

COMMONWEALTH OF PENNSYLVANIA



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February 25, 2014

Rosemary Chiavetta, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
Harrisburg, PA 17120

RE: Petition for Generic Investigation or Rulemaking
Regarding "Gas-On-Gas" Competition Between
Jurisdictional Natural Gas Distribution Companies
Docket No. P-2011-2277868

Generic Investigation Regarding Gas-on-Gas
Competition Between Jurisdictional Natural Gas
Distribution Companies
Docket No. I-2012-2320323

Dear Secretary Chiavetta:

Enclosed please find the Office of Consumer Advocate's Main Brief in the above-captioned proceeding.

Copies have been served upon all parties of record as shown on the attached Certificate of Service.

Sincerely,

A handwritten signature in black ink, appearing to read "Darryl A. Lawrence".

Darryl A. Lawrence
Assistant Consumer Advocate
PA Attorney I.D. # 93682

Enclosures

cc: Hon. Elizabeth H. Barnes, ALJ
Certificate of Service

*159861

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Petition for Generic Investigation or	:	
Rulemaking Regarding "Gas-On-Gas"	:	
Competition Between Jurisdictional Natural	:	P-2011-2277868
Gas Distribution Companies	:	
	:	
	:	
Generic Investigation Regarding Gas-On-Gas	:	
Competition Between Jurisdictional Natural	:	I-2012-2320323
Gas Distribution Companies	:	

MAIN BRIEF OF THE
OFFICE OF CONSUMER ADVOCATE

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Dated: February 25, 2014

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I. INTRODUCTION

In certain areas of western Pennsylvania, prior to the economic regulation of public utilities, multiple natural gas distribution companies (NGDCs) shared the same geographic locations. These overlapping and non-exclusive service territories continue to exist to this day. Due to the close proximity of multiple NGDCs to various commercial and industrial customers, and due to the non-exclusivity of service territories, it is feasible for customers to switch between NGDCs. In an attempt to attract additional customers, or to retain existing customers, the NGDCs in the overlapping areas offer distribution rates below the fully tariffed rates to certain large commercial and industrial customers that are geographically located in close proximity to the natural gas infrastructure of more than one NGDC. Such discounting, referred to as “gas-on-gas competition”,¹ is often done on a case by case basis in order to combat rate discounts offered by neighboring NGDCs. No residential customers participate in this rate discounting practice. OCA St. 1 at 6.²

The practice of gas-on-gas rate discounting creates tens of millions of dollars in discounts. These discounts are billed to all other captive ratepayers of the utilities involved. The current practice of gas-on-gas discounting does not represent true competition. Moreover, it neither spurs product innovation, nor does it lead to greater efficiencies or reduced prices. Rather, it merely represents an uneconomic transfer of wealth from captive ratepayers (including

¹ The OCA uses the term “gas-on-gas rate discounting” to describe this practice, as for all the reasons discussed herein, the current practice of discounting rates for a select few customers is not competition.

² OCA Statement No. 1 is the Public Version of the Direct Testimony of OCA witness Glenn A. Watkins. Mr. Watkins is a Principal and Senior Economist with Technical Associates, Inc., an economics and financial consulting firm. Mr. Watkins has conducted marginal and embedded cost of service, rate design, cost of capital, revenue requirement, and load forecasting studies involving numerous electric, gas, water/wastewater, and telephone utilities, and has provided expert testimony in Alabama, Arizona, Georgia, Illinois, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Vermont, Virginia, South Carolina, Washington, and West Virginia. A more complete description of Mr. Watkins education and experience is provided in Schedule GAW-1, attached to OCA St. 1.

captive commercial and industrial ratepayers) to a certain few, large commercial and industrial customers who happen to be located in the right area. This gas-on-gas rate discounting is uneconomic and inconsistent with the public interest, and the best interest of the ratepayers of the participating NGDCs. The OCA submits that the time has come for the current practice and form of gas-on-gas rate discounting to be discontinued in Pennsylvania.

In rate cases for the applicable NGDCs, the ratemaking treatment and revenue responsibility associated with these discounts has consistently been a source of controversy and disagreement. One of the largest obstacles in resolving the disagreements associated with gas-on-gas discounting is that only one NGDC participates in each particular rate case. It has been argued by the utilities in many of these rate cases that the resolution of gas-on-gas discounting has direct ramifications and impacts on other NGDCs that operate in the same geographic location as the applicant NGDC. As such, the controversy over gas-on-gas rate discounting has been repetitive and at the same time evaded comprehensive review – until now.

Peoples Natural Gas Company (Peoples) is one of the NGDCs that engage in gas-on-gas discounting. In Peoples base rate proceeding at Docket No. R-2010-2201702, the Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA), the Bureau of Investigation and Enforcement (I&E), and Peoples disputed the ratemaking treatment and revenue responsibility associated with gas-on-gas discounts given by Peoples.³ Jt. Pet. at 2. The OCA argued that the Company should be presumed to be recovering full rates from customers whose rates have been flexed. Jt. Pet. at 2. The OCA argued that the cost of the discounts provided to commercial customers should be recovered within the commercial class, and the cost

³ See Joint Petition Requesting that the Pennsylvania Public Utility Commission Institute a Generic Investigation or Rulemaking Concerning Gas on Gas Competition Between Natural Gas Distribution Companies, Dock. No. P-2011-2277868 (submitted Dec. 8, 2011) (Joint Petition).

of discounts provided to industrial customers should be borne by the Company. Id. I&E argued that the practice of gas-on-gas competition should be discouraged by requiring the Company to absorb the cost of the discounts. OSBA agreed that the practice of rate discounting was inequitable and argued that the cost of discounting the rates should be absorbed by the class that contained the customer that received the discount. Conversely, Peoples argued that it could not discontinue rate discounting because it would lose customers to other NGDCs that continued to discount rates. Id.

All parties resolved the disagreement regarding gas-on-gas discounting by entering into a settlement which, in part, provided that the parties would jointly petition the Pennsylvania Public Utility Commission (Commission) for a generic investigation on gas-on-gas rate discounting. The other NGDCs that engage in gas-on-gas discounting – Equitable Gas Company,⁴ Columbia Gas Company, and T.W. Phillips Gas and Oil Company – had previously entered into similar settlement agreements in their respective rate cases that had been filed over the last number of years.

Peoples, Peoples TWP, OCA, I&E, and OSBA submitted the Joint Petition to the Commission seeking a generic investigation into all aspects of gas-on-gas rate discounting. The Commission granted that petition, and opened the current generic investigation (Investigation) docket. Most of the major Pennsylvania NGDCs and many other stakeholders intervened in this Investigation and were granted party status. The OCA and many other parties in this docket have vigorously engaged in formal and informal discovery, and have submitted several rounds of testimony for the record.

⁴ Since this generic investigation was instituted, the Commission has approved the merger of Equitable and Peoples.

As discussed throughout this Main Brief, the current practice and form of gas-on-gas rate discounting serves no reasonable public policy goal and its continuation in its present form may not be in accord with case precedent of the Commission or the appellate courts of Pennsylvania. The OCA submits that the Commission should end gas-on-gas rate discounting as it is currently being practiced.

II. PROCEDURAL HISTORY

On December 8, 2011, Peoples, Peoples TWP, OCA, I&E, and OSBA filed a “Joint Petition Requesting that the Pennsylvania Public Utility Commission Institute a Generic Investigation or Rulemaking Concerning Gas on Gas Competition Between Natural Gas Distribution Companies.” Joint Petition. On December 28, 2011, the Industrial Energy Consumers of Pennsylvania (IECPA or Industrials) filed an Answer to the Joint Petition, which did not oppose the request for the institution of a generic investigation. On March 19, 2012, pursuant to its settlement agreement at Docket Number R-2010-2215623, Columbia Gas of Pennsylvania (Columbia) submitted a Petition to Intervene.

On July 25, 2012, the Commission issued a Secretarial Letter granting the Joint Petition and provided that “the issues related to a NGDC’s flexing of distribution rates to meet the ratemaking proceedings should be resolved through a generic investigation.” The Investigation was assigned to the Office of Administrative Law Judge and further assigned to Administrative Law Judge Elizabeth Barnes (Judge Barnes). In the weeks following the issuance of the July 25 Secretarial Letter, Petitions to Intervene were submitted by PECO Energy Company (PECO), Equitable Gas Company LLC (Equitable), the Industrial Energy Consumers of Pennsylvania (IECPA), UGI Distribution Companies (UGI), the Penn State University (Penn State) and National Fuel Gas Distribution Corporation (NFGD). On August 23, 2012, Judge Barnes issued

a Prehearing Conference Order to advise the parties that an initial prehearing conference would take place on August 31, 2012.

An Initial Prehearing Conference was held by Judge Barnes on August 31, 2012. The following parties were granted Intervenor status at the Initial Prehearing Conference: The Pennsylvania State University; National Fuel Gas Distribution Corporation; IECPA; Columbia Gas of Pennsylvania, Inc.; PECO Energy Company; UGI Distribution Companies; and Equitable Gas Company LLC. At this Initial Prehearing Conference, the scope of the Investigation was discussed at length. Certain of the NGDCs argued that the scope of this Investigation should be limited to only the ratemaking treatment of “flexed” distribution revenues. Conversely, the OSBA and OCA argued that the July 25 Secretarial Letter intended for a broad and searching inquiry into all aspects of gas-on-gas rate discounting, including whether the practice should be allowed to continue. Judge Barnes ordered the parties to submit formal comments as to the appropriate scope of this Investigation and as to the exact issues that should be included.

The OCA submitted its Formal Comments on October 1, 2012. In its Formal Comments, the OCA argued that the July 25 Secretarial Letter was clear and unambiguous that this Investigation should encompass all aspects of gas-on-gas rate discounting, including whether this practice should be ended.

On December 11, 2012, Judge Barnes issued an order consistent with the positions of OSBA and OCA, and outlined four specific issues to be explored in the generic investigation. In re Gas-on-Gas Competition, Dock Nos. P-2011-2277868, I-2012-2320323 (Order entered Dec. 11, 2012), (December 2012 Order). Those issues are as follows: (1) the current extent and nature of gas-on-gas rate discounting, in terms of number of customers and load by rate class, geographical regions affected, and NGDCs involved; (2) whether discounting rates for certain

customers to meet competition from other NGDCs is appropriate; (3) in the event the Commission determines that discounting rates is appropriate what types of rate discounting should be permitted and under what circumstances, and how should the cost of the discounts be absorbed and/or allocated; and (4) if the Commission determines that discounting rates is not appropriate, how should the existing discounting policies and practices be phased out or eliminated. December 2012 Order at 3-4.

On November 30, 2012, the Pennsylvania Independent Oil and Gas Association (PIOGA) submitted a Petition to Intervene. On January 4, 2013, Duquesne Light Company (Duquesne) submitted a Petition to Intervene. On January 23, 2013, Peoples submitted a Petition to Hold Proceedings in Abeyance (Peoples Hold Petition). In Peoples Hold Petition, the Company argued that the Investigation should be held in abeyance, as the proposed merger of Peoples and Equitable had just been announced. The proposed merger, if consummated, could substantially change the landscape as to gas-on-gas rate discounting and could have a substantial impact on the current Investigation.

A second Prehearing Conference was held on January 24, 2013. At that time, PIOGA and Duquesne were granted Intervenor status. As to Peoples Hold Petition, Judge Barnes instructed the parties to file answers by February 1, 2013. Numerous parties, including the OCA, filed answers in support of holding the Investigation in abeyance pending the final outcome of the proposed Peoples and Equitable merger proceeding. IECPA and OSBA filed answers in opposition to Peoples Hold Petition, and argued that this proceeding should continue on its current course. On February 5, 2013, Judge Barnes issued an Order denying Peoples Hold Petition and establishing a procedural schedule for the Investigation.

On May 16, 2013, the procedural schedule was amended at the request of the OCA and OSBA. Pursuant to the amended procedural schedule, on August 8, 2013, the OCA served the written direct testimony and exhibits of Glenn A. Watkins. OCA St. 1. On October 17, 2013, the OCA filed the rebuttal testimony of Glenn A. Watkins (OCA St. 1-R) and followed with the surrebuttal testimony of Mr. Watkins (OCA St. 1-S) on November 26, 2013. Evidentiary hearings were convened on December 10, 2013, during which time each party submitted written testimony and exhibits into the record and waived cross-examination of witnesses.

The OCA now submits this Main Brief in order to address all aspects of gas-on-gas rate discounting as ordered by Judge Barnes and in accord with the amended procedural schedule.

III. LEGAL STANDARD

In a generic investigation no party bears the burden of proof. See, e.g., In re Equitable Gas Co., 68 Pa. PUC 574, 613 (1988). The purpose of an investigation is the collection of facts. Id. Participating parties collect facts pertinent to the investigation and put those facts as a complete record at the disposal of the Commission to determine what action, if any, should be taken. See id. at 594. As no party to an investigation bears the burden of proof, it is irrelevant that the facts presented or positions taken by a party advocate a deviation from the status quo.

In this Investigation of gas-on-gas rate discounting, no party bears the burden of proof. Those parties advocating for a change in the status quo, whether it be the complete elimination of gas-on-gas rate discounting or some other modification to the current practice, stand on equal footing with those parties who argue for no change. The OCA submits that the parties in this matter have compiled a suitable record as to the issue at bar, and presented their recommendations for Commission consideration.

In the OCA's view, the gravamen of this issue is the concept of basic fairness. This simple tenet is woven into the fabric of the law in general, and, specifically, in public utility law fairness equals the avoidance of undue discrimination. The Public Utility Code prohibits unreasonable discrimination in rates. 66 Pa. C.S. § 1304. Pursuant to Section 1304 of the Public Utility Code:

No public utility shall, as to rates, make or grant any unreasonable preference or advantage to any person, corporation, or municipal corporation, or subject any person, corporation, or municipal corporation to any unreasonable prejudice or disadvantage. No public utility shall establish or maintain any unreasonable difference as to rates, either as between localities or as between classes of service.

Id.

As the OCA discusses throughout this Main Brief, the current practice of gas-on-gas rate discounting not only represents poor public policy, but may also represent unreasonable and undue discrimination. A few customers are able to extract discounts on monopoly distribution service from the NGDCs based solely on their geographic location. These discounts, totaling into the tens of millions of dollars, are then collected from all other customers who have no opportunity whatsoever to likewise negotiate for discounted rates. These facts highlight the unreasonable nature of this practice as it currently exists.

IV. DISCUSSION

A. The Current Extent and Nature of Gas-on-Gas Rate Discounting.

The first issue that Judge Barnes requested that parties address is “the current extent and nature of gas-on-gas rate discounting, in terms of number of customers and load by rate class, geographical regions affected, NGDCs involved, etc.” There are currently four Pennsylvania jurisdictional NGDCs that engage in gas-on-gas rate discounting: Peoples Natural Gas Company; Peoples Natural Gas Company – Equitable Division; Peoples T. W. Phillips; and

Columbia Gas of Pennsylvania. OCA St. 1 at 8-9.⁵ The gas-on-gas discounting in which these companies engage occurs only in the western portions of Pennsylvania. OCA St. 1 at 6. Further, the practice is limited to commercial and industrial customers; residential customers do not enjoy discounted distribution rates. OCA St. 1 at 6.

As OCA witness Watkins testified, “the level and degree in which full tariff distribution rates are discounted due to gas-on-gas rate discounting varies and is customer specific.” OCA St. 1 at 9. However, in response to OSBA I-2, the NGDCs provided Highly Confidential responses in which the customers that receive a below full tariff rate are identified. OCA St. 1 at 9. The NGDCs responses also included each customer’s annual usage, actual discounted distribution revenue, and annual distribution revenue at full tariff rates. OCA St. 1 at 9. From this data, OCA witness Watkins could calculate each customer’s discounted rate and the discount below full tariff rates. As the following grid summarizes, OCA witness Watkins’ aggregate calculations indicate that 855 commercial and industrial customers receive a total of \$45.160 million in rate discounts, and on a weighted average basis are 73% below full tariff rates.⁶ OCA St. 1 at 10.

⁵ The current matter started before the acquisition of Equitable Natural Gas Company by Peoples. For approval of the merger of Peoples and Equitable see Docket Nos. A-2013-2353647, A-2013-2353649, A-2013-2353651.

⁶ Counsel for OCA contacted Company Counsel for the four NGDCs listed in the chart and obtained authorization via e-mails from each that the information contained in the referenced chart, depicted on an aggregate basis, could be used on a non-confidential basis. The complete, individual data is set out in OCA St. 1, Highly Confidential Version, Schedule GAW-2.

	<u>Columbia</u>	<u>Equitable</u>	<u>Peoples</u>	<u>Peoples TWP</u>	<u>Total</u>
Number of Discounted Cust./Accts.	24	696	119	16	855
Annual Revenue Discount (\$millions) ⁷	\$1.332	\$33.838	\$9.635	\$0.355	\$45.160
Weighted Avg. Pct. Discount	54%	75%	67%	49%	73%

OCA St. 1 at 10.

These discounts are determined on a customer-by-customer basis, and although each NGDC has an incentive to maximize revenue from each customer, the discounts are often set to meet or beat the actual or perceived offers of other NGDCs engaging in gas-on-gas discounting. OCA St. 1 at 12. The discounts, generally, do not approximate the full tariff rates of competing NGDCs for similar service; the actual discounted rates are generally much lower. OCA St. 1 at 12. As explained by OCA Witness Watkins:

[I]t should be remembered that with respect to gas-on-gas rates and negotiations, full tariff rates are nothing more than a price cap. Each of the four NGDCs that engage in gas-on-gas rate discounting must meet or beat the actual or perceived offers from alternative NGDC's. As such, these rates are typically negotiated below the full tariff rates of alternative NGDC's.

OCA St. 1 at 12.⁸

However, gas-on-gas discounts, from a ratemaking perspective, do not result in a revenue or profit shortfall. OCA St. 1 at 10. As explained by OCA Witness Watkins:

When each of the NGDCs rates are (were) established, a total jurisdictional revenue requirement is determined. This total revenue requirement is then

⁷ Difference between full tariff rate revenue and actual negotiated rate revenue.

⁸ Mr. Watkins' Highly Confidential Schedule GAW-2 provides complete comparisons of each NGDCs' Commission-approved tariff rate, the corresponding gas-on-gas negotiated rate, the percentage discounts and also the individual and aggregate revenue deficiencies that result from the current practice.

distributed (allocated) to individual customer classes and rate schedules. However, when the Companies' overall revenue requirements are allocated to specific customer classes it is recognized that those commercial and industrial customers which receive rate discounts will pay no more than their current discounted rates. As a result, the revenue shortfalls associated with rate discounts are effectively assigned and spread to all remaining customers that are captive to the individual NGDC. In other words, it is recognized that customers with an alternative NGDC will not pay their full cost of service such that captive ratepayer distribution rates subsidize the discounted rate customers. As a result of this practice, each NGDC is afforded the opportunity to collect its full revenue requirement; gas-on-gas customers are priced collectively at 73% below their respective full cost; and on an annual basis captive ratepayers collectively pay \$45.160 million more than their fair share for distribution service than they otherwise would absent the current practice of gas-on-gas rate discounting.

OCA St. 1 at 10-11.⁹

While all customer classes have some captive customers, the vast majority of captive customers are within the residential and small commercial classes. OCA St. 1 at 11. There are no residential customers that receive gas-on-gas discounts, and although 628 of the total customers in the above grid are small commercial customers,¹⁰ this is a small percentage of all small commercial natural gas customers and the discounts to these 628 small commercial customers only accounts for 1.1% (\$0.533 million) of the total \$45.160 million in discounted revenue. OCA St. 1 at 12.

As to the extent and nature of gas-on-gas rate discounting in Pennsylvania, the current practice is an anomaly that only exists in the western part of the state. On a dollar basis, the overwhelming majority of discounts are received by large commercial and industrial customers. These discounts, that run into the tens of millions of dollars, are paid for by captive ratepayers

⁹ Discounted rates are typically accompanied by multi-year service and rate agreements. OCA St. 1 at 11. These agreements expire and renew continuously such that new or renegotiated contracts may provide for higher or lower revenue; thus, between rate cases, NGDCs may over or under-collect revenues stated in the most recent rate case. OCA St. 1 at 11.

¹⁰ Small commercial customers are those that use less than an average of 500 MCF/Dth per month. OCA St. at 11.

who are unable to benefit from or participate in such discounted rates. The OCA submits that the practice of gas-on-gas rate discounting, as it currently exists, should be eliminated or substantially modified.

B. The Current Form and Practice of Gas-on-Gas Rate Discounting is Not Appropriate and Should be Ended.

The second issue that Judge Barnes requested to be addressed is “whether discounting rates for certain customers to meet competition from other NGDCs is appropriate.” The OCA submits that the current practice and form of gas-on-gas discounting should not be continued.

As OCA witness Watkins testified:

First, it should be made clear that I do not consider the current practice of allowing ratepayer funded gas-on-gas discounts to be reflective of true competition. Rather, the current practice of ratepayers subsidizing those commercial and industrial NGDC customers who happen to be located in an area served by multiple regulated NGDCs results in nothing more than undue price discrimination to captive ratepayers.

OCA St. 1 at 3. As Mr. Watkins testified, the current practice and form of gas-on-gas rate discounting is not true competition. Mr. Watkins explained that:

unlike true competition, the reduced revenues resulting from this commercial/industrial rate discounting are not borne by, or the burden of, shareholders. Rather, each NGDC’s captive ratepayers fund the difference in revenue (and resulting profits) between full tariff and actual discounted rate levels within the ratemaking process. Because each NGDC has historically been allowed to recover its reduced revenue attributable to the difference between full tariff and all discounted rates from captive ratepayers, the current practice of gas-on-gas rate discounting is totally uneconomic and not reflective of competition or competitive markets.

OCA St. 1 at 3.

This “competition” also does not result in improved service, better or innovative products, or lower prices, but rather represents an uneconomic transfer of wealth from captive ratepayers to a select few customers. OCA witness Watkins testified that true competition and

the practice of gas-on-gas discounting are distinguishable. See also OSBA St. 1 at 4. Mr.

Watkins explained what occurs in the context of true competition as follows:

Under true competition, it is perfectly acceptable and economically efficient to price discriminate and offer some products/services above variable costs yet below average total cost, in the short-run. However, such a pricing policy or practice cannot be sustained in the long-run as this excess available capacity currently being used by the price discounted customers will either be demanded by other customers at a higher price or the existing facilities will need to be replaced with less capacity (preventing the ability to offer products or services below long-run marginal cost). In either event, under true competition, below full cost pricing to some customers will be funded by the Company's equity owners and not by its remaining customers such that below cost pricing cannot be sustained in the long-run. In other words, in the long-run, all prices must include not only variable costs but also all so-called fixed costs which are generally capacity-related in nature.

OCA St. 1 at 13. The current practice and form of gas-on-gas discounting not only violates basic principles of fairness, but may also be inconsistent with the Public Utility Code and the long history of appellate case law on undue price discrimination.

Section 1304 of the Pennsylvania Public Utility Code, in pertinent part, states that:

[n]o public utility shall, as to rates, make or grant any unreasonable preference or advantage to any person, corporation, or municipal corporation to any unreasonable prejudice or disadvantage. No public utility shall establish or maintain any unreasonable difference as to rates, either as between localities or as between classes of service.

66 Pa. C.S. § 1304. Although not all differences in rates are discriminatory and therefore unlawful, *unreasonable* differences are prohibited. Id. As explained by the Commonwealth

Court of Pennsylvania:

Before a rate can be declared unduly preferential and therefore unlawful, it is essential that there be not only an advantage to one, but a resulting injury to another. Such an injury may arise from collection from one more than a reasonable rate to him in order to make up for inadequate rates charged to another, or because of a lower rate to one of two patrons who are competitors in business. There must be an advantage to one at the expense of the other.

Phila. Elec. Co. v. Pa. PUC, 470 A.2d 654, 657 (Pa. Commw. Ct. 1984), (citing Alpha Portland Cement Co. v. Public Service Comm'n, 84 Pa. Super. 225 (1925)).¹¹

As noted above, however, in gas-on-gas discounting, revenue shortfalls associated with rate discounts are assigned to all remaining customers that are captive to the individual NGDC, and thus captive ratepayer distribution rates are higher than they should reasonably be in order to make up for the revenue deficiency created by the discounted rate customers. OCA St. 1 at 10. OCA Witness Watkins further explained the difference between true competition and gas-on-gas discounting:

[U]nder the current practices of gas-on-gas rate discounting in Pennsylvania, a much different situation exists. Because of the monopoly status of NGDCs for most distribution customers (i.e., captive customers that do not have the ability to choose their distribution company), and current regulatory practices, the NGDCs are able to price their competitive business at little more than variable cost and have captive customers pay their respective full cost of service plus the additional unrecovered costs associated with gas-on-gas rate discounting. These additional costs paid for by captive ratepayers include unrecovered fixed operating and maintenance expenses as well as unrecovered capital costs (depreciation, interest and equity return) associated with gas-on-gas discounting. As was discussed earlier, this overcharging of captive ratepayers is achieved by allowing each NGDC an opportunity to recover its full cost of service (revenue requirement); accepting the below cost revenue generated from gas-on-gas discounting in the ratemaking process; and, then assigning all unrecovered costs (including profits) to captive ratepayers. In economic terms, the higher prices paid by captive ratepayers are referred to as monopoly rents and results in what is known as undue price discrimination.

¹¹ Vernon Twp. v. Pub. Serv. Comm'n, 75 Pa. Super. 54 (1920) (holding that furnishing free gas was unduly discriminatory because “[i]f any service is rendered by the utility free or at a reduced price, it necessarily must be paid for by someone, and the burden of its cost is imposed upon other shoulders”); Alpha Portland Cement Co. v. Pub. Serv. Comm'n, 84 Pa. Super. 255 (1925) (recognizing that different rates can be charged for different services provided to different classes). Accord Bell Telephone Co. of Pa. v. Pa. PUC, 5 A.2d 410 (Pa. Super. Ct. 1939); City of Phila. v. Pa. PUC, 63 A.2d 391 (Pa. Super. Ct. 1949); Riverton Consol. Water Co. v. Pa. PUC, 140 A.2d 114 (Pa. Super. Ct. 1957); U.S. Steel Corp. v. Pa. PUC, 390 A.2d 865 (Pa. Commw. Ct. 1977); Mfrs. Ass’n of Erie v. Pa. PUC, 407 A.2d 114 (Pa. Commw. Ct. 1979); Peoples Natural Gas Co. v. Pa. PUC, 409 A.2d 446 (Pa. Commw. Ct. 1979); Mill v. Commonwealth, 447 A.2d 1100 (Pa. Commw. Ct. 1982); Phila. Elec. Co. v. Pa. PUC, 470 A.2d 654 (Pa. Commw. Ct. 1984); Bldg. Owners & Managers Ass’n v. Pa. PUC, 470 A.2d 1092 (Pa. Commw. Ct. 1984); Allegheny Ludlum Corp. v. Pa. PUC, 612 A.2d 604 (Pa. Commw. Ct. 1992); Phila. Suburban Water Co. v. Pa. PUC, 808 A.2d 1044 (Pa. Commw. Ct. 2002); Hatfield Twp. Mun. Auth. v. Pa. PUC, 853 A.2d 1 (Pa. Commw. Ct. 2004); Lloyd v. Pa. PUC, 904 A.2d 1010 (Pa. Commw. Ct. 2006).

OCA St. 1 at 14. Thus, the current practice of gas-on-gas discounting results in unreasonable rates being paid by captive customers and inadequate rates being paid by a select few large commercial and industrial customers.

Such discrimination is both interclass and intra-class. As for the interclass discrimination, it is undisputed that certain (but not all) industrial and commercial customers that benefit from gas-on-gas discounting receive an advantage – a natural gas distribution rate below that of the full tariff rate. OCA St.1 at 3. And while the Commonwealth Court of Pennsylvania has stated that a mere difference in rates between classes does not rise to the level of undue price discrimination, see, e.g., Alpha Portland Cement Co. v. Pub. Serv. Comm’n, 84 Pa. Super. 255, 271 (1925), the practice of gas-on-gas discounting is more than a mere difference in rates.¹²

As OCA Witness Watkins discussed in his testimony, the captive ratepayers – residential and small commercial class customers – subsidize the discounted rates so as to allow the NGDCs to collect their full revenue requirement. OCA St. 1 at 10, 14. Thus, the discounted rates cause added expense to the residential and small commercial class customers that those customers would not pay in the absence of gas-on-gas discounts. More plainly, the captive ratepayers suffer an injury.

The discrimination that results from gas-on-gas discounts also occurs within the commercial class (intra-class). Not only does a commercial class customer that does not receive a discount subsidize commercial customers that do receive a discount, just as the residential customers do, but the commercial customer without a discount is also injured in its ability to compete. OCA St. 1 at 17. OCA Witness Watkins provides the following example to illustrate intra-class price discrimination:

¹² See e.g., OCA St. 1 Highly Confidential, Schedule GAW-2.

Consider two commercial laundry/uniform service providers in the greater Pittsburgh area. These laundry/uniform service providers use a significant amount of natural gas which reflects a substantial portion of their operating costs and compete neck and neck with each other. However, one of these customers is able to enjoy lower natural gas rates simply because it happens to be located on a street in Pittsburgh that has mains owned by two different NGDCs. The other laundry/uniform service provider is captive to one NGDC and pays significantly higher rates for natural gas delivery service than his competitor across town. All else constant, the second laundry/uniform service provider is clearly injured in that it is unable to effectively compete with the other supplier without reducing its profits below those of the competitor with gas-on-gas discounted rates.

OCA St. 1 at 17.

It is not only the case that non-discount commercial customers are at a disadvantage as to competitors that do receive a gas-on-gas discount, but the non-discounted commercial customers subsidize the discount just as the residential customers do. There is not just a competitive disadvantage for non-discounted commercial customers; the non-discounted commercial customers are paying for their competitors' economic advantage.

The OCA submits that this is the type of "advantage to one and resulting injury to another" that the Commonwealth Court of Pennsylvania has identified as prohibited undue price discrimination. See Phila. Elec. Co., 470 A.2d at 657 (stating that "injury may arise from collection from one more than a reasonable rate to him in order to make up for inadequate rates charged to another, or because of a lower rate to one of two patrons who are competitors in business").

The long-term practice¹³ of captive ratepayers funding revenue shortfalls is particularly relevant. As Mr. Watkins testified:

¹³ OCA Witness Watkins testified that "[b]ecause of the overlapping service areas in western Pennsylvania and no prohibitions against customers switching NGDCs, the practice of negotiating rates has been in place for more than a century," and that the current regulatory practice has been in place since he became involved in the ratemaking process for NGDCs in western Pennsylvania in the mid-1980s. OCA St. 1 at 14.

It is one thing if NGDCs have short-term excess capacity available and maximize the utilization of their existing facilities (capacity) with short-term interruptible opportunity sales (delivery service) that would not occur absent discounted rates.

[I]t is an entirely different, inefficient, and unfair matter when the NGDC's plan, install, and replace existing facilities to accommodate the firm loads and requirements of these rate discounted customers, and then unduly price discriminate against captive ratepayers by forcing these captive ratepayers to pay for not only their required capacity and other fixed costs but also those required to serve rate discounted customers. This latter occurrence is exactly what occurs in Western Pennsylvania. Virtually all gas-on-gas rate discounted customers receive firm delivery service and each NGDC plans for, and replaces, plant to serve all firm service customers. Since the current practices have been in place for decades, it is apparent that this is a long-term occurrence.

OCA St. 1 at 15.

The NGDCs in western Pennsylvania are currently planning for and replacing gas distribution infrastructure in their service territories that are at, or beyond, retirement age, and as a result, long-term planning for replacement facilities is particularly important at the current time. OCA St. 1 at 15. "NGDC's are making long-term investments in mains investments that are required to meet the needs of not only captive ratepayers but also the current and future firm demands of gas-on-gas rate discounted customers." OCA St. 1 at 15. Not only will some of these replacement facilities be duplicative, "the level of unjustness and overpayment for delivery service by captive ratepayers will only worsen over time if the current practices continue." OCA St. 1 at 15.

OCA Witness Watkins testified that duplicative facilities, as well as the injuries received by businesses that do not receive discounted distribution rates, create a negative-sum game. OCA St. 1 at 17. With respect to duplicative facilities, OCA Witness Watkins explained the negative societal benefit as follows:

It is well known that distribution utilities are considered natural monopolies and it has been the long-standing belief and practice of regulators that duplicative utility

distribution facilities are not in the public interest such that regulation of monopoly providers will serve as a surrogate for effective competition and are deemed the most efficient utilization of society's resources. As such, the additional costs posed by duplicative facilities are considered a societal cost, or negative benefit.

OCA St. 1 at 17. In the context of the laundry/uniform service provider example above, Mr. Watkins explained that the injury to the non-discounted laundry/uniform service provider created a negative societal benefit because:

[a]t the very least, there is a net cost to laundry/uniform service providers in the Pittsburgh area (by reducing the fair return or profit available to all laundry/uniform providers). At most, this undue price discrimination stifles competition within the laundry/uniform service industry in the Pittsburgh area.

Id.

Finally, it should be noted that in Mr. Watkins' experience practicing utility ratemaking throughout the United States for over thirty years, he has never seen a situation similar to gas-on-gas discounting occur in any other jurisdictions. OCA St. 1 at 17. In addition, further research conducted by Mr. Watkins did not reveal any jurisdictions in which utility distribution competition exists along with captive ratepayers subsidizing competitive segments of distribution service. OCA St. 1 at 17-18. As Mr. Watkins explained:

these finding are not surprising considering the long-standing general agreement among regulators and policymakers that public utility distribution companies are natural monopolies and that society and the public interest is best served with sole source regulated utilities thereby eliminating the need for duplicative facilities.

OCA St. 1 at 18.

The Commission has previously investigated the issue of gas-on-gas rate discounting in several cases, and its prior findings are particularly instructive here. The most recent, and complete example comes from the Commission's Opinion and Order in the 2006/2007 proposed

merger of Peoples and Equitable. The Commission's Order there provided the following regarding gas-on-gas discounting:

After a careful review of the record, we conclude that the economics of the elimination of gas-on-gas distribution competition is correctly presented by Equitable. Equitable witness, Dr. Hieronymus, characterized gas-on-gas distribution competition that creates rate discounts as a dead weight loss and wholly uneconomic. (Equitable St. No. 6-R at 7). Dr. Hieronymus also explained that with or without an actual merger, Equitable and Peoples will retain the ability and incentives they have today to provide economic development discounts. (Equitable St. No. 6-R at 10). Furthermore, Dr. Hieronymus concluded that maintenance of gas-on-gas distribution competition is poor public policy. (Equitable St. No. 6-R at 11-13; I.D. at 65). Overall, customers will benefit more from an effectively competitive retail market through choice and opportunities for savings on gas commodity purchases than they will from gas-on-gas distribution competition. (I.D. at 62).

In re Equitable Resources, Inc., at *102-103 2007 PA PUC LEXIS 32 (Apr. 13, 2007) (Equitable 2007).

In Equitable 2007, Equitable witness Dr. Hieronymus presented extensive testimony detailing why gas-on-gas competition is "wholly uneconomic", represents poor public policy and should be discontinued. As the Order provides, the Commission agreed with Dr. Hieronymus on all counts. OCA witness Watkins' testimony in the present matter reaches the same conclusions and presents the same type of economic analysis. In fact, Dr. Hieronymus' observations about the importance and benefits to be derived from an "effectively competitive retail market" ring even truer today than they did in 2007. The Commission's well-reasoned decision on these matters in Equitable 2007 should be upheld and applied to the current situation, such that gas-on-gas rate discounting as it is currently practiced is discontinued.

The Industrial Energy Consumers of Pennsylvania (IECPA or Industrials) presented the testimony of Diane Meyer Burgraff in support of maintaining gas-on-gas discounting. See IECPA St. 1. Ms. Burgraff testified that gas-on-gas discounting benefits "all customers of gas-

on-gas competitive utilities.” IECPA St. 1 at 2. Ms. Burgraff’s assertions are incorrect and not in accord with the evidence produced in this matter.

OCA Witness Watkins and OSBA Witness Knecht both agree that gas-on-gas discounting is not true competition, but, rather, represents undue price discrimination. OCA St. 1-R at 1; OSBA St. 1 at 4. Ms. Burgraff attempts to support her position that discounting helps all customers by arguing that keeping large volume users on the system benefits other customers because these large volume customers will contribute “a portion of the costs of service.” IECPA St. 1 at 4. Ms. Burgraff argues that as long as gas-on-gas discounted customers are paying above their incremental costs, captive ratepayers are better off. IECPA St. 1 at 5. First, this argument ignores the fact that captive ratepayers are not afforded a rate discount and “must be responsible for, and pay for the revenue shortfall associated with a selected few large customers that enjoy natural gas distribution rates significantly below the full tariff rates authorized by the Commission.” OCA St. 1-R at 2. Second, as Mr. Watkins testified, Ms. Burgraff is incorrect as to her assertions relative to “incremental costs”.

Mr. Watkins explained that “[w]hat Ms. Burgraff refers to as incremental costs is nothing more than the variable cost of providing distribution service. For NGDCs, variable costs reflect only a very small portion of its total cost of providing service.” OCA St. 1-R at 3. The variable cost does not consider the large amount of fixed cost associated with mains and other infrastructure required to deliver the gas to each customer. OCA St. 1-R at 3. As Mr. Watkins testified:

variable costs do not include any expenses associated with the repair and maintenance of the Company’s infrastructure, salaries and wages of NGDC’s employees, administrative, general, and other overhead expenses, or any other costs that do not vary directly with usage.

OCA St. 1-R at 4. Further, variable costs do not include the replacement of mains even though these mains are required to serve gas-on-gas discounted customers. OCA St. 1R at 4.

In addition, as explained by OCA Witness Watkins, the rates paid by discounted customers barely cover the variable costs and captive ratepayers bear the burden of all of the fixed cost:

Although considerable investment (rate base) is required to serve these customers, the current practices of gas-on-gas rate discounting barely cover variable operating expenses much less the fixed costs incurred to meet the needs of discounted customers. As explained earlier, such a pricing practice results in severe undue price discrimination considering that the current practice requires captive ratepayers to pay for all investment and all expenses including those devoted and attributable to customers that enjoy distribution prices at little above variable operating expense levels. Moreover, under current practices, captive ratepayers are bearing the full burden of the costs of duplicative facilities.

OCA St. 1-R at 4. Ms. Burgraff also ignores the fact that virtually all gas-on-gas rate discounted customers receive firm distribution service, meaning that the “NGDC must plan for, build, and provide sufficient capacity to serve each discounted customer.” OCA St. 1-R at 4. The following hypothetical by OCA Witness Watkins exemplifies this point:

Suppose that for a given natural gas distribution company (“NGDC”) all but a few retail customers had a competitive NGDC supplier available; i.e., two or more NGDCs are willing and able to serve most customers. Under current practices, the majority of customers that rely upon a NGDC for service, would pay only a small fraction of the total cost to serve them (i.e., their rates are deeply discounted due to current practices). However, the prices paid by the small minority of customers that are captive to a single NGDC would be required to not only recover their respective costs of service, but also satisfy the revenue shortfall created from the majority of customers’ rate discounting. In other words, prices are established such that the NGDC is able to recover its total cost of doing business even though the Company only has monopoly power over a small minority of its customers. Under this scenario, captive ratepayers’ rates (full tariff rates) would be so high as to not be considered just and reasonable in a regulatory environment nor are they possible or sustainable in competitive markets.

The only difference between the example presented above and the situation that actually exists in Western Pennsylvania is the number and magnitude of customers that enjoy gas-on-gas rate discounting.

OCA St. 1-S at 1-2.

Ms. Burgraff also argues that gas-on-gas rate discounting is no different than negotiated rates that result from the threat of a pipeline bypass or termination of service for alternate fuel capability. IECPA St. 1R at 4. There are multiple fundamental distinctions, however, between gas-on-gas discounting and rate discounts for pipeline bypass or alternate fuels. OCA St. 1-S at 2.

First, “gas-on-gas discounted customers must obtain their natural gas [delivery] from a NGDC while those with bypass or alternative fuel capabilities do not.” OCA St. 1-S at 2. Second, gas-on-gas “results in inefficient duplication of facilities and does not preserve load that would otherwise be lost to Pennsylvania NGDCs.” OSBA St. 3 at 7. Third, as OSBA witness Knecht testified, “other discounting techniques will retain margin revenues that would otherwise be lost to Pennsylvania customers, whereas gas-on-gas discounting reduces Pennsylvania NGDC margin revenues.” OSBA St. 3 at 7. Lastly, customers that negotiate reduced rates because of pipeline bypass or alternative fuels have made or would need to make the investment in additional infrastructure (*i.e.*, pipeline or infrastructure that can use alternative fuels).

Threats of interstate bypass occur when large industrial or commercial customers are located within a reasonable proximity to an interstate pipeline. As Mr. Watkins explained, “it could be economically feasible for the end user to simply bypass the local NGDC and have its natural gas delivered directly from the transmission pipeline absent a lower than full tariff distribution rate from the local NGDC.” OCA St. 1 at 4. In the context of alternative fuels, commercial and industrial customers are “equipped with dual fuel capabilities such that propane, oil, and perhaps electricity or coal can act as a substitute for natural gas. In these instances, negotiated rates are common in Pennsylvania and elsewhere.” OCA St. 1 at 4.

An end-user may have enough alternative fuel capacity to meet a portion or all of their energy needs. OCA St. 1 at 4. As Mr. Watkins testified, however, if the end-user only has alternative fuel capacity sufficient to meet part of their needs, the “customer may negotiate for a portion of their needs on a “firm” basis and a portion on an interruptible basis.” OCA St. 1 at 4. In addition, “commercial and industrial customers may negotiate with NGDCs for a discounted firm service rate that recognizes a portion of the customer’s load could be satisfied with alternative fuels and a portion that realistically must be met with natural gas.” OCA St. 1 at 4.

Natural gas rates are also sometimes discounted below full tariff rates for economic development purposes if an end-user consumes a lot of energy and “is considering a new facility and which natural gas distribution costs may play a pivotal role in the decision making, or when an economically depressed entity may relocate or cease to exist absent a lower than full tariff natural gas distribution rate.” OCA St. 1 at 4.

The OCA submits that pipeline bypass, dual fuel and economic development discounting practices reflect legitimate business practices, result in reasonable price discrimination, and are in the public interest. OCA St. 1 at 5. As such, the OCA does not advocate a change of the status quo with regard to these discounts. OCA St. 1 at 5, 7. Thus, pipeline bypass, dual fuel and economic development rate discounts are the only discounts that are appropriate and should continue. Despite Ms. Burgraff’s suggestion to the contrary, these rate discounts are distinguishable from gas-on-gas discounts. Mr. Watkins explained further why these discounting practices reflect legitimate business practices and distinguished gas-on-gas discounts, stating:

There is a fundamental principle of regulatory economics that no price (rate) should be higher than a customer’s “stand-alone” cost; i.e., the cost of providing a regulated product or service by another means. With respect to the potential for interstate transmission pipeline by-pass, as well as the substitutability of natural gas with alternative fuels, these are definite examples of customer-based “stand-alone” costs. This pricing below a customer’s stand-alone cost is in stark contrast

to gas-on-gas rate discounting in which traditional distribution service is required but discounted to meet a lower price of another similar NGDC. That is, under gas-on-gas rate discounting, each customer still requires a traditional natural gas distribution supplier. Hence, gas-on-gas discounted rates do not reflect the NGDC's cost to serve, nor do they reflect the maximum threshold of a customer's stand-alone cost.

With respect to economic development/sustainability rates, economics may take a back seat to other public policy considerations such as the creation or preservation of jobs, the overall economic multiplier effect of a particular large natural gas user on a locality or the Commonwealth as a whole, impacts on state and local tax revenues, etc.

OCA St. 1 at 5.

Gas-on-gas rate discounting is not the same as negotiated rates for threats of pipeline bypass, alternative fuels, and economic development because: (1) "gas-on-gas discounted customers must obtain their natural gas distribution service from a NGDC while those with bypass or alternative fuel capabilities do not;" (2) gas-on-gas "results in inefficient duplication of facilities and does not preserve load that would otherwise be lost to Pennsylvania NGDCs"; (3) other discounting techniques will retain margin revenues that would otherwise be lost to Pennsylvania customers, whereas gas-on-gas discounting reduces Pennsylvania NGDC margin revenues; and (4) customers that negotiate reduced rates because of pipeline bypass or alternative fuels have made or would need to make the investment in additional infrastructure. OCA St. 1-S at 2; OSBA St. 3 at 7.

Lastly, Ms. Burgraff testified that changing the practice of gas-on-gas discounting will create "upheaval" for gas-on-gas discounted customers. IECPA St. 1 at 6. As Mr. Watkins testified, recent volatility in another component of the total cost – the cost of the gas itself – provides the best example as to why Ms. Burgraff is incorrect. OCA Witness Watkins explained that:

currently, natural gas wellhead prices are about \$3.00 per MCF, whereas only a few years ago, they were as high as \$12.00 per MCF, or 300% higher. With this volatility in total gas prices, there has been no “upheaval” relating to commercial and industrial customers business activities in Western Pennsylvania.

OCA St. 1-R at 4. Ms. Burgraff’s assertions that the business community in Western Pennsylvania is unable to deal with fluctuations in the market is without merit. Further, as discussed in the next section, the OCA is advocating for a transitional period in which the current practice of gas-on-gas discounting will be phased out and thus no market shock or “upheaval” should occur.

Based on the foregoing, the OCA submits that the current practice and form of gas-on-gas rate discounting is not in the public interest, is not economically justified, and is not in accord with past Commission or appellate court decisions. Accordingly, the OCA submits that the practice of gas-on-gas rate discounting as it currently exists should be discontinued.

C. If The Commission Determines That Gas-on-Gas Rate Discounting Should Continue, The Practice Should Be Substantially Modified.

The third issue Judge Barnes requested to be addressed is “if the Commission determines that discounting rates is appropriate: (a) what types of rate discounting should be permitted and under what circumstances; and, (b) how the cost of the discounts should be absorbed and/or allocated.” The OCA submits that this is a generic investigation into gas-on-gas rate discounting only, and as such, the OCA does not suggest any change to the status quo for rate discounting in the context of viable interstate pipeline bypass, availability of alternative fuels or energy sources, and economic development. OCA St. 1 at 7.

In the event that the Commission determines that gas-on-gas discounting is appropriate and should continue, the OCA submits that fundamental changes would need to be made. As OCA witness Watkins testified:

gas-on-gas discounts should only be a result of true competition such that no discounts will be funded by captive ratepayers and that the risks and rewards will be the sole responsibility of, and absorbed totally by, shareholders and those customers engaging in true gas-on-gas NGDC competition.

OCA St. 1 at 7. To be clear, it is the OCA's view that gas-on-gas rate discounting as it currently exists should be ended. Should the practice be authorized to continue, however, the OCA submits that significant changes should be made. Mr. Watkins' recommendation that shareholders fund such activities is one possible alternative.

D. OCA's Recommendations on How Gas-on-Gas Discounting Should Be Eliminated.

The last issue that Judge Barnes requested to be addressed is "if the Commission determines that discounting rates is not appropriate, how the existing discounting policies and practices should be phased out or eliminated." The OCA is open to ideas and approaches that effectively terminate the practice of captive ratepayers subsidizing the rates of a select number of commercial and industrial customers due to gas-on-gas discounting and recognizes there are no clear-cut and simple solutions. OCA St. 1 at 20-21. Regardless of the ultimate method or mechanism chosen to end gas-on-gas discounting, the OCA recommends a definite and reasonable transition period to allow for all stakeholders to plan for and accommodate the changes. OCA St. 1 at 20; St. 1-S at 3. As OCA Witness Watkins explained:

The time period should be long enough to facilitate the orderly transition of this change in regulatory practice, but not so long as to unreasonably delay the correction of the current unjustness to captive ratepayers. In this regard, a time period of three to five years after the issuance of a Commission Order in this case should provide ample time for a fair and orderly transition.

OCA St. 1 at 20. Mr. Watkins testified that:

the OCA recommends that the "initial decision in this case should be a directive that ratepayer funded gas-on-gas discounts will be abolished within a definite and predefined period of time and that a task force comprised of all stakeholders, [as

well as legal and technical experts], will be formed to make recommendations, or at least provide alternative solutions, to accomplish this directive.”

OCA St. 1 at 20; OCA St. 1-S at 3.

With respect to specific approaches, Mr. Watkins suggested three alternatives:

(1) create specific and exclusive service areas in Western Pennsylvania for each NGDC; (2) allow for the duplication of facilities with multiple NGDCs operating in the same geographical areas, but prevent current and future customers from switching NGDCs; or (3) allow for true competition and the duplication of facilities in Western Pennsylvania, but ensure by allocation, or other means, that captive ratepayers do not fund or subsidize competitive NGDC business.

OCA St. 1 at 21.

Establishing specific and exclusive service areas is likely the most effective method, as it would eliminate the continuation of duplicative facilities. OCA St. 1 at 21. This option, however, is likely the most complex and challenging from both a legal and technical perspective because it would require the transfer of assets between NGDCs and/or abandonment of facilities.

OCA St. 1 at 21.

The second approach of preventing customers from switching is likely the less complicated option and theoretically preferred. OCA St. 1 at 21. OCA Witness Watkins recommended the following with respect to preventing customers from switching NGDCs:

If this option is considered, I recommend that there be a specific sunset provision for existing customers to decide on which entity their permanent NGDC will be while new customers would have one opportunity (at the beginning of service) to choose a willing NGDC, and that once a NGDC is selected, the then incumbent utility would become the permanent provider of natural gas distribution service at that physical location regardless of change in ownership or control of real estate.

OCA St. 1 at 21. Although this approach continues the inefficient duplication of facilities, if the Commission chooses not to create a task force to explore alternatives and make recommendations, the OCA recommends that the Commission adopt this approach as it is likely the most equitable solution to all stakeholders. OCA St. 1-S at 4.

Peoples' witness, Joseph Gregorini, criticized Mr. Watkins recommended second option, stating that it would create stranded cost recovery issues for the facilities that will no longer be needed to service permanently lost customers. Peoples St. 1-R at 9. As noted above, however, gas-on-gas discounted rates are only presumed to, at best, make small contributions to fixed costs. As Mr. Watkins testified:

If there are dedicated facilities required to serve gas on gas customers, captive ratepayers should never be responsible for the revenue shortfall associated with the under recovery of facility (capital) costs dedicated to serve gas on gas customers.

Furthermore, if there is a real situation in which a potential for stranded costs is possible, that specific instance and issue can be raised by the NGDC and properly addressed in each NGDC's future base rate case proceeding.

OCA St. 1-S at 5.

The third option of allowing gas-on-gas discounting to continue but ensuring that captive ratepayers do not subsidize competitive distribution service may be the simplest approach. OCA St. 1 at 22. OCA Witness Watkins explained this option as follows:

Under this approach, each NGDC's business would be separated between captive and competitive distribution segments. In reality, this would most likely be achieved through an allocation process in which rate base, expenses, and revenue are directly assigned or allocated to captive and competitive business segments. Under this approach, a revenue requirement would be separately established for the captive and competitive business segments. Rates for captive customers would then be established using traditional ratemaking procedures. With respect to each NGDC's competitive business segments, I would recommend that the Commission establish price caps to ensure that all customers in competitive geographic areas do in fact, reap the benefits of competition and are not unduly discriminated against.

OCA St. 1 at 22. OCA Witness Watkins also noted that this type of allocation procedure is commonly used in the utility industry when jurisdictional and non-jurisdictional separations are determined. Mr. Watkins provided the following example:

[I]n Virginia, governmental customers are not subject to the Virginia State Corporation Commission jurisdiction even though these customers are dispersed throughout each utility's service area and share joint facilities with jurisdictional customers. When jurisdictional revenue requirements are established, governmental rate base, expenses, and revenue are allocated away from SCC jurisdictional business.

OCA St. 1 at 22. It should be noted, however, that this approach is likely the most subjective to enforce. OCA St. 1 at 22.

Although Peoples Witness Gregorini agrees that the current practice of gas-on-gas discounting should not continue, Mr. Gregorini recommended that NGDCs should be allowed to continue to compete at full-margin, cost based rates (full tariff rates) for customers in areas with duplicative facilities. Peoples St. 1 at 15. Further, Mr. Gregorini argues that because Peoples' and other NGDC's rates are a product of black box settlements, it cannot be determined if the NGDCs respective rates are cost-based or reflect a compromise of competing positions on numerous ratemaking issues. Peoples St. 1 at 18. Consequently, to ensure fair competition at full tariff rates, Mr. Gregorini recommends that the Commission establish a subsequent generic proceeding to consider whether all NGDCs should be required to establish cost-based rates for all rate classes using a standard and similar cost allocation methodology. Peoples St. 1 at 18.

With respect to Mr. Gregorini's recommendation that the Commission should allow NGDCs to continue to compete at full tariff rates, the OCA submits that this proposal does not resolve the issue of inefficient and unneeded duplication of infrastructure and facilities. OCA St. 1-R at 8. Further, it would not address the future duplication of facilities caused by nearly every NGDC's pipeline replacement program. Last, it does not address the unfair competition between businesses. OCA St. 1-R at 8.

With respect to Mr. Gregorini's recommendation of establishing a generic proceeding to establish standard cost allocation methods, several parties to this investigation -- including OCA,

OSBA, I&E, Penn State, Columbia, NFGD, IECPA -- find this recommendation unadvisable. See OCA St. 1-R at 8; OSBA St. 2 at 9; I&E St. 1R at 10; PSU St. 1 at 11; Columbia St. 1R at 8; NFGD St. 1 at 6; IECPA St. 1R at 25. First, as OCA Witness Watkins testified, this generic investigation is about gas-on-gas discounting, and should not be side-tracked by the ever controversial topic of class cost allocations. OCA St. 1-R at 8. Mr. Watkins went on to further explain why such a generic proceeding should not be initiated, in relevant part:

in Pennsylvania, we consider an NGDC's total cost of service. These total Company revenue requirements vary greatly across NGDCs. Therefore, cost allocations play only a partial role in developing a particular distribution rate and will vary across NGDCs simply because the total costs vary across NGDCs.

OCA St. 1-R at 9.

In surrebuttal, Peoples witness Gregorini modified his earlier position as to the establishment of cost-based rates through a generic proceeding. Mr. Gregorini now advocates for cost-based rates to be established in future base rate cases. Peoples St. 1-S at 6-7. Mr. Gregorini went on to also modify his initial proposal to allow NGDCs to continue to offer gas-on-gas discounts based on their full tariff rates. Mr. Gregorini testified that a more equitable approach would be to allow discounting to continue, but only to the lower full tariff rate of the competing NGDCs. See Peoples St. 1-S at 7-8.

Notwithstanding Mr. Gregorini's attempts to construct a compromise position as to the practice of gas-on-gas rate discounting, the OCA submits that numerous issues remain if the Commission decides to entertain Peoples latest proposal. For one, continuing the practice of discounting without further limitation could lead to continuation of efforts to obtain customers from neighboring NGDCs and potential large swings in load lost or gained, which would be disruptive and not in the best interest of either NGDCs' customers. Further, under Peoples latest proposal additional duplicative infrastructure could conceivably be constructed in order to serve

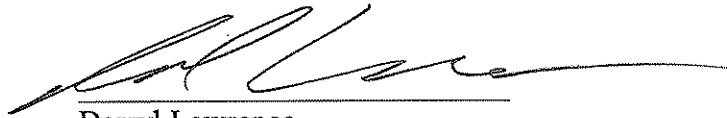
a “new” customer, recently obtained from a neighboring NGDC. As Mr. Watkins discussed, the current state of maintaining duplicative infrastructure is not in the public interest, and certainly building out further to reach competitive customers is not either. See OCA St. 1-S at 5. Moreover, allowing the NGDCs to continue their current contracting methods, unchecked, could also lead to contract terms that run well into the future and are no longer representative of the economic conditions or costs that were in place when the contract was negotiated. In the OCA’s view, Peoples proposal, without more, should not be considered as a viable option to address the totality of the issues surrounding gas-on-gas rate discounting.

In conclusion, the OCA is open to ideas and approaches that effectively terminate the current practice of gas-on-gas rate discounting. The OCA recommends that gas-on-gas rate discounting as it currently exists be ended within a definite and predefined period of time, and that a task force comprised of all stakeholders, legal experts, and technical experts be formed to make recommendations and explore alternative methods, including the three suggested by the OCA, to accomplish this end.

V. CONCLUSION

The Office of Consumer Advocate respectfully requests the Commission to enter an Order in this proceeding to end the current practice of gas-on-gas "competition" within Pennsylvania, consistent with the discussion herein. Alternatively, should the Commission determine that such gas-on-gas rate discounting should continue, the Commission should enter an Order that substantially modifies the current practice.

Respectfully Submitted,



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Dated: February 25, 2014

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CERTIFICATE OF SERVICE

Re: Petition for Generic Investigation or Rulemaking Regarding "Gas-On-Gas Competition"
Between Jurisdictional Natural Gas Distribution Companies
Docket No. P-2011-2277868

Generic Investigation Regarding Gas-on-Gas Competition Between Jurisdictional Natural
Gas Distribution Companies
Docket No. I-2012-2320323

I hereby certify that I have this day served a true copy of the foregoing document,
the Office of Consumer Advocate's Main Brief, upon parties of record in this proceeding in
accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in
the manner and upon the persons listed below:

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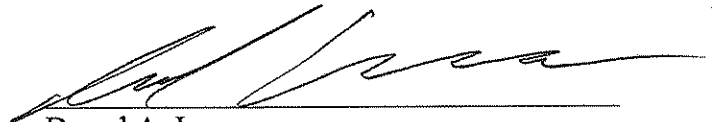
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