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March 30, 2011

Rosemary Chiavetta  
Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street, 2nd Floor North  
P.O. Box 3265  
Harrisburg, PA 17105-3265

**RE: Application of UGI Penn Natural Gas, Inc. for Approval of the Transfer by Sale of  
9.0 Mile Natural Gas Pipeline Appurtenant Facilities and Right of Way, Located in  
Mehoopany, PA  
Docket No. A-2010-2213893**

**Affiliated Interest Filing of UGI Penn Natural Gas, Inc.  
Docket No. G-2010-2213894**

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Dear Secretary Chiavetta:

Enclosed please find the Main Brief of UGI Penn Natural Gas, Inc. in the above-referenced proceeding.

As indicated on the certificate of service, copies have been provided to the parties in the manner indicated.

Respectfully Submitted,

David B. MacGregor

DBM/skr  
Enclosure

cc: Certificate of Service  
Honorable Dennis J. Buckley

**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the foregoing has been served upon the following persons, in the manner indicated, in accordance with the requirements of § 1.54 (relating to service by a participant).

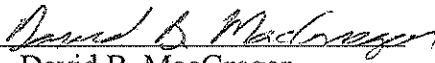
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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Application of UGI Penn Natural Gas, Inc. for Approval of the Transfer by Sale of 9.0 Mile Natural Gas Pipeline, Appurtenant Facilities and Right of Way, Located in Mehoopany, PA	:	:	Docket No. A-2010-2213893
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**MAIN BRIEF OF  
UGI PENN NATURAL GAS, INC.**

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## **I. INTRODUCTION**

On December 1, 2010, UGI Penn Natural Gas, Inc. (“PNG”) filed the above-captioned Application requesting a certificate of public convenience from the Pennsylvania Public Utility Commission (“Commission”) authorizing the transfer by sale of a nine-mile natural gas pipeline located in Auburn, Meshoppen, and Washington, Pennsylvania (the “Auburn Line”), together with its appurtenant facilities and right-of-way, to PNG’s affiliate UGI Energy Services, Inc. (“UGIES”). To carry out the contemplated transaction, PNG also filed an affiliated interest agreement requesting Commission approval of the “Pipeline Interconnection, Operating and Emergency Services Agreement between UGI Energy Services, Inc. and UGI Penn Natural Gas, Inc.” (the “PNG-UGIES Interconnection Agreement”).

Notice of PNG’s Application was published in the Pennsylvania Bulletin and the Scranton Times in December 2010, which provided notice to interested parties of the opportunity to intervene or protest on or before January 3, 2011. Protests, Notices of Intervention, and Notices of Appearance were filed by the Office of Trial Staff (“OTS”), the Office of Consumer Advocate (“OCA”), and the Office of Small Business Advocate. An initial prehearing conference was held before Administrative Law Judge Dennis J. Buckley (“ALJ”) on January 7, 2011. The Parties who participated in the prehearing conference filed prehearing memoranda identifying potential issues. A litigation schedule was established.

The Parties undertook formal and informal discovery and submitted testimony in support of their respective positions. Settlement discussions were held which resulted in the resolution of all issues raised by OTS, OCA, and PNG prior to the evidentiary hearing date scheduled for March 16, 2011. The agreement by and between OTS, OCA, and PNG is embodied in a Joint Stipulation filed on March 23, 2011. OSBA did not join in the Joint Stipulation and reserved one issue for litigation.

An evidentiary hearing was held on March 16, 2011, at which the parties moved their respective testimonies and exhibits into the record without objection. At the hearing, the ALJ asked PNG witness Robert F. Beard several questions and identified specific issues to be briefed by the Parties. Pursuant to the litigation schedule established by the ALJ, PNG herein submits this Main Brief in support of the proposed transaction. PNG also responds to the issues identified by the ALJ at the evidentiary hearing, as well as to the issue reserved for litigation by OSBA.

As explained below, the proposed transaction will benefit PNG, its customers, and the Commonwealth, and all criteria necessary for approval of the proposed transaction pursuant to the Public Utility Code have been met. PNG therefore respectfully requests that the ALJ recommend and the Commission approve the issuance of certificates of public convenience, pursuant to Section 1102(a)(3) of the Public Utility Code, 66 Pa.C.S. § 1102(a)(3), evidencing the Commission's approval of the proposed transaction subject to the terms and conditions of the Joint Stipulation. PNG also requests that the ALJ and Commission approve the PNG-UGIES Interconnection Agreement as an affiliated interest agreement pursuant to Section 2102 of the Public Utility Code, 66 Pa.C.S. § 2102.

## **II. SUMMARY OF ARGUMENT**

The unrebutted record evidence demonstrates that PNG's proposed transfer of the Auburn Line to its affiliate UGIES, as modified by the Joint Stipulation, provides substantial public benefits and should be approved. Indeed, the proposed transaction provides a classic "win-win" scenario for PNG and its customers, the local area served by PNG and the Commonwealth as a whole. Under the transaction as proposed, customers are assured of continued safe and reliable distribution service from the Auburn Line at reduced distribution

rates. And, PNG has retained the economic value of distribution service from this facility, including the present value associated with the 20-year Rate XD Agreement with P&G, which will reduce and/or defer the need for future PNG base rate increases. At the same time, customers are insulated from the very significant investment risk of converting the line to gathering service. Moreover, this project will provide broad, long-term benefits to PNG customers and the Commonwealth by promoting the development of Marcellus Shale gas resources.

Importantly, all interested parties agree that the proposed transaction, as modified by the Joint Stipulation, provides substantial public benefits. OTS and OCA affirmatively support approval of the transaction, and the principal customer affected by the transaction, P&G, has affirmatively expressed its support of the transaction. Even OSBA, who has continued to litigate this proceeding, agrees that the transaction as originally filed provides public benefits.

OSBA opposes the transaction because the Auburn Line will be transferred to an affiliate at depreciated original cost. In OSBA's view, the sales price should reflect the market value of the asset, and ratepayers should be entitled to share in some unspecified portion of "gain" from such a revised transaction. OSBA's argument should be rejected for at least eight reasons.

First, the issue of the proper ratemaking treatment of the gain on the sale of a utility asset is not presented in this proceeding. PNG proposes to transfer the asset at depreciated original cost; there is no "gain" to share. In essence, the OSBA is asking the Commission to review a transaction that is not before it. PNG has asked for approval to transfer the asset at depreciated original cost. It does not propose and is not willing to propose to transfer at a higher price, and UGIES is not willing to pay a higher price. All of OSBA's hypothetical and unsupported speculation about possible additional value therefore is moot. The Company has outlined the

many, many benefits of this transaction to customers and to the Commonwealth. These benefits are simply not available at a higher transfer price. The issue presented is whether the transaction presented provides substantial public benefits. It clearly does, as all parties and P&G agree, and it therefore should be approved.

Second, the OSBA proposal is inconsistent with all relevant precedent. As explained below, the Commonwealth Court has expressly held that the market value of an asset does not need to be determined in the context of a sale of utility property to a third party. And, the Commission itself has repeatedly approved the transfer of property to an affiliate at depreciated original cost. PNG is not aware of any decision by this Commission requiring a utility to sell assets at a specified price. OSBA's novel and unprecedented proposal should be rejected.

Third, to the extent that market value is relevant to this proceeding, and it is not, the issue of market value is raised by the OSBA, and under well-established practice and precedent, the OSBA bears the burden of proof on this issue. Importantly, and despite the full opportunity to do so, the OSBA has presented no evidence as to the specific market value of the Auburn Line. The OSBA speculates that the same transaction with all the same terms and conditions should be acceptable to a third party who would pay a higher price. However, the OSBA has provided absolutely no evidence to support that claim, and PNG has presented un rebutted evidence that this is simply not the case for a variety of compelling reasons. The OSBA also presented a brief summary of general economic theory as to the maximum possible value of the Auburn Line, but its own witness candidly admits that these theoretical maximums overstate the actual market value. The OSBA has completely failed to present any probative evidence that the market value of the Auburn Line exceeds its depreciated original cost. It has failed to meet its burden of proof on this issue, and its proposal should be rejected.

Fourth, OSBA assumes that PNG could obtain the market value of the Auburn Line by transferring the line to an independent, third-party gas gathering entity under the same conditions and limitations as those proposed in this transaction. However, OSBA ignores that the proposal before the Commission imposes significant conditions and limitations that are not likely to be attractive to an independent unregulated third party. Further, OSBA also ignores the fact that there are substantial risks that the investment could fail or be less profitable than anticipated.

Fifth, the OSBA essentially ignores the fact that this is a unique transaction because the distribution value of the Auburn Line is not being sold; it is being retained by PNG. And, the unrebutted record evidence shows that this retained distribution value exceeds even the maximum hypothetical replacement cost value identified by OSBA. Thus, to the extent that market value is relevant to this proceeding, and it is not, the evidence shows that by retaining the distribution value of the line, PNG is providing ratepayers with more than the maximum possible market value of the line under PNG's proposed transaction.

Sixth, OSBA's argument that ratepayers should share in the value of the line as a gathering line ignores the basic facts that conversion of the line requires a very substantial (\$15 million) investment and involves very substantial risks of failure. Ratepayers are not being asked to make this investment and are not being asked to undertake the risks of this investment. OSBA fails to explain and presumably cannot explain why ratepayers are entitled to share in the value of this project as a gathering line on these facts.

Seventh, even if the line were sold at a price above depreciated original cost, ratepayers should not share in that gain because they did not pay for the asset. The unrebutted evidence shows that the entire cost of the line has been allocated to P&G and not to any other customers and that P&G fully supports this transaction. It is well-established that ratepayers should not

share in the gain on the sale of an asset for which they did not pay. It is un rebutted that ratepayers, other than P&G, did not pay for this line and therefore should not share in the proceeds.

Finally, the OSBA appears to be concerned that the asset is being sold to an affiliate rather than to a third party. In PNG's view, this concern is misplaced. This is a unique transaction, which involves continued utility service to PNG customers and requires substantial and ongoing interactions between UGIES and PNG to assure continued safe and reliable service to customers. PNG, in this context, is more comfortable dealing with a skilled and experienced affiliate, as opposed to a totally independent third party. This arrangement should also provide comfort to the Commission, particularly given its continuing jurisdiction and supervisory control over the terms and conditions of affiliate agreements, which would not be present if the asset were sold to a non-affiliated third party.

It is un rebutted that this transaction, as modified by the Joint Stipulation, provides substantial public benefits. The OSBA's irrelevant and unsupported arguments should be rejected, and the proposed transaction, as modified by the Joint Stipulation, should be approved.

### **III. LEGAL STANDARD FOR COMMISSION APPROVAL**

#### **A. TRANSFER OF PROPERTY**

Section 1102(a)(3) of the Pennsylvania Public Utility Code requires that public utilities obtain a certificate of public convenience prior to transferring "the title to, or the possession or use of, any tangible or intangible property used or useful in the public service." 66 Pa.C.S. § 1102(a)(3). The Commission may issue a certificate of public convenience upon a finding that "the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public." 66 Pa.C.S. § 1103(a). The standard for approval of a

certificate of public convenience to transfer property used or useful in the public service under Section 1102(a)(3) has been interpreted to require the Commission to find that the transaction would “promote the service, accommodation, convenience, or safety of the public in some substantial way.” *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 151, 295 A.2d 825, 828 (1972).

In *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. 583, 611, 615, 937 A.2d 1040, 1057, 1059 (2007), the Supreme Court of Pennsylvania interpreted the Pennsylvania Public Utility Code and the “substantial public interest” standard articulated in *City of York* as satisfied by a simple preponderance of the evidence of benefits, and that such burden can be shown without legally binding commitments or quantifiable benefits. The Supreme Court further held that *City of York* does not require that every customer receive a benefit from the proposed transaction. *Id.* at 617-18, 937 A.2d at 1061 (“we agree ... that requiring that all types of customers receive unique, affirmative, and direct benefits from a transaction, would, in effect, prohibit transactions among companies which target their businesses to particular customer classes, even where other classes suffer no harm.”).

## **B. AFFILIATED INTEREST AGREEMENT**

Under Section 2102 of the Public Utility Code, 66 Pa.C.S. § 2102, Commission approval is required for any affiliated interest contract before the contract can become effective. Section 2102 provides that the Commission shall approve an affiliated interest agreement “if it shall clearly appear and be established upon investigation that it is reasonable and consistent with the public interest.” 66 Pa.C.S. § 2102(b). The Commission will disallow excessive payments under an affiliated interest agreement that are in excess of the reasonable price for the services provided for in the agreement. 66 Pa.C.S. § 2102(c). Moreover, the Commission has continuing jurisdiction over affiliated interest agreements “so far as necessary to protect the public interest”

and may take remedial action if necessary. 66 Pa.C.S. § 2103; *see also Application of PECO Energy Company*, Docket Nos. R-00973953, et al., 1997 Pa. PUC LEXIS 51; 181 P.U.R.4th 517 (December 23, 1997); *Affiliated Interest Agreement between United Telephone Company of Pennsylvania and United Telephone Long Distance, Inc. whereby the former will provide the latter with Billing and Collection Services, Equipment Leasing, Management Services, Repair Services and Telemarketing Services*, Docket No. G-870086, 1987 Pa. PUC LEXIS 11; 65 Pa. PUC 446 (December 21, 1987).

### C. BURDEN OF PROOF

Section 332(a) of the Public Utility Code, 66 Pa.C.S. § 332(a), provides that the party seeking a rule or order from the Commission has the burden of proof in that proceeding. It is well established that “[a] litigant’s burden of proof before administrative tribunals as well as before most civil proceedings is satisfied by establishing a preponderance of evidence which is substantial and legally credible.” *Samuel J. Lansberry, Inc. v. Pennsylvania Public Utility Commission*, 578 A.2d 600, 602 (Pa. Cmwlth. 1990). The preponderance of evidence standard requires proof by a greater weight of the evidence. *Commonwealth v. Williams*, 557 Pa. 207, 732 A.2d 1167 (1999). Consequently, as the party seeking relief, PNG bears the burden of proving that the proposed transaction satisfies the requirements of Sections 1102 and 1103 of the Public Utility Code.

Although PNG, as the applicant, bears the burden of proving that the proposed transaction is in the public interest, a party that proposes an issue that is not included in a public utility’s proposal bears the burden of proof. For example, in *Pennsylvania Public Utility Commission v. Metropolitan Edison Company, et al.*, Docket Nos. R-00061366, et al., 2007 Pa. PUC LEXIS 5 (January 11, 2007), a party offered proposals that were not included in the public utilities’ filings. The ALJ held that, as the proponent of a Commission order with respect to the



offered proposals, the party bears the burden of proof as to proposals that are not included in the companies' filings. The Commission agreed and adopted the ALJ's conclusion that the Public Utility Code cannot reasonably be read to place the burden of proof on the utility with respect to an issue the utility did not include in its filing and which, frequently, the utility would oppose. *Id.* at \*184-87. See also *Joint Default Service Plan for Citizens' Electric Company of Lewisburg, PA and Wellsboro Electric Company for the Period of June 1, 2010 through May 31, 2013*, Docket Nos. P-2009-2110798, et al., 2010 WL 1259684 at \*2, 19-20 (February 25, 2010) (the companies had the burden of proof as to the proposed plan, but other parties that had submitted their own proposals bore the burden of proof with respect to their proposals).

#### **IV. THE PROPOSED TRANSACTION IS IN THE PUBLIC INTEREST**

##### **A. OVERVIEW OF THE PROPOSED TRANSACTION**

###### **1. Description of the Auburn Line**

The Auburn Line is currently owned and operated by PNG for use in providing distribution services. The Auburn Line is a gas pipeline, approximately nine miles in length which extends from PNG's Auburn city gate station interconnection with Tennessee Gas Pipeline Company's ("Tennessee") mainline facilities located in Auburn Township, Susquehanna County ("Auburn Station I") to the Procter & Gamble Paper Products Company ("P&G") facility located near Mehoopany, Pennsylvania in Washington Township, Wyoming County, Pennsylvania. Located on the Auburn Line, approximately one-half mile north of the P&G plant, is the Manning Regulator Station ("Manning Regulator"), and immediately upstream of Manning Regulator is the interconnection with a pipeline system owned and operated by PVR Marcellus Gas Gathering, LLC ("PVR") ("PVR Interconnection"). PNG Statement No. 1, pp. 4-5; Exhibit ALJ-1.

The Auburn Line is essentially a dedicated line, *i.e.*, it was designed and installed in the 1960's to serve a single customer, P&G. PNG Statement No. 1-R, p. 3; Tr. 41. As currently configured, natural gas flows through the Auburn Line in a southerly direction from Tennessee through Auburn Station I and the Manning Regulator and on to P&G's plant. P&G owns and operates a paper products plant and is PNG's largest customer. PNG Statement No. 1, p. 4; PNG Exhibit RFB-3.

P&G and PNG have entered into a 20-year agreement under which P&G agreed to take and PNG agreed to provide distribution service to P&G's Mehoopany facility at rates which are above the fully allocated cost of service. This agreement has allowed PNG to establish and lock in the distribution value of the Auburn Line for itself and its customers for a 20-year period. PNG's continued service to customers and related demand from the Auburn Line will provide more than \$800,000 of annual base rate revenue (and more than \$16 million over the life of the agreement) that will reduce the rates paid by other customers. PNG Statement No. 1, p. 13.

P&G frequently intervenes and actively participates in PNG's proceedings where it needs to protect its interests or oppose a PNG proposal. *See, e.g., Pennsylvania Public Utility Commission v. UGI Penn Natural Gas, Inc., et al.*, Docket Nos. R-2008-2079660, *et al.* (August 27, 2009). In this case, P&G fully supports the transaction and Commission approval of it, as evidenced by its letter previously filed with the Commission. PNG Exhibit RFB-3.

Along the way to Manning Regulator, PNG also provides natural gas distribution service to fourteen other small customers: thirteen residential customers and one commercial customer, through taps off of the Auburn Line.<sup>1</sup> PNG Statement No. 1, pp. 5-6; Tr. 47. However, the rates

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<sup>1</sup> In rural areas, these tap lines which serve small customers off of a dedicated industrial line are referred to as "farm taps."

paid by the fourteen farm tap customers are not based on the local costs incurred to provide service. The rates paid by the 14 farm tap customers are the generally applicable system-wide residential and small commercial rates, which are based on the average cost of serving these customer classes. Specifically, the distribution rates of the 14 farm tap customers are not based on the local cost of the Auburn Line; they are based on the average cost of service for their respective rate classes. PNG Statement No. 1-RJ, p. 6. Similarly, the purchased gas cost rates paid by these customers are the average system-wide PGC rates.

P&G has substantial real estate holdings in the area. Marcellus Shale gas exploration on P&G's property has provided P&G with a new source of competitively priced, locally produced natural gas. Citrus Energy Corporation ("Citrus"), a local producer, currently produces natural gas for the account of Procter & Gamble delivered into the Auburn Line through the recently installed PVR Interconnection. PNG Statement No. 1, p. 4; PNG Exhibit RFB-3; Tr. 42. Citrus' gas supply is comprised of Marcellus Shale gas produced on and around P&G's property. Under current configurations, no gas can be delivered into Tennessee from the Auburn Line. PNG Statement No. 1, p. 5. Stated otherwise, Citrus is presently without means to get the Marcellus Shale gas produced from P&G property to market beyond those currently served by the Auburn Line.

Because Citrus presently is limited in its ability to get its Marcellus Shale gas to market, there is a very real threat that P&G and Citrus will seek alternative means to transport Marcellus Shale gas to market and part of such a project could include a complete bypass PNG altogether. PNG Statement No. 1-R, pp. 2, 4. In the event that P&G bypasses the Auburn Line, Citrus could very well elect another gathering service option that likely would be less economic than use of the Auburn Line. PNG Statement No. 1-R, pp. 4, 8.

## 2. Description of the Proposed Transaction

Given the unique circumstances of the Auburn Line and P&G's facilities, it is possible to convert the Line to gathering service, reverse the direction of the flow, and thereby provide access for P&G and its gas producer to get Marcellus Shale gas to market, while at the same time maintaining PNG's connection to P&G and the other distribution taps off of the Auburn Line. PNG Statement No. 1, p. 6. P&G expressed an interest in this arrangement and approached PNG to discuss how such a transaction might be accomplished. PNG determined that it was not willing to convert the line to gathering service due to the very substantial investment required to convert the line, the substantial risks associated with this largely unregulated service,<sup>2</sup> and because such service was outside of its core competency as a provider of distribution service and did not fit its risk profile as a natural gas distribution company. PNG Statement No. 1, pp. 7-8; PNG Statement No. 1-R, p. 17. PNG determined that if this project were to proceed, it should be undertaken by an affiliate who was in this business and was willing to undertake these risks and make the very substantial investment required to convert the line to gathering service. PNG Statement No. 1, p. 14; PNG Statement No. 1-R, p. 17.

PNG also considered going to an independent third party to do this transaction but did not do so because various aspects of the transaction were unlikely to be attractive to an independent,

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<sup>2</sup> The exploration and production business is ripe with risk at various points along the production line. Any midstream or gathering business tied directly to or largely reliant on a particular producer or acreage position realizes many of these risks, as well. Risks on the producers range from inability to find marketable quantities of gas, inability to find downstream markets willing to purchase production, inability to realize prices that enable a reasonable return on investment, changes in regulatory requirements, changes in permitting and environmental requirements, discovery of other more economic producing basins, liquidity, etc. There are additional risks for this project related to gas quality control, compression, operation and maintenance, etc. These risks ultimately pass through to anyone providing infrastructure that serves a producer. Gathering has the same risk profile as producing since it is entirely dependent upon the drilling of wells. See PNG Statement No. 1-R, pp. 7-10.

unregulated producer or midstream operator including: The limited capacity of the line; the large amount of investment necessary for compression due to the operating pressure limitations of the pipeline; the fact that PNG will retain an emergency backup service obligation and the revenue received from P&G; and additional obligations required under the PNG-UGIES Interconnection Agreement, including the continued obligation to provide capacity at no cost to PNG so it could continue to serve the farm tap customers who receive distribution service through distribution taps off of the Auburn Line. PNG Statement No. 1-R, p. 12. Given the unique and ongoing interaction between PNG and the proposed operation of the Auburn Line as a gathering Line, PNG determined that it was more comfortable dealing with an affiliate as opposed to a totally independent third party.

The proposal before the Commission is more than just a straight asset sale because it allows PNG to keep the current economic value of the line through the retention of ownership of the distribution taps serving P&G and the farm tap customers. Moreover, the transaction is part of a broader arrangement involving P&G and Citrus. PNG Statement No. 1-R, p. 12. P&G plans to fully replace its gas supply with competitively priced and reliable Marcellus Shale natural gas produced by Citrus on or near P&G's property. PNG Statement No. 1, p. 9; PNG Exhibit RFB-3.

Although the Marcellus Shale gas produced by Citrus will supply all or at least a significant portion of P&G natural gas needs, P&G wants to maintain emergency backup service from PNG to ensure reliable long-term natural gas service to its plant. P&G is not prepared to rely solely on Marcellus supplies at this point given the risks associated with local gas production, including uncertainty as to whether the planned wells will produce marketable quantities of gas.

As part of this overall transaction, P&G and PNG previously have entered into a 20-year agreement under which P&G agreed to take and PNG agreed to continue providing distribution service to P&G's Mehoopany facility. This will assure continued annual revenue to PNG, which is very substantially above the cost of serving P&G and which will contribute to PNG's recovery of fixed cost of service from all customers and avoid or defer the need for, and the amount of, future base rate increases. PNG Statement No. 1-R, p. 2. This agreement has allowed PNG to lock in the distribution value of the line for itself and its customers for a 20 year period. PNG's continued service to customers and related demand from the Auburn Line will provide more than \$800,000 of annual base rate revenue (more than \$16 million over the life of the contract) that will reduce the rates paid by other customers. PNG Statement No. 1, p. 13. The current cost of replacing the Auburn Line is considerably less than the present value to customers of retaining the right to serve P&G and other customers on the Line. PNG Statement No. 1-R, p. 10.

PNG is proposing to transfer to UGIES, by sale and assignment: (1) the Auburn Line; (2) the PVR Interconnection Facilities owned by PNG; and (3) PNG's rights and obligations under the interconnection agreement with PVR. As consideration for this transfer, UGIES will pay PNG an amount equal to the depreciated original cost of the Auburn Line. PNG Statement No. 1, pp 5-6; PNG Exhibit RFB-2.

In addition, PNG and UGIES will enter into the PNG-UGIES Interconnection Agreement. Under the PNG UGIES Interconnection Agreement, UGIES will assume the following obligations, among others: (1) to operate and maintain the Auburn Line and PVR Interconnection Facilities in accordance with applicable federal and state standards; and (2) to deliver natural gas to PNG at the Manning Regulator and other PNG meter and regulator facilities used to serve customers from the Auburn Line, including P&G, the fourteen farm tap

customers, and other customers that may elect from time to time to take service from PNG which requires the use of the Auburn Line. Specifically, under the PNG-UGIES Interconnection Agreement, UGIES is obligated to deliver locally produced natural gas from the Auburn Line to PNG's on a firm, first priority basis and, in the case of an emergency shortage of locally produced natural gas, to accept natural gas delivered from Tennessee through PNG's Auburn Station I. PNG Statement No. 1, pp 5-6; PNG Exhibit RFB-2.

The PNG-UGIES Interconnection Agreement also provides PNG with the option to re-acquire portions of the Line at net book value should the Agreement be terminated. In the event that the PNG-UGIES Interconnection Agreement is terminated for any reason, PNG shall have the option to re-acquire such portions of the Auburn Line as PNG may require assuring the continuity of its retail distribution service.<sup>3</sup> PNG would pay the net book value for only those portions of the Auburn Line necessary to provide retail delivery service. Thus, if the line is returned to PNG, PNG ratepayers will not be asked to pay for the cost of the compression facilities or any other facilities that are not required to assure the continuity of its retail distribution service. PNG Statement 1-R, p. 15; PNG Exhibit RFB-2.

After the transfer, UGIES plans to reverse the flow of the Auburn Line and substantially expand its capacity. The produced gas will be delivered into the Line through the PVR Interconnection Facilities or future interconnects. This gas then will be delivered: (1) to the inlet side of PNG valves connected to the Auburn Line so that PNG can provide natural gas

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<sup>3</sup> PNG explained that it has an obligation to serve the customers that are presently served by the Auburn Line. In the event that production is not available or that the PNG-UGIES Agreement is otherwise terminated, PNG would continue to have the obligation to provide service to these customers. Therefore, in the event that the PNG-UGIES Agreement is terminated, and in the absence of a Commission-approved abandonment, PNG would have to exercise its right to take back those portions of the Auburn Line that are necessary to assure the continuity of its retail distribution service, unless a more attractive alternative were available. Tr. 50-51.

distribution service to both present and future customers located along the Auburn Line, including P&G; and (2) into Tennessee through compressor facilities to be constructed by UGIES for further transportation and delivery into the interstate natural gas market. This change in operations will require UGIES to reverse the flow of the Line so that gas travels northward from the PVR Interconnection to the inlet side of PNG valves located along the Auburn Line and to a new, second interconnection with Tennessee (“Auburn Station II”), while deliveries to Procter & Gamble will continue to flow southerly into PNG’s facilities at Manning Regulator for further transportation on facilities owned by PNG and terminating at P&G’s Mehoopany plant. The Auburn Station II must be constructed with substantial compression equipment to compress the gas up to interstate pipeline operating pressures so that it may be delivered into Tennessee. A general estimate of the capital investment for compression and related facilities required to move the produced gas into Tennessee is approximately \$15 million. PNG Statement No. 1, pp. 6-7.

Both Auburn I and the Manning Regulator will continue to be owned and operated by PNG. PNG Statement No. 1, p. 7. Through the Auburn I interconnection, PNG will still maintain the ability to take gas from Tennessee. Tr. 42. Further, PNG will retain ownership of the taps and distribution lines that serve customers from the Auburn Pipeline. Tr. 47-48. Under the 20-year agreement with P&G and the PNG-UGIES Interconnection Agreement, PNG will continue to provide distribution services to P&G, the fourteen farm tap customers, and any new customers that from time to time seek to take service from the Auburn Line.

After the proposed transfer, the farm tap customers on the Auburn Line will continue to have the ability to shop for an alternative supplier. While farm tap customers on the Auburn Line will be physically served by local production, except under emergency conditions, they will



be free to shop for an alternative supplier if they so desire. PNG Statement No. 1, p. 16; PNG Statement No. 1-R, p. 17; Tr. 53-54.

Citrus intends to begin construction and production of its Marcellus Shale natural gas wells as soon as possible. Commission approval is one of the regulatory requirements needed before Citrus may proceed. In order to accommodate Citrus' construction and production schedule, PNG seeks Commission approval of the proposed transaction on or before June 1, 2011. Tr. at 29.

### **3. Terms of Joint Stipulation**

Settlement discussions were held which resulted in the resolution of all issues raised by OTS, OCA, and PNG prior to the evidentiary hearing on March 16, 2011. The agreement by and between OTS, OCA, and PNG is embodied in a Joint Stipulation filed on March 23, 2011. In order to fully resolve their issues in this proceeding, the OTS, OCA, and PNG stipulated and agreed to certain terms and conditions that modified the proposed transaction.

Under the Joint Stipulation, PNG shall be permitted to transfer ownership of the Auburn Line and related facilities to UGIES at net depreciated original cost. Joint Stipulation ¶ 16(a). PNG also shall be permitted to enter into the PNG-UGIES Interconnection Agreement. Joint Stipulation ¶ 16(b). However, the PNG-UGIES Interconnection Agreement will be revised to remove the \$60,000 annual fee originally proposed in the Application to be paid by PNG to UGIES. The PNG-UGIES Interconnection Agreement also will be revised to provide for the reversion of ownership of the subject pipeline to PNG in the event that UGIES for any reason ceases to operate the line in a manner that allows PNG to continue to provide distribution service to its customers. The transfer price upon any such reversion of ownership will be at the then depreciated original cost of the facilities originally transferred from PNG to UGIES, but in no event will the transfer price upon reversion exceed the original transfer price. In the event of

such reversion of ownership, PNG shall not seek to recover from ratepayers any costs incurred to alter, reconfigure, reverse, or otherwise change the subject pipeline in response to alterations made by UGIES. Joint Stipulation ¶ 16(f).

The OTS, OCA, and PNG agreed that the Commission may continue to conduct safety inspections of the Auburn Line after the transfer of ownership to UGIES. To the extent that there is a separate assessment on PNG by the Commission to recover the costs of these inspections, UGIES will be obligated to reimburse PNG for any such inspection costs. Joint Stipulation ¶ 16(d).

On the day after the Auburn Line is transferred from PNG to UGIES, PNG will file a tariff supplement with the Commission, to be effective on one day's notice, that reduces PNG's rates to reflect the removal of the Auburn Line from rate base and the removal of all associated expenses, including depreciation and operating and maintenance expenses. Joint Stipulation ¶ 16(e).

The OTS, OCA, and PNG further agreed that the Joint Stipulation is not precedential and shall not be cited regarding the question of whether an entity operating a gathering line is required to file an application for a certificate of public convenience with the Commission to own and operate the gathering line. Joint Stipulation ¶ 16(g).

The proposed transaction as modified by the terms and conditions of the Joint Stipulation is just, reasonable, and provides important substantial public benefits as explained below.

#### **B. SUBSTANTIAL BENEFITS OF THE PROPOSED TRANSACTION**

The proposed transaction, as modified by the Joint Stipulation, is a unique opportunity that will provide important benefits to PNG, its customers, and the Commonwealth. Under the transaction as proposed, customers are assured of continued safe and reliable distribution service from the Auburn Line at reduced distribution rates. PNG has retained the economic value of

distribution service from this facility and, at the same time, customers are insulated from the very significant investment risk of converting the line to gathering service. Moreover, this project will provide broad, long-term benefits to PNG customers and the Commonwealth by promoting the development of Marcellus Shale gas resources.

Under the terms of the Joint Stipulation, PNG and its customers will receive this safe and more reliable service from the Auburn Line at a lower cost. PNG's customers currently served from the Auburn Line will continue to receive PNG's distribution service through distribution taps off of the Line, and PNG will be able to provide service to any new customers along the Auburn Line. PNG will have the ability to draw gas from the Auburn Line on a firm, first priority basis, as it does today. PNG Statement No. 1, pp 5-6; PNG Exhibit RFB-2. Further, the proposed transaction will provide an additional point of delivery, which will help prevent the interruption of service to customers served off of the Line in the event of a curtailment on the Tennessee Line. Tr. 56-57; *see also* PNG Statement No. 1, pp. 11-12.

As explained above, if the Auburn Line project does not proceed or subsequently is abandoned, PNG has the right to reacquire those portions of the Auburn Line required to continue providing distribution service at the then depreciated original cost of the facilities originally transferred from PNG to UGIES, thereby further assuring reliable service to customers. As a result, PNG customers will see no disruption in service, will not pay for any of the substantial capital investment needed to convert the line to gathering operations, and will bear none of the risks should the project fail or not be less profitable than anticipated. PNG Statement 1-R, p. 15; PNG Exhibit RFB-2.

The proposed transaction, as modified by the Joint Stipulation, will ensure continued safe operation of the Auburn Line. Under the PNG-UGIES Interconnection Agreement, UGIES is

obligated to operate and maintain the Auburn Line in accordance with applicable federal and state laws and regulations designed to ensure the safety, integrity and continuous operation of the Line. Further, under the Joint Stipulation, the Commission may continue to conduct safety inspections of the Auburn Line after the transfer of ownership to UGIES. PNG Statement No. 1, pp 5-6; PNG Exhibit RFB-2; Joint Stipulation ¶ 16(d).

Under the terms of the Joint Stipulation, PNG customers will receive a credit to base rates reflecting the revenue requirement associated with the depreciated original cost of the Auburn Line and associated operating expenses. Joint Stipulation ¶ 16(e). Further, P&G has entered into a 20-year agreement to continue to take distribution service from PNG. This will assure continued annual revenue to PNG, which is very substantially above the cost of serving P&G and which will contribute to PNG's recovery of fixed cost of service from all customers and avoid or defer the need for, and the amount of, future base rate increases. PNG Statement No. 1-R. p. 2.

Importantly, PNG has retained the economic value of distribution service from the Auburn Line and, at the same time, customers are insulated from the very significant investment risk of converting the line to gathering service. The Auburn Line will be transferred to UGIES. However, PNG will retain all the commercial benefit of the distribution customers that are connected to the Line. PNG will continue to provide distribution service to P&G and the farm tap customers, and the associated revenue from this service, and those customers will still be guaranteed service under PNG's rate schedule. PNG Statement No. 1-R, pp. 4-5; Tr. 46-47. Further, customers will not pay for the very substantial investment necessary to convert the Auburn Line into a gathering line, and they are not assuming any of the substantial risk of gathering or producing should the project fail or is not profitable. PNG Statement No. 1-R, pp. 7-10. Therefore, the proposed transaction provides customers with continued safe and reliable

service at lower rates and retains the value of the line as a distribution line, while avoiding the risk associated with investing in converting the line to gathering service.

In PNG's 2010 PGC proceeding at Docket Nos. R-2010-2172928 *et al.*, PNG was encouraged by the Commission to seek opportunities to utilize Marcellus shale gas supplies. PNG Statement No. 1, p. 18. The proposed transaction will help facilitate the development of the Marcellus Shale gas market in the area, produce many related benefits to the local economy and environment, and will otherwise help constrain the wholesale market price for gas to the ultimate benefit of consumers. PNG Statement No. 1-R, p. 3. Citrus' gas supply is comprised of Marcellus Shale gas produced on and around Procter & Gamble's property. Under current configurations, no gas can be delivered into Tennessee from the Auburn Line. PNG Statement No. 1, p. 5. The proposed transaction provides a means to transport additional Marcellus Shale gas to market, which provides an immediate positive benefit to all gas customers. PNG Statement No. 1-R, pp. 16-17.

The proposed transaction also will have a positive impact on the local economy and the environment. The local economic benefits are several: (1) P&G's plant will benefit from a lower cost source of supply, thus making the plant more competitive; (2) a more competitive P&G plant will benefit P&G's employees and local businesses that supply the plant and the plant's employees; (3) local landowners leasing their land for natural gas production will benefit from royalty revenue for gas produced on their land; and (4) Citrus' production and related gathering services will be a source of income for production and gathering field workers that otherwise would not be employed in the area. Further, the proposed transaction provides an important environmental benefit because use of the existing Auburn Line as a gathering line will

avoid the environmental impact of building a second pipeline to bypass the Auburn Line. PNG Statement No. 1, p. 17.

Finally, approval of the PNG-UGIES Agreement as an affiliate interest agreement provides certain additional benefits to customers, the Commission, and the parties. Under the terms of the PNG-UGIES, UGIES is obligated to, among other things, connect and service new customers and sell, exchange, or transport natural gas for PNG in the event of an emergency. Further, in the event that the PNG-UGIES Interconnection Agreement is terminated for any reason, PNG shall have the option to re-acquire such portions of the Auburn Line as PNG may require to assure the continuity of its retail distribution service. PNG Statement No. 1-R, p. 12. There is no assurance that a similarly acceptable agreement could be achieved through a sale to an independent producer or midstream operator, that the many benefits to customers from this transaction would be retained, or that Citrus would not begin the construction of bypass facilities to avoid further delay. PNG Statement No. 1-R, p. 13. Moreover, the Commission will continue to have jurisdiction over the PNG-UGIES Interconnection Agreement “so far as necessary to protect the public interest” and may take remedial action if necessary. 66 Pa.C.S. § 2103.<sup>4</sup> This jurisdiction would not exist if the asset were sold to an independent third party. PNG Statement No. 1-R, p. 13.

Based on the foregoing, the proposed transaction, as modified by the Joint Stipulation, will provide important benefits to PNG, its customers, and the Commonwealth. If approved,

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<sup>4</sup> See also *Application of PECO Energy Company*, Docket Nos. R-00973953, et al., 1997 Pa. PUC LEXIS 51; 181 P.U.R.4th 517 (December 23, 1997); *Affiliated Interest Agreement between United Telephone Company of Pennsylvania and United Telephone Long Distance, Inc. whereby the former will provide the latter with Billing and Collection Services, Equipment Leasing, Management Services, Repair Services and Telemarketing Services*, Docket No. G-870086, 1987 Pa. PUC LEXIS 11; 65 Pa. PUC 446 (December 21, 1987).

customers will continue to receive safe and reliable distribution service from the Auburn Line at reduced distribution rates. The value of the Auburn Line as a distribution line will be retained by PNG, while at the same time customers will be insulated from the significant investment risk of converting the line to gathering service. Further, if approved, the proposed transaction, as modified by the Joint Stipulation, will provide long-term benefits to PNG customers and the Commonwealth through the development of Marcellus Shale gas resources.

The parties to the Joint Stipulation have carefully analyzed the proposed transaction and have agreed that, as modified by the terms and conditions of the Joint Stipulation, Commission approval of the transaction is in the public interest. Joint Stipulation ¶ 17; *see also* Statements in Support of OTS, OCA, and PNG. Furthermore, as explained below, although OSBA was not a signatory to the Joint Stipulation, the OSBA concedes that the transaction, as proposed, has merit and provides public interest benefits.<sup>5</sup> *See* PNG Main Brief Section IV.D, *infra*; OSBA Statement No. 1, p. 11. For these reasons, as well as those more fully explained above, the proposed transaction, as modified by the Joint Stipulation, is just, reasonable, and in the public interest and therefore should be approved.

### **C. ISSUES RAISED BY ALJ**

At the evidentiary hearing on March 16, 2011, the ALJ raised additional issues to be addressed by the Parties. Below, PNG responds to each of the issues raised by the ALJ. Many of these issues were addressed above and/or resolved by the Joint Stipulation filed on March 23,

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<sup>5</sup> As discussed below, OSBA contends that there is a potential that the transaction could have greater public benefits if the Auburn Line and related facilities are transferred at market value rather than at the net depreciated original cost. For the reasons explained below, OSBA's proposal should be rejected. *See* PNG Main Brief Section IV.D, *infra*.

2011. For the reasons set forth below, as well as those more fully explained above and in the Joint Stipulation, the proposed transaction is in the public interest and should be approved.

One of the issues raised by the ALJ was the operation and safety of the Auburn Line if the proposed transaction is approved by the Commission. Specifically, the ALJ asked whether reversing the flow of gas on the Auburn Line would cause any operation or safety concerns, and whether the Commission would retain safety jurisdiction over the Line after the transfer and conversion to a gathering line. Tr. 42-43, 54. PNG explained on the record that reversing the direction of the flow of gas on the Auburn Line would have no effect on the operation and safety of the Line. Tr. 43. Further, as explained above, the Joint Stipulation provides that the Commission may continue to conduct safety inspections of the Auburn Line after the transfer of ownership to UGIES. Main Brief Section IV.A.3, *supra*; Joint Stipulation ¶ 16(e).

The ALJ also asked whether PNG's customers served by the Auburn Line after it is converted to a gathering line would still have the ability to shop and take competitive supply from a natural gas supplier of their choice. As explained above, customers on the Auburn Line will continue to have the ability to shop for an alternative supplier if the proposed transaction is approved. PNG Main Brief Section IV.A.2, *supra*; PNG Statement No. 1-R, p. 17; Tr. 53-54.

The ALJ raised a concern with PNG's "option" under the PNG-UGIES Interconnection agreement to re-acquire portions of the Auburn Line should the Agreement be terminated. Tr. 50. As explained above, in the event that the PNG-UGIES Interconnection Agreement is terminated for any reason PNG shall have the option to re-acquire such portions of the Auburn Line as PNG may require to assure the continuity of its retail distribution service. PNG Main Brief Section IV.A.2, *supra*. However, PNG explained that it has an obligation to serve the customers that are presently served by the Auburn Line. In the event that production is not



available or that the PNG-UGIES Agreement is otherwise terminated, PNG would continue to have the obligation to provide service to the customers served by the Auburn Line. Therefore, in the event that the PNG-UGIES Agreement is terminated, and in the absence of a Commission-approved abandonment, PNG would undoubtedly exercise its right to take back those portions of the Auburn Line that are necessary to assure the continuity of its retail distribution service unless there were another alternative method of providing safe and reliable service at a lesser cost. Tr. 50-51. Also, as explained immediately below, transferring this asset to an affiliate provides for additional continuing jurisdiction of the Commission over the terms and conditions of the contract.

The ALJ also questioned whether the terms and conditions of the PNG-UGIES Interconnection Agreement would be enforceable by the Commission or the applicable Court of Common Pleas. Generally, the Commission is without jurisdiction to adjudicate private contractual disputes.<sup>6</sup> However, in this proceeding, PNG has asked for, and the Joint Stipulation provides for, Commission approval of the PNG-UGIES Interconnection Agreement as an affiliated interest agreement pursuant to Chapter 21 of the Public Utility Code. Joint Stipulation ¶ 16(b). Section 2102 provides that the Commission shall approve an affiliated interest agreement “if it shall clearly appear and be established upon investigation that it is reasonable and consistent with the public interest.” 66 Pa.C.S. § 2102(b). Importantly, the Commission has

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<sup>6</sup> See, e.g., *Adams v. Pa. P.U.C.*, 819 A.2d 631 (Pa. Cmwlth. 2003) (concluding that the Commission lacked jurisdiction over private contractual disputes); see also *Fairview Water Co. v. Pennsylvania Public Utility Commission*, 502 A.2d 162 (Pa. 1985) (holding that the Commission does not have jurisdiction to determine the scope and validity of an easement); *Tucker v. Pa. P.U.C.*, 917 A.2d 378, 380 (Pa. Cmwlth. 2007) (holding that the Commission lacks jurisdiction to adjudicate matters relating to negotiable instruments).

continuing jurisdiction over affiliated interest agreements “so far as necessary to protect the public interest” and may take remedial action if necessary. 66 Pa.C.S. § 2103.<sup>7</sup>

Further, the Commission has exclusive jurisdiction over the rates and services of public utilities. *Philadelphia Electric Co. v. Pennsylvania Human Relations Com.*, 290 A.2d 699, 700 (Pa. Cmwlth. 1972). The doctrine of primary jurisdiction requires a court to defer action pending a ruling by an administrative agency, in order that “the courts can have the benefit of the agency’s views on issues within the agency’s competence.” *Elkin v. Bell Telephone Co. of Pennsylvania*, 491 Pa. 123, 131, 420 A.2d 371, 376 (1980). Therefore, to the extent that any dispute arising from the PNG-UGIES Interconnection Agreement relates to or otherwise affects the rates or services provided by PNG, the Commission may have primary jurisdiction over the matter before it would proceed to the Court of Common Pleas for a determination of damages or any other available contractual remedies.<sup>8</sup>

Finally, the ALJ questioned whether the Commission would retain jurisdiction over the rates charged and the service provided by the Auburn Line after the transfer of the Line to UGIES, and the precedential effect of the transfer on other gathering lines. Tr. 46, 57-58. After the transfer of the Auburn Line to UGIES, the Line will be converted to and classified as a

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<sup>7</sup> See also *Application of PECO Energy Company*, Docket Nos. R-00973953, et al., 1997 Pa. PUC LEXIS 51; 181 P.U.R.4th 517 (December 23, 1997); *Affiliated Interest Agreement between United Telephone Company of Pennsylvania and United Telephone Long Distance, Inc. whereby the former will provide the latter with Billing and Collection Services, Equipment Leasing, Management Services, Repair Services and Telemarketing Services*, Docket No. G-870086, 1987 Pa. PUC LEXIS 11; 65 Pa. PUC 446 (December 21, 1987).

<sup>8</sup> It is well established that the Commission does not have the jurisdiction to order a public utility to pay monetary damages. *Diane M. Hamilton and Eva J. Hamilton v. Verizon Pennsylvania, Inc.*, Docket No. C-2009-2135715, 2010 Pa. PUC LEXIS 234 at \*8 (July 28, 2010) (Initial Decision) (citing *DeFrancesco v. Western Pennsylvania Water Company*, 499 Pa. 374, 453 A.2d 595 (1982); *Elkin v. Bell of Pa.*, 491 Pa. 123, 420 A.2d 371 (1980); *Feingold v. Bell of Pa.*, 477 Pa. 1, 383 A.2d 791 (1977)); *Byer v. Peoples Natural Gas Co.*, 380 A.2d 383 (Pa. Super. 1977) (holding that the Commission does not have the authority to award damages).

gathering line. Although PNG will retain ownership of the service lines needed to provide distribution services to P&G and the fourteen farm tap customers, the Auburn Line will not be a distribution line post transfer; rather, it will be operated and maintained as a gathering line. PNG Statement No. 1, pp. 6-7; Tr. 46-49. Therefore, post transfer the Commission would not have distribution system jurisdiction over the rates of the Auburn Line.

The issue of the Commission's jurisdiction over gathering lines is currently pending before the Commission. *See Application of Laser Northeast Gathering Company, LLC for Approval to Begin to Offer, Render, Furnish or Supply Natural Gas Gathering and Transporting or Conveying Service by Pipeline to the Public in Certain Townships of Susquehanna County, Pennsylvania*, Docket No. A-2010-2153371 ("*Laser*").<sup>9</sup> The Joint Stipulation provides that approval of PNG's application does not address and has no precedential value regarding Commission jurisdiction over gathering facilities. If the Commission ultimately determines that it has general jurisdiction over gathering facilities, then the question would arise as to whether the specific gathering services provided by UGIES from the Auburn Line are "to or for the public." This issue would be addressed in a future proceeding.

#### **D. OSBA'S ISSUE**

OSBA raises essentially one issue. OSBA recommends that the Commission reject PNG's proposal to transfer the Auburn Line at the depreciated original cost, unless and until PNG makes an effort to assess the market value of the transfer in an arms-length transaction.

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<sup>9</sup> In *Laser*, the gathering line argued that it was a public utility. The Recommended Decision in the *Laser* recommended that the Commission disapprove a non-unanimous settlement and deny the gathering company's application for a certificate of public convenience because it does not meet the definition of "public utility" under the Public Utility Code. Specifically, the Recommended Decision found that transporting a product that cannot be used by end-use customers on behalf of gas producers does not equate to service "to or for the public." *See Laser*, Recommended Decision, p. 13.

According to OSBA, customers are entitled to share in the value of the line, if any, in excess of the depreciated original cost. OSBA's proposal to transfer the Auburn Line at market value lacks merit and disregards the many important facts and circumstances involved in the proposed transfer.

First, all Parties to this proceeding, including OSBA, agree that the proposed transaction is in the public interest. Second, the issue of the treatment of gain on the sale of a utility asset is not properly at issue in this proceeding, and the OSBA has presented no specific evidence as the value of the Auburn Line. Third, to the extent that market value is relevant to this proceeding, and it is not, the issue of market value is raised by the OSBA and under well-established practice and precedent, the OSBA bears the burden of proof on this issue. OSBA failed to meet its burden of proof on this issue. Fourth, OSBA ignores that the proposal before the Commission imposes significant conditions and limitations that are not likely to be attractive to an independent third party. Fifth, the OSBA essentially ignores the fact that this is a unique transaction in that the distribution value of the Auburn Line is not being sold; it is being retained by PNG and this retained distribution value exceeds the maximum possible theoretical value of the Line. Sixth, OSBA's argument that ratepayers should share in the value of the line as a gathering line ignores the fact that ratepayers are not being asked to make this investment and are not being asked to undertake the risks of this investment. Finally, even if the line were sold at a price above depreciated original cost, ratepayers should not share in that gain because they did not pay for the asset. As explained below, OSBA's contentions are without merit and should be rejected.

#### **1. OSBA Agrees That There Is A Public Benefit**

The transaction proposed by PNG is to transfer the Auburn Line and the related facilities by sale and assignment to UGIES for an amount equal to the depreciated original cost of the Auburn Line and the related facilities at the time of transfer. PNG Statement No. 1, pp 5-6; PNG

Exhibit RFB-2. Through the Joint Stipulation, OTS, OCA, and PNG have resolved this issue and agreed that PNG should be permitted to transfer ownership of the Line and related facilities to UGIES at the net depreciated original cost, and agreed that the transaction is in the public interest and should be approved. Joint Stipulation ¶¶ 16(a), 17. As the applicant, PNG bears the burden to demonstrate that the transaction, as proposed, has the likelihood or probability of public benefits. *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. 583, 611, 615, 937 A.2d 1040, 1057, 1059 (2007); 66 Pa.C.S. §§ 1102, 1103. See PNG Main Brief Section III.C. For the reasons explained above, the proposed transaction, as modified by the terms and conditions of the Joint Stipulation, is just, reasonable, and in the public interest. See PNG Main Brief Section IV.B, *supra*. Indeed, OSBA witness Robert D. Knecht concedes that the transaction, as proposed, has merit and provides public interest benefits, stating, in relevant part, as follows:

I note that a market-based transaction related to the sale of the Auburn Line would have the same public benefits as the affiliated transaction proposed by PNG in this proceeding.

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A sale of the Auburn Line to a gas gathering entity would appear to offer potential public interest benefits, by providing a lower-cost option for getting local Marcellus Shale gas to market than could be achieved through the development of new gathering systems. Moreover, some features of the proposed transaction, notably those in which PNG retains the rights and obligations to serve customers attached to the Auburn Line as distribution customers, have merit.

OSBA Statement No. 1, p. 11.

OSBA witness Mr. Knecht recommends that the Commission reject the proposed transfer of the Auburn Line, unless and until PNG assesses the market value of the transfer in an arms-length transaction. OSBA Statement No. 1, p. 12. OSBA contends that there is a potential that the transaction could have greater public benefits if the Auburn Line and related facilities are

transferred at market value rather than at the net depreciated original cost. However, the “substantial public interest” standard articulated in *City of York* is satisfied by a simple preponderance of the evidence of benefits, and such burden can be shown without legally binding commitments or quantifiable benefits. *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. 583, 611, 615, 937 A.2d 1040, 1057, 1059 (2007). See PNG Main Brief Section III.A. Therefore, PNG need not demonstrate that a proposed transaction will provide the absolute maximum public benefits that may or may not be possible but, rather, that the proposed transaction has the likelihood or probability of some public benefits. As discussed above, the public benefits presented herein are already quite substantial. Further, as explained above, all Parties to this proceeding, including OSBA, agree that the proposed transaction is in the public interest because it will provide public benefits. For this reason alone, OSBA’s proposal should be rejected and the proposed transaction should be approved.

**2. The Treatment Of Gain On The Sale Of A Utility Asset Is Not Properly At Issue In This Proceeding.**

The issue of the treatment of gain on the sale of a utility asset is not properly at issue in this proceeding. As explained above, the proposed transaction presented for Commission approval is the transfer of the Auburn Line and related facilities at the net depreciated original costs. Therefore, the issue of sharing of value is not presented for resolution because there is no “gain” to share with or allocate to customers in the transaction presented for Commission approval.

Further, to the extent that OSBA contends that the public benefits of the transaction cannot be determined until the market value of the Auburn Line is known, such contention must be rejected. The Commonwealth Court has previously considered and rejected this argument. In *Middletown Township v. Pennsylvania Public Utility Commission*, 482 A.2d 674 (Pa. Cmwlth.

1984), a township argued that, among other things, the “Commission’s determination of whether the acquisition was or was not in the public interest necessarily demanded that the probable cost of acquisition be calculated as part of that process.” *Id.* at 682. The Commonwealth Court disagreed, stating:

Such a determination ... does not necessarily play a significant role, if any, in the public interest determination. When public utility property is sold either in an arms-length transaction or a forced acquisition, the compensation received ... represents capital belonging to the utility and its stockholders, and not to the utility’s customers, nor may those monies be transferred to the remaining customers in the form of lower rates. *Philadelphia Suburban Water Company v. Pennsylvania Public Utility Commission*, 427 A.2d 1244 (Pa. Cmwlth. 1981), citing *Board of Public Commissioners v. New York Telephone Company*, 271 U.S. 23, 32, 46 S.Ct. 363, 366, 70 L.Ed. 808 (1926), (customers pay for service, not for the property used to render it; by paying . . . bills for service they do not acquire any interest, legal or equitable in the property used for their convenience or in the funds of the company). Under the facts of this case, there was no need for a determination of the price in order to decide whether the acquisition was in the public interest. The compensation would inure to the benefit of the stockholders and company itself, and have little, if any, direct impact on the Water Company’s customers.

*Id.* at 682. Accordingly, the market value of the transferred Auburn Line is not necessary to the determination of whether the proposed transaction provides public benefits. Indeed, as explained above, OSBA concedes that the transaction as proposed by PNG has merit and will provide public interest benefits. OSBA Statement No. 1, p. p. 11.

Finally, the Commission has repeatedly approved the sale of utility assets to affiliates at depreciated original cost. See, e.g., *Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code*, Docket Nos. R-00973953, *et al.*, 1997 Pa. PUC LEXIS 51; 181 P.U.R.4th 517 (December 23, 1997) (approving the transfer of generation assets to affiliates at the depreciated original cost); *Application of Pennsylvania Power & Light Company*, Docket No. R-00973954 1998 Pa. PUC LEXIS 131 (June 15, 1998)

(same); *Pennsylvania Public Utility Commission v. T. W. Phillips Gas & Oil Co.*, Docket Nos. R-00051178 (August 22, 2006) (adopting the Recommended Decision approving a joint petition for settlement that provided for, among other things, approval of T. W. Phillips' transfer of production plant assets to its unregulated subsidiary, and removal from T. W. Phillips' books of account the original cost of the transferred assets and the amount of depreciation reserve applicable to the original cost as of the transfer date); *Pennsylvania Public Utility Commission v. UGI Utilities, Inc. - Gas Division*, Docket No. R-00994786 (June 29, 2000) (approving the transfer of UGI's peaking facilities to an affiliate at the depreciated original cost). In each of these cases, the Commission determined that the overall transactions provided substantial public benefits and approved the transactions as a whole, including the transfer at depreciated original cost. The same analysis should apply to the instant proceeding, and the proposed transaction should be approved.

**3. The OSBA Provided No Specific Evidence That Value Of The Auburn Line Exceeds Its Depreciated Original Cost.**

As explained above, the issue of the treatment of gain on the sale of a utility asset is not properly at issue in this proceeding. OSBA has proposed that the Auburn Line and related facilities be transferred at some hypothetical, unstated market value. This is not the proposal presented in PNG's application.<sup>10</sup> Consequently, OSBA bears the burden of proof with respect

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<sup>10</sup> Unlike the siting of high voltage transmission lines where the utility is required by Commission regulations to consider and present all reasonably available alternatives, *see* 52 Pa. Code §§ 57.71-77, a utility seeking Commission approval under Section 1102 of the Public Utility Code is not required to consider all available alternatives. Imputing such a requirement to complex, and often times multi-partied, business transactions would effectively preclude any such transaction from being completed because, unlike the siting of a transmission line between two points, there are endless possible different ways to structure a business transaction. The risks and benefits of alternative business transactions are for the utility to consider in the first instance and ultimately determine which transaction to present to the Commission for approval. *See Metropolitan Edison Co. v. Pennsylvania Public Utility Commission*, 437 A.2d 76 (Pa. (Continued on next page ...))



to its proposal that was not included in PNG's application. See *Pennsylvania Public Utility Commission v. Metropolitan Edison Company, et al.*, Docket Nos. R-00061366, *et al.*, 2007 Pa. PUC LEXIS 5 (January 11, 2007). See PNG Main Brief Section III.C., *supra*.

To the extent that the OSBA believes that the Auburn Line has value in excess of the depreciated original cost, it had the burden to introduce such evidence. They hired an economic expert, but he provided no appraisal or any other determination of that the fair market value of the Auburn Line exceeds its depreciated original cost. Instead, he presented an entirely hypothetical discussion of maximum possible theoretical market value, and no evidence that such value could be obtained. Indeed, OSBA's witness acknowledged that "[e]ven with a solid analysis of the incremental value of the contract between P&G and PNG to ratepayers, the value of the Auburn Line would remain unknown." OSBA Statement No. 2, p. 3. Accordingly, there is no evidence to support OSBA's position that the value of the line exceeds its depreciated original cost and, therefore, OSBA has failed to meet its burden of proof.<sup>11</sup> For this reason, OSBA's proposal should be rejected.

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(...continued from previous page.)

Cmwlth. 1981) (the Commission's authority to interfere in the internal management of a utility company is limited and it is not empowered to act as a super board of directors for the public utility companies of the state).

<sup>11</sup> Any finding of fact necessary to support an adjudication of the Commission must be based upon substantial evidence. *Met-Ed Indus. Users Group v. Pennsylvania Public Utility Commission*, 960 A.2d 189, 193 n.2 (Pa. Cmwlth. 2008) (citing 2 Pa. C.S. § 704). Substantial evidence must be "more than a scintilla and must do more than create a suspicion of the existence of the fact to be established. Without substantial evidence, our vaunted system of justice would rest upon nothing higher than arbitrary edicts of its administrators." *Kyu Son Yi v. State Board of Veterinary Medicine*, 960 A.2d 864, 874 (Pa. Cmwlth. 2008) (internal quotations and citations omitted).

**4. OSBA Disregards Important Aspects of the Proposed Transaction That Would Not Likely Be Attractive To An Independent Third Party.**

OSBA assumes that PNG could obtain the market value of the Auburn Line by transferring the line to an independent, third-party gas gathering entity under the same conditions and limitations as those proposed in this transaction. Again, however, OSBA presented no evidence that such a transaction could occur and its testimony is sheer speculation. Further, OSBA's assumption that PNG could obtain market value of the Auburn Line from an independent, third-party disregards various aspects of the proposed transaction.

Importantly, OSBA ignores that the proposal before the Commission is more than just a straight asset sale. The transaction before the Commission imposes significant conditions and limitations that are not likely to be attractive to an independent third party. Further, OSBA also ignores that there are substantial risks that the investment will fail or be less profitable than anticipated.

There are various aspects of the transaction that would not likely be attractive to an independent, unregulated producer or midstream operator, including: the limited capacity of the line; the larger amount of investment necessary for compression due to the operating pressure limitations of the pipeline. Further, the PNG-UGIES Interconnection Agreement imposes significant conditions and obligations, including: the obligation to provide capacity to existing customers at no cost; the obligation to connect and service new customers; sell, exchange, or transport natural gas for PNG in the event of an emergency; and PNG's option to re-acquire portions of the line at net book value should the Agreement be terminated. There presently is an overall transaction that is acceptable to PNG, UGIES, P&G, and Citrus, and is beneficial to PNG's customers as explained above. There simply is no assurance, and OSBA presented no evidence, that a similarly acceptable agreement could be achieved through a sale to an

independent producer or midstream operator, that the many benefits to customers from this transaction would be retained, or that Citrus would not begin the construction of bypass facilities to avoid further delay. PNG Statement No. 1-R, pp. 11-12.

OSBA also ignores that there are substantial encumbrances on the investment that would further reduce the value of the line to an independent third-party. *See* PNG Main Brief Section IV.A.2; PNG Statement 1-R, pp. 7-10. This encumbered value is further amplified by the obligations imposed on UGIES by the PNG-UGIES Interconnection Agreement. PNG Statement No. 1-R, p. 12. An independent third party would have little interest in agreeing to accept these conditions and constraints when other options are available without these conditions and constraints.

**5. OSBA Ignores The Retained Distribution Value Of The Line, Which Exceeds Even OSBA's Hypothetical Maximum Market Value**

As explained above, OSBA presented no evidence that the Auburn Line has value in excess of the depreciated original cost. *See* PNG Main Brief Section IV.B.2. Instead, OSBA presented some hypothetical discussion of maximum possible theoretical market value, but no evidence that such value could be obtained. However, even if OSBA's hypothetical maximum market value were accepted as achievable, PNG already has retained more than that value for its customers.

OSBA essentially ignores the un rebutted fact that even after the line is transferred to UGIES, PNG will continue to serve the distribution load connected to the Auburn Line and retain the right to use the capacity of the Line to continue offering distribution service. PNG Statement No. 1-R, pp. 4-5. As explained above, the Rate XD Agreement between PNG and P&G has allowed PNG to lock in the distribution value of the line for itself and its customers for

a 20-year period.<sup>12</sup> PNG's continued service to customers and related demand from the Auburn Line will provide more than \$800,000 of annual base rate revenue (more than \$16 million over the life of the contract) that will reduce the rates paid by other customers. PNG Statement No. 1, p. 13. As Mr. Beard explained in unrebutted testimony, this retained distribution value exceeds the replacement cost of the Auburn Line, which OSBA agrees is the maximum possible market value. PNG Statement No. 1-R, p. 10. OSBA indicates that if the net value of the Rate XD Agreement between PNG and P&G exceeds the value of the Auburn Line based on replacement costs, the OSBA's concerns would be resolved. OSBA Statement No. 2, p. 3.<sup>13</sup> This is precisely the testimony presented by Mr. Beard. Mr. Beard explained that the "current market value of the Auburn Line is likely not greater than the cost of building a gathering line that would enable Citrus to deliver gas into Tennessee independent of the Auburn Line. Our estimate of the current cost of building such a line is considerably less than the present value to customers of retaining the right to serve Procter & Gamble and other customers on the Line." PNG Statement No. 1, pp. 15-16.

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<sup>12</sup> While the 20-year agreement between P&G and PNG is not expressly contingent upon the conversion of the Auburn Line to a gathering line, the two agreements are inextricably interrelated. The long-term agreement with P&G is an essential part of the value retained by PNG under the PNG-UGIES Interconnection Agreement and, therefore, is highly relevant to evaluating this transaction. The fact that PNG will retain the current market value of the line obviously restricts the marketability of the Auburn Line to other potential purchasers. PNG Statement No. 1-RJ, p. 2.

<sup>13</sup> At the time OSBA served its Rebuttal Testimony, the Rate XD Agreement between PNG and P&G had not been provided to OSBA. According to OSBA, without that information, it was unable to make an assessment of the value of the Agreement. OSBA has since been provided with a copy of the Agreement and has had the opportunity to assess the Agreement. *See* Exhibit PNG/OSBA-1 [**HIGHLY CONFIDENTIAL**].

**6. Ratepayers Are Not Entitled To Receive Any Value Of The Auburn Line As A Gathering Line.**

As explained above, the Auburn Line will not be a distribution line post transfer; rather, it will be operated and maintained as a gathering line. PNG Statement No. 1, pp. 6-7; Tr. 46-49. However, customers should not receive any value of the Auburn Line as a gathering line because they are not making any investment in the conversion and they are not bearing any risk of failure of the project.

As explained above, there are substantial risks that the investment may fail or be less profitable than anticipated. However, under the proposed transaction, customers are not being asked to pay, and will not pay, the very substantial investment necessary to convert the Auburn Line into a gathering line, and they are assuming no risk if the project fails or is not profitable. PNG Statement No. 1-R, p. 5. It would be inequitable and unlawful for distribution customers to share in the possible future value of this transaction when they are not being asked to pay for the incremental investment needed to provide gathering services, are assuming no risk if the venture should fail, and are retaining the value of the line as a distribution line.

**7. Ratepayers Should Not Share In That Gain Because They Did Not Pay For The Asset.**

OSBA's proposal is based on the incorrect assumption that any gain from the sale of the Auburn Line should be shared with all PNG ratepayers because they have been paying for these assets through base rates and, therefore, are entitled to a reasonable share of the economic value associated with these facilities. OSBA Statement No. 1, p. 3. However, ratepayers other than P&G have not paid for the costs of the Auburn Line as a distribution line and, therefore, are not entitled to share in the gain on the sale of the Line.

"A gain on an investment, however, should benefit those who have provided the funding." *Barasch, et al. v. Pennsylvania Public Utility Commission*, 515 A.2d 651, 653 (Pa.

Cmwlth. 1986) (acknowledging that this is the principle upon which our economic system was built and which the Court relied upon in *Philadelphia Suburban Water Company v. Pennsylvania Public Utility Commission*, 427 A.2d 1244 (Pa. Cmwlth. 1981). In this case, as OSBA concedes, the entire costs of the Auburn Line have been directly and solely allocated to P&G in filed cost allocation studies, and that P&G has contributed revenues in excess of these allocated costs since at least 1996. OSBA Statement No. 1, p. 7. Thus, virtually all of the costs of the Auburn Line, and its associated operating costs, have been assigned to and included in the rates paid by P&G. PNG Statement No. 1-R, p. 3.

Therefore, pursuant to *Barasch, supra*, even if ratepayers were entitled to share in any gain realized upon the sale of the Auburn Line, which PNG denies for the reasons stated above, it should be assigned to solely to P&G, and not to any other core market customers.<sup>14</sup> However, under the unique circumstances of this transaction, P&G, which is a substantial and sophisticated business entity and long-term transportation customer, has made its desires known. P&G fully supports the transaction and Commission approval of it, as evidenced by its letter previously filed with the Commission. PNG Exhibit RFB-3. Accordingly, the issue of treatment of any gain on the sale of the Auburn Line has been essentially settled since the only customer even arguably entitled to any material share of the gain has already agreed to PNG's proposal. PNG Statement No. 1-R, p. 6.

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<sup>14</sup> See *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. 583, 617-18, 937 A.2d 1040, 1061 (“we agree ... that requiring that all types of customers receive unique, affirmative, and direct benefits from a transaction, would, in effect, prohibit transactions among companies which target their businesses to particular customer classes, even where other classes suffer no harm.”).

## 8. Summary.

Based on the foregoing, OSBA's proposal should be rejected. As explained above, OSBA's proposal to transfer the Auburn Line at market value disregards the many important facts and circumstances involved in the proposed transfer. Importantly, OSBA's proposal is based on the incorrect assumption that any gain from the sale of the Auburn Line should be shared with all PNG ratepayers because they have been paying for these assets through base rates. This is simply not the case for the Auburn Line. Moreover, the Parties to this proceeding, including OSBA, all agree that the transaction as proposed by PNG will provide important substantial public benefits. For these reasons, the ALJ and the Commission should reject OSBA's proposal and approve the proposed transaction as modified by the Joint Stipulation.


## V. CONCLUSION

As explained above, the proposed transaction, as modified by the Joint Stipulation, will provide important benefits to PNG, its customers, and the Commonwealth, and all criteria necessary for approval of the proposed transaction pursuant to the Public Utility Code have been met. If approved, customers will continue to receive safe and reliable distribution service from the Auburn Line at reduced distribution rates. The value of the Auburn Line as a distribution line will be retained by PNG, while at the same time customers will be insulated from the significant investment risk of converting the line to gathering service. Further, if approved, the proposed transaction will provide long-term benefits to PNG customers and the Commonwealth through the development of Marcellus Shale gas resources. These are all important and substantial public benefits that may not be realized if the transaction is not approved as proposed and modified by the Joint Stipulation. Importantly, all the Parties to this proceeding agree that the transaction as proposed by PNG will provide important substantial public benefits.

WHEREFORE, UGI Penn Natural Gas, Inc. respectfully requests that Administrative Law Judge Dennis J. Buckley and the Pennsylvania Public Utility Commission: (1) issue certificates of public convenience, pursuant to Section 1102(a)(3) of the Public Utility Code, 66 Pa.C.S. § 1102(a)(3), approving of the transfer of the Auburn Line, together with its appurtenant facilities and right-of-way, to UGI Energy Services, Inc., subject to the terms and conditions of the Joint Stipulation; and (2) approve the Pipeline Interconnection, Operating and Emergency Services Agreement between UGI Energy Services, Inc. and UGI Penn Natural Gas, Inc. as an affiliated interest agreement, pursuant to Section 2102 of the Public Utility Code, 66 Pa.C.S. § 2102.

Respectfully submitted,

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