

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF SMALL BUSINESS ADVOCATE

Suite 1102, Commerce Building
300 North Second Street
Harrisburg, Pennsylvania 17101

William R. Lloyd, Jr.
Small Business Advocate

(717) 783-2525
(717) 783-2831 (FAX)

May 23, 2011

HAND DELIVERY

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 Exceptions, on behalf of the Office of Small Business Advocate, in the above-captioned proceedings. 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,

A handwritten signature in black ink, appearing to read "Sharon E. Webb".

Sharon E. Webb
Assistant Small Business Advocate
Attorney ID No. 73995

Enclosures

cc: Cheryl Walker Davis
Office of Special Assistants

Robert D. Knecht

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**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, : Docket Nos. A-2010-2213893
Appurtenant Facilities and Right of Way : G-2010-2213894
located in Mehoopany, Pennsylvania to an :
Affiliate and for Approval of Related :
Affiliated Interest Agreement :**

**EXCEPTIONS
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE**

**Sharon E. Webb
Attorney ID No. 73995
Assistant Small Business Advocate**

**For: William R. Lloyd, Jr.
Attorney ID No. 16452
Small Business Advocate**

**Office of Small Business Advocate
300 North Second Street, Suite 1102
Harrisburg, PA 17101
(717) 783-2525**

Dated: May 23, 2011

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I. Introduction

A. Procedural History

UGI Penn Natural Gas, Inc. (“PNG” or “Company”) filed an application (“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 ("PNG/OSBA 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 of the Settlement ("Statements in Support") had been filed.

The Settlement was not filed until March 23, 2011. Furthermore, the filing did not include the parties' Statements in Support. Therefore, the OSBA's Main Brief addressed the proposed transaction as set forth in the Application and reserved the right to respond to the Settlement in the Reply Brief.

The OSBA and PNG each filed a Main Brief on March 30, 2011. PNG, the OCA, and the OTS also filed their Statements in Support on March 30, 2011.

On April 7, 2011, the OSBA submitted a Reply Brief pursuant to the procedural schedule set forth in ALJ Buckley's January 14, 2011, Prehearing Order. PNG also submitted a Reply Brief on April 7, 2011.

By Secretarial Letter of May 12, 2011, the Commission issued the Recommended Decision ("RD") of ALJ Buckley.

The OSBA files these exceptions to that RD.

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 asset, *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

C. PNG-P&G Agreement

For much of this proceeding, PNG implied that the principal benefit of the proposed transaction to customers is the retention of P&G as a distribution customer and, therefore, P&G’s continued contribution of \$800,000 in distribution revenues which would otherwise have to be paid by other customers.⁷ However, prior to the filing of the Application, PNG and P&G had already entered a 20-year agreement under which P&G is obligated to pay PNG \$800,000 each

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.

⁷ *See, e.g.*, PNG Statement No. 1 at 14; and PNG Main Brief at 3, 11, and 35-36.

year for distribution service. Furthermore, in its Main Brief, PNG conceded that “the 20-year agreement between P&G and PNG is not expressly contingent upon the conversion of the Auburn Line to a gathering line.”⁸

D. Settlement

As summarized by PNG, the Settlement alters the as-filed transaction in the following significant ways:⁹

First, PNG (and, therefore, PNG’s ratepayers) would be relieved of having to make an annual payment of \$60,000 to UGIES in order to continue using the Auburn Line.

Second, if UGIES were to cease operating the Auburn Line in a manner that allows PNG’s continued use of the line to serve distribution customers, ownership of the line would revert to PNG at the then-depreciated original cost of the line, but in no event at a cost in excess of the price at which UGIES purchased the line from PNG.

Third, The Commission would retain the right to conduct safety inspections of the Auburn Line. UGIES would be required to reimburse PNG for any related fees.

Fourth, rather than waiting until its next base rate case, PNG would immediately file a tariff to reduce the revenue requirement by \$154,000 to reflect the removal of the Auburn Line from rate base and the removal of all associated expenses.

Fifth, the Settlement would not be precedent regarding whether an entity operating a gathering line must obtain a certificate of public convenience.

E. Relevant Legal Standards

PNG and the OSBA agree that the sale of the Auburn Line to the Company’s affiliated interest, UGIES, cannot be effectuated unless the Commission approves the proposed transaction

⁸ PNG Main Brief at 36, fn. 12.

⁹ PNG Main Brief at 17-18 and PNG Statement in Support at 4-5.

and issues a certificate of public convenience pursuant to Sections 1102(a)(3) and 1103(a) of the Public Utility Code, 66 Pa. C.S. §§1102(a)(3) and 1103(a).¹⁰

Section 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. . . .

According to PNG, the test for whether the proposed transaction satisfies the standard under Section 1103(a) is the same as the test for approval of a merger under *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 151, 295 A.2d 825, 828 (Pa. 1972), *i.e.*, “that the transaction would ‘promote the service, accommodation, convenience, or safety of the public in some substantial way.’” PNG also pointed to *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. 583, 617-618, 937 A.2d 1040, 1061 (Pa. 2007), for the proposition that a certificate of public convenience may be granted even if some customers would receive a benefit but others would not.¹¹

In effect, PNG’s interpretation of *City of York* and *Popowsky* ignores the requirement that the benefits of the transaction to the public must be “substantial.” Even with the changes made by the Settlement, the benefits to the public from the sale of the Auburn Line are minimal in comparison to the potential windfall profit to UGIES.

However, even assuming *arguendo* that the proposed transaction would otherwise meet the standard for obtaining a certificate of public convenience, PNG has failed to prove that the proposed transaction complies with Section 2102 of the Public Utility Code, 66 Pa. C.S. §2102.

¹⁰ PNG Main Brief at 6-7 and OSBA Main Brief at 3-4.

¹¹ PNG Main Brief at 6-7.

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).

PNG has failed to prove that the proposed transaction meets the standard imposed by Section 2102(b). Therefore, the Commission must either reject the proposed transaction or remand to the ALJ for a determination of the fair market value of the Auburn Line.

II. Exception No. 1: The ALJ erred when he concluded that the potential unjust enrichment of UGIES is not relevant to adjudication of the Application. (RD at 14)

A. Summary

The ALJ concluded that the ratemaking treatment of any gain was not presented in this proceeding by PNG, in that the transfer of the Auburn Line to UGIES was not intended by PNG or UGIES as a “sale for ‘gain.’” As a result, he concluded that the OSBA’s argument about the

potential unjust enrichment of UGIES is not relevant. However, he did note that the unjust enrichment issue might have been relevant if PNG had presented the transaction as a sale for gain.¹²

The ALJ erred when he concluded that the potential unjust enrichment of UGIES is not relevant. In effect, the ALJ's reasoning would permit a utility to read Section 2102 out of the statute by how the utility styles a proposed transaction with an affiliated interest.

The Auburn Line is an asset financed by PNG's ratepayers, *i.e.*, they have been providing 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 fair market value of the line.¹³ 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 overall investment cost of the project to UGIES would be the purchase price of the Auburn Line plus the costs necessary to reverse the flow and expand the capacity. This total investment cost would be less under the proposed transaction than it would be if UGIES were required to pay fair market value for the line. Therefore, any profit UGIES realized under the proposed transaction would be larger (and any loss would be smaller) than it would be if UGIES were required to pay fair market value for the line.¹⁴

Regardless of the ALJ's conclusion that PNG has not styled the proposed transaction as a

¹² RD at 14.

¹³ OSBA Statement No. 1 at 3.

¹⁴ See OSBA Statement No. 1 at 5 and OSBA Statement No. 2 at 4.

sale for gain, the Commission is required to enforce Chapter 21 of the Public Utility Code.

Under Section 2102(b), the Commission can not approve the proposed transaction unless “it shall clearly appear and be established upon investigation that [selling the Auburn Line at the depreciated original cost] is reasonable and consistent with the public interest.”

B. PNG’s Application

PNG witness Mr. Beard testified that there is no “gain” to be shared among ratepayers because the proposed sale is at full value.¹⁵ However, Mr. Beard presented no evidence of the fair market value of the Auburn Line and, therefore, no comparison of the fair market value to the depreciated original cost.

OSBA witness Mr. Knecht pointed out the fallacy in Mr. Beard’s reasoning, which is also a fallacy in the argument presented in PNG’s Main Brief. Specifically, Mr. Knecht testified 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.¹⁶

In effect, PNG’s argument is that because any gain would be realized by UGIES and not by PNG, that gain is not relevant to the adjudication of the proposed transaction. PNG’s argument is faulty because the Commission must consider the potential unjust enrichment of UGIES in order to determine whether the proposed transaction would comply with Section

¹⁵ PNG Statement No. 1R at 4.

¹⁶ OSBA Statement No. 2 at 3-4.

2102(b).

C. Chapter 21 of the Public Utility Code

PNG recognized that Section 2102(b) requires Commission approval of a contract between affiliated interests before that contract can take effect.¹⁷ Therefore, the OSBA and PNG apparently agree that the Auburn Line can not be transferred from PNG to UGIES at the depreciated original cost unless that transfer “is reasonable and consistent with the public interest.”

As recognized by the Commonwealth Court, Section 2102 “provides for the protection of the public from self-dealing between affiliates” *UGI Utilities, Inc. v. Pennsylvania Public Utility Commission*, 684 A.2d 225, 231 (Pa. Cmwlth. 1996). The statute does not prohibit a utility from selling an asset to the utility’s affiliated interest, but the statute does require clear proof that such a transfer would be reasonable and consistent with the public interest.

PNG conceded that it chose not to seek bids from any independent, third party to undertake the reversal of the Auburn Line and the expansion of the line’s capacity.¹⁸ Therefore, PNG has failed to prove that UGIES is the only entity that is willing and able to undertake the project. PNG has also failed to prove that no other entity would be willing to pay more for the Auburn Line than UGIES is willing to pay. Without such evidence, the Commission can not conclude that the sale of the Auburn Line at less than fair market value is reasonable and is consistent with the public interest.

Section 2102(c) and Section 2106 of the Public Utility Code, 66 Pa. C.S. §2106, spell out explicit procedures for the Commission to disallow excessive payments by a utility to an

¹⁷ PNG Main Brief at 7.

¹⁸ PNG Main Brief at 12.

affiliated interest. Chapter 21 does not provide a similarly explicit procedure for requiring an affiliated interest to increase its payment for the purchase of a utility asset if the Commission determines that the proposed payment is too low. Therefore, the Commission's remedy in this proceeding is simply to reject the proposed transaction.

The ALJ concluded that the ratemaking treatment of any gain is not before the Commission.¹⁹ However, contrary to the ALJ's implicit assumption, the OSBA is not asking the Commission to decide whether there definitely will be such a gain, how large that gain will be, or how that gain should be shared. Instead, the OSBA's argument is that the Commission must reject the sale at the depreciated original cost because PNG has taken no action to determine the fair market value of the Auburn Line.

Because UGIES is not subject to the Commission's ratemaking jurisdiction, there is no obvious future proceeding in which the OSBA will be able to challenge, or seek disgorgement of, any unjust enrichment which does occur. Therefore, by declaring the potential unjust enrichment of UGIES to be irrelevant to the instant proceeding, the ALJ has guaranteed that UGIES will be never be forced to share any windfall with ratepayers.

D. Ratemaking Effect

According to PNG, ratepayers are not entitled to any value from the Auburn Line because ratepayers would not be investing in the reversal and upgrading of the line and would not be at risk if the project failed or were less successful than hoped.²⁰ However, PNG missed the point. *The question in this proceeding is not how much money UGIES would, or would not, make.* Rather, the question is whether PNG may sell the Auburn Line to UGIES for less than fair

¹⁹ RD at 14.

²⁰ PNG Main Brief at 37.

market value.

PNG also argued that even if the Company were to sell the Auburn Line at a price in excess of depreciated original cost, the small commercial and industrial (“Small C&I”) customers represented by the OSBA would be entitled to little, if any, of the “gain.” According to PNG, if the Company were required to share that gain with any ratepayers, only P&G would be entitled to any of the gain because the revenue requirement related to the Auburn Line has been assigned to P&G in prior distribution rate cases.²¹

This line of argument appears to be inconsistent with the treatment of the base rate credit in the Settlement. As one of the claimed benefits of the Settlement, PNG pointed to an immediate credit to base rates “reflecting the revenue requirement associated with the depreciated original cost of the Auburn Line and associated operating expenses.”²² Unfortunately, neither PNG’s Main Brief, nor its Statement in Support, nor the Settlement indicates how that credit would be allocated among PNG’s rate classes.²³

To be consistent with the logic of the argument in PNG’s Main Brief, the entirety of that credit should be allocated to P&G because the costs of the Auburn Line have been directly assigned to P&G in prior distribution rate cases. That is, under PNG’s line of reasoning, if P&G has paid for the Auburn Line, it should receive the credit associated with the elimination of those costs from PNG’s revenue requirement. In reality, however, the credit can not be allocated to P&G because P&G has contractually agreed to pay \$800,000 per year for distribution service. Reducing costs allocated to P&G would not reduce P&G’s contractual payment obligations.

²¹ PNG Main Brief at 37-38.

²² PNG Main Brief at 20.

²³ See Settlement at ¶16(e), which specifies \$154,000 as the amount of the credit but which does not specify how the \$154,000 is to be allocated among ratepayers.

Therefore, either the credit would have to be allocated to other ratepayers or PNG would realize a windfall.

On the other hand, if the intent of the Settlement is that the credit should be directly allocated to ratepayers other than P&G, that is consistent with the OSBA's position in this proceeding. Under this interpretation of the Settlement, ratepayers other than P&G would benefit from the sale of the Auburn Line through a rate reduction based on the net book value of the assets and other avoided costs.²⁴ Therefore, under this interpretation of the Settlement, all of the settling parties would be in conceptual agreement with the OSBA that ratepayers other than P&G should reasonably share in the benefit from the sale of the Auburn Line.²⁵ Furthermore, PNG would implicitly have abandoned its argument that "ratepayers should not share in that gain because they did not pay for the asset."

III. Exception No. 2: The ALJ erred when he concluded that the OSBA has the burden of proving that the transfer of the Auburn Line to UGIES would not be at fair market value. (RD at 14 and 16)

A. Summary

According to the ALJ, even if the potential unjust enrichment of UGIES were relevant to this proceeding, the OSBA did not present probative evidence of the fair market value of the Auburn Line. Therefore, he concluded that the OSBA failed to meet its burden of proof.²⁶

Contrary to the ALJ's conclusion, PNG (not the OSBA) has the burden of proof because PNG is the moving party seeking approval of the transfer of the Auburn Line to UGIES at the

²⁴ OSBA Statement No. 1, Exhibit IEc-1, Attachment OSBA-I-16 (CORRECTED) sets out the basis for the \$154,000, which includes depreciation and the estimated cost of capital related to the Auburn Line.

²⁵ The only remaining difference would be whether the benefit of the sale should be based on the depreciated original cost of the Auburn Line or on the fair market value of that line.

²⁶ RD at 14 and 16.

depreciated original cost.

B. Statutory Requirements

The sale of the Auburn Line to the Company's affiliated interest, UGIES, cannot be effectuated unless the Commission approves the proposed transaction and issues a certificate of public convenience pursuant to Sections 1102(a)(3) and 1103(a).²⁷

However, even assuming *arguendo* that the proposed transaction would otherwise meet the standard for obtaining a certificate of public convenience, the proposed transaction must also comply with Section 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). Because PNG has failed to meet the standard imposed by Section 2102(b), the Commission must reject the proposed transaction.

C. Commission Precedent

The question of which party has the burden of proof in Commission proceedings is not new and novel. For example, ALJ Wayne L. Weismandel summarized the case law regarding the burden of proof as follows:

²⁷ PNG Main Brief at 6-7 and OSBA Main Brief at 3-4.

The 'burden of proof' is composed of two distinct burdens: the burden of production and the burden of persuasion. [citation omitted]

The burden of production, also called the burden of producing evidence or the burden of coming forward with evidence, determines which party must come forward with evidence to support a particular proposition. This burden may shift between the parties during the course of a trial. If the party (initially, this will usually be the complainant, applicant, or petitioner, as the case may be) with the burden of production fails to introduce sufficient evidence the opposing party is entitled to receive a favorable ruling. That is, the opposing party would be entitled to a compulsory nonsuit, a directed verdict, or a judgment notwithstanding the verdict. Once the party with the initial burden of production introduces sufficient evidence to make out a prima facie case, the burden of production shifts to the opposing party. If the opposing party introduces evidence sufficient to balance the evidence introduced by the party having the initial burden of production, the burden shifts back to the party who had the initial burden to introduce more evidence favorable to his position. The burden of production goes to the legal sufficiency of a party's case.

Having passed the test of legal sufficiency, the party with the burden of proof must then bear the burden of persuasion to be entitled to a verdict in his favor. '[T]he burden of persuasion never leaves the party on whom it is originally cast, but the burden of production may shift during the course of the proceedings.' [citation omitted] The burden of persuasion, usually placed on the complainant, applicant or petitioner, determines which party must produce sufficient evidence to meet the applicable standard of proof. [footnote and citation omitted] It is entirely possible for a party to successfully bear the burden of production but not be entitled to a verdict in his favor because the party did not bear the burden of persuasion. Unlike the burden of production, the burden of persuasion includes determinations of credibility and acceptance or rejection of inferences. Even un rebutted evidence may be disbelieved. [citation omitted] In order to bear the burden of proof and be entitled to a decision in his favor, a party must bear both the burden of production and the burden of

persuasion.²⁸

D. Evidence *Not* Presented by PNG

The Auburn Line is an asset financed by PNG's ratepayers, *i.e.*, they have been providing 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 fair market value of the line.²⁹ 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.

As the proponent of the proposed transaction, PNG has the burden of persuasion. To prevail, PNG must prove "clearly" that selling the Auburn Line to an affiliated interest at the depreciated original cost would be "reasonable" and "consistent with the public interest."

Despite its burden of persuasion under Section 2102(b), PNG presented no record evidence that the project will be feasible only if the Auburn Line is sold by PNG (to UGIES or some other entity) at the line's depreciated original cost rather than at fair market value.

Furthermore, PNG presented no record evidence that UGIES is the only entity interested in, or capable of, making the necessary modifications to effect the proposed reversal of the flow of the Auburn Line and thereby facilitate the development of the Citrus Energy wells or the wells of any other gas producer.

Finally, PNG presented no record evidence that the reversal of the flow of the Auburn

²⁸ *Noland Wenger v. UGI Utilities, Inc.-Gas Division*, Docket No. C-2008-2076768 (Initial Decision of September 18, 2009) at 7-8. The Commission affirmed ALJ Weismandel's decision by Order entered December 4, 2009.

²⁹ OSBA Statement No. 1 at 3.

Line is the only economic alternative for transporting gas from Citrus Energy's wells to the Tennessee Pipeline.

Without evidence proving any of these three propositions, the Commission can not conclude that it is "clear" that selling the Auburn Line to UGIES at the depreciated original cost is "reasonable" and "consistent with the public interest."

Rather than presenting such evidence, PNG sought to impose the burden of proof on the OSBA. For example, according to PNG, the "OSBA has proposed that the Auburn Line and related facilities be transferred at some hypothetical, unstated market value. . . . Consequently, OSBA bears the burden of proof with respect to its proposal that was not included in PNG's application."³⁰ The ALJ agreed with PNG. In that regard, he stated as follows:

PNG anticipated the arguments of the OSBA and responded to them in PNG's Main Brief. PNG's position, in sum, is that the OSBA has posed an argument that the Auburn Line must be sold at market value, but that the argument is based entirely on speculation as to that value of the line by the OSBA, which then claims that the theoretical proceeds from the transaction must be shared with ratepayers. PNG Main Brief at 32-33; PNG Reply Brief at 16. PNG correctly states that the OSBA failed to present any probative evidence in this proceeding that the market value of the Auburn Line exceeds its depreciated original cost, and that 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. PNG Main Brief at 4, 32-33; PNG Reply Brief at 13, fn 6. I agree with PNG that the OSBA has not met its burden of proof in this respect, and that the OSBA's approach goes far beyond the limited facts and applicable law in this proceeding.³¹

Under the ALJ's reasoning, a utility could avoid having ever to prove that the price of selling an asset to an affiliated interest at the depreciated original cost is "reasonable." If the utility were simply to designate the depreciated original cost as the proposed sale price in its

³⁰ PNG Main Brief at 32-33.

³¹ RD at 16.

pleadings, the burden would fall on the intervenor to prove that the price is “unreasonable.” If the Commission were to adopt the ALJ’s logic, Section 2102(b) would no longer provide any meaningful protection to ratepayers. Such a construction of Section 2102(b) would conflict with the Commonwealth Court’s conclusion in *UGI* as to the legislative intent of the statute.

E. Evidence of Fair Market Value

Even if the OSBA did bear the burden of proof regarding the fair market value of the Auburn Line (which it did not), the OSBA introduced at least enough evidence on that question to shift the burden of production to PNG.

In his direct testimony, PNG witness Mr. Beard stated as follows regarding the market value:

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.³²

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

³² PNG Statement No. 1 at 14.

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 be no more than the full cost of constructing and operating such an alternative gas gathering system.³³

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.³⁴ Therefore, there is no evidence supporting Mr. Beard's claim that the book value and the 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.³⁵ 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

³³ OSBA Statement No. 1 at 4.

³⁴ OSBA Statement No. 1 at 4.

³⁵ OSBA Statement No. 1 at 5.

be of “significantly higher cost.”³⁶ Therefore, Mr. Knecht pointed out in rebuttal testimony that the 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.³⁷

Mr. Knecht’s rebuttal testimony set the parameters for the market value of the Auburn Line. If PNG had a basis for disputing those parameters, the Company had the burden of identifying that basis in surrebuttal testimony. However, PNG chose not to rebut Mr. Knecht regarding those parameters.

Instead, PNG stated in its Main Brief that the OSBA’s argument that PNG might be able to obtain a better price for the Auburn Line than the depreciated original cost is “sheer speculation.” PNG added that there is no “assurance” that it would be possible for PNG to find an independent, third party willing to undertake the Auburn Line project subject to the conditions to which UGIES has agreed.³⁸

Contrary to PNG’s argument, it is the Company which is engaging in “sheer speculation.” Instead of offering the project in a competitive solicitation (or even making an informal inquiry as an act of “due diligence”), PNG simply chose to enter an agreement with its own affiliated interest to sell a ratepayer-funded asset at the depreciated original cost.³⁹ That is precisely the kind of self-dealing from which Section 2102(b) is intended to protect ratepayers.

PNG is the party that has the burden of proof in this proceeding. To be entitled to a decision approving the proposed transaction, PNG must meet both the burden of production and the burden of persuasion regarding Chapter 21. PNG has not met either burden.

³⁶ OSBA Statement No. 1 at 5, *citing* OSBA-I-2.

³⁷ OSBA Statement No. 2 at 7-8.

³⁸ PNG Main Brief at 34-35.

³⁹ PNG Main Brief at 12.

IV. Exception No. 3: The ALJ erred when he concluded that the transfer of the Auburn Line to UGIES at the depreciated original cost is necessary for the development of Marcellus Shale. (RD at 20-23)

A. Summary

According to the ALJ, “[t]he essential nature of this transaction is to facilitate the development of and access to Marcellus Shale natural gas”⁴⁰ The ALJ also cited numerous other claimed benefits of the transaction and the Settlement as the basis for concluding that approval of the transfer of the Auburn Line to UGIES would be in the public interest.⁴¹ However, implicit in the ALJ’s analysis is the assumption that Citrus Energy would not be able to develop Marcellus Shale gas wells without the transfer of the Auburn Line to UGIES at the depreciated original cost.

The ALJ’s assumption is incorrect.

B. Essential Question

The essential question in this proceeding is whether the sale of the Auburn Line by PNG to an affiliated interest at less than fair market value is permitted under the Public Utility Code. For the reasons explained in the OSBA’s Main Brief and Reply Brief and for the reasons set forth in these Exceptions, the answer to that question is “no.”

In its Main Brief and in its Statement in Support, PNG sought to divert the Commission’s attention from that essential question. In summary, PNG sought to convince the Commission that:

1. Approval of the transaction is necessary in order to enable Citrus Energy to develop Marcellus Shale wells;

⁴⁰ RD at 18.

⁴¹ RD at 20-23.

2. Approval of the transaction is inextricably linked to P&G's ongoing contribution of distribution revenues to PNG; and

3. An independent, third party would not be willing to purchase and upgrade the Auburn Line if the purchase price were more than the line's depreciated original cost and if that third party were required to adhere to the conditions imposed on UGIES.

Although these arguments are spread throughout the Company's Main Brief and Statement in Support, the following is a representative statement:

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.⁴²

However, as summarized in PNG's own Main Brief, the record evidence either does not support the Company's assertions or flatly contradicts them.

First, according to PNG, there is a realistic chance that Citrus Energy will lose patience waiting for Commission approval of the proposed transaction and will construct its own line to connect the Marcellus Shale wells to the Tennessee Pipeline.⁴³ By making this representation, PNG, in effect, conceded that the construction of a new line is a viable option.⁴⁴ Therefore, there is no evidentiary support for a conclusion that the future of Citrus Energy's Marcellus Shale production on and around P&G's property requires the approval of the proposed transaction.

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

⁴² PNG Main Brief at 22.

⁴³ PNG Main Brief at 11, 17, and 22.

⁴⁴ The fact that Citrus Energy chose not to be a party to this proceeding implies that Citrus Energy does not consider the proposed transaction to be essential to the development of its Marcellus Shale production.

project's failure.⁴⁵ If UGIES were to acquire the Auburn Line for only \$240,000, UGIES might choose to recover only its costs and a reasonable return by imposing cost-based rates on Citrus Energy. In that event, any value of the Auburn Line in excess of depreciated original cost would effectively 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.⁴⁶ 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.

PNG also represented that “the two agreements [*i.e.*, the agreement between PNG and P&G and the agreement between PNG and UGIES] are inextricably interrelated.”⁴⁷ In addition, PNG represented that “the transaction [*i.e.*, the agreement between PNG and UGIES] is part of a broader arrangement involving P&G and Citrus.”⁴⁸ If there are other relevant agreements among PNG, P&G, and Citrus Energy, PNG should have provided record evidence of those agreements. Having failed to offer such evidence, PNG sought (through unsupported statements in its Main Brief) to convince the Commission that the failure to approve the proposed transaction would unravel a complicated business deal. Based on the evidence that PNG *did* offer, it is more

⁴⁵ 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.

⁴⁶ OSBA Statement No. 2 at 4. 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.

⁴⁷ PNG Main Brief at 36, fn. 12.

⁴⁸ PNG Main Brief at 13.

reasonable to infer that the party which could be “hurt” by disapproval of the proposed transaction is UGIES and not either Citrus Energy or P&G.

Second, at various points throughout this proceeding, PNG implied that the principal benefit of the proposed transaction to customers is the retention of P&G as a distribution customer and, therefore, P&G’s continued contribution of \$800,000 in distribution revenues which would otherwise have to be paid by other customers.⁴⁹ However, prior to the filing of the Application, PNG and P&G had already entered a 20-year agreement under which P&G is obligated to pay PNG \$800,000 each year for distribution service. Furthermore, in its Main Brief, PNG conceded that “the 20-year agreement between P&G and PNG is not expressly contingent upon the conversion of the Auburn Line to a gathering line.”⁵⁰ Therefore, there is no credible basis for concluding that approval of the proposed transaction is necessary to forestall bypass of the Company’s distribution system. In that regard, the ALJ concluded that “the whole ‘bypass argument’ is so conjectural as to be of little to no weight in adjudicating this matter.”⁵¹

Third, the Company dismissed the possibility that an independent, third party might be willing to pay significantly more for the Auburn Line than the depreciated original cost. Specifically, PNG argued that it is unlikely that any entity other than UGIES would be willing to undertake the reversal and upgrading of the Auburn Line subject to the same limitations imposed by the proposed transaction, *i.e.*, the limitations identified in the Application and the limitations added by the Settlement.⁵²

⁴⁹ See, e.g., PNG Statement No. 1 at 14; and PNG Main Brief at 3, 11, and 35-36.

⁵⁰ PNG Main Brief at 36, fn. 12.

⁵¹ RD at 15, fn. 9.

⁵² PNG Main Brief at 3-5, 22, 28, and 34-35.

However, because PNG conceded that it never approached any independent, third party about that possibility, there is no record evidence to support PNG's assertion.⁵³ As OSBA witness Mr. Knecht testified, PNG could have solicited bids on the project, subject to the same conditions that would be imposed on UGIES.⁵⁴ PNG chose not to solicit bids or even to make an informal inquiry regarding the terms, if any, on which an independent, third party would have been willing to undertake the project. Therefore, there is no basis to support a Commission conclusion that a transfer to UGIES is the only viable option for using the Auburn Line to benefit the development of Citrus Energy's Marcellus Shale gas wells.

Similarly, there is no basis to support the ALJ's conclusion that selling the Auburn Line to UGIES at the depreciated original cost is necessary to avoid the potentially negative environmental impact of constructing a new line.⁵⁵ Like PNG, the ALJ overlooked the fact that construction of a new line could be avoided by selling the Auburn Line to UGIES (or another entity) at fair market value.

V. Exception No. 4: The ALJ erred when he concluded that approval of the transfer of the Auburn Line to UGIES at the depreciated original cost would not set a precedent for other transfers to affiliated interests. (RD at 18-19)

A. Summary

The ALJ acknowledged the OSBA's concern that approval of the transfer of the Auburn Line to UGIES at the depreciated original cost would constitute precedent that an NGDC's affiliated interest is allowed to profit by acquiring assets from an NGDC at less than fair market

⁵³ PNG Main Brief at 12.

⁵⁴ OSBA Statement No. 1 at 5-6 and 11-12.

⁵⁵ RD at 23.

value.⁵⁶ However, the ALJ's suggested distinctions missed the mark.

B. Inadequate Distinctions

The ALJ suggested two possible distinctions to allay the OSBA's concerns that the Commission's approval of the proposed transaction in this proceeding would open the floodgates to the unjust enrichment of affiliated interests.

First, the ALJ pointed to a provision of the Settlement in which the settling parties represent that approval of the transaction (with the changes set forth in the Settlement) is not intended to be precedent.⁵⁷ However, that provision is binding only on the parties to the Settlement. Therefore, nothing in the Settlement will prevent other NGDCs from citing Commission approval of this transaction as authority for Commission approval of some other transfer of a ratepayer-funded asset to an affiliated interest without having to prove that the transfer is at fair market value.

Second, the ALJ pointed to a statement in PNG's Main Brief that the Settlement is not intended to be precedential regarding Commission jurisdiction over gathering systems.⁵⁸ Unfortunately, that statement is irrelevant to the question of whether approval of this transaction will be precedent for another utility to transfer a ratepayer-funded asset to an affiliated interest without having to prove that the transfer is at fair market value.

VI. Conclusion

For the reasons set forth herein, the OSBA respectfully requests that the Commission approve the OSBA's Exceptions and either (a) reject the proposed transaction or (2) remand to

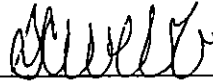
⁵⁶ RD at 18.

⁵⁷ RD at 18.

⁵⁸ RD at 19.

the ALJ for further proceedings to determine the market value of the Auburn Line.

Respectfully submitted,



Sharon E. Webb
Attorney ID No. 73995
Assistant Small Business Advocate

For: William R. Lloyd, Jr.
Attorney ID No. 16452
Small Business Advocate

Office of Small Business Advocate
300 North Second Street, Suite 1102
Harrisburg, PA 17101
(717) 783-2525

Dated: May 23, 2011

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

**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 : **Docket No. A-2010-2213893**
Pipeline, Appurtenant Facilities and Right : **G-2010-2213894**
of Way located in Mehoopany, Pennsylvania :
and a Related Affiliated Interest Agreement :

CERTIFICATE OF SERVICE

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

Hon. Dennis J. Buckley
Administrative Law Judge
PA Public Utility Commission
P. O. Box 3265
Harrisburg, PA 17105-3265
(717) 787-1191
(717) 787-0481 (fax)
debuckley@state.pa.us
(E-mail and Hand Delivery)

Charles Daniel Shields, Esquire
Office of Trial Staff
PA Public Utility Commission
P. O. Box 3265
Harrisburg, PA 17105-3265
(717) 787-4886
(717) 772-2677 (fax)
chshields@state.pa.us
(E-mail and Hand Delivery)

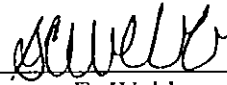
Kent D. Murphy, Esquire
UGI Penn Natural Gas, Inc.
460 North Gulph Road
King of Prussia, PA 19406
(610) 337-1000
(610) 992-3258 (fax)
murphyke@ugicorp.com

James A. Mullins, Esquire
Tanya J. McCloskey, Esquire
Office of Consumer Advocate
555 Walnut Street - 5th Floor
Harrisburg, PA 17101-1923
(717) 783-5048
(717) 783-7152 (fax)
jmullins@paoca.org
tmccloskey@paoca.org
(E-mail and Hand Delivery)

David B. MacGregor, Esquire
Post & Schell, PC
Four Penn Center
1599 John F. Kennedy Blvd.
Philadelphia, PA 19103-2808
(215) 587-1197
(215) 320-4879 (fax)
dmacgregor@postschell.com

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SECRETARY'S BUREAU

Christopher T. Wright, Esquire
Post & Schell, PC
17 North Second Street - 12th Floor
Harrisburg, PA 17101
(717) 731-1970
(717) 731-1985 (fax)
cwright@postschell.com



Sharon E. Webb
Assistant Small Business Advocate
Attorney ID No. 73995

Date: May 23, 2011

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