**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17105-3265**

Public Meeting held June 14, 2017

Commissioners Present:

Gladys M. Brown, Chairman

Andrew G. Place, Vice Chairman, Statement

John F. Coleman, Jr.

Robert F. Powelson

David W. Sweet

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| Petition of PECO Energy Company for Approval  of its Second Modified Gas Long-Term Infrastructure Improvement Plan | Docket Number:  P-2013-2347340 |

**OPINION AND ORDER**

**BY THE COMMISSION:**

Before the Commission for consideration is the Petition for approval of the Second Modified Gas Long-Term Infrastructure Improvement Plan (LTIIP) of PECO Energy Company (PECO).

**HISTORY OF THE PROCEEDING**

PECO is a corporation organized and existing under the laws of the Commonwealth of Pennsylvania with its principal office in Philadelphia, Pennsylvania. PECO provides electric delivery service to approximately 1.6 million customers and natural gas delivery service to approximately 513,000 customers in Pennsylvania. PECO furnishes gas service within its authorized service territory in Bucks, Chester, Delaware, Lancaster and Montgomery Counties. PECO is a “public utility” within the meaning of Section 102 of the Public Utility Code, 66 Pa. C.S. §§ 102, and, with respect to its provision of gas service, a “natural gas distribution company,” as defined in 66 Pa. C.S. § 2201 and is subject to the regulatory jurisdiction of the Commission.

PECO’s original LTIIP Petition was filed on February 8, 2013, and approved on May 9, 2013.[[1]](#footnote-1) PECO filed for its first modification of its LTIIP on February 4, 2015, and the modification was approved on May 7, 2015.[[2]](#footnote-2) The first modification concerned the issue of increasing PECO’s average annual expenditures in the LTIIP from $34 million to $61 million, with the goal of reducing the timeline for removing all target pipelines from the distribution system in 20 years, down from the previous target of 34 years.

PECO filed the instant Petition on March 1, 2017. Copies of the Petition were served on the statutory advocates, the Commission’s Bureau of Investigation & Enforcement (BIE), and all other parties of record for Docket No. P‑2013‑2347340.

The Office of Small Business Advocate (OSBA) filed comments on March 31, 2017. In its comments, the OSBA did not object to PECO’s proposed modified LTIIP and acknowledged that PECO has made a good faith effort to meet its burden of proof to show that its proposed cost increases are prudent. However, the OSBA averred that additional information may be necessary to make a determination of whether these costs are in fact reasonable and prudent.

On April 17, 2017 via a Secretarial Letter, the Commission issued a data request to PECO for more details regarding the factors requiring the proposed modifications to the LTIIP in order to ensure cost-effectiveness of the LTIIP as required per 52 Pa. Code § 121.4(e). On May 12, 2017, PECO filed a response to the data request.

**BACKGROUND**

On February 14, 2012, Governor Thomas Wingett Corbett signed into law Act 11 of 2012 (Act 11),[[3]](#footnote-3) which amends Chapters 3, 13 and 33 of Title 66. Act 11, *inter alia*, provides utilities with the ability to implement a Distribution System Improvement Charge (DSIC) to recover reasonable and prudent costs incurred to repair improve or replace certain eligible distribution property that is part of the utility’s distribution system. The eligible property for the utilities is defined in 66 Pa. C.S. §1351. Act 11 states that as a precondition to the implementation of a DSIC, a utility must file an LTIIP with the Commission that is consistent with 66 Pa. C.S. §1352. The Commission’s LTIIP Regulations are codified at 52 Pa. Code Chapter 121.

On April 5, 2012, the Commission held a working group meeting for discussion and feedback from stakeholders regarding its implementation of Act 11. On May 10, 2012, the Commission issued a Tentative Implementation Order addressing and incorporating input from the stakeholder meeting. Stakeholders filed comments to the Tentative Implementation Order on June 6, 2012. On August 2, 2012, the Commission issued the Final Implementation Order, at Docket No. M‑2012‑2293611, establishing procedures and guidelines necessary to implement Act 11.

The Final Implementation Order adopts the requirements established in 66 Pa. C.S. § 1352, provides additional standards that each LTIIP must meet, and gives guidance to utilities for meeting the Commission’s standards. The Final Implementation Order of Act 11 requires the inclusion of eight elements in the LTIIP.

PECO’s initial and first modified LTIIPs addressed the required elements of an LTIIP at the time they were approved. Therefore, we will only discuss the proposed changes from the first modified LTIIP to the instant Second Modified Gas LTIIP.

**PECO’S PROPOSED LTIIP CHANGES**

PECO’s Second Modified LTIIP is a ten year plan, spanning the years 2013-2022, with two major changes that build upon PECO’s first modified LTIIP. The first change is an increase in infrastructure spending designed to maintain PECO’s rate of infrastructure improvement while managing increasing construction costs. Under the instant LTIIP, PECO still plans to replace all of its targeted at-risk pipe within 20 years. In order to maintain this accelerated pace, PECO will increase its average spending level from $61 million per year to $92 million per year. This will raise the overall cost of the entire LTIIP from $534.4 million to $761.9 million, or by approximately 43%. As this increase in costs represents more than 20% of the original expected expenditures over the course of the first modified LTIIP, PECO was required to file for a Major Modification.[[4]](#footnote-4)

The second major change made in PECO’s Second Modified LTIIP is an increase in the rate of service line replacement for the remainder of the LTIIP period. PECO has been falling short of its LTIIP targets for the replacement of bare steel services. PECO’s second modified LTIIP addresses this shortfall by increasing the service line replacement target for the remainder of the LTIIP. PECO avers this will ensure that all bare steel services will be removed within the 20 year timeframe. Both major changes are discussed, below.

**(1) INCREASING CONSTRUCTION COSTS**

**Discussion**

PECO contends that several factors have increased their construction costs significantly higher than previously planned. PECO notes that changing pipeline construction market conditions are one major factor. PECO avers that several changes in this market have caused PECO’s construction costs to rise, including:

* A shortage of qualified labor personnel in the industry that perform gas construction work
* A limited number of reputable contractors that can complete gas construction projects according to PECO’s requirements for quality and safety
* Increased amounts of pipeline construction due to LTIIP programs being implemented concurrently by other Pennsylvania NGDCs combined with limited qualified contracting resources

PECO claims that the impact of these market conditions became evident when the bids were received for its 2015 construction contracts. PECO competitively bids contracts for per unit LTIIP construction for a period of time, locking in the costs for the term of the contract and ensuring price certainty. In 2015, PECO entered into 5-year contracts with 6 contractors through its Contractors of Choice (COC) program and bid process. PECO notes that the winning bids resulted in an increase in the company’s average main installation costs from $1 million per mile to $1.5 million per mile. PECO also notes that the new contracts resulted in an increase in the cost per service line replaced in the bare steel service replacement program. These costs rose from an average of $2,113 per service to an average of $4,150 per service.

PECO identified another factor that has resulted in higher projected construction costs. PECO avers that a number of townships in which it is doing construction work have recently changed their ordinances regarding road restoration requirements for utility excavations. These changes have frequently resulted in increased costs due to additional mill and overlay requirements, which are more expensive than the previous ordinances.

Table 1, below, details the increased projected expenditures from the first modified LTIIP to the instant Second Modified LTIIP.

**Table 1: Increase in Projected Expenditures from Current LTIIP to Modified LTIIP, 2017 Through 2022**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** |
| **Mains (Current LTIIP)** | $48.8 | $55.7 | $56.3 | $57.6 | $59.0 | $60.5 |
| **Mains (Modified LTIIP)** | $72.9 | $79.0 | $77.0 | $80.4 | $86.5 | $88.7 |
| **Mains (% Increase)** | 49.4% | 41.8% | 36.8% | 39.6% | 46.6% | 46.6% |
|  |  |  |  |  |  |  |
| **Services (Current LTIIP)** | $5.3 | $5.6 | $5.8 | $5.8 | $5.8 | $5.8 |
| **Services (Modified LTIIP)** | $15.4 | $15.4 | $15.5 | $15.5 | $14.7 | $15.0 |
| **Services (% Increase)** | 190.6% | 175.0% | 167.2% | 167.2% | 153.4% | 158.6% |
|  |  |  |  |  |  |  |
| **Total (Current LTIIP)** | $54.1 | $61.3 | $62.1 | $63.4 | $64.8 | $66.3 |
| **Total (Modified LTIIP)** | $88.3 | $94.4 | $92.5 | $95.9 | $101.2 | $103.7 |
| **Total (% Increase)** | 63.2% | 54.0% | 49.0% | 51.3% | 56.2% | 56.4% |

PECO provided Commission Staff with additional information for review pursuant to a data request. This information included additional details regarding PECO’s bidding process and contracts as well as information regarding specific cost increases in material and labor costs for construction. PECO also provided details regarding the increases in restoration costs and municipal fees.

PECO’s instant Petition outlines a number of measures that it has taken to mitigate the increasing costs of its infrastructure improvements. One measure PECO has undertaken involves the grouping of sections of main for replacement by geographic location. PECO explains that this will create efficiencies and cost savings, including:

* Reduced work scoping, engineering, and design by aggregating individual main and service replacement efforts into larger, centralized projects
* Reduced mobilization and demobilization time associated with moving construction crews to different areas
* Reduced tie-in work, by replacing facilities in areas larger than individual city blocks

PECO also notes that fixed, long-term construction contracts help to reduce rising construction costs. As described, above, PECO bid out contracts for per unit construction for a period of time, locking in their costs for the term of the contract. Although the 2015 winning bids resulted in higher costs than the previous contracts, PECO notes the process resulted in cost certainty in a market where costs continue to trend higher each year.

PECO has also taken steps to address the significant demand for a limited supply of qualified pipeline contractor employees. PECO explains that it has been working with local community colleges to offer a program to train workers and increase the available workforce. PECO recently partnered with the Collegiate Consortium for Workforce and Economic Development to create the Gas Distribution Pipeline Mechanic Introduction Program. This program provides students with fundamental gas mechanic skills and introductory training needed to work in the natural gas industry.

PECO notes that Delaware County Community College hosted two Gas Distribution Pipeline Mechanic Introduction courses in September and December of 2016. Most of the 12 graduates are currently employed and working on PECO main installation projects. The Community College of Philadelphia began a course in February 2017, with 9 students currently enrolled. PECO has plans to set up additional courses at Bucks County Community College in May 2017, and Montgomery County Community College in July 2017. PECO explains that this effort is designed to increase qualified labor resources that can enhance the natural gas workforce in southeastern Pennsylvania.

PECO submitted several sets of data to support their assertion that the cost of restoration work and municipal fees have risen significantly in recent years. A major portion of these specific cost increases are related to additional mill and overlay requirements being imposed by municipalities. PECO notes that its preferred methodology would be to cut a trench into a street surface to accomplish the required construction work, then refill and cover the patch of the street that had been cut. PECO avers this is the most cost-effective method for doing pipeline replacement work, when it is feasible.

PECO claims that most municipalities have historically had ordinances that govern when trenching and filling may be an insufficient method for restoring the road. These requirements might include such criteria as: the number of cuts within a certain distance; the length or width of a cut into the road; how recently the road had previously been repaved; or any other requirements that the municipality may specify. Depending on the circumstances, the municipality may instead require the utility to mill and overlay a portion or the entirety of a street. This work is far more expensive for the utility. PECO demonstrated in its original and first modified LTIIPs that it undertakes planning with PennDOT and townships to coordinate street paving projects with LTIIP projects. PECO notes the new requirements make restoration work more expensive even with coordination.

PECO has provided a breakdown of the percentage of jobs that have required mill and overlay work as compared to those that have required only trench restoration. Table 2, below, details the shift from the requirement for trench work to mill and overlay work from 2012 through 2016. As Table 2 shows, nearly all of PECO’s LTIIP construction jobs in 2016 required mill and overlay work.

**Table 2: Restoration Type by Year as a Percentage of Total Jobs Performed**

|  |  |  |
| --- | --- | --- |
| **Year** | **Mill and Overlay** | **Trench Only** |
| 2012 | 35% | 65% |
| 2013 | 60% | 40% |
| 2014 | 76% | 24% |
| 2015 | 95% | 5% |
| 2016 | 99% | 1% |

PECO explains that in addition to requiring mill and overlay restoration, municipalities have also been increasing the paving specifications for such work. This means that such restoration is now more expensive than it would have been under prior ordinances. PECO provided specific examples in which the requirements of new ordinances raised the cost of doing milling and overlay work, ranging from an increase of 52% to 122% of the prior cost per square yard of paving.

PECO notes a number of these new ordinances may also require that an entire length of a street be repaved rather than just a section. Although roadway length and width varies greatly, assuming as an example a roughly average street block length of 750 feet with a width of 300 feet, this would require an increased cost to repave the street of an additional $231,000 to $377,000.

**Comments**

As noted, above, the OSBA did not oppose PECO’s LTIIP Petition in its comments. However, the OSBA points out that Commission regulations state that PECO has the burden of proof to “demonstrate that its proposed LTIIP and associated expenditures are reasonable, cost-effective and are designed to maintain efficient, safe, adequate, reliable and reasonable service to customers” (OSBA Comments at 2). While the OSBA acknowledges that PECO has in good faith attempted to meet its burden of proof that the proposed cost increases in the Petition are prudent, it contends that additional information may be necessary for the Commission to make such a determination, especially considering the magnitude of the cost increases.

**Disposition**

The Commission agrees with the OSBA comments that more information was required for the Commission to make its determination. As noted above, the Commission requested additional information, which PECO provided for review.

Based on a review of the supplemental information, it appears that PECO’s bidding process was thorough and designed to procure contractors at the best price while maintaining the standards of quality and safety required by PECO. PECO also demonstrated that there seemed to be a robust marketplace for the construction contracts. Out of the 25 COCs eligible to submit bids to PECO, 12 COCs provided bids from which PECO selected 6 COCs to award its contracts. However, as PECO has outlined, the pipeline construction market forces have increased construction costs.

PECO has provided sufficient information that details the increase in township restoration requirements. Despite continuing coordination on construction projects, PECO has shown that a significant number of townships have enacted ordinances that have increased restoration costs.

Upon review of PECO’s Second Modified LTIIP and all supplemental information filed, the Commission finds that PECO’s Second Modified Gas LTIIP and its associated expenditures are reasonable, cost-effective and are designed to maintain efficient, safe, adequate, reliable and reasonable service to customers and the requirements the Final Implementation Order have been fulfilled. Further, PECO has demonstrated the significant increase in construction costs despite its best efforts to mitigate those increases.

**(2) Accelerated Service Line Replacement**

**Discussion**

PECO’s previous LTIIP had called for the replacement of 3,850 services per year over the course of the 10-year plan. In the first 4 years of the LTIIP, PECO replaced a total of 9,968 services, or an annual average of 2,492 services. This is 1,358 less than the projected annual average.

PECO notes it still plans to complete the removal of all at-risk service lines by the end of its LTIIP. To achieve this goal, PECO is raising its annual planned replacement goals to a range of 4,000-4,500 services per year. While this is an acceleration of the annual average in the original LTIIP, the total number of services replaced will be lower than originally planned. This is due to changes in estimates of the total number of services of at-risk material within PECO’s distribution system, and should not affect PECO’s commitment to remove all bare steel services from their system by the end of the Second Modified LTIIP.

PECO provided data detailing the increasing cost to replace services of at-risk materials. PECO includes the cost of replacing service lines in conjunction with main replacement projects in the cost of the main replacement project, and does not track the cost of replacing these services separately for main projects. However, PECO also has a program to proactively replace bare steel service lines that are not along current main replacement projects. PECO does track the cost of replacing these service lines, and has provided data showing the increasing cost of replacing these services over the prior 5 years, summarized in Figure 1, below.

**Figure 1: Cost per Service Line Replaced in PECO’s Proactive Replacement Program**

PECO’s construction contracts entered into through their COC program will cover the cost of proactively replacing services, preventing continuing cost increases for the term of the contracts. Based on the data provided, the cost per service was 142% higher in 2016 as compared to 2012 and the trend appeared to be heading higher each year. PECO’s 5-year construction contracts may have prevented that continuing rise by presenting price certainty.

**Disposition**

Upon review of PECO’s Second Modified Gas LTIIP and all supplemental information filed, the Commission finds that the acceleration in at-risk service line replacements is reasonable, cost-effective and designed to maintain efficient, safe, adequate, reliable and reasonable service to customers and the requirements the Final Implementation Order have been fulfilled.

**CONCLUSION**

Upon review, the Commission finds that PECO’s Second Modified Gas LTIIP and manner in which it was filed conforms to the requirements of Act 11 and our Final Implementation Order and the Petition should be granted; **THEREFORE,**

**IT IS ORDERED:**

1. That the Petition for Approval of a Second Modified Gas Long-Term Infrastructure Improvement Plan (LTIIP) filed by PECO Energy Company is approved, consistent with this Order.

2. That the proceeding at Docket No. P-2013-2347340 be closed.

**BY THE COMMISSION,**

Rosemary Chiavetta

Secretary

(SEAL)

ORDER ADOPTED: June 14, 2017

ORDER ENTERED: June 14, 2017

1. *See Petition of PECO Energy Company for Approval of its Gas Long-Term Infrastructure Improvement Plan*, Order entered May 9, 2013, at Docket No. P-2013-2347340. [↑](#footnote-ref-1)
2. *See Petition of PECO Energy Company for Approval of its Modified Gas Long-Term Infrastructure Improvement Plan,* Order Entered May 7, 2015, at Docket No. P-2013-2347340. [↑](#footnote-ref-2)
3. <http://www.legis.state.pa.us/WU01/LI/LI/US/HTM/2012/0/0011..HTM> [↑](#footnote-ref-3)
4. *See* 52 Pa. Code § 121.2 and § 121.5. [↑](#footnote-ref-4)