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March 30, 2011

HAND DELIVERED

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: In re: Application of UGI Penn Natural Gas, Inc. For Expedited Approval of the Transfer By Sale of a 9.0 Mile Natural Gas Pipeline, Appurtenant Facilities and Right of Way located in Mehoopany, Pennsylvania, to an Affiliate and for Approval of Related Affiliated Interest Agreement
Docket Nos. A-2010-2213893 and G-2010-2213894

Dear Secretary Chiavetta:

Enclosed for filing are the original and nine (9) copies of the Main Brief, on behalf of the Office of Small Business Advocate, in the above-docketed proceedings. Please note that both Proprietary and Non-Proprietary versions of this Brief are being filed. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Sharon E. Webb WRL

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Assistant Small Business Advocate
Attorney ID No. 73995

Enclosures

cc: Parties of Record
Robert D. Knecht

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of UGI Penn Natural Gas, Inc. for Expedited Review and Approval of the Transfer By Sale of a 9.0 Mile Natural Gas Pipeline, Appurtenant Facilities and Right of Way located in Mehoopany, Pennsylvania and a Related Affiliated Interest Agreement	:	**Docket No. A-2010-2213893 G-2010-2213894**

CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Main Brief, in both Proprietary and Non-Proprietary versions, on behalf of the Office of Small Business Advocate, by e-mail and first class mail (unless otherwise noted) upon the persons addressed below:

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Date: March 30, 2011

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

In re: Application of UGI Penn Natural Gas, Inc. for Expedited Approval of the Transfer By Sale of a 9.0 Mile Natural Gas Pipeline, Appurtenant Facilities and Right of Way located in Mehoopany, Pennsylvania to an Affiliate and for Approval of Related Affiliated Interest Agreement	:	Docket Nos. A-2010-2213893 G-2010-2213894

MAIN BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

NON-PROPRIETARY VERSION

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Dated: March 30, 2011

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I. Introduction

UGI Penn Natural Gas, Inc. ("PNG") filed an application (the "Application") with the Pennsylvania Public Utility Commission ("Commission") on December 1, 2010, seeking approval of the sale of a 9.0 mile natural gas pipeline, appurtenant facilities, and right-of-way located between Auburn and Mehoopany, Pennsylvania ("Auburn Line"); PNG's interest in an interconnection agreement with PVR Marcellus Gas Gathering, LLC. ("PVR"), which is the owner of a gathering line between the Auburn Line and local gas wells; and the facilities associated with that interconnection agreement, to UGI Energy Services, Inc. ("UGIES").

PNG is a Commission-certificated natural gas distribution company ("NGDC"). UGIES is an affiliated interest of PNG.

On December 21, 2010, the Office of Small Business Advocate ("OSBA") filed a Notice of Intervention and Protest with respect to the Application. Interventions were also filed by the Office of Consumer Advocate ("OCA") and the Office of Trial Staff ("OTS").

The Application was ultimately assigned to Administrative Law Judge ("ALJ") Dennis J. Buckley. A pre-hearing conference was held on January 7, 2011.

The Company submitted the direct testimony of witness Robert F. Beard, Jr., on January 21, 2011.

On February 18, 2011, the OSBA submitted the direct testimony of its witness, Robert D. Knecht. The OCA and the OTS also submitted direct testimony.

On March 2, 2011, PNG submitted the rebuttal testimony of Mr. Beard.

On March 11, 2011, the OSBA submitted the surrebuttal testimony of Mr. Knecht. The OCA and the OTS also submitted surrebuttal testimony.

On March 15, 2011, PNG submitted Mr. Beard's rejoinder testimony.

On March 16, 2011, PNG and the OSBA submitted an evidentiary stipulation containing highly confidential material.

An evidentiary hearing was held before ALJ Buckley on March 16, 2011.

It was represented at the evidentiary hearing that a non-unanimous settlement ("Settlement") had been reached by the Company, the OTS, and the OCA. The OSBA requested an opportunity to respond to the Settlement after the document and the parties' Statements in Support had been filed.

Unfortunately, the Settlement was not filed until March 23, 2011. Furthermore, the filing did not include the parties' Statements in Support of the Settlement. As a result, the OSBA's Main Brief will address the proposed transaction as set forth in the Application. The OSBA will respond to the Settlement in its Reply Brief. If the Statements in Support of the Settlement are not filed until after the Reply Briefs are due, the OSBA reserves the right to file a subsequent response to the Statements in Support.

The OSBA submits this Main Brief pursuant to the procedural schedule set forth in ALJ Buckley's January 14, 2011, Prehearing Order.

II. Question Presented: Is the sale of the Auburn Line by PNG to an affiliated interest at less than fair market value permitted under the Public Utility Code?

Suggested Answer: No.

III. Argument

A. Legal Standard

PNG's sale of the Auburn Line to its affiliated interest, UGIES, cannot be effectuated unless the Commission approves the proposed transaction and issues a certificate of public convenience. In that regard, Section 1102(a)(3) of the Public Utility Code, 66 Pa. C.S. §1102(a)(3), provides in pertinent part as follows:

> **§1102. Enumeration of acts requiring certificate**
> **(a) General rule.**—Upon the application of any public utility and the approval of such application by the commission, evidenced by its certificate of public convenience first had and obtained, and upon compliance with existing laws, it shall be lawful:
>
> ***
>
> (3) For any public utility or an affiliated interest of a public utility as defined in section 2101 (relating to definition of affiliated interest), . . . to acquire from, or transfer to, any person or corporation . . . by any method or device whatsoever, . . . including a . . . sale . . . , the title to, or the possession or use of, any tangible or intangible property used or useful in the public service. . . .

Section 1103(a) of the Public Utility Code, 66 Pa. C.S. §1103(a), provides the following standard for the issuance of a certificate of public convenience:

> **§1103. Procedure to obtain certificates of public convenience**
> **(a) General rule.**— . . . A certificate of public convenience shall be granted by order of the commission, only if the commission shall find or determine that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public. . . .

Because the proposed transaction involves the sale of the Auburn Line by PNG to an affiliated interest, the transaction also must comply with Section 2102 of the Public Utility Code, 66 Pa. C.S. §2102. Section 2102 provides in pertinent part as follows:

> **§2102. Approval of contracts with affiliated interests**
> **(a) General rule.—** . . . [N]o contract or arrangement for the . . . sale . . . of any property, right, or thing . . . shall be valid or effective unless and until such contract or arrangement has received the written approval of the commission. . . .
>
> **(b) Filing and action on contract.—** . . . The commission shall approve such contract or arrangement . . . only if it shall clearly appear and be established upon investigation that it is reasonable and consistent with the public interest. . . .
>
> ***

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. As the proponent of the proposed transaction, PNG has the burden of proof under both Section 1103(a) and Section 2102(b). It is axiomatic 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).

B. Proposed Transaction

The Auburn Line currently functions as a distribution line with which PNG provides distribution service to Procter & Gamble ("P&G"), 13 residential customers, and one commercial customer.[1] The gas delivered to those customers comes either from the interstate pipeline of the Tennessee Gas Pipeline Company ("Tennessee Pipeline") or from local production.[2]

Locally produced gas, *i.e.*, Marcellus Shale gas produced by Citrus Energy Corporation ("Citrus Energy") on and around the P&G property, was added as a second supply source for Auburn Line customers in 2010.[3] Given the current configuration, no gas can be delivered from the Auburn Line to the Tennessee Pipeline.[4] In order to accommodate Citrus Energy's desire to expand its local gas production and to transport that gas to the Tennessee Pipeline, PNG is proposing to sell the Auburn Line to an affiliated interest, UGIES, at the net book value of the assets, *i.e.*, for approximately $240,000.[5] UGIES intends to reverse the flow of the Auburn Line, as well as expand the capacity of the line, in order to transport gas for Citrus Energy to the Tennessee Pipeline.[6]

The OSBA recognizes the importance of Marcellus Shale development to the Commonwealth. Furthermore, the OSBA is not questioning Citrus Energy's need for a gathering system to transport gas to the Tennessee Pipeline. However, the OSBA is challenging the potential unjust enrichment of UGIES.

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[1] PNG Statement No. 1 at 5; and OSBA Statement No. 1 at 1 and IEc-2, *citing* OSBA-I-7.

[2] PNG Statement No. 1 at 2 and OSBA Statement No. 1 at 1-2.

[3] PNG Statement No. 1 at 5 and OSBA Statement No 1 at 2.

[4] PNG Statement No. 1 at 5.

[5] PNG Statement No 1 at 6; and OSBA Statement No. 1 at 2, *citing* PNG's response to OSBA I-1.

[6] Application at 4. *See also* PNG Statement No. 1 at 6.

C. Failure To Satisfy Statutory Standards

The Auburn Line is an asset financed by PNG's ratepayers, *i.e.*, they have provided both a return of the capital invested by PNG (and its predecessor NGDCs) and a return on that capital. Rather than acquiring the Auburn Line at fair market value, UGIES would acquire it at the depreciated original cost. PNG agreed to sell the Auburn Line to an affiliated interest at the depreciated original cost without seeking bids from other entities to establish the market value of the line.[7] By selling the Auburn Line to UGIES at what is likely to be less than the fair market value, PNG would present its affiliated interest with the opportunity to realize a windfall profit.

The Commission must deny PNG a certificate of public convenience for the proposed transaction because there is no record evidence that the sale of the Auburn Line for less than fair market value is "necessary or proper for the service, accommodation, convenience, or safety of the public," as required by Section 1103 of the Public Utility Code.

Specifically, there is no record evidence that UGIES is the only entity interested in, or capable of, implementing the proposed reversal of the flow of the Auburn Line to facilitate the development of the Citrus Energy wells or the wells of any other gas producer.

Furthermore, there is no record evidence that the project will be feasible only if the Auburn Line is sold by PNG (to UGIES or any other entity) at the line's depreciated original cost.

Finally, there is no record evidence that the reversal of the flow of the Auburn Line is the only economic alternative for transporting gas from Citrus Energy's wells to the Tennessee Pipeline.

[7] OSBA Statement No. 1 at 3.

These same deficiencies in the record require the Commission to reject the proposed transaction under Section 2102(b), because there is no evidence "clearly . . . establish[ing] . . . that it [the proposed transaction] is reasonable and consistent with the public interest."

D. PNG's Attempted Justifications

In its Notice of Intervention and Protest and in testimony, the OSBA raised concerns about the proposed transfer of the Auburn Line to an affiliated interest for less than fair market value.[8] However, the Company argued that the circumstances of this proposed transfer make the market valuation irrelevant for several reasons.[9] None of those proffered reasons is persuasive.

1. Value of the *Auburn* Line

PNG attempted to justify the sale of the Auburn Line for book value by suggesting that there is little difference between the book value and the fair market value. For example, PNG witness Mr. Beard asserted on rebuttal that there is no "gain" to be shared among ratepayers because the proposed sale is at full value.[10]

However, OSBA witness Mr. Knecht responded as follows:

> Mr. Beard is certainly correct that there is no gain in the *proposed* affiliate transaction, because PNG and its affiliate UGIES did not establish a sale price in excess of book value. The value in the proposed transaction is unfortunately indicative of nothing, other than a number derived as part of an agreement between affiliated interests that is not an arms-length, competitive transaction. The correct question, of course, is whether a third party would establish a higher value of the Auburn Line in a competitive procurement. However, Mr. Beard dismisses that question.[11]

[8] *See, e.g.*, OSBA Notice of Intervention and Protest at ¶6(a) and (b) and OSBA Statement No. 1 at 3.

[9] PNG Statement No. 1 at 13.

[10] PNG Statement No. 1R at 4.

[11] OSBA *Statement* No. 2 at 3-4.

In a further attempt to explain away the potential windfall to UGIES, Mr. Beard testified as follows:

> The market value of the Auburn Line as a gathering facility, as currently configured, is negligible because it cannot deliver natural gas into the Tennessee system. Deliveries to Tennessee can only occur with the estimated $15 million investment contemplated by UGIES.[12]

In contrast to Mr. Beard, OSBA witness Mr. Knecht provided a comprehensive explanation of how to determine the market value of the Auburn Line as part of a gathering system for collecting and transporting gas to the Tennessee Pipeline. Specifically, Mr. Knecht testified as follows:

> Two factors determine the value of these assets. The first is the difference between the net present value of the gas at the wellhead and the net present value of the gas delivered into the interstate pipeline. Because the potential for gas production exceeds the local consumption, the value of the gas at the wellhead is essentially the cost of producing the gas. The value of the gas at the interstate pipeline is the market price of gas in northeast Pennsylvania. Net present values would be calculated over the life of the producing region or the life of the assets, whichever is shorter. From this difference in net present values, the cost of upgrading the asset to accommodate the changes in gas flow would be deducted.
>
> This valuation approach represents an upper bound to the value of the assets for two reasons. First, a transporter could not extract the full value associated with the price differential, because there would be little interest on the part of gas producers in such an arrangement. Second, the market valuation as measured by net present values will overstate the economic value of the Auburn facilities if other alternatives for getting the gas to market are available. That is, if the local producers can interconnect to the interstate pipeline system with a separate gathering line, the value of the Auburn Line (inclusive of required capital upgrades) can

[12] PNG Statement No. 1 at 14.

> be no more than the full cost of constructing and operating such an alternative gas gathering system.[13]

As Mr. Knecht pointed out, PNG did not present any evidence regarding the market value of the Auburn Line, measured by the difference between the value of the gas at the Tennessee Pipeline and the value of the gas at the wellhead.[14] Therefore, there is no evidence supporting Mr. Beard's claim that the book value and the fair market value are about the same. The fact is that PNG does not know what the fair market value of the Auburn Line is because PNG did not offer the proposed transaction to other potential buyers in a competitive procurement.

Furthermore, when asked in an interrogatory about the estimated cost of constructing an alternative to the Auburn Line for Citrus Energy to deliver gas to the Tennessee Pipeline, the Company responded that it had no estimate of the cost.[15] However, in response to another OSBA interrogatory, PNG reported that the replacement cost for the Auburn Line would be $10.5 million, and that it is likely that developing an alternative line for gathering services would be of "significantly higher cost."[16] Therefore, Mr. Knecht pointed out, in unrebutted testimony, that the fair market value of the Auburn Line presumably lies somewhere between the book value of $240,000 and the $10.5 million cost of building an entirely new line.[17]

Admittedly, UGIES, or any other purchaser of the Auburn Line, would need to incur certain investment costs to reverse the flow of the Auburn Line and would bear the risk of the

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[13] OSBA Statement No. 1 at 4.

[14] OSBA Statement No. 1 at 4.

[15] OSBA Statement No. 1 at 5.

[16] OSBA Statement No. 1 at 5, *citing* OSBA-1-2.

[17] OSBA Statement No. 2 at 7-8.

project's failure.[18] If UGIES were to acquire the Auburn Line for only $240,000, UGIES could recover its costs and a reasonable return by charging Citrus Energy less than UGIES would have to charge if the line were to be purchased at fair market price. In that event, any value of the Auburn Line in excess of depreciated original cost would be passed on to Citrus Energy and would not be a windfall to UGIES. However, there is no evidence that UGIES intends to base its charges to Citrus Energy on anything other than an assessment of what the market will bear.[19] Therefore, there is no basis for concluding that approval of the proposed transaction between PNG and UGIES is necessary to make the development of the Citrus Energy wells economic.

2. No Benefit to OSBA's Clients

PNG also argued that even if the Company were to sell the Auburn Line at a price in excess of book value, the small commercial and industrial ("Small C&I") customers represented by the OSBA would be entitled to little, if any, of that gain. According to PNG witness Mr. Beard, if the Company were required to share that gain with any ratepayers, P&G would be entitled to the lion's share because the bulk of the revenue requirement related to the Auburn Line has been assigned to P&G in distribution rate cases.[20]

However, Mr. Beard missed the point. The issue is *not* how PNG would be required to treat any funds it received from selling the Auburn Line at fair market value. Rather, the issue is

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[18] Despite PNG's representations regarding the relative magnitude of any such costs, Mr. Knecht's unrebutted testimony indicates that the $15 million in costs identified by PNG (to reverse the flow of the Auburn Line and increase its capacity) would amount to only "pennies per Dth in costs per unit of throughput, if the forecast flow of 120,000 Dth per day were achieved." OSBA Statement No. 1 at 6.

[19] PNG's evidence on this subject is contradictory. In response to an OSBA interrogatory, PNG indicated that it had no knowledge as to UGIES' expected pricing strategy. *See* OSBA Statement No. 1 at 8-9, *citing* OSBA-I-11. However, PNG witness Mr. Beard opined on rebuttal that the UGIES pricing strategy would be cost-based. *See* PNG Statement 1R at 10. Significantly, however, there was no testimony from UGIES or Citrus Energy, despite the fact that they are the two entities that presumably know how the price for using the Auburn Line will be set.

[20] PNG Statement No. 1R at 3.

the potential unjust enrichment of UGIES. In short, the difference between the fair market value and the depreciated original cost of the Auburn Line belongs to PNG, PNG's ratepayers, or some combination thereof. ***It does not belong to UGIES.***

The Commission's decision in this proceeding is likely to set a precedent regarding whether affiliated interests of NGDCs are permitted to profit from the Marcellus Shale boom by acquiring pipelines, storage facilities, and other assets from the NGDC at less than fair market value. Therefore, regardless of the impact on PNG's Small C&I customers in this case, there is a potentially significant impact on Small C&I ratepayers of PNG and other NGDCs in the cases that follow.

3. Bypass

Initially, PNG implied that the proposed transaction is necessary to forestall significant bypass of the PNG distribution system. For example, in direct testimony, Company witness Mr. Beard touted the retention of P&G and the other retail customers served by the Auburn Line as significant since those customers provide more than $800,000 of annual revenue that would have to be provided by PNG's other distribution ratepayers in the event of bypass.[21] Specifically, Mr. Beard testified as follows on direct:

> While legal title to the Auburn Line will be transferred to UGIES, PNG will retain the full current economic value of the Line by continuing to serve PNG customers from the Auburn Line, including Procter & Gamble, and by continuing to receive revenues related thereto. Continued service to Procter & Gamble and other Auburn Line customers currently provides more than $800,000 of annual revenue for the ratemaking benefit of PNG's other customers. Moreover, as Procter & Gamble demand comprises 7 percent of PNG's peak day and almost 20 percent of its commodity volumes, the continued presence

[21] PNG Statement No. 1 at 14.

> of Procter & Gamble and the other Auburn Line customers will continue to provide the rest of the system significant rate support in the form of lower administrative and general, operating and maintenance expense, and capital cost requirements. Thus, unlike the sale of a pipeline system and related transfer of the right to serve customers from that system, the proposed Auburn Line transaction allows PNG to retain the current economic and ratemaking value of the Auburn Line by retaining the customers, throughput and related revenue.[22]

Furthermore, on rebuttal, Mr. Beard represented that ". . . in anticipation of this transaction, [P&G], PNG's largest customer, has entered into a 20-year agreement to continue to take distribution service from PNG."[23] The implication of Mr. Beard's rebuttal testimony was that the 20-year agreement was somehow conditioned on approval of the proposed transaction.

*******BEGIN PROPRIETARY*******[redacted]

[redacted]

[redacted]

[redacted]

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[22] PNG Statement No. 1 at 14.

[23] PNG Statement No. 1R at 2.

[redacted]

[redacted]

[redacted] *****END PROPRIETARY*****

In view of the foregoing, there is no credible basis for concluding that approval of the proposed transaction is necessary to forestall bypass of the Company's distribution system.

[24] PNG/OSBA Stipulation at 2-3.

IV. Conclusion

For the reasons set forth above, the Commission should reject the proposed transaction because PNG has failed to prove that selling the Auburn Line to an affiliated interest at less than the fair market price "is necessary or proper for the service, accommodation, convenience, or safety of the public" and "is reasonable and consistent with the public interest."

Respectfully submitted,

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