of Philadelphia “Grant-Back” The City Fee To PGW

The ALJs recommended that PGW formally ask the City to grant-back the City Fee, although it was not clear whether they were suggesting that this request be made prior to an increase in the DSIC, or as a potential source of additional funding for accelerated cast iron main replacement.⁵⁰ PGW filed an exception on this issue,⁵¹ which showed that the recommendation contradicts the sound conclusions in the Recommended Decision that granting back of the City Fee is not a viable alternative to increasing PGW’s DSIC. Nonetheless, the OCA and PICGUG have latched onto the City Fee as a convenient way to claim that a DSIC increase can be avoided and demand that PGW make a “formal request” of some kind to the City administration and City Council to grant back the City Fee. These demands should also be rejected.

To be clear, PGW is required to pay the City Fee to the City pursuant to Management Agreement⁵² and Section 2212(f) of the Public Utility Code.⁵³ The City Fee is the only compensation that the City receives for owning the Gas Works.⁵⁴ The City budgets the receipt of

⁵⁰ RD at 106, Ordering Para. 5. “IT IS RECOMMENDED ... That Philadelphia Gas Works shall also make a formal request of the City of Philadelphia to waive its City fee.” *Id.*

⁵¹ PGW’s exception is incorporated herein by reference.

⁵² The “Management Agreement” was adopted as an ordinance of the City. City of Philadelphia, Pa., Mgmt. Agreement Ordinance No. 455, as amended.

⁵³ 66 Pa. C. S. § 2212(f). Section 2212(f) provides as follows: “The Commission shall permit the city natural gas distribution operation to impose, charge or collect rates and charges as necessary to permit the city natural gas distribution operation to transfer or pay to the city that is the owner of the city natural gas distribution operation, on an annual basis, such amount as may be specified from time to time in the applicable ordinances of the city or agreement of the city approved by ordinances.” *Id.* Section 2212(f) also provides some discretion to the Commission concerning the City payment but under limited circumstances. The Commission is permitted to review and approve only that portion of the City payment that exceeds 110% of the amount authorized. *Id.*

⁵⁴ See footnotes 5452 and 5553, *supra*. The City Fee is akin to a very modest return on the City’s massive investment, which includes ownership of over \$1.2 Billion in gas distribution assets.

the City Fee,⁵⁵ and the City Fee becomes part of the City's General Fund. Any "granting-back" of the City Fee by the City Council⁵⁶ is essentially an expenditure of the City.

Most importantly, PGW already has made a request of the City to consider granting back the City Fee. Consistent with the suggestion in the Commission's Staff Report,⁵⁷ PGW explored the opportunity of the City granting-back the City Fee in order to fund additional cast iron main replacement. PGW's efforts were explained in its original Petition⁵⁸, PGW's testimony⁵⁹, and PGW's Briefs.⁶⁰ The City declined each of the requests. The ALJs correctly found that demanding that PGW further request the City waive its City Fee is not a viable alternative to increasing PGW's DSIC.⁶¹ The ALJs also correctly concluded that the Commission is not authorized to interfere with the payment of the \$18 million City Fee by PGW.⁶²

The record shows that the City is well aware of the suggestion in the PUC Staff Report, as well as similar suggestions made by the witnesses in this proceeding to forego its sole compensation for owning the Gas Works and has considered and rejected them under the present circumstances. To wit, the City appoints a voting majority of PGW's board and has the ability to

⁵⁵ "The revenues of PGW are required to be segregated from other funds of the City. Payments for debt service on PGW bonds are made directly by PGW." *See, e.g.*, Official Statement for General Obligation Bonds, Series 2015B, at A-32, A-36, which is available at: <http://www.phila.gov/investor/pdfs/GO2015BFinalOS.pdf>

⁵⁶ The City Council, the legislative arm of Philadelphia municipal government, "consists of seventeen members. Ten Councilmembers are elected by district and seven from the City-at-large. ... Every proposed ordinance is in the form of a bill introduced by a Councilmember. ... Passage of a bill requires the favorable vote of a majority of all members of Council. A bill becomes law upon the approval of the Mayor. If the Mayor vetoes a bill, Council may override the veto by a two-thirds vote." <http://phlcouncil.com/about-city-council/>.

⁵⁷ *Staff Report* at 6.

⁵⁸ Petition at 13, n. 31.

⁵⁹ PGW St. 2 at 13-14; PGW St. 2-R at 1, 5-6; PGW St. 3-R at 4-12; Tr. 67-93.

⁶⁰ PGW Main Brief a 24-31; PGW Reply Brief at 3-20.

⁶¹ RD at 57, 59.

⁶² RD at 105.

modify or approve the Company's budget.⁶³ As Mr. Golden explained, it is solely within the power of the City of Philadelphia, PGW's owner, to determine whether or not the \$18 million payment is to be granted back.⁶⁴ While the City did grant back the \$18 million payment for a time in the mid-2000's, when PGW was in financial crisis, those circumstances do not exist today, and the City does not have any plans to grant back the City Fee.⁶⁵ This was confirmed by the Deputy City Finance Director, who declined another request made by PGW as to whether the City could consider a grant-back just a day before the evidentiary hearing.⁶⁶

PICGUG's new spin on its argument is that, before any increase to the DSIC cap may take effect, PGW must "present a formal written request to Council, complete with supporting testimony and analysis for Council's review."⁶⁷ But there is no legal or practical support or precedent for such a "formal request."⁶⁸ Moreover, under PICGUG's logic, this Commission would be directing PGW to adopt a position (i.e., grant-back the City Fee to fund additional cast iron main replacement) regardless of the views of PGW's management, and to advocate the position dictated by the Commission before the City Council. Such advocacy is clearly beyond the power of the Commission to mandate and makes little logical sense. Nevertheless, as PGW

⁶³ See, e.g., City of Philadelphia, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2014, at 43, which is available at: <http://www.phila.gov/investor/CAFR.html>.

⁶⁴ PGW St. 3-R at 10-12.

⁶⁵ "Revenue estimates contained the Revised Twenty-Fourth Five-Year Plan include the \$18 million annual payment to the General Fund from PGW for Fiscal Years 2016 to 2020. The Fiscal Year 2016 Adopted Budget includes that \$18 million annual payment to the General Fund from PGW for the Fiscal Year 2016." See, e.g., Official Statement for General Obligation bonds, Series 2015B, at A-36, which is available at: <http://www.phila.gov/investor/pdfs/GO2015BFinalOS.pdf>.

⁶⁶ PGW Main Brief at 30.

⁶⁷ PICGUG Exceptions at 7.

⁶⁸ The Commission must act within and cannot exceed its jurisdiction. See, e.g., *Feingold v. Bell of Pa.*, 383 A.2d 791 (Pa. 1977). The Commission is not a "super board" of directors, See, e.g., *Bell Tel. Co. of Penna. v. Driscoll*, 21 A.2d 912, 916 (Pa. 1941) (PUC is not a super board of directors for public utilities), and is not authorized to micromanage the day-to-day operations of the regulated entities under their jurisdiction, see, e.g., *Joint Application of Verizon Commc'ns, Inc. and MCI, Inc. For Approval of Agreement and Plan of Merger*, Docket No. A-310580F0009, Final Order entered January 11, 2006, *affirmed*, *Popowsky v. PUC*, 937 A.2d 1040 (Pa. 2007).

stated in its Exceptions, it always stands ready to engage in a dialogue with the City and the PUC about reasonable and fair methods of financing additional cast iron main replacement.⁶⁹

(d) PGW's Base Rates Are Not A Viable Avenue For Funding Additional Cast Iron Pipeline Replacement

OCA suggests that PGW's base rates should be examined to determine if the existing base rates can bear some of all of the cost of additional cast iron main replacement.⁷⁰ This suggestion was made even after OCA says that this proceeding should not turn into a "base rate review."⁷¹ OCA also appears not to understand that the IGF, which it is demanding be appropriated, *comes from base rates*. As discussed above, OCA's suggestion fails to recognize that commandeering existing base rates is completely inappropriate in the DSIC context and would threaten PGW's financial health, risk downgrading PGW's bonds, and could put the Company on the downward spiral that resulted in its requiring extraordinary rate relief just a few years ago.⁷²

Based on its view that base rates are the "preferred source of funding," PICGUG suggests that PGW cannot show that an increase in DSIC is "necessary" since PGW has announced an upcoming base rate proceeding.⁷³ This suggestion is completely inconsistent with the entire purpose of the DSIC and makes no sense. PGW has historically removed 18 miles of high risk cast iron main each year, financed from funds provided from its base rates. Act 11 was enacted to provide utilities with an additional funding mechanism to permit infrastructure modernization,

⁶⁹ PGW Exceptions at 3, 7.

⁷⁰ OCA Exceptions at 7.

⁷¹ OCA Exceptions at 5.

⁷² RD at 35, citing PGW's Reply Brief at 7-8.

⁷³ PICGUG Exceptions at 4.

in addition to base rates.⁷⁴ Requiring PGW to fund additional cast iron main replacement from existing or future base rates is completely contrary to the purpose Act 11 was enacted by the General Assembly. Recovery of eligible costs through the DSIC (under Act 11) is no different than PGW's recovery of eligible natural gas costs through its Gas Cost Rate ("GCR"). No party could successfully argue that PGW (or any gas utility) should not recover increased wholesale gas costs until it could show that it could not pay for such increases from its base rates.⁷⁵

3. OCA's Claims About the Effect of the DSIC Cap Increase on Ratepayers Are Not a Valid Basis for Denying PGW's Petition and Should Be Rejected

The OCA argues that the Commission should refuse to grant PGW's requests because of the alleged effect on PGW's ratepayers,⁷⁶ some of whom OCA points out are low income. However, the record shows that the increase in DSIC to 7.5% would have a relatively small effect on PGW's customers.⁷⁷ That being said, the OCA generally argues against any increase in DSIC,⁷⁸ but, in doing so, the OCA does not show how the actual effect of the increased DSIC

⁷⁴ See, e.g., 66 Pa. C.S. § 1350 (DSIC is an "additional mechanism for a distribution system to recover costs related to the repair, improvement and replacement of eligible property.").

⁷⁵ Ms. Everette tried to argue that the provision in Act 11 which directs that the DSIC should be reset at zero if in any quarter the Commission makes a determination that the utility would be earning a return in excess of its allowed rate of return justifies an investigation into alternative funding sources (OCA St. 1-S at 7). But the procedure referenced is a separate process that would require an analysis of a utility's existing rates. Moreover, for PGW, the Commission has indicated that it intends to simply "monitor" its rate levels with the DSIC. *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611, Final Implementation Order entered Aug. 2, 2012 ("Implementation Order") at 42-43. If the Commission believes PGW's rate levels are excessive for a cash flow company it can take a separate action to raise that issue; notably neither the PUC nor the OCA has not taken any such action.

⁷⁶ OCA Exceptions at 3, 4, 7, 21. The OCA also makes a cryptic reference to the projected size of the City's equity. OCA Exceptions at 7. That reference is misleading. See PGW Reply Brief at 8, n. 21. City Equity is not a cash account and PGW does not have those dollars available to fund projects. But, to be clear, PGW does not make a dime as a result of its DSIC; every dollar billed is used to finance main replacement. Any dollars not so used are returned to ratepayers, with interest.

⁷⁷ RD at 57-58. The increase in the DSIC rate from its current 5% to 7.5% for the average residential heating customer is projected to be \$1.65 per month. The decrease in gas costs will help to mitigate the impact of the increase on PGW's customers such that total rates will actually be lower than when the DSIC was initiated. RD at 58; PGW St. 2-R at 10.

⁷⁸ OCA Exceptions at 7.

will be material for customers. Moreover, as noted in PGW's Reply Brief,⁷⁹ it would be neither legal nor fair to deny PGW's Petition for a modest increase in its DSIC because of the unproven assertions about the "ability to pay" of some PGW customers.⁸⁰

That being said, the Company is concerned about its customers and has a number of programs and initiatives designed to help them deal with their natural gas bills. Those programs include its CRP program, its low income weatherization program – CRP Home Comfort ("LIURP") and several other efforts which are outlined in PGW's Reply Brief. Importantly, PGW has approximately 60,000 customers enrolled in its "percentage of income" CRP program; none of whom will see an increase in their charges due to PGW's DSIC increase proposal.⁸¹

B. PGW MET THE STANDARD FOR INCREASING THE MAXIMUM ALLOWED DSIC EXPENDITURES TO 10% (INCLUDING RECONCILIATION)

PGW proposes that the total maximum DSIC, including reconciliation, may not be higher than 10% of its distribution revenues.⁸² As proposed (and recommended for approval in the Recommended Decision), an additional percentage (of up to 2.5%) will be available to recover under-collections from prior years.⁸³ The actual percentage above 7.5% will be determined based on actual under-collections. So, by itself, the maximum percentage cap (which is dedicated to the collection of under-collection amounts) does not harm any customer. Currently PGW's under-collection is just .3%, which produces a total proposed DSIC percentage of 7.64%.⁸⁴

⁷⁹ PGW Reply Brief at 17-20.

⁸⁰ PGW Main Brief at 17-18.

⁸¹ PGW Reply Brief at 19-20; PGW St. 2-R at 8-9; Tr. 116-117.

⁸² PGW St. 2 at 13, 14; PGW St. 2-R at 1, 5-6.

⁸³ PGW Reply Brief at 24-26.

⁸⁴ Corrected Attachment A to PGW's Petition, Gas Service Tariff – Pa P.U.C. No. 2 at 2 (filed September 9, 2015).

OCA and PICGUG argue that PGW has not established a need to have an additional percentage for under-collections (the 7.5% to 10% cap).⁸⁵ They are wrong. The circumstances justifying an additional percentage are established by the record and are clearly explained in PGW's Main Brief⁸⁶ and Reply Brief.⁸⁷ As noted, OCA and PICGUG are taking the position that PGW should not be permitted to both replace "at risk" mains using the full 7.5% level and be given the ability to collect monies from under collections. They take the position that PGW must reduce its rate of replacement in order to collect monies from undercollections. PGW proposed the separate undercollection cap in order to ensure that it would be able to expend the full \$33 million per year on main replacement and would not have to scale back its program in order to keep its total charge (including recovery of undercollection) at the 7.5% level. The OCA/PICGUG position would cause main replacements in future years to suffer in order to assure collection of any under-collection,⁸⁸ and is thus neither reasonable nor in the public interest.

C. PGW SATISFIED THE STANDARD FOR GRANTING THE WAIVERS FOR LEVELIZATION AND ANNUALIZATION

OCA is the only remaining party to oppose PGW's request to charge an annualized and levelized DSIC rate. The Commission should deny OCA's exceptions related to annualization and levelization because they have either been satisfied by PGW, are not supported by the record, and/or represent an invalid legal interpretation.

⁸⁵ OCA Exceptions at 16-18; OCA Main Brief at 24-27; PICGUG Exceptions at 7; PICGUG Main Brief at 13-14.

⁸⁶ PGW Main Brief at 11-12, 31-33.

⁸⁷ PGW Reply Brief at 24-26.

⁸⁸ PGW Reply Brief at 24-26.

1. The Recommended Decision Correctly Set Forth the Standard For Granting The Waivers For Levelization And Annualization

The OCA claims that the ALJs did not apply the correct standard to this waiver request.⁸⁹ However, to a certain extent, this issue is moot because the OCA does not take an explicit position on whether (or not) the applicable statutory standard for waiver has been satisfied.

In any event, the ALJs did indeed apply the correct legal standard. The ALJs applied that standard for waivers in Section 2212(c) of the Public Utility Code, which provides that “upon request of a city natural gas distribution operation, the commission may suspend or waive the application to a city natural gas distribution operation of any provision of this title, including any provision of this chapter other than this section.”⁹⁰ All of the parties, except OCA, agreed that Section 2212 (as interpreted by the Commission) set forth the applicable standard.⁹¹

The OCA argues that the standard in Section 1358(a)(1),⁹² which is applicable to waiver of the DSIC cap, is the appropriate standard for PGW requested waivers to charge an annualized and levelized DSIC rate. The OCA is wrong.⁹³ Nothing in Section 1358(a)(1) suggests that its language should be applied to a context other than a waiver of the 5% DISC cap. And, nothing in Sections 1352(a)(7)⁹⁴ or 1353(a)⁹⁵ suggest that they are establishing the standard for a statutory waiver. None of the provisions in the Statutory Construction Act support the OCA’s

⁸⁹ OCA Exceptions at 18-19.

⁹⁰ 66 Pa. C.S. § 2212(c).

⁹¹ RD at 81.

⁹² Section 1358(a)(1) provides that: “The commission may upon petition grant a waiver of the 5% limit under this paragraph for a utility in order to ensure and maintain adequate, efficient, safe, reliable and reasonable service.” 66 Pa. C.S. § 1358(a)(1).

⁹³ PGW Main Brief at 8-12; PGW Reply Brief at 26-27.

⁹⁴ The Commission may order a new or revised LTIP “if the plan is not adequate and sufficient to ensure and maintain adequate, efficient, safe, reliable and reasonable service.” 66 Pa. C.S. § 1352(a)(7).

⁹⁵ The Commission may “approve the establishment of a [DSIC] to provide for the timely recovery of 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).

interpretation of Sections 1352(a)(7), 1353(a) or 1235(a)(1).⁹⁶ OCA's reading of Act 11 would require the conclusion that the PUC has the statutory authority to grant a waiver of section 1358(a)(1) (the provision that limits DSIC recovery to property that is placed in service in the prior quarter) for any utility, if that utility satisfies the standard for increasing the DSIC cap. Nothing in the law itself or the PUC's Implementation Order even suggests this. PGW's request for a waiver of the "prior quarter" language is based not on Act 11 but a separate provision in Section 2212 of the Code that applies only to PGW. OCA's argument rests on a misunderstanding and must be rejected.

2. The OCA's Continued Requests For Additional Conditions Are Not Supported By The Record

As part of its exceptions, OCA argues that if the waivers for an annualized and leveled DSIC rate are granted by the Commission, then additional steps must be taken (i.e., conditions imposed) to mitigate any potential harm to customers.⁹⁷ None of the conditions proposed by the OCA continue to be relevant or reasonable for the reasons stated below.

- **Accounting Controls:** The existing proposal by PGW does not permit any diversion of DSIC revenues for any other purpose.⁹⁸ This point was acknowledged in the cross-examination of OCA witness Everette.⁹⁹ OCA is now rejecting this concession by its witness and seeking the full segregation of DSIC monies from other monies.¹⁰⁰ However, nothing in the record demonstrates that the dollar-by-dollar tracking (with subsequent audit) to track the DSIC as well as other automatic adjustment clause revenues and expenses such as the GCR is flawed or that some special segregation is either reasonable or necessary. There is no justification for this proposed condition and it should be rejected.

⁹⁶ The object of all statutory construction is to ascertain and effectuate the General Assembly's intent, 1 Pa. C.S. § 1921(a), the best indication of which is the plain language of the statute. "When the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." *Id.*, § 1921(b).

⁹⁷ OCA Exception at 19-22.

⁹⁸ *Id.*

⁹⁹ Tr. 114-115, 117-118.

¹⁰⁰ OCA Exceptions at 19-20.

- **Triggers for Quarterly Adjustments:** The records supports, and OCA appears to agree¹⁰¹ with, PGW's stated commitment to adjusting the DSIC percentage by October 1 if projected total billings and expenditures for the remainder of the year indicate that a material over or under-collection was likely to develop. The reasonable standard for materiality would be plus or minus 2% (or approximately \$660,000). There is no justification to change the proposed triggers.
- **Enrollment In Budget Billing Program:** Nothing in the record demonstrates that there is a need to modify PGW's Budget Billing program or to increase awareness of PGW's Budget Billing program. In its exceptions, OCA merely repeats the factual inference that not every eligible residential customer is enrolled in budget billing.¹⁰² But nothing in PGW's DSIC proposal justifies additional budget billing efforts. The two things are not logically related. The fact that PGW is actually requesting to levelize its DSIC charge – so that the same percentage would be charged each month (not including reconciliation) – will arguably make the bill less volatile, not increase volatility. Moreover, OCA did nothing to show that PGW's customers are not aware of PGW's Budget Billing or that any additions are needed to PGW's already extensive efforts to inform customers about Budget Billing.¹⁰³ The OCA's proposed condition appears, once again, to be based on a misunderstanding of the facts, is not justified, and should be rejected.

¹⁰¹ OCA Exceptions at 20-21.

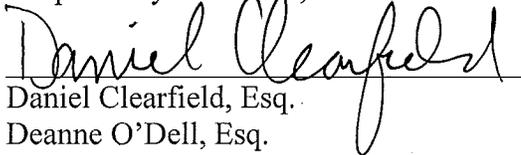
¹⁰² See OCA Exceptions at 21. There are a “large percentage of residential customers who are not choosing or required to enroll in budget billing.” *Id.*

¹⁰³ See PGW Main Brief at 44-45; Reply Brief at 31-32; RD at 100-103.

III. CONCLUSION

PGW respectfully requests that the Commission (1) adopt the Recommended Decision with the exception of the ALJs' recommendation that the Commission require that it formally request the City of Philadelphia to waive its City Fee; and (2) reject the Exceptions of both OCA and PICGUG.

Respectfully submitted,



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