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October 12, 2012

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: Kathleen Moran-Roberto, et al. v. UGI Penn Natural Gas, Inc.
Docket Nos. C-2011-2251178, C-2011-2253878, C-2011-2254311, C-2011-2258722, C-
2011-2262771, C-2011-2266076, C-2011-2267370, C-2011-2272802 and C-2012-
2281722**

Dear Secretary Chiavetta:

Enclosed please find the Reply of UGI Penn Natural Gas, Inc. to the Exceptions of the Office of Consumer Advocate in the above-referenced proceeding. Copies will be provided as indicated on the Certificate of Service.

Respectfully Submitted,

Anthony D. Kanagy

ADK/skr

Enclosure

cc: Honorable Ember Jandebour
Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document 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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I. INTRODUCTION AND BACKGROUND

UGI Penn Natural Gas, Inc. (“PNG” or the “Company”) herein files this Reply to the Exceptions filed by the Office of Consumer Advocate (“OCA”) in the above-captioned, consolidated proceedings. The OCA advocates on behalf of eleven Gas Beyond the Mains (“GBM”) customers who filed formal complaints with the Pennsylvania Public Utility Commission (“Commission”) challenging the previously-approved continuation of PNG’s GBM service with a phase-in to market-based propane rates.¹

The Initial Decision (“I.D.”) of Administrative Law Judge Ember S. Jandebour (“ALJ”) was issued by Secretarial Letter dated September 12, 2012. Therein, the I.D. concluded that: (1) under Section 1501 of the Public Utility Code, 66 Pa.C.S. § 1501, utilities are only required to extend service to customers under “reasonable conditions” subject to the regulations and orders of the Commission; (2) PNG’s line extension rules have been approved by the Commission as part of PNG’s tariff and have the force and effect of law; (3) PNG’s line extension rules do not violate Section 1501; (4) PNG’s line extension rules apply to GBM customers; (5) PNG is not required to make uneconomic line extensions to GBM customers; and (6) PNG is not terminating propane service but, rather, will continue the GBM service and transition long-term GBM customers to market-based propane rates.

On October 2, 2012, the OCA filed Exceptions to the I.D., asserting that PNG is required to make uneconomic main extensions to the GBM complainants without any contribution in aid of construction (“CIAC”). The OCA argued that PNG is required to make uneconomic line extensions to GBM customers for several reasons, including that GBM customers were promised gas service, that they made investments in propane equipment, and that PNG’s line extension

¹ The procedural history is fully set forth in PNG’s Response Brief filed on May 30, 2012. (PNG Brief, pp. 2-4.)

rules only apply to new customers. As explained below, OCA's arguments are contrary to law and were properly rejected by the I.D.

The fundamental issues to be decided by this Commission are whether the I.D. correctly determined that PNG's line extension tariff provisions apply to GBM customers, and whether PNG is required to make uneconomic main extensions to the GBM complainants. PNG submits that a basic understanding of history of PNG's GBM program is appropriate to properly address OCA's Exceptions.

The GBM service began in or about 1963, when PNG's predecessor in interest, Pennsylvania Gas and Water Company ("PG&W"), began offering propane gas in lieu of natural gas to certain customers that were beyond the territory supplied by PG&W's distribution mains.² The rate charged to these customers was the prevailing rate charged for natural gas service. PG&W's propane service was offered where the extension of natural gas facilities was, at the time, uneconomic but anticipated, but not guaranteed, to be economic in the near future. (I.D. Finding of Fact No. 95.)

After PNG acquired in 2006 all of the property and assets of PG&W's successor in interest, the PG Energy Division of Southern Union Company, PNG proposed, as part of its 2009 base rate case at Docket No. R-2008-2079660, to continue its GBM tariff service. During the base rate proceeding, the Commission's Office of Trial Staff ("OTS"), now the Bureau of Investigation and Enforcement ("I&E"), recommended the discontinuance of Rate GBM to eliminate the continued subsidy of propane costs to long-term GBM customers by all other PGC

² In certain areas of a utility's service territory, it is sometimes uneconomic to extend natural gas service. As a result, a number of utilities established GBM programs, under which a natural gas distribution company ("NGDC") can provide a temporary mechanism, the GBM program, to bridge the gap between economic and uneconomic service extensions where it is anticipated that a main extension will become economic at some future point. (I.D. Finding of Fact No. 93.)

customers. (I.D. Finding of Fact Nos. 104, 138.) The active parties to the 2009 base rate case, *including the OCA*, ultimately reached a comprehensive settlement of all issues in the proceeding, which was adopted by Commission in an Order entered on August 27, 2009. Pursuant to the Commission-approved settlement, PNG's tariff was amended to provide for the elimination of the GBM subsidies by 2014. (I.D. Finding of Fact Nos. 105, 139.)

In its 2011 PGC proceeding at Docket No. R-2011-2238943, PNG proposed to implement the GBM terms of the 2009 base rate case settlement by transitioning existing GBM customers to market-based rates for propane in such a way that long-term PNG GBM customers would be paying the full market rate for propane by August 27, 2014, and continue to receive the benefits of regulated service. (I.D. Finding of Fact No. 106.) The active parties to the 2011 PGC proceeding, *including the OCA*, ultimately reached a settlement of all issues, which was adopted by the Commission in an Order entered on October 14, 2011. Pursuant to the Commission-approved settlement, PNG's tariff was amended to provide that GBM customers will be fully transitioned to market-based propane rates by August 27, 2014, and will continue to receive regulated utility service, along with all of the associated consumer protections. (I.D. Finding of Fact Nos. 106, 140, 109.)

The GBM complainants filed formal complaints challenging the Commission-approved continuation of the GBM service with a phase-in to market-based propane rates. (I.D. Finding of Fact No. 110.) For relief, the OCA and GBM complainants requested that PNG be ordered to extend natural gas mains to the GBM complainants without requiring any customer CIAC. (I.D. Finding of Fact No. 111.)

The OCA's and GBM complainants' request for uneconomic main extensions without CIAC is directly contrary to the Company's tariff. In compliance with the Commission's

regulation, 52 Pa. Code § 59.27, PNG has adopted main extension rules, which are part of its Commission-approved tariff. PNG's main extension rules provide that if the Company's investment is not warranted by the anticipated revenue to be derived from the extension, customers are entitled to a line extension only with a customer CIAC. (I.D. Finding of Fact No. 112.) In this case, it was undisputed that that none of the GBM complainants meet the requirements of this tariff, and that PNG cannot, under its Commission-approved tariff, extend service to these customers without a very substantial CIAC. (I.D. Finding of Fact Nos. 113-14, 123). None of the GBM complainants are willing to pay a CIAC and, therefore, each of the extensions would be uneconomical for PNG and precluded by the Company's Commission-approved tariff. (I.D. Finding of Fact Nos. 114-15.)

The I.D. concluded that PNG's Commission-approved main extension tariff provisions have the force and effect of law and are applicable to the GBM customers. (I.D. Conclusion of Law Nos. 6-13.) The I.D. further found that OCA and the GBM complainants failed to meet their burden to establish that PNG is required to make uneconomic main extensions to the GBM complainants without any customer CIAC. (I.D. Conclusion of Law Nos. 15-16, 19.) The OCA takes several exceptions to the I.D., which are separately addressed below. The OCA's exceptions should be rejected for the reasons explained below, as well as the many reasons explained in PNG's Response Brief and the well-reasoned I.D.

II. PNG'S REPLY TO EXCEPTIONS

A. Reply to OCA Exception No. 1: The I.D. Correctly Determined That PNG's Main Extension Tariff Provisions Apply To GBM Customers.

1. Utilities Are Not Required To Make Uneconomic Line Extensions Under Section 1501.

The OCA does not dispute the I.D.'s finding that main extensions to the GBM complainants would be uneconomical and require CIAC. (I.D. Finding of Fact Nos. 113-14,

123). Rather, the OCA argues that PNG's failure to make uneconomic line extensions to GBM customers constitutes "unreasonable service" under Section 1501 of the Public Utility Code, 66 Pa.C.S. § 1501. (OCA Exceptions, p. 7.) The OCA's argument is without merit.

Under Section 1501, utilities are only required to extend service to customers "under reasonable conditions" subject to the regulations and orders of the Commission. *Fayette County Gas Co. v. Pa. PUC*, 33 A.2d 761 (Pa. Super. 1943). The Commission has implemented this statutory provision through regulations, which provide that the "utility may, upon proper cause shown, refuse or condition the acceptance of a particular application of extension of facilities." 52 Pa. Code § 59.27. The Commission requires NGDCs to have line extension rules in order to protect existing customers from bearing unreasonable costs and to maintain reasonable rates. Consistent therewith, PNG's Commission-approved main extension rules establish these terms and conditions and clearly require a CIAC for all uneconomic main extensions. (I.D. Conclusion of Law No. 8.)

The OCA's central argument -- that PNG is required to make uneconomic line extensions under Section 1501 -- has been previously rejected by this Commission and the appellate courts. In *Popowsky v. Pa. PUC*, 589 Pa. 605, 910 A.2d 38 (2006), the OCA argued that Pennsylvania American Water Company's ("PAWC") line extension regulations violated Section 1501, and that PAWC should make uneconomic line extensions. This Commission rejected the OCA's argument, holding that PAWC's line extension provisions applied and that the line extension provisions did not violate Section 1501. See *Township of Collier v. Pennsylvania-American Water Company*, Docket No. C-20016207, 2004 Pa. PUC LEXIS 26 (May 3, 2004). On appeal, the Commonwealth Court and the Supreme Court of Pennsylvania also held that PAWC's line

extension rules did not violate Section 1501. *See Popowsky v. Pa. PUC*, 853 A.2d 1097 (Pa. Cmwlth. 2004); *Popowsky v. Pa. PUC*, 589 Pa. 605, 910 A.2d 38 (2006).³

Furthermore, the Commission has recently addressed main extension issues for GBM customers. Similar to PNG, UGI Utilities, Inc. – Gas Division (“UGI”) has a GBM tariff provision that transitions GBM customers to full market-based propane rates over a multi-year period. In an order entered on October 31, 2011, the Commission clearly recognized that, under UGI’s main extension tariff provisions, a GBM customer may be required to pay a CIAC if the requested extension is uneconomical. *Adams v. UGI Utilities, Inc. – Gas Division*, Docket No. C-2010-2182016, 2011 Pa. PUC LEXIS 338 at *9 (October 31, 2011).⁴

2. PNG’s Main Extension Rules Clearly Apply To GBM Customers.

The I.D. concluded that PNG’s Commission-approved main extension tariff provisions apply to GBM customers seeking to have mains extended to provide natural gas service. (I.D. Conclusion of Law Nos. 6-13.) The OCA takes exception to this conclusion, arguing that GBM customers are existing customers of PNG and, according to the OCA, the main extension tariff provisions only apply to new customers applying for service. (OCA Exceptions, pp. 12-14.) The OCA’s argument violates well-established principles of law and must be rejected.

It is well-established that a public utility may not charge any rate or provide a service other than that lawfully tariffed. *Pennsylvania Electric Co. v. Pa. PUC*, 663 A.2d 281, 284 (Pa. Cmwlth. 1995); *The Bell Telephone Co. of Pa. v. Pa. PUC*, 417 A.2d 827, 828-29 (Pa. Cmwlth. 1980). Indeed, tariff provisions that have been approved by the Commission have the full force

³ A full discussion of the OCA’s opposition to PAWC’s line extension tariff provision in *Popowsky* is provided in PNG’s Response Brief. (PNG Response Brief, pp. 19-21.) PNG notes that the OCA takes exception to the I.D.’s reliance on this case, which is addressed below.

⁴ A full discussion of the *Adams* case is provided in PNG’s Response Brief. (PNG Response Brief, pp. 21-23.) PNG notes that the OCA takes exception to the I.D.’s reliance on this case, which is addressed below.

of law and are binding on the utility and its customers. *Pennsylvania Electric Co. v. Pa. PUC*, 663 A.2d 281 (Pa. Cmwlth. 1995); *Brockway Glass Co. v. Pa. PUC*, 437 A.2d 1067 (Pa. Cmwlth. 1981); *Stiteler v. Bell Telephone Co. of Pa.*, 379 A.2d 339 (Pa. Cmwlth. 1977).

Here, PNG's Commission-approved main extension rules establish the terms and conditions for main extensions and plainly require a CIAC for all uneconomic main extensions.⁵ (I.D. Conclusion of Law No. 8.) There is only one main extension provision in PNG's tariff that applies to all line extension requests, whether they are made by new or existing customers. The I.D. concluded that PNG's main extension tariff provisions clearly apply to all customers that request a line extension, including GBM customers. (I.D., p. 44.) The I.D.'s conclusion is consistent with this Commission's ruling in *Adams*, which, as explained above, held that a gas utility's line extension rules apply to GBM customers.

Despite the clear provisions of the Company's tariff and the Commission's ruling in the *Adams* case, OCA argues that PNG's line extension tariff provisions do not apply to the GBM complainants because the GBM customers are existing customers of PNG and, according to the OCA, the main extension tariff provisions only apply to new applicants for service. (OCA Exceptions, pp. 12-14.) PNG acknowledges that the GBM customers are existing customers of PNG. However, the GBM customers are not natural gas customers; rather, they are propane customers that are not currently receiving service via a natural gas main. GBM customers do not

⁵ Main extension are governed by Rule 5 of the Company's tariff, which provides in relevant part, as follows:

5. EXTENSION REGULATION

5.1 Obligations to Extend. Under the rules set forth below and under normal conditions of construction and installation, upon written application, the Company will extend its facilities within its service territory, provided that (a) the requested extension will not adversely affect the availability or deliverability of gas supply to existing customers and (b) the Company's investment in facilities is warranted by the anticipated revenue to be derived from the extension. The costs of extending facilities beyond that provided by the Company shall be paid by the applicant.

(PNG Exhibit DEL 3.)

have natural gas mains extending to their homes. PNG's tariff expressly states that an individual who wants a main extension must file a "written application." The word "applicant" clearly refers to someone who has filed a "written application" under PNG's tariff. (PNG Response Brief, p. 27.) Accordingly, in order for the GBM customers to receive natural gas service, they would have to apply for a main extension under the Company's main extension tariff provisions.

Further, the term applicant in the Company's main extension tariff provision is different than the defined term "Applicant" under the definitions section of the tariff. The capitalized term "Applicant" clearly refers to someone who is applying for new service. The un-capitalized term "applicant" under the line extension rules is any customer, new or existing, that applies for a main extension. GBM customers clearly are "applicants" under the line extension rules because they are applying to have mains installed and to be connected to PNG's primary distribution system. (PNG Response Brief, pp. 27-28.)

Finally, it is reasonable and prudent for the Company to apply its line extension rules to existing customers who are applying for an extension or upgrade of facilities because to do otherwise would potentially result in an uneconomic investment on the part of the Company simply because the application has been submitted by an existing customer. (PNG Response Brief, pp. 25-26.)

If OCA's argument that PNG's line extension rules do not apply to existing customers is accepted, this would have significant, and perhaps severe, impacts on PNG's cost of providing service to existing customers. Under the OCA's interpretation of the main extension rules, existing customers would not be required to pay for service upgrades, even if, for example the upgrades cost several million dollars and provided insufficient revenue to cover the costs of providing service. The Company's main extension tariff provisions are intended to protect the

Company's customers from bearing uneconomic costs for extending or upgrading facilities to both new and existing customers. (PNG St. No. 1-R, p. 21.)

In an effort to support its argument that PNG's Commission-approved main extension tariff provisions do not apply to GBM customers, OCA argues that the Company's use of a 5.5 year investment recovery period to determine if a CIAC is required for a requested main extension is not reasonable. (OCA Exceptions, pp. 14-16.) The OCA is confusing the facts in this proceeding. The 5.5 value is not the investment recovery period. The Company uses 5.5 times the annual margin to calculate the allowance and the predetermined rate of return. PNG explained that using this 5.5 ratio yields a predetermined rate of return of approximately 10.6% after tax. (PNG St. 2-R, p. 9.) The Company does not recover its investment in 5.5 years. The Company explained that it applies the main extension tariff provisions and the 5.5 ratio to requests for main extensions to determine whether the requested main is economical for the Company and whether a CIAC is required.⁶ Moreover, PNG's use of the 5.5 ratio is completely irrelevant to the legal issue of whether PNG's main extension tariff provisions apply to the GBM customers.

3. GBM Customers Were Never Promised Uneconomic Main Extensions And Any Such Promise Would Be Void As A Matter of Law.

In an effort to avoid PNG's Commission-approved main extension tariff provisions, the OCA asserts that PNG's predecessor, PG&W, allegedly promised the GBM customers that they would receive propane service at natural gas rates until gas mains were extended. (OCA Exceptions, pp. 5-9.) The OCA cites this alleged agreement or promise as support for its position that PNG should make uneconomic main extensions. (OCA Exceptions, pp. 6-7, 11). The OCA's reliance on the purported agreement is misplaced for several reasons.

⁶ The ratio would have to be significantly higher to even get the most economical GBM customers.

First, it is unclear whether an agreement was in fact made to the GBM customers and, if so, what are the terms and conditions of the alleged agreement. (PNG Response Brief, pp. 30-31.) Moreover, none of the Complainants alleged that the promise or agreement provided for uneconomic main extensions. In an effort to demonstrate that there was an alleged promise between PG&W and the GBM complainants, OCA goes to great lengths to show that the GBM complainants have made investments in reliance on the purported agreement. (OCA Exceptions, pp. 7-11.) In essence, OCA is attempting to establish the existence of an agreement under the theory of promissory estoppel or contract implied-in-law, and requests that the Commission grant the equitable relief of specific performance. However, the Commission has unequivocally held that “[t]here cannot be any detrimental reliance such as would preclude the utility from carrying out its statutory duty to adhere to its tariff.” *Barbara J. Kieth v. Pennsylvania Power & Light Co.*, Docket No. C-00970726, 1998 Pa. PUC LEXIS 74 at *10 (August 24, 1998). Therefore, the fact that the GBM customers invested in, replaced, or maintained their propane equipment is legally irrelevant.

Furthermore, the OCA ignores the fact, as found by the I.D., that the GBM customers have received, in some cases for more than 40 years, a real and substantial benefit in the form of subsidized propane rates. The average annual savings for GBM customers, as compared to paying full propane rates, over the past 22 years was approximately \$1,093 per year, assuming and average annual usage of 100 Mcf. Consequently, for that 22 year period the total subsidy per GBM customer would have been approximately \$24,024. (I.D. Finding of Fact Nos. 99-102.) It is the Commission’s policy to eliminate such subsidies. (PNG Response Brief, pp. 38-40.)

Second, as found by the I.D., the issue of whether there was a promise or agreement, and the terms of any such agreement are all matters that are beyond the jurisdiction of the Commission.⁷ (I.D., p. 39.) The determination of whether there was a private agreement between PNG's predecessor and the GBM complainants, and the terms of any such agreement, is matter for the courts to decide.⁸

Third, as explained above, the extension of mains to all customers, including existing or GBM customers, is controlled by PNG's Commission-approved main extension tariff provisions. Tariffs have the force and effect of law and, moreover, parties cannot contractually alter the terms of a tariff. Indeed, the cases addressing this issue have been clear and consistent for nearly 100 years -- any agreement guaranteeing a rate or service outside of tariff rules would be unenforceable and void as against public policy. *See, e.g., Leiper v. The Baltimore & Philadelphia Railroad Company*, 262 Pa. 328, 332, 334, 105 A. 551 (1918); *Philadelphia Suburban Water Company v. Pa. PUC*, 808 A.2d 1044, 1057, 1058 (Pa. Cmwlth. 2002). (*See* PNG Response Brief, pp. 31-32.)⁹

⁷ *See also PDJ Cab Company v. Pa. PUC*, 501 A.2d 342 (Pa. Cmwlth. 1988) (While the Commission has jurisdiction over any complaints filed by any person or corporation alleging a violation of the Public Utility Code or any of the Commission's regulations or orders, it does not have jurisdiction over private contract disputes between a utility and another person); *Snyder v. Pa. PUC*, 144 A.2d 468 (Pa. Super. 1958) (same).

⁸ Although the OCA does not dispute that the Commission is without jurisdiction to decide private contractual disputes, the OCA takes exception to the conclusion reached by the I.D. arguing that the issue of whether PNG should be required to make uneconomical main extensions to the GBM customers in violation of its Commission-approved tariff is, according to the OCA, a Section 1501 service matter and not a contractual dispute. (OCA Exceptions, p. 7.) Despite OCA's assertion to the contrary, the principle allegation in *all* of the GBM complaints is that there was an alleged promise to provide propane and natural gas rates until natural gas mains could be extended to serve the GBM customers. OCA's attempt to characterize the issue as a service issue rather than a main extension issue clearly ignores the allegations in the complaints. Furthermore, as explained above, the Commission and appellate courts have clearly held that Section 1501 does not require utilities to make uneconomic line extensions.

⁹ Only three of the GBM complainants were the original homeowners. Even assuming, *arguendo*, that these three GBM complainants were able to establish an agreement with PG&W whereby PG&W agreed to extend natural gas distribution mains to the GBM customer complainants or to continue to provide propane at natural gas rates indefinitely, such an indefinite agreement would not be enforceable. (PNG Response Brief, pp. 32-33; *Hutchinson v. Sunbeam Coal Corp.*, 513 Pa. 192, 519 A.2d 385 (1986); 13 Pa.C.S. §§ 2105, 2309.)

Fourth, the Commission clearly assumed jurisdiction over the GBM service many years ago. Tariffed rates and services are always subject to change by the Commission, and no rate or service remains the same for perpetuity. Indeed, there can be no lawful rate *except* the last tariff published as provided by law, which supersedes all prior rates relating to the service called for. *The Bell Telephone Co. of Pa. v. Pa. PUC*, 417 A.2d 827, 828-29 (Pa. Cmwlth. 1980). As a result, the GBM complainants are subject to Commission-approved changes in their PGC rates implemented to address concerns about the cross-subsidization of propane costs incurred to serve long-term GBM customers by all other PGC customers. (PNG Response Brief, pp. 32-33.)

4. PNG Did Not Receive Incremental Profits From GBM Customers.

In an effort to demonstrate that PNG's Commission-approved main extension tariff provisions should not be applied to the GBM complainants and that PNG should be required to make uneconomic main extensions to the GBM customers, the OCA contends that the Company has realized incremental profits from the GBM customers for decades, while ratepayers have subsidized the costs of supplying propane to the GBM customers. (OCA Exceptions, pp. OCA Exceptions, pp. 6, 10, 13.) OCA's argument is incorrect and misconstrues the ratemaking process.

The distribution charges paid by GBM customers were in no way "incremental" to the Company's approved rate of return. The distribution rate paid by the GBM customers was established on a class basis. The distribution charges paid by the GBM customers contributed to the recovery of the existing costs associated with serving the class as a whole. The distribution charges paid by GBM customers were included with revenues received from all residential or commercial customers in the ratemaking process to provide the necessary revenue requirement to recover the Company's costs and earn a reasonable rate of return. Had GBM customers not paid distribution charges, the rates for all other customers would have been higher. (PNG Response

Brief, pp. 40-41.) The OCA also fails to acknowledge that GBM customers have received the same numerous benefits and customer protections received by PGC customers as a result of paying these distribution charges.¹⁰ (PNG Response Brief, p. 39.)

Further, OCA completely disregards the finding by the I.D. that PNG applies its main extension tariff provisions to existing natural gas customers when determining if a CIAC will be required. (I.D. Finding of Fact No. 117; PNG Response Brief, pp. 25-28.) Undoubtedly, existing natural gas customers have paid the same Commission-approved distribution charges paid by the GBM customers. It would be discriminatory to apply the main extension tariff provisions to the existing natural gas customers but not to the existing GBM customers because both types of customers pay the same distribution charges.

5. The OCA's Reliance on Service Issues and Number of Potential New Customers is Fundamentally Flawed.

The OCA asserts that certain service issues experienced by some of the GBM complainants and the potential to add additional customers supports a finding that PNG's Commission-approved main extension tariff provisions do not apply to the GBM complainants. (OCA Exceptions, pp. 10-11, 16-17.) The OCA's arguments are without merit and must be rejected.

In an effort to demonstrate that PNG should be required to extend uneconomic mains to the GBM customers, OCA raises several service-related issues to demonstrate that PNG has violated Section 1501. However, these issues are completely unrelated to and have no affect on the primary issue in this case -- whether PNG is obligated to make uneconomical main extensions. Further, as found by the I.D., only two complainants raised service issues, and the

¹⁰ The GBM customers would not have received these benefits if they were private propane customers.

other service-related issues raised by the OCA are outside the scope of the GBM complaints.¹¹ (I.D., p. 45.) Importantly, if the Commission were to conclude that there are specific service-related issues, the remedy is for the Company to take prospective steps to correct the service issues; not force PNG to make uneconomic main extensions at the expense of other customers or shareholders. Finally, the OCA simply disregards PNG's efforts and the record evidence, which clearly indicates that PNG has been responsive to the concerns of the GBM Complainants, many of which have been already fully resolved. (PNG Response Brief, pp. 50-54.)

In a further effort to justify the extension of mains to GBM customers without a CIAC, OCA argues that PNG will be able to recoup the "uneconomic" portion of the investment if it is able to add potential new customers that could be served from lines extended to the complainants. In making this assertion, the OCA disregards that additional investment would be required to serve these additional customers. Indeed, as found by the I.D., the total "uneconomic" portion of the investment to extend mains to serve the 11 GBM Complainants, and 138 of the potential new customers and proximate GBM customers for which the Company has current cost estimates, would be approximately \$2.4 million. It would take the addition of approximately 1,176 customers to offset the uneconomic investment; many more than the "potential" number identified by the OCA. (I.D. Finding of Fact No. 123; PNG Response Brief, p. 44.)

Moreover, PNG recognizes the benefits of Marcellus Shale natural gas and of extending gas service to individuals that do not currently have natural gas service. In that regard, PNG is considering ways to extend its distribution facilities. However, any extension plan must consider the impact on current customers. As demonstrated in this proceeding, the GBM customers are

¹¹ OCA has taken exception to this conclusion, which is further discussed below

located too far from PNG's existing facilities and in low density areas that make extending mains to these customers very uneconomical. (PNG Response Brief, pp. 23-24.)

B. Reply to OCA Exception No. 2: The I.D. Properly Considered and Rejected OCA's Proposal that PNG Should Bear the Costs of Uneconomic Main Extensions to GBM Customers.

OCA recommended that the "economic" portion of the proposed main extensions should be included in rate base, and that the "uneconomic" portion of those main extensions should be paid for by PNG's shareholders. (OCA Exceptions, p. 17.) The I.D. concluded that PNG's main extension tariff provisions apply to the GBM customers and, therefore, implicitly rejected the OCA's unprecedented proposal. The OCA argues that the I.D. erred in rejecting OCA's proposal that PNG should bear the costs of uneconomic main extensions to GBM customers. (OCA Exception No. 2.) For the reasons explained above, the I.D. correctly determined that PNG's main extension tariff provisions apply to GBM customers.

OCA asserts that PNG should be required to invest capital to serve customers and only have a future "potential" right to recover a return on its investment if and when additional customers connect to the mains in the future. (OCA Exceptions p. 17.) This argument ignores PNG's right to recover a return on its investment at the time it is being used for public service.¹² Further, as explained above, the OCA's recommendation is based on an erroneous assumption that PNG will be able to recoup the "uneconomic" portion of the investment if additional customers could be served from lines extended to the Complainants alone. Indeed, it would take the addition of approximately 1,176 customers to offset the uneconomic investment; many more than the "potential" number identified by the OCA. (I.D. Finding of Fact No. 123; PNG Response Brief, p. 44.)

In further support of its proposal, OCA argues that PNG has realized incremental profits from GBM customers for decades while, at the same time, PNG ratepayers have funded the additional costs of supplying propane to the GBM customers. (OCA Exceptions, p. 19.). However, as explained above, PNG did not realize incremental profits from GBM customers. (PNG Response Brief, pp. 40-41.)

Furthermore, as explained in PNG's Response Brief, OCA's proposal is flawed for several reasons. First, and perhaps most importantly, the OCA's argument is completely unprecedented. In line extension cases, the issue has never been whether the utility should bear the costs of the investment and not be able to recover its costs. Second, Pennsylvania case law clearly has recognized that a public utility's duty to provide line extensions is not unlimited and, therefore, does not obligate the public utility to make line extensions that are uneconomic or unreasonable. *Sherman v. Public Service Commission*, 90 Pa. Superior Ct. 523 (1927); *Popowsky v. Pa. PUC*, 589 Pa. 605, 910 A.2d 38 (2006). Third, if PNG is required to extend mains to customers, PNG must be permitted to earn a return on its investment in those mains under the "regulatory compact."¹³ To hold otherwise would deny PNG an opportunity to earn a fair return on its investment. There simply is no precedent for PNG's shareholders to bear the costs of uneconomic main extensions.

¹² See *National Utils. v. Pa. PUC*, 709 A.2d 972, 976 (Pa. Cmwlth. 1998) ("the 'just compensation' safeguarded to a utility by the fourteenth amendment of the federal constitution is a reasonable return on the fair value of its property at the time it is being used for public service") (citation omitted).

¹³ As a regulated utility, PNG is both subject to and protected by the "regulatory compact" under which PNG provides service to customers and is authorized to earn a return on its the fair market value of prudent investments made to provide service to the public. When PNG devotes property, including monetary capital, to public service, PNG is entitled to a fair opportunity to earn a fair return on its investment. Rates that do not meet this standard are confiscatory and, therefore, are unconstitutional. See U.S. Const. Amend. 14, § 1; Pa. Const. Article I, Section 10; *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Bluefield Waterworks and Imp. Co. v. P.S.C. of West Virginia*, 252 U.S. 679 (1923); *Pa. P.U.C. v. Pennsylvania Gas and Water Co. – Water Division*, 492 Pa. 326, 424 A.2d 1213 (1980), *cert. denied*, 454 U.S. 824 (1981).

C. **Reply to OCA Exception No. 3: The I.D. Properly Relied On The Decisions from The Commonwealth Court And This Commission.**

The I.D. concluded that, consistent with *Popowsky v. Pa. PUC*, 589 Pa. 605, 910 A.2d 38 (2006), and the Commission's recent decision in *Adams v. UGI Utilities, Inc. – Gas Division*, Docket No. C-2010-2182016, 2011 Pa. PUC LEXIS 338 (October 31, 2011), PNG's main extension tariff provisions apply to GBM customers to determine whether a CIAC is required. The OCA contends that the I.D. erred in relying upon these decisions. (OCA Exception No. 3.) For the reasons explained below, the OCA's exception is without merit.

The OCA contends that the I.D. erred in relying on *Popowsky*, because, according to OCA, the Pennsylvania Supreme Court's holding applies only to new customers and the GBM customers are not new customers of PNG. (OCA Exceptions, p. 20-21.) However, there was nothing in *Popowsky* that limited the holding to only new customers. Indeed, the issue in *Popowsky* was "whether a demonstration of public need for water alone is sufficient to require a water company to extend its water lines and service without receiving customer contribution, in an instance where the cost of the extension project would exceed the company's expected revenue from the extension." *Id.* at 609, 910 A.2d at 40. The Supreme Court rejected this proposition, affirming the holdings of the Commission and Commonwealth Court that the utility's Commission-approved line extension provisions applied. The Supreme Court held that, under Section 1501, utilities are only required to extend service to customers "under reasonable conditions," and that utilities are not required to make uneconomic line extensions without CIAC. *Id.* at 632, 634-35, 910 A.2d at 44, 56. Clearly, Section 1501 applies equally to existing customers and new applicants for service, and there is nothing in *Popowsky* that limited its holding to apply only to new customers.

Further, the OCA's contention that the I.D. erred in relying on *Popowsky* is premised on its erroneous argument that PNG's main extension tariff provisions do not apply to GBM customers because they are existing customers. As explained above, PNG applies its main extension tariff provisions to new *and* existing natural gas customers, when determining if a CIAC will be required. (I.D. Finding of Fact No. 117; PNG Response Brief, pp. 25-28.)

The OCA also contends that the I.D. erred in relying on this Commission's recent decision in *Adams*. In *Adams*, this Commission unequivocally held that main extension tariff provisions similar to PNG's applied to an existing GBM customer, and that the GBM customer may be required to pay a CIAC if the requested extension is uneconomical. The Commission's holding in *Adams* clearly is dispositive of the pending complaints.

The OCA attempts to distinguish *Adams*, asserting that the issues raised in this pending matter is "whether the Complainants have sustained their burden of proving their complaints," and that the issue raised in *Adams* was whether the utility promised the GBM customer that he would receive propane service at natural gas rates until gas mains were extended. (OCA Exceptions, p. 22.) The OCA's attempt to distinguish *Adams* on this basis is nonsensical. A review of the complaints in this case clearly reveals that each of the GBM complaints alleged that PNG's predecessor promised the GBM customers that they would receive propane service at natural gas rates until gas mains were extended -- this is the very same issue raised by the complaint in *Adams*. Furthermore, the OCA disregards that the issue actually decided by this Commission in *Adams* was not whether there was an agreement but, rather, whether UGI's main extension tariff provisions should be applied to the GBM customer. *Id.* at *9-11.

The OCA attempts to further distinguish *Adams* from the pending matter on the basis that the complainant in *Adams* was *pro se*, and suggests that the Commission would have reached an

entirely different result had the complainant in *Adams* been represented by legal counsel. (OCA Exceptions, p. 22-23.) PNG submits that there is absolutely no basis for the OCA's position. Clearly, the Commission relies on the merits and the evidence of record in reaching a decision, and the presence or absence of legal counsel had no impact on the Commission's disposition of *Adams*. The Commission carefully considered the sole legal issue before it in *Adams* -- whether UGI was obligated to convert the complainant's propane service to natural gas distribution service -- and held that UGI's line extension tariff provisions applied to GBM customers.

D. Reply to OCA Exception No. 4: The I.D. Applied the Correct Burden of Proof With Respect to the OCA's Challenge to Previously Approved Tariff Provisions.

The OCA argues that the I.D. failed to apply the correct burden of proof. (OCA Exception No. 4.) The I.D. held that the OCA and the GBM complainants had the burden to demonstrate that the facts and circumstances have changed so as to render the Commission's prior approval of PNG's tariff provisions unreasonable.¹⁴ (I.D. Conclusions of Law Nos. 4-5.) The OCA does not dispute that this is the correct burden of proof; rather, the OCA argues that it is not challenging Commission-approved settlements from the 2009 base rate case and the 2011 PGC proceeding or PNG's main extension tariff provisions. (OCA Exceptions, p. 24.) OCA's exception is without merit for several reasons.

First, despite its assertion to the contrary, the OCA is, in effect, challenging the terms and conditions of the Commission-approved settlements from the 2009 base rate case and the 2011

¹⁴ Tariff provisions previously approved by the Commission are deemed just and reasonable and, therefore, a party challenging a previously-approved tariff provision bears the burden to demonstrate that the Commission's prior approval is no longer justified. *See, e.g., Pa. PUC v. Philadelphia Gas Works*, Docket Nos. R-00061931, *et al.*, 2007 Pa. PUC LEXIS 45 at *165-68 (September 28, 2007) (adopting the ALJ's discussion on burden of proof); *Brockway Glass Co. v. Pa. PUC*, 437 A.2d 1067, 1070 (Pa Cmwlth. 1981). To meet this burden, the party challenging a previously-approved tariff provision must demonstrate that the "facts and circumstances have changed so drastically as to render the application of the tariff provision unreasonable." *Kanowicz v. PPL Electric Utilities Corporation*, Docket No. C-20043915, 2005 Pa. PUC LEXIS 42 at *6-7 (November 1, 2005) (citing *Brockway Glass Co. v. Pa. PUC*, 437 A.2d 1067 (Pa. Cmwlth. 1981)).

PGC proceeding. The 2009 base rate settlement provided for the elimination of GBM service, and the 2011 PGC settlement allowed for the continuation of GBM service with a transition to market-based propane rates.¹⁵ The OCA agreed to fully support the terms and conditions of both settlements, including the GBM service provisions. However, here the OCA is, in effect, opposing the settlement terms -- the phase-in to full market-based propane rates -- that it expressly agreed to and supported less than one year ago. The OCA has offered absolutely no reasonable explanation for its departure from its prior position.¹⁶

Second, if the continuation of the GBM service without extending mains violates Section 1501, as the OCA contends, then the OCA should not have agreed to the 2011 PGC settlement, which clearly provides for the continuation of GBM service without requiring main extensions. Moreover, the Commission, by its approval of these settlements, has concluded that the continuation of the GBM service with a phase-in to market-based rates is adequate, efficient, safe, and reasonable service and, therefore, consistent with Section 1501 of the Public Utility Code.

Third, the OCA's argument that it is not challenging PNG's main extension tariff provisions is based on its erroneous position that the main extension tariff provisions do not apply to the GBM customers. The I.D. correctly determined that the main extension tariff provisions applied to all the GBM complainants. (I.D. Conclusion of Law No. 13; PNG Response Brief, pp. 24-28.) As explained above, a public utility may not charge any rate or

¹⁵ The terms and conditions of these Commission-approved settlements are set forth in PNG's Commission-approved tariff, which has the full force of law and is binding on PNG and its customers. *Pennsylvania Electric Co. v. Pa. PUC*, 663 A.2d 281 (Pa. Cmwlth. 1995); *Brockway Glass Co. v. Pa. PUC*, 437 A.2d 1067 (Pa. Cmwlth. 1981); *Stiteler v. Bell Telephone Co. of Pa.*, 379 A.2d 339 (Pa. Cmwlth. 1977).

¹⁶ While the OCA may not be technically barred from abandoning the prior settlement agreement, the OCA should not now be permitted to essentially walk away from these Commission-approved settlements by reversing its prior position and directly challenging the terms of these settlements that it previously agreed to and supported.

provide a service other than that lawfully tariffed. Here, there is only one main extension provision in PNG's tariff, which PNG uniformly applies to all individuals who request a main extension whether they are existing or new customers. (I.D. Conclusion of Law No.12, Finding of Fact No. 117.) Indeed, as this Commission recently held, the starting point to address the OCA's and GBM complaints' contention that PNG has an "obligation to serve" by extending natural gas mains is PNG's main extension tariff provisions. *Adams*, at *9.

Clearly, the OCA and GBM complainants are challenging the application of the terms and conditions of the Commission-approved settlements from the 2009 base rate case and the 2011 PGC proceeding, as well as PNG's main extension tariff provisions. Therefore, the I.D. correctly determined that the OCA and GBM complaints had the burden to demonstrate that the facts and circumstances have changed so drastically as to render the application of these Commission-approved tariff provisions unreasonable.

In an effort to demonstrate that the OCA and GBM complainants met their burden of proof, OCA contends that development of Marcellus Shale natural gas and the fact that PNG is soliciting additional customers justifies a departure from the Commission-approved settlements and PNG's main extension tariff provisions. (OCA Exceptions, p. 25.) The fact that PNG has sought Commission approval to expand certain portions of its service territory in no way justifies *uneconomic* line extensions. Indeed, PNG has sought Commission approval to expand its service in certain limited areas only because it is *economical* to do so. Here, it is undisputed that the main extensions advocated by the OCA would be uneconomical.

Based on the foregoing, the OCA and GBM complainants have failed to meet their burden to introduce any facts or circumstances that have drastically changed since the Commission approved the 2009 base rate case and 2011 PGC settlements that would render the

continuation of the GBM service with a phase-in to market-based rates or the application of PNG's main extension tariff provisions unreasonable.

E. Reply to OCA Exception No. 5: The I.D. Properly Refused To Consider Issues That Were Beyond Those Raised In The GBM Complaints.

Although the OCA raised numerous service-related issues at the hearing and in its brief, the I.D. noted that only two of the GBM complaints actually raised service issues and, therefore, found that all other service issues raised by the OCA were outside the scope of the GBM complaints. (I.D., p. 45.) The OCA contends that the I.D. erred by failing to consider these additional service issues, arguing that the conclusion reached by the I.D. contradicts the ALJ's order in PNG's 2011 PGC proceeding. (OCA Exceptions, p. 27.) The OCA further argues that the I.D. erred because the OCA provided service-related exhibits to PNG three days in advance of the hearing, and that service-related evidence was admitted into the record. (OCA Exceptions, p. 28.) OCA's arguments are without merit for several reasons.

First, the ALJ's order in PNG's 2011 PGC proceeding did not preserve "service-related" issues as suggested by the OCA. PNG was served with a complaint filed by Kathleen Moran-Roberto at Docket No. C-2011-2248372, which challenged the GBM rate transition mechanism proposed by PNG in the 2011 PGC proceeding and requested that PNG install a gas main to provide Ms. Moran-Roberto with natural gas. Clearly, the complaint filed by Ms. Moran-Roberto did *not* raise any service-related issues.

Because the complaint challenged the proposed GBM rate transition mechanism, PNG moved to consolidate the complaint with the 2011 PGC proceeding. In an order issued on July 6, 2011, ALJ Melillo granted PNG's motion with respect to the portion of the complaint that related to the proposed GBM rate transition mechanism. However, the ALJ noted that the "service extension does not relate to purchase gas costs" and, therefore, reserved that portion of the

complaint that “relates to natural gas mains extension ... for separate litigation at a separate docket.” *See Pa. PUC v. UGI Penn Natural Gas, Inc. 1307(f), et al.*, Docket Nos. R-2011-2238943, *et al.*, at p. 10 (Order of Administrative Law Judge Melillo entered July 6, 2011). Clearly, the ALJ’s order in the 2011 PGC proceeding did not preserve any and all “service-related” issues that could possibly be raised, as asserted by the OCA. Rather, the only issue reserved for litigation in the ALJ’s order was the limited issue raised in the complaint -- whether mains should be extended to serve the complainant.

Second, even assuming that the ALJ’s order in the 2011 PGC proceeding reserved service-related issues, which PNG denies, the order only applied to Ms. Moran-Roberto. There is nothing in the order to suggest that the other GBM complainants were excused from identifying and setting forth in their respective pleadings any service-related issue they may have.¹⁷

Third, the OCA’s reliance on the fact that the OCA provided service-related exhibits to PNG three days in advance and that service-related evidence was admitted into the record is without merit. Although the ALJ admitted certain service-related evidence into the record, over the objection of PNG, the ALJ’s ruling clearing indicated that the evidence was not being admitted to amend the complaints or to convert the proceeding into a general service complaint proceeding. Rather, the ALJ explained that the evidence was being admitted solely for the purpose of addressing the issue of whether PNG should be required to provide main extensions to the GBM customers. (Apr. 5, 2012 Tr. 122.) Furthermore, the fact that this evidence was provided to PNG at the eleventh hour and admitted to the record for limited purposes does not change the fact that these service issues were not raised in the GBM complaints. Any

¹⁷ Notably, even Ms. Moran-Roberto failed to raise any service-related issues in her GBM complaint filed in this proceeding.

consideration of these issues clearly would be a denial of PNG's due process of law.¹⁸ It must be remembered that there is an adequate and proper remedy to address these alleged service concerns without violating PNG's due process rights -- the GBM complainants each could have filed formal complaints with the Commission that actually raised and alleged service-related issues.

Fourth, even assuming that the GBM complaints properly raised the service issues alleged by the OCA, which PNG denies, these issues are completely unrelated to and have no affect on the primary issues in this case -- whether the I.D. correctly determined that PNG's line extension tariff provisions apply to GBM customers and whether PNG is obligated to make uneconomical main extensions. In essence, the OCA is raising these service-related issues in an attempt to bootstrap its burden to demonstrate that the facts and circumstances have changed so drastically as to render the Commission's prior approval of line extension and GBM service provisions of PNG's tariff unreasonable. Clearly, this is not the appropriate standard for deciding the actual issues raised in this proceeding.

18 In *Edward T. O'Toole v. Metropolitan Edison Company*, Docket No. C-2008-2045487, 2009 Pa. PUC LEXIS 626 (April 20, 2009), the Commission entered an order adopting the an initial decision that dismissed several issues raised by a complainant for the first time at the hearing that were not raise in the complaint. In dismissing the issues that were not raised in the complaint, the initial decision explained as follows:

Since Complainant never raised these issues in his complaint, these issues will receive no consideration here. Administrative agencies, such as the Commission, are required to provide due process to the parties appearing before them. *Schneider v. Pa. P.U.C.*, 479 A.2d 10 (Pa. Cmwlth. 1984). This due process requirement is satisfied, when the parties are accorded notice and the opportunity to appear and be heard. *Id.* If an issue is not raised in a complaint or a party's pleading, the responding party receives no notice that that issue will be litigated at a hearing. If this occurs, the responding party is denied due process of law. Just in this fashion, any consideration of these issues here, after Complainant's failure to raise these issues in his complaint, will deny Met-Ed due process of law. Accordingly, these issues will be dismissed.

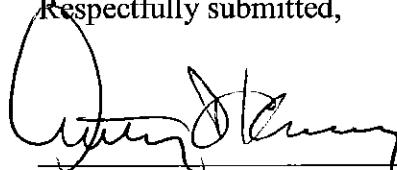
Edward T. O'Toole v. Metropolitan Edison Company, Docket No. C-2008-2045487, 2009 Pa. PUC LEXIS 907 (Initial Decision entered February 4, 2009).

Finally, the OCA's exception is without merit because it ignores the record evidence that PNG has been responsive to the concerns of the GBM Complainants, many of which have been already fully resolved. (PNG Response Brief, pp. 48-54.)

III. CONCLUSION

WHEREFORE, UGI Penn Natural Gas, Inc. respectfully requests that the Pennsylvania Public Utility Commission deny the Exceptions of the Office of Consumer Advocate and adopt recommendations set forth in the well reasoned Initial Decision of Administrative Law Judge Ember S. Jandebour.

Respectfully submitted,



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