



COMMONWEALTH OF PENNSYLVANIA  
PENNSYLVANIA PUBLIC UTILITY COMMISSION  
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE  
REFER TO OUR FILE

January 11, 2016

Secretary Rosemary Chiavetta  
Pennsylvania 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:

Enclosed please find an original copy of the Bureau of Investigation and Enforcement's (I&E) **Reply Exceptions** in the above-captioned proceeding.

Copies are being served on all active parties of record as evidenced in the attached certificate of service. If you have any questions, please contact me at (717) 787-8754.

Sincerely,

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Prosecutor  
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CBW/GLL/wf  
Enclosure

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

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

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**REPLY EXCEPTIONS  
OF THE  
BUREAU OF INVESTIGATION & ENFORCEMENT**

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Dated: January 11, 2016

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## I. INTRODUCTION

I&E incorporates, by reference, both the Introduction and Procedural History sections contained in its Main Brief of November 13, 2015.<sup>1</sup> After the parties to this proceeding filed Main Briefs, in accordance with the established procedural schedule, the Bureau of Investigation & Enforcement (“I&E”), Philadelphia Gas Works (“PGW”), the Office of the Consumer Advocate (“OCA”), the Office of the Small Business Advocate (“OSBA”), and the Environmental Defense Fund (“EDF”) filed Reply Briefs on November 17, 2015. Although the Philadelphia Industrial & Commercial Gas Users Group (“PICGUG”) submitted a Main Brief in the proceedings, it declined to address the arguments presented by the parties through its election not to file a Reply Brief.

On December 11, 2015, Administrative Law Judges Christopher P. Pell and Marta Guhl (“ALJs”) issued a Recommended Decision (“RD”) approving PGW’s Petition for Waiver of Provisions of Act 11 to Increase the Distribution System Improvement Charge CAP and to Permit Levelization of DSIC Charges (“Petition”) as modified by the Stipulation between PGW and I&E (“Stipulation”). Additionally, the RD granted PGW’s waiver of the current DSIC cap and approved: (1) a 2½ percentage point increase in the maximum allowed DSIC from 5% to 7.5% (not including reconciliation) for construction purposes; and (2) a total, 10% cap including any reconciliation recovery, both for service rendered on or after January 1, 2016. The RD also granted and approved PGW’s request to waive or suspend the requirements of Act 11 so as to permit PGW to use an annual, levelized charge as the basis for establishing a DSIC, subject to subsequent true-up for

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<sup>1</sup> I&E Main Brief, pp. 1-5.

PGW's actual experience. Pursuant to the RD, PGW is ordered to place into effect a tariff supplement codifying the changes after the submission of a compliance tariff, on at least one day's notice. PGW was also ordered to make a formal request of the City of Philadelphia ("City") to waive its City fee. Finally, the RD directed PGW to file a Petition to Amend the Long Term Infrastructure Improvement Plan by December 31, 2015 or fifteen (15) days after the entry of the Commission's Order approving the current Petition, whichever is later.

I&E did not submit exceptions to any of the terms of the RD. However, Exceptions to the RD were filed by PICGUG and OCA on December 30, 2015, and by PGW on December 31, 2015. Neither EDF nor OSBA filed exceptions addressing the findings in the RD. Pursuant to the Secretarial Letter issued on December 11, 2015, I&E now files these timely Reply Exceptions in response to the Exceptions raised by PICGUG and OCA.

To properly frame its Reply Exceptions, I&E notes that no party to this proceeding disputes that it is in the public interest for PGW to systematically replace its pipeline. Instead, the issue before the Commission is whether PGW has satisfied its burden of proving that use of DSIC funding is the best way to achieve its targeted 48-year replacement of at-risk mains. At the outset, it must be recognized that the General Assembly enacted Act 11 to allow natural gas distribution companies, such as PGW, a vehicle to fund the systematic infrastructure replacement on a long-term basis. While PICGUG, OSBA, and the OCA argue that PGW has not met its burden, the analysis contained in the RD properly rejects these parties' contentions that PGW's use of

internally generated funds would offer a viable alternative funding mechanism for PGW's 48-year replacement program. Instead, PGW, as a cash-flow company that has faced historical financial difficulties, has proven that internally generated funds are not a comprehensive funding source for the duration of its 48-year replacement project, and that a DSIC increase is necessary to meet its main replacement target.

## II. REPLY EXCEPTIONS

### 1. Reply to PICGUG Exception No. 1 and OCA Exception No. 1: The ALJs Properly Found that PGW Met its Burden of Proving that an Increase to the DSIC Cap to 7.5% is Necessary. (RD, pp. 56-57)

After evaluating all of the testimony, presiding over an evidentiary hearing, and reviewing the Main Briefs and Reply Briefs submitted in this proceeding, the ALJs the ALJs recommended approval of PGW's request to increase its DSIC funding cap to 7.5%, absent reconciliation, noting that accelerating the rate of PGW's pipeline replacement is necessary to ensure safe and reliable service for its ratepayers.<sup>2</sup> The ALJs indicated that they did not find that pursuit of other funding sources would eliminate the need to increase PGW's DSIC cap.<sup>3</sup> In their Exceptions, PICGUG and OCA dispute the ALJs' findings on several bases, each of which I&E addresses below.

#### A. **The ALJs Correctly Concluded PGW's Pursuit Of Other Funding Sources Would Not Eliminate the Need to Increase its DSIC Cap. (RD, p. 58-59).**

Both PICGUG and OCA argue that PGW should be required to use internally generated funds ("IGFs"), in lieu of a DSIC increase, to fund its mainline replacement.

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<sup>2</sup> RD at 69; RD at 105.

<sup>3</sup> RD at p. 55.

Collectively, PICGUG and OCA identify PGW's potential IGFs as the following: (1) the proceeds of PGW's August 18, 2015 revenue bond refunding; (2) the proceeds of proposed reduction of PGW's cash on hand; (3) the proceeds of PGW's accumulation of short term debt; and (4) savings from the grant-back of PGW's annual \$18 million payment owed to the City.<sup>4</sup> The ALJs evaluated the suggested alternative funding sources proposed by other parties and concluded that none were a viable alternative to an increase in PGW's DSIC funding.<sup>5</sup>

**1) The Uncontroverted Record Indicates that PGW's Savings From 2015 Bond Revenue Bond Refunding Has Been Devoted to Other Uses**

A simple review of OCA's exception on this point reveals that while OCA argues that PGW should fund accelerated main replacement with savings resulting from its August 18, 2015 revenue bond refunding, PGW produced evidence that those savings are devoted to other uses.<sup>6</sup> Specifically, OCA exceptions reference testimony from PGW witness Golden that PGW "would be utilizing them [dollars made available through expense savings] to fund the increase in expenditures from the last rate case or again to fund the net increase in operating expenses since the last rate increase."<sup>7</sup> No party has offered any evidence to refute Mr. Golden's testimony. These funds were not found to be a viable alternative to an increase in PGW's DSIC funding.

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<sup>4</sup> PICGUC Exceptions, pp. 2-7; OCA Exceptions, pp. 4-7.

<sup>5</sup> RD at p. 58.

<sup>6</sup> OCA Exceptions, p. 5.

<sup>7</sup> Hearing Tr., at. 69, ln. 10- p. 70, ln. 5.

**2) The ALJs Properly Determined that Reducing PGW's Cash-on-Hand was Not an Appropriate Option at this Time (RD, p. 70).**

After evaluating the evidence, the ALJs were persuaded by PGW's argument that reduction of PGW's cash on hand "would create deficiencies that would ultimately have to be filled in PGW's next rate case, and that doing so could potentially put PGW's financial health at risk."<sup>8</sup> As recognized in pages 6-7 of I&E's Reply Brief, PGW witness Golden presented compelling evidence to explain that the reduction of PGW's cash on hand would be detrimental to its financial position:

PGW witness Joseph Golden explained that use of existing internal funds is not possible because that use would reduce PGW's level of available year-end cash, eroding its financial indicators to unacceptable levels, which would impact PGW's currently bond ratings.<sup>9</sup> Mr. Golden correctly noted that PGW has only recently emerged from a decade of extreme financial distress which triggered it to request and be awarded at least three emergency or extraordinary rate increases, and he noted that because of PGW's lack of internal funds, it was forced to issue long-term debt that resulted in a capitalization level of approximately 85%.<sup>10</sup> Though Mr. Golden acknowledged that while PGW's financial position has only recently improved, it still had a debt ratio of 71.7% at the end of this fiscal year of 2014.<sup>11</sup> Furthermore, PGW still has only about 65 days of cash on hand, which should be increased by 25%-50% to provide for financial flexibility and to protect or increase its bond rating.<sup>12</sup>

Nonetheless, OCA avers that the record shows that PGW is in a relatively strong position, relying upon the analysis contained in OSBA witness Knecht's testimony.<sup>13</sup> A

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<sup>8</sup> RD at 55.

<sup>9</sup> PGW St. 3-R, p. 4., ln. 19- p. 5, ln. 2.

<sup>10</sup> PGW St. 3-R, p. 5, ln. 16- p. 6, ln. 1.

<sup>11</sup> PGW St. 3-R, p. 6, ln. 6-11.

<sup>12</sup> PGW St. 3-R, p. 6, ln. 14-19.

<sup>13</sup> OSBA St. 1, p. 6.

reading of the RD demonstrates that the ALJs did consider witness Knecht's testimony in their analysis;<sup>14</sup> however, the ALJs determined that reducing PGW's cash on hand "would increase PGW's financial risks, and would result in harm to the Company and its ratepayers."<sup>15</sup> The risk of harm is particularly unnecessary when, as previously recognized by I&E, the General Assembly has enacted a statute to address infrastructure improvement.<sup>16</sup>

Additionally, PICGUG attempts to discredit PGW's reference to a US Power Rating Criteria report by Fitch Ratings as an indicator that PGW should have 60-90 days of cash-on-hand at the end of its fiscal year.<sup>17</sup> Specifically, PICGUG disputes the report's application to PGW.<sup>18</sup> Yet, even assuming, arguendo, as PICGUG alleges, that the report is a "sector-specific" analysis that is not determinative, PICGUG fails to address other evidence PGW presented on this issue. Specifically, PGW witness Golden<sup>19</sup> testified that "based on his [my] experience and understanding, the level of cash on hand is a key determinant of the financial strength of a cash flow regulated utility and an indication of the adequacy of rates for a cash flow company."<sup>20</sup> Notably, PICGUG did not produce any witness or evidence to discredit the basis of Mr. Golden's testimony on this point.

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<sup>14</sup> RD at 30; RD. at 36.

<sup>15</sup> RD at 70.

<sup>16</sup> I&E Reply Brief, pp. 7-8.

<sup>17</sup> PGW St. 3-R, p. 5.

<sup>18</sup> PICGUG Exceptions, pp. 3-4.

<sup>19</sup> Witness Golden is PGW's Executive Vice President and Acting Chief Financial Officer and he has worked for PGW since 1986. His past positions at PGW included Controller, Treasurer, Manager of the Treasury Department, and Senior Staff Accountant. PGW St. 3-R, p. 1, ln. 2-7.

<sup>20</sup> RD at 41; Tr. 82, 87, 90-91; PGW St. 3-R at 5-7. See 52 Pa.Code § 69.2703 (a)(1).

**3) The ALJs Properly Determined that PGW's Accumulation of Short Term Debt Would Cost Ratepayers More than a DSIC Increase**

The OCA acknowledges that the ALJs rejected PGW's use of short-term financing to fund accelerated main replacement, but they generally allege that PGW is in a relatively strong financial position.<sup>21</sup> To the extent that the OCA's comments constitute an exception to the ALJs' finding, the RD provides an adequate basis for the finding. Specifically, the ALJs indicated:

we are persuaded by I&E's assessment that this mechanism [accumulation of short term debt] would require PGW to acquire debt, and that ultimately that debt will ultimately be paid by PGW's ratepayers with interest. We agree with I&E that PGW's ratepayers would instead benefit from increasing the DSIC cap, as that would require them to pay only for the actual cost of the accelerated replacement.<sup>22</sup>

No party to the proceeding has refuted that paying unnecessary interest, when DSIC funding is available without interest, would burden ratepayers. Furthermore, PGW witness Golden testified that considering existing obligations, PGW will have only \$40 million of its \$120 million commercial paper program funds that are intended for working capital through the winter and for operating needs.<sup>23</sup> Accordingly, PGW provided evidence that incurring short-term debt would not only impact its ratepayers but also compromise planned expenditures, and the ALJs were persuaded by this evidence.

**4) The ALJs Properly Determined that PGW Already Requested a Waiver of its \$18 Million Annual Payment to the City and that the Request was Denied. (RD pp. 70-71).**

PICGUG excepts on the erroneous basis that the RD declined to direct PGW to formally request a waiver of its annual \$18 million payment to the City, this exception

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<sup>21</sup> OCA Exceptions, pp. 6.

<sup>22</sup> RD at. 56.

<sup>23</sup> I&E Reply Brief, p. 9; Hearing Tr. at 72, ln.17- p. 73, ln. 2.

was made despite the fact that Ordering Paragraph No. 5 of the RD clearly states that “Philadelphia Gas Works shall [also] make a formal request of the City of Philadelphia to waive its City fee.”<sup>24</sup> On its face, PICGUG’s exception on this point fails. I&E will assume, arguendo, that PICGUG intended to make the same argument presented in OCA’s exceptions. OCA avers that PGW should have been required to make a request to the City for a waiver before receiving increased DSIC funding.<sup>25</sup> However, the ALJs correctly determined that PGW made the request and its request was denied.<sup>26</sup> No party submitted any evidence to refute PGW’s testimony on this basis.

Instead, the crux of PICGUG and OCA’s argument is that PGW failed to make a “formal” request prior to requesting a DSIC increase.<sup>27</sup> Although I&E will not speculate upon what type of subjective formality that PICGUG and OCA would find acceptable, such conjecture is not necessary because no formality requirement exists. The lack of a “formality” requirement explains why neither PICGUG nor OCA ever offered any legal support for the proposition that PGW was required to make a formal request before seeking a DSIC increase, and instead those parties merely allege that PGW’s efforts fail the reasonableness test. The RD reveals that the ALJs did consider PICGUG and OCA’s arguments, but that the ALJs rejected those arguments, as a formal request would not provide a viable alternative to PGW’s request to increase its DSIC.<sup>28</sup>

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<sup>24</sup> RD at 106.

<sup>25</sup> OCA Exceptions, pp. 6-7.

<sup>26</sup> RD at 44; RD at 57; I&E Reply Brief, pp. 11-12; Hearing Tr. at 84-88.

<sup>27</sup> I&E acknowledges that while PICGUG also argues that Mr. Golden’s contact was insufficient because it represented a single telephone call, PICGUG arrived at this unsupported conclusion after electing to cross-examine only Mr. Golden on this basis, and ignoring that fact that Mr. Golden testified that he was aware of additional inquiries made by other PGW employees. Hearing Tr., at 92; I&E Reply Brief p. 12.

<sup>28</sup> RD at 45-46; RD at 57.

**B. The ALJs Considered PGW's Ability to Safely Increase DSIC Spending by \$11 Million in Determining that PGW's Funding Request Should be Granted (RD p. 60; pp. 68-70).**

While OCA argues that the ALJs failed to consider evidence that PGW may not be able to safely spend an additional \$11 million in DSIC funding, that argument is disproved by a clear reading of the RD. Specifically, the RD references the testimony of PGW witness Murray, who testified that if the DSIC cap were increased to 7.5%, PGW projects that it would expend the \$11 million to accelerate main replacement.<sup>29</sup> Furthermore, although the OCA argues that PGW previously acknowledged its own concerns with increasing the level of main replacements,<sup>30</sup> the concerns PGW spoke of in the referenced testimony were regarding PGW's potential future requests for an increased DSIC cap beyond the 2.5% at issue in this case.<sup>31</sup> Instead, Mr. Murray testified that he had no concerns about PGW's ability to have an adequate staff of qualified employees to meet PGW's goal.<sup>32</sup>

Furthermore, OCA fails to acknowledge the additional level of protections provided in the Stipulation.<sup>33</sup> As noted on page 22 of RD, at the outset of this proceeding, I&E was also concerned that PGW's Petition failed to address the additional staffing needs that PGW would need to carry out the unprecedented acceleration of its replacement of cast iron and unprotected steel mains, as proposed.<sup>34</sup> I&E's Gas Safety Division is charged, in part, with enforcing both safety standards for pipeline facilities

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<sup>29</sup> RD at 60; PGW St. 1, p. 11.

<sup>30</sup> OCA Exceptions, p. 8 (referencing PGW St. 1, pp. 14-15).

<sup>31</sup> PGW St. 1, p. 14-15; Hearing Tr. p. 43, ln. 12-21.

<sup>32</sup> Hearing Tr. at 43-44.

<sup>33</sup> The Stipulation was admitted into the record at the evidentiary hearing on November 5, 2015 as PGW/I&E Ex. No. 1.

<sup>34</sup> I&E St. No. 3, p. 2, ln 17-22.

and federal safety standards.<sup>35</sup> I&E witness Horensky, a Gas Safety Engineer in I&E's Gas Safety Division, testified that PGW would be obligated to follow the regulations contained in Title 49 of the Code of Federal Regulations, Part 192, "Transportation of Natural and Other Gas by Pipeline: Minimum Federal Safety Standards," which will require it to have additional trained personnel to meet the minimum requirements for Operator Qualifications.<sup>36</sup> Mr. Horensky recommended that PGW should be required to submit a detailed plan setting forth its plan to comply with such regulations and to describe its increased training.<sup>37</sup>

Through the Stipulation, PGW acknowledged I&E's concerns and agreed that PGW would:

[p]rovide a plan showing how PGW intends to train staff and contractors to meet the Operator Qualification requirements of 49 CFR Subpart N and to otherwise demonstrate that it will have qualified personnel available to accomplish the accelerated main replacement authorized by the PGW Petition.<sup>38</sup>

PGW additionally agreed that

for a period of two years from the date that the Commission approves PGW's Amended Long Term Infrastructure Improvement Plan, it [PGW] will provide the Bureau of Investigation & Enforcement with 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 Long Term Infrastructure Improvement Plan.<sup>39</sup>

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<sup>35</sup> I&E Main Brief, pp. 15-16.

<sup>36</sup> I&E St. No. 3, p. 3, ln 1-10; I&E Main Brief, pp. 11-12.

<sup>37</sup> I&E Statement No. 3, p. 6, ln 1-11.

<sup>38</sup> Stipulation, ¶1(B)(1)(c).

<sup>39</sup> Stipulation, ¶1(D)(b).

Additionally, PGW again acknowledged Mr. Horensky's concerns by agreeing to "provide to I&E on a quarterly basis: all quarterly reconciliation updates and [PGW] shall agree to honor all of I&E's appropriate requests for back-up information."<sup>40</sup> In the RD, the ALJs acknowledged these protections in their determination that protections exist to ensure that PGW's additional DSIC revenues will be prudently spent.<sup>41</sup>

**C. The ALJs Correctly Determined that PGW's Plan to Submit a Revised LTIP, as Modified by the Stipulation, Should be Approved**

**1) PGW's DSIC Rate Should Be Increased to 7.5% as Proposed**

OCA argues that the ALJs do not understand that PGW intends to immediately increase the DSIC rate in order to collect the additional \$11 million annually.

Considering the ALJs' footnote states the following:

OCA also argued against the increase to 7.5% and cited to the fact that the Company would start collecting the new DSIC right away (January 1, 2016) but would not spend it until an amended LTIP was approved by the Commission. However, we do not see any real connection with this argument and whether the Commission should increase the DSIC to 7.5%.<sup>42</sup>

It appears from these comments that the ALJs do indeed understand the implications of this DSIC increase. OCA is concerned that, "[t]here 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."<sup>43</sup> Further OCA states that it is not a foregone conclusion that PGW will be able to accelerate its pipeline replacement at

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<sup>40</sup> Stipulation, ¶1(D)(a); I&E Main Brief, pp. 13-15.

<sup>41</sup> RD, at 22-23; RD at 54.

<sup>42</sup> RD at 69.

<sup>43</sup> OCA Exceptions p. 8.

the level it has proposed.<sup>44</sup> OCA's concern ignores the fact that as part of the Stipulation entered into between PGW and I&E, PGW has agreed that its Amended LTIP will:

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

Furthermore, in an effort to insure that DSIC funds are not misspent, PGW has also agreed that it will not undertake any main replacement made possible by the incremental DSIC funding authorized by the Petition unless and until the Commission has approved its LTIP.<sup>45</sup>

OCA ignores the fact that under Act 11 and existing federal requirements there are adequate safeguards that will ensure PGW does not misspend the increased DSIC revenue. Further, although the DSIC would increase effective immediately, PGW has agreed not to undertake any main replacement made possible by any incremental increase in DSIC funding unless and until the Commission approves its revised LTIP. And most importantly, OCA's concern about the DSIC being immediately increased to 7.5% is unfounded as ratepayers are already adequately protected by the fact that any portion of the DSIC not used to fund pipeline replacement will be returned to ratepayers with interest.<sup>46</sup> Therefore, there is no incentive for PGW to implement a DSIC increase and then misspend the funds when it will have to pay the money back to its customers with interest.

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<sup>44</sup> OCA Exceptions p. 8.

<sup>45</sup> Stipulation, 1(B)(4).

<sup>46</sup> I&E Reply Brief, pp. 23-24; RD at 55.

**2) PGW's Lack of a Revised LTIIP is Not Fatal and Adequate Protections are In Place**

The ALJs are correct that the lack of a revised LTIIP is not fatal to PGW's request for a DSIC increase to 7.5%. The requirement that a utility submit an LTIIP in order to be eligible to initially recover DSIC costs<sup>47</sup> does not apply to a utility seeking a waiver of the 5% DSIC limit. If time and circumstances permitted, I&E agrees that a revised LTIIP should have been filed either before, or concurrently with PGW's current DSIC Petition. However, with PGW's aging infrastructure, it is essential that PGW be allowed to implement its increased DSIC in an expedited fashion. The fact that PGW did not provide a revised LTIIP in conjunction with this proceeding should not invalidate PGW's request to increase its DSIC to 7.5%. PGW has presented a valid explanation for its failure to provide an LTIIP in conjunction with its Petition, as PGW witness Murray explained that PGW is working with an outside company, DNV GL, to have a prioritization/benchmark study completed.<sup>48</sup> This will ensure that the most accurate and recent data is used to prioritize pipeline replacement.

As correctly noted by the OCA,<sup>49</sup> at the outset of this proceeding, I&E witness Cooper Smith, a Gas Safety Engineer within I&E's Gas Safety Division, expressed multiple concerns about PGW's LTIIP, mostly driven by deficiencies in PGW's Distribution Integrity Management Program ("DIMP") plan.<sup>50</sup> The DIMP plan requirement, which originated in Federal Pipeline safety laws, requires all gas

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<sup>47</sup> 66 Pa.C.S. § 1352(a).

<sup>48</sup> PGW Statement 1-R, p. 5, ln. 11-14.

<sup>49</sup> OCA Exceptions, p. 12.

<sup>50</sup> I&E St. No. 2, pp. 2-8.

distribution operators to develop and implement a DIMP plan that addresses risk evaluation and ranking, performance measurement and monitoring, and periodic evaluation and improvement.<sup>51</sup> Among Ms. Cooper Smith's concerns was that PGW had been out of compliance with Federal Regulations in previous DIMP inspections, and that PGW's DIMP did not document adequately that PGW has assigned risk rankings based on the available data.<sup>52</sup> Although Ms. Cooper Smith opined that PGW should submit a revised, compliant DIMP before its LTIP is approved by the Commission, she recommended that the lack of a compliant DIMP not stop PGW's pipeline replacement that is underway.<sup>53</sup>

As indicated in I&E's Main Brief,<sup>54</sup> PGW responded to the concerns Ms. Cooper Smith raised, pursuant to the Stipulation. More specifically, PGW agreed that its revised LTIP will address its non-compliant DIMP in the following manner:

- (a) Identify how PGW proposes to expend the increased DSIC revenues, including identifying the types and sizes of at risk main PGW proposes to target with the increased revenues;
- (b) Utilize PGW's Distribution Integrity Management Program ("DIMP") risk scores, as modified by PGW to respond to issues raised by the PUC's Gas Safety Division's Non-Compliance letter to PGW dated May 7, 2015.<sup>55</sup>

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<sup>51</sup> 49 C.F.R. § 192.1005; 49 C.F.R. § 192.1007; I&E Main Brief, p. 2.

<sup>52</sup> I&E Statement No. 2, pp. 6-7.

<sup>53</sup> I&E Statement No. 2, p. 8, ln 1-5.

<sup>54</sup> I&E Main Brief, pp. 20-21.

<sup>55</sup> Stipulation, ¶(1)(B)(1)(a)-(b)).

Aside from these terms, PGW also agreed to the extent feasible, it will consult with I&E about the contents of its revised LTIP prior to its formal filing with the Commission.<sup>56</sup>

As more fully explained in I&E's Main Brief,<sup>57</sup> PGW's agreement has provided the I&E Gas Safety Division with a level of oversight necessary to monitor PGW's compliance, ultimately ensuring that any awarded DSIC funds will be spent to replace the riskiest pipeline. Furthermore, additional opportunities for oversight are included in the LTIP process.<sup>58</sup> I&E opines that the terms of the Stipulation afford the protections initially sought by I&E's Gas Safety Division, and provide an avenue to address the concerns raised by the OCA and that additional reporting proposed by the OCA is unnecessary.<sup>59</sup> As the ALJs properly recognized, the Stipulation is a safeguards built into PGW's request to ensure that DSIC revenues are prudently spent.<sup>60</sup>

2. **Reply to PICGUG Exception No. 2 and OCA Exception No. 2: The ALJs Correctly Found that PGW's Proposal to Add a Separate 2.5% Cap for Reconciliation Adjustments Should Be Granted. (RD, pp. 79-80).**

Contrary to the OCA and PICGUG position, the ALJs correctly opined that an additional 2.5% cap for reconciliation of undercollections was warranted. A gas company's DSIC may not exceed 5% revenues unless the Commission grants a waiver of that limit to ensure and maintain adequate, efficient, safe, reliable and reasonable service to the company's customers.<sup>61</sup> Therefore, the most important consideration in this entire

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<sup>56</sup> Stipulation, ¶(1)(B)(2).

<sup>57</sup> I&E Main Brief, pp. 22-24.

<sup>58</sup> 52 Pa.Code §123.5, 52 Pa. Code §121.5; I&E Main Brief, p. 22-23.

<sup>59</sup> OCA Exceptions, p. 14-15.

<sup>60</sup> RD at 54.

<sup>61</sup> 66 Pa.C.S. §1358(a)(1).

proceeding for PGW and its customers is that PGW be able to provide safe and reliable service. This Commission has already reported that:

...PGW experienced more than double the number of hazardous leaks than any other NGDC in 2013. Furthermore, PGW's leak rate increased in 2014. PGW discovered approximately 6,200 total leaks in 2013, of which 3,122 leaks were classified as hazardous. In 2014, PGW discovered 7,600 total leaks and its hazardous leaks increased to 3,448. PGW's aging infrastructure and leak rates are particularly concerning, given that its territory is largely urban and is a high-population area, which can pose a potential threat to life and property.<sup>62</sup>

As a result, it is necessary that PGW be given the opportunity to fully utilize its \$33 million construction budget to minimize the potential threat to life and property. Part of enabling PGW to fully utilize this budget includes allowing an additional 2.5% cap for reconciliation adjustments. In the Recommended Decision, the ALJs conclude:

...the added mechanism of the increase in the cap to 10% for reconciliation is necessary in order to ensure the construction and pipeline replacement can continue at an accelerated pace. It is certainly within the public interest to accelerate the pipeline and main replacement in order to ensure the safety of the public and also to ensure reliable gas service. Therefore, we recommend that PGW's request to increase the reconciliation cap to 10% be approved.<sup>63</sup>

While OCA seems to be of the impression that PGW's request for this exception is a result of its unique status as a cash flow company, the reality is that it is not PGW's cash flow status that necessitates this exception. Instead, the reality is that PGW's aging infrastructure necessitates that PGW be given an opportunity to spend all available funds.

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<sup>62</sup> *Staff Report: Inquiry into Philadelphia Gas Works' Pipeline Replacement Program* p. 4. (April 21, 2015).

<sup>63</sup> RD at p. 80.

As previously explained by PGW, if PGW is not allowed to exceed the 7.5% cap, PGW may not be able to fully bill the amounts that it plans to spend on pipeline replacement.<sup>64</sup>

By way of explanation PGW Witness Dybalski notes:

Any over or under collection from the previous year will be calculated in an annual reconciliation based on actual billed DSIC revenues and DSIC recoverable costs during each month of the calendar year. At present, the annual reconciliation of the DSIC results in a lag in which recoverable costs for the months of September to December are not included in the current year annual reconciliation. Note that in the first year the annual reconciliation will have 16 months of recoverable costs due to this lag. For any under collection, the DSIC may be increased by an additional 2.5% (up to 10%) in order to recover the under collection. Any under or over collection will be reconciled and filed by January 31 of each year and will be billed or credited from April 1 to March 31 each year.<sup>65</sup>

The 10% cap for reconciliation simply represents another safeguard to ensure that PGW can accelerate its pipeline replacement in a manner that will allow it to provide safe and reliable service to its customers. While OCA's exceptions seem to imply that this is a request by PGW to double its DSIC, the 10% actually only permits PGW to expend its fully budgeted amount for pipeline replacement when there was an undercollection from the prior calendar year. This feature essentially allows PGW to catch up on its DSIC to correct the September to December lag that PGW Witness Dybalski addresses below. If not allowed to address this lag, there is the possibility that PGW will always be behind on its DSIC. Furthermore, as noted by the ALJs "...PGW will return to the customers any

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<sup>64</sup> PGW's Petition 49.

<sup>65</sup> PGW St. 2, pp. 12-13.

unused portion of the DSIC with interest.”<sup>66</sup> As such, there are ample safeguards in place to assure the 10% cap is not misused.

Further, PICGUG’s conclusion that the ALJs provided no explanation as to why the 2.5% cap on reconciliations was warranted is completely without merit.<sup>67</sup> As noted above, the ALJs explained that the 2.5% was warranted in order to ensure that PGW would be able to fully expend its construction budget. In fact, PICGUG itself notes that this was the ALJs’ reasoning for granting the cap, further confounding its argument that no explanation was given. The exceptions filed by OCA and PICGUG demonstrate no reason that PGW should not be given the opportunity to fully utilize its \$33 million construction budget and thereby, provide the safe and reliable service required under the Public Utility Code. The accelerated replacement of PGW’s aging infrastructure is of paramount importance. Not allowing PGW the opportunity to fully expend its pipeline replacement budget would be irresponsible.

3. **Reply to OCA Exception No. 3: The ALJs Applied the Correct Standard in Determining that PGW’s Request to Annualize and Levelize the DSIC Rate and Properly Rejected the Conditions OCA Advocated. (RD, pp. 89-91).**

A. **The ALJs Applied the Correct Standard**

As indicated in the RD, the ALJs correctly found that the standard to apply to a city natural gas distribution operation seeking a waiver of a provision of the Public Utility Code, such as PGW, is whether the waiver “will be just and reasonable and in the public

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<sup>66</sup> RD at 80.

<sup>67</sup> PICGUG Exceptions, p. 7.

interest.”<sup>68</sup> The adopted standard, which was asserted by PGW, I&E, and EDF, is consistent with previous Commission precedent.<sup>69</sup> Despite the precedential support for the “just and reasonable and in the public interest” standard, which OCA agrees does apply,<sup>70</sup> OCA nonetheless argues that 66 Pa. C.S. §1358(a)(1) requires that the waiver of the DSIC cap includes a showing that the waiver will ensure and maintain adequate, efficient, safe, reliable, and reasonable service.<sup>71</sup>

The fatal flaw in OCA’s argument is that PGW made its waiver request under 66 Pa.C.S. § 2212(c), a provision that applies exclusively to city natural gas distribution operations, such as PGW.<sup>72</sup> Pursuant to 66 Pa. C.S. §2212(c): “upon [the] 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.”<sup>73</sup>

Accordingly, PGW’s waiver request, made under 66 Pa. C.S. §2212(c), supersedes any standard that may arguably be imposed under 66 Pa. C.S. §1358(a)(1). Therefore, the ALJs properly recognized and applied the correct standard.

**B. The Need for OCA’s Conditions Was Not Supported by Evidence**

OCA avers that the ALJs should have required PGW to do all the following: (1) put accounting controls in place to ensure that DSIC revenues that are collected in

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<sup>68</sup> RD at 81.

<sup>69</sup> *Pa. Pub. Util. Comm'n v. PGW*, R-2008-2073938, 2009 WL 884424 (Mar. 26, 2009).

<sup>70</sup> OCA Exceptions, p. 18.

<sup>71</sup> OCA Exceptions, p. 18-19.

<sup>72</sup> PGW Petition, ¶35; I&E MB at 29; I&E RB at 22.

<sup>73</sup> Emphasis added.

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.<sup>74</sup>

Contrary to the OCA's assertions, the RD reveals that the ALJs did consider and evaluate the OCA's proposed conditions and the ALJs properly determined that each of those conditions were unnecessary.<sup>75</sup>

### 1) Designation of DSIC Funds

In the RD, the ALJs made a finding of fact that “[t]he audit and reconciliation process does not permit any diversion of DSIC revenues for any other purpose.”<sup>76</sup> OCA excepts and argues that “if PGW is not required to designate the dollars collected through the DSIC for future spending or refund, nothing prevents the utility from diverting the amounts for other purposes and seeking relief from the Commission to address the shortfall.”<sup>77</sup> Despite the OCA's position, the RD illustrates that the ALJs considered the OCA's recommendation, as well as the evidence presented by PGW and I&E regarding stipulated quarterly reporting,<sup>78</sup> and quarterly reconciliation requirements that are already in existence.<sup>79</sup> Additionally, as the ALJs recognized in their RD, but which OCA ignored in its Exceptions, OCA witness Everett actually agreed that PGW's existing plan negated the need for an OCA designation mechanism.<sup>80</sup> Accordingly, the ALJs

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<sup>74</sup> OCA Exceptions, p. 19.

<sup>75</sup> RD at 95-103.

<sup>76</sup> RD at 13; Hearing Tr. 52-53, 117-118; PGW St. 2-R, p. 7.

<sup>77</sup> OCA Exceptions, p. 19.

<sup>78</sup> RD at 92.

<sup>79</sup> RD at 93.

<sup>80</sup> Hearing Tr. at 118, ln. 1-17; PGW Reply Brief, p. 29; RD at 96-98.

comprehensively evaluated the OCA's proposal and, after evaluating the evidence, they properly recommended the denial of OCA's proposal.

## **2) Quarterly DSIC Rate Updates**

The ALJs properly rejected OCA's recommendation that PGW's annualization and levelization waivers should be contingent on requiring PGW to update its DSIC rate each quarter to reflect changes in projected construction costs and proposed quarterly revenues. PGW witness Dybalski explained that due to the seasonal nature of PGW's business, it would be more prudent to assess the revenues on October 1, when PGW would have eight months of actual revenue figures available and could predict the remaining four months on normal weather conditions.<sup>81</sup> Finally, to the extent that the OCA is concerned about placing a limitation on PGW's discretion on whether to make necessary adjustments for any differences between projected and actual billed amounts, projected, or changes in the construction budget that could arise, Mr. Dybalski correctly noted that PGW has an incentive to avoid overcollection because it would have to pay interest on such any resulting overcollection.<sup>82</sup>

## **3) Increased Promotion of Budget Billing**

The RD demonstrates that the ALJs considered and properly rejected OCA's recommendation that PGW be required to do more to enroll customers in budget billing.<sup>83</sup> In their RD, the ALJs referenced the fact that the entire record in this case is devoid of any evidence showing that PGW's customers are not aware of PGW's Budget Billing

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<sup>81</sup> Hearing Tr. at 59, ln. 6-11.

<sup>82</sup> Hearing Tr. at 60, ln, 1-2.

<sup>83</sup> RD at 100-103.

program.<sup>84</sup> Instead of providing an evidentiary basis for need, the OCA merely asserted that while approximately one-third of PGW's customers are low-income customers, only 13% of those customers are enrolled in the CRP program.<sup>85</sup> These figures fail to make any connection to PGW's alleged lack of promotion of the budget billing program. On the other hand, PGW presented evidence that its budget billing plan meets all regulatory requirements and is "adequately serving all customers who wish to take advantage of it."<sup>86</sup> No party has offered any testimony to dispute PGW's position on this basis,<sup>87</sup> and thus, the ALJs properly concluded there is no support for requiring PGW to do more.

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<sup>84</sup> RD at 102.

<sup>85</sup> OCA Reply Brief, p. 18.

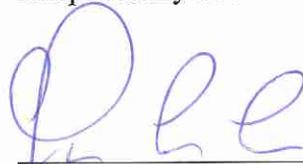
<sup>86</sup> PGW St. No. 2-R, p. 8, ln. 19-28.

<sup>87</sup> RD at 102.

### III. CONCLUSION

For the reasons stated herein, the Bureau of Investigation & Enforcement respectfully requests that the Commission deny both the exceptions of both the Philadelphia Industrial and Commercial Gas Users Group and the Office of the Consumer Advocate and adopt the Recommended Decision of the Administrative Law Judges without modification.

Respectfully submitted,



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Dated: January 11, 2016

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

**CERTIFICATE OF SERVICE**

I hereby certify that I am serving the foregoing **Reply Exceptions** dated January 11, 2016, in the manner and upon the persons listed below, in accordance with the requirements of § 1.54 (relating to service by a party):

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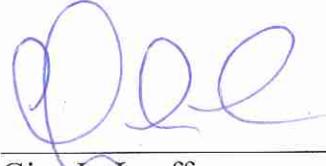
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