



COMMONWEALTH OF PENNSYLVANIA

March 12, 2014

E-Filed

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

**Re: Petition of 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:

I am enclosing for filing today the Reply Brief, on behalf of the Office of Small Business Advocate, in the above-docketed proceedings. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please contact me.

Sincerely,

A handwritten signature in cursive script that reads "Elizabeth Rose Triscari".

Elizabeth Rose Triscari
Assistant Small Business Advocate
Attorney ID #306921

Enclosures

cc: Parties of Record

Robert D. Knecht

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

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

CERTIFICATE OF SERVICE

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

Hon. Elizabeth H. Barnes
Administrative Law Judge
Pa. Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105
(717) 787-1191
(717) 787-0481 (fax)
ebarnes@pa.gov
(E-mail and Hand Delivery)

William H. Roberts, Esquire
Peoples Natural Gas Company, LLC
375 North Shore Drive - #600
Pittsburgh, PA 15212
(412) 208-6527
(412) 208-6577 (fax)
william.h.roberts@peoples-gas.com

Dawn Lindner, Esquire
Jennifer L. Petrisek, Esquire
Peoples TWP, LLC
205 N. Main Street
Butler, PA 16001
(724) 431-4924
dawn.lindner@peoples-gas.com
jennifer.petrisek@peoples-gas.com

Darryl A. Lawrence, Esquire
Aron J. Beatty, Esquire
Office of Consumer Advocate
555 Walnut Street - 5th Floor
Harrisburg, PA 17101-1923
(717) 783-5048
(717) 783-7152 (fax)
dlawrence@paoca.org
abeatty@paoca.org
(E-mail and Hand Delivery)

Allison C. Kaster, Esquire
Bureau of Investigation and Enforcement
Pa. Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105
(717) 787-1976
(717) 772-2677 (fax)
akaster@pa.gov
(E-mail and Hand Delivery)

David P. Zambito, Esquire
Cozen O'Connor
305 North Front Street - #400
Harrisburg, PA 17101-1236
(717) 703-5892
(215) 989-4216 (fax)
dzambito@cozen.com

Theodore J. Gallagher, Esquire
NiSource Corporate Services Company
121 Champion Way - #100
Canonsburg, PA 15317
(724) 416-6355
(724) 416-6384 (fax)
tjgallagher@nisource.com

Charles E. Thomas, Jr., Esquire
Thomas T. Niesen, Esquire
Thomas Long Niesen & Kennard
P. O. Box 9500
Harrisburg, PA 17108-9500
(717) 255-7615
(717) 236-8278 (fax)
cthomasjr@thomaslonglaw.com
tniesen@thomaslonglaw.com

Maureen Geary Krowicki, Esquire
National Fuel Gas Distribution Corp.
P. O. Box 2081
1100 State Street
Erie, PA 16512
(814) 871-8035
KrowickiM@natfuel.com

Amy Neufeld, Esquire
500 North Third Street - #800
Harrisburg, PA 17110
amy.neufeld@exeloncorp.com

Donna M. J. Clark, Esquire
Energy Association of Pennsylvania
800 North Third Street - #205
Harrisburg, PA 17101
dclark@energypa.org
(E-mail Only)

Tishekia E. Williams, Esquire
Duquesne Light Company
411 Seventh Avenue
Pittsburgh, PA 15219
(412) 393-1541
(412) 393-5757 (fax)
Twilliams@duqlight.com

Mark C. Morrow, Esquire
Melanie J. Elatieh, Esquire
UGI Corporation
460 North Gulph Road
King of Prussia, PA 19406
(610) 768-3628
morrowm@ugicorp.com
Elatiehm@ugicorp.com

Thomas J. Sniscak, Esquire
William E. Lehman, Esquire
Hawke McKeon & Sniscak, LLP
P. O. Box 1778
Harrisburg, PA 17105
(717) 236-1300
tjsniscak@hmslegal.com
welehman@hmslegal.com


Teresa K. Schmittberger, Esquire
Pamela C. Polacek, Esquire
McNees Wallace and Nurick, LLC
P. O. Box 1166
Harrisburg, PA 17108
(717) 237-5270
tschmittberger@mwn.com
ppolacek@mwn.com

Michael S. Swerling, Esquire
PECO Energy Company
2301 Market Street - S23-1
Philadelphia, PA 19101-8699
(215) 841-4220
(215) 568-3389 (fax)
michael.swerling@exeloncorp.com

Kevin J. Moody, Esquire
Pennsylvania Independent Oil & Gas Assoc.
212 Locust Street - #300
Harrisburg, PA 17101-1510
(717) 234-8525 ext. 113
(717) 234-8812 (fax)
kevin@pioga.org

James L. Crist
JLCrist@aol.com
(E-mail Only)

Benjamin L. Shechtman, Esquire
Stevens & Lee
620 Freedom Business Center - #200
King of Prussia, PA 19406
(610) 205-6010
bls@stevenslee.com



Elizabeth Rose Triscari
Assistant Small Business Advocate
Attorney ID No. 306921

Date: March 12, 2014

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Petition for Generic Investigation or Rulemaking :
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Generic Investigation Regarding Gas-on-Gas :
Competition Between Jurisdictional Natural Gas : **Docket No. I-2012-2320323**
Distribution Companies :

**REPLY BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE**

**Elizabeth Rose Triscari
Assistant Small Business Advocate
Attorney ID # 306921**

**For: John R. Evans
Small Business Advocate**

**Office of Small Business Advocate
300 North Second Street - Suite 1102
Harrisburg, PA 17101**

Dated: March 12, 2014

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I. PROCEDURAL BACKGROUND

The Main Brief filed by the Office of Small Business Advocate (“OSBA”) on February 25, 2014, provides a thorough overview of the factual and procedural background of the above-captioned proceeding (the “Investigation”) and will not be repeated herein.

On February 25, 2014, Main Briefs were filed by the OSBA, Office of Consumer Advocate (“OCA”), Bureau of Investigation and Enforcement (“I&E”), Peoples Natural Gas Company (“Peoples”) and Peoples TWP LLC (“PTWP”) (together, “Peoples/PTWP”), Industrial Energy Consumers of Pennsylvania (“IECPA”), National Fuel Gas Distribution Corporation (“NFG”), Columbia Gas of Pennsylvania, Inc. (“Columbia”), and The Pennsylvania State University (“Penn State”).

The procedural schedule, as amended, directs Rely Briefs to be filed on March 12, 2014. Therefore, the OSBA submits this Main Brief in accordance with the amended procedural schedule.

II. SUMMARY OF REPLY ARGUMENT

The OSBA submits this Reply Brief primarily in response to the self-serving arguments made by the IECPA and Penn State, namely, that the Commission should preserve the status quo with respect to the practice commonly referred to as “gas-on-gas competition.” As the OSBA explained in its Main Brief, this practice of discounting rates for favored customers, where rates are based not on differences in cost to serve, but solely on whether a customer’s geographical location permits it to be served by more than one natural gas distribution company (“NGDC”), is not actual competition. Because it is not competition and does not therefore afford the benefits of competition, gas-on-gas discounting results in discriminatory rates that cannot be justified.

Based upon the evidence submitted in this proceeding, it is clear that gas-on-gas discounting is not competition. Competition requires that firms strive to reduce costs in order to reduce prices, improve product quality, and/or improve customer service in order to entice more customers to purchase their products. None of these activities apply in the case of gas-on-gas discounting, wherein NGDCs simply cut prices for certain favored customers and then recover the foregone revenues by raising prices to their captive customers. Rather, gas-on-gas discounting is simply inequitable price discrimination, where captive ratepayers are forced to pay for the discounts offered to favored ratepayers to keep them from switching to another Pennsylvania NGDC.

It is also important to recognize what this Investigation is not about. In addition to gas-on-gas discounting, Pennsylvania NGDCs are generally permitted to flex rates for customers who (a) have interstate pipeline bypass opportunities, (b) have the option to relocate business out of the Commonwealth, (c) offer an attractive economic development opportunity, or (d) have lower cost alternative fuel options (together, “Competitive Options”). Unlike gas-on-gas discounting, flexing rates for customers with Competitive Options can provide a net benefit to ratepayers, and OSBA supports continuation of this important ratemaking technique. However, because these policies are not at issue in this proceeding, any arguments that eliminating gas-on-gas “competition” will result in an outflow of manufacturing activity from Western Pennsylvania are without foundation and irrelevant. This Investigation is not and has never been about *real* competitive threats that could induce a customer to choose not to be served by *any* Pennsylvania NGDC.

All of the arguments presented in support of continuing gas-on-gas discounting without modification should be rejected. This reply brief will address how: (1) gas-on-gas discounting is

not competition and is not beneficial to customers; (2) public utility law and recent Commission decisions do not support gas-on-gas discounting; (3) gas-on-gas discounting is not consistent with ratemaking principles; (4) gas-on-gas discounts are fundamentally distinguishable from other flex rate offerings in response to real competition threats; and (5) a change in the discriminatory policy of gas-on-gas discounting is warranted whether or not circumstances have changed in Western Pennsylvania.

The OSBA strongly believes that gas-on-gas discounting should be phased out over as short a time period as is practicable and that, going forward, NGDCs should be permitted to compete for customers in overlapping service territories solely on the basis of their regular tariff rates. However, if the Commission determines that gas-on-gas discounting should continue, but should be modified, the OSBA disagrees with the recommendations made by all parties with the exception of the proposal made by Peoples/PTWP in its Main Brief (“Proposal”).¹ The OSBA would agree that the Proposal is a compromise that would achieve the OSBA’s aims of reducing the net subsidies currently required from captive customers, provided that all of the “Potential Acceptable Options” described in Appendix B of Peoples/PTWP’s Main Brief are adopted.

¹ During the course of the Investigation, Equitable Gas Company LLC was merged into Peoples with the surviving legal entity being Peoples Natural Gas Company LLC – Equitable Division, a division of Peoples. When referring to Peoples/PTWP herein, the Equitable Division is intended to be included in that reference. The OSBA also notes that the testimony submitted by the former entity, which no longer exists, has not been adopted by Peoples/PTWP.

III. REPLY ARGUMENT

A. Gas-on-Gas Discounts Are Not Beneficial

IECPA argues that gas-on-gas discounting should continue in its current form because it benefits all customers as well as NGDCs.² IECPA argues that NGDCs benefit because they can attract and retain large volume customers to reduce their overall costs. This is incorrect. First, from a Commonwealth-wide perspective, this is not an issue about retaining large industrial customers; it is an issue about which NGDC will serve the large industrial customers. As noted earlier, flex rates related to potential economic bypass will be retained if gas-on-gas discounting is eliminated. In addition, retaining a large volume customer would increase revenues and contribute toward an NGDC's fixed cost recovery, but would not lower its costs. NGDCs will recover their costs regardless of whether a large volume customer leaves the system for another NGDC.

IECPA also argues that regular customers (paying full tariff rates) benefit because without the revenue from a large industrial customer (paying a discounted rate), regular customers would have to make up the difference. Finally IECPA argues that gas-on-gas customers (those receiving gas-on-gas discounts) benefit by receiving lower rates. IECPA concludes that from all perspectives, gas-on-gas discounting is a beneficial practice that must be preserved.³

However, as the OSBA explained at pp. 12-15 of its Main Brief, gas-on-gas discounting does not provide a net benefit to all Pennsylvania ratepayers, when the effects on all

² It is important to note that IECPA does not represent the interest of all large commercial and industrial NGDC customers, but rather only a handful of large volume customers that presumably receive gas-on-gas discounts.

³ IECPA Main Brief at 6.

Pennsylvania NGDCs are considered. IECPA's argument continues to remain entrenched in the context of a single NGDC's base rate proceeding. In fact, it quotes from OSBA testimony in that context, failing to recognize the fundamental difference between a case involving a single NGDC and a Commonwealth-wide policy investigation. In a base rate proceeding, without the ability to address the gas-on-gas discounting of other NGDCs, of course it would be preferable *for that utility and its specific ratepayers* to obtain or retain a customer even at a discounted rate rather than to completely lose the revenue it generates.⁴ In that context, the parties and the Commission would logically deem, and in fact have so deemed, the discounts offered to gas-on-gas customers to be reasonable.

However, if gas-on-gas discounts are not permitted and all customers must pay full tariff rates, the overall Pennsylvania NGDC customer base benefits (with the exception of the gas-on-gas customers who have unfairly received the subsidies for many years). The OSBA's Main Brief at pp. 14-15 offers a hypothetical example to illustrate this. In that example, a customer could take service from either Columbia (tariff rate of \$424,000 annually) or PTWP (tariff rate of \$529,000 annually). If gas-on-gas discounts are permitted, the gas-on-gas customer would accept a discounted rate of \$100,000 annually to take service from PTWP. In contrast, if gas-on-gas discounts are prohibited, the gas-on-gas customer will presumably choose to take service from Columbia, the lower cost option at \$424,000 annually. Although PTWP ratepayers will experience an incremental cost of \$100,000 (the discounted rate the gas-on-gas customer would pay if such discounts were not prohibited), there is a benefit of \$424,000 to regular Columbia ratepayers or a *net* benefit to the overall customer base of regular ratepayers of \$324,000. This

⁴ OSBA Statement No. 2 at 3.

example illustrates how the argument that gas-on-gas discounts benefit all customers is simply wrong. These discounts result in a net cost to Pennsylvania NGDC ratepayers, not a net benefit.

Gas-on-gas discounts are undeniably beneficial to the customers who receive them, but this does not justify their continuation at the expense of other ratepayers. IECPA argues that lower operating costs as a result of gas-on-gas discounting “promote industry viability and growth in Western Pennsylvania, which facilitates job growth and a greater overall economy in the Commonwealth.”⁵ This is a worthy goal and gas-on-gas discounting may provide a competitive advantage to the lucky customers who receive gas-on-gas discounts. However, there is a fundamental flaw in this analysis. IECPA’s argument presupposes that it is only customers who are located in the overlapping service territories who should receive this economic development subsidy, and that customers who are not so fortunately situated should pay the subsidy. IECPA offers no evidence that this is the case, and it is most unlikely that economic need would correlate specifically with location in overlapping service territory. Any benefit from gas-on-gas discounting necessarily requires that residential, commercial and industrial customers subsidize these discounts by paying excessive rates. The operating costs of captive ratepayers are increased by gas-on-gas discounts. Such excessive rates are contrary to the goals of promoting industry viability and growth in Western Pennsylvania. Gas-on gas discounts are nothing more than an inequitable and unduly discriminatory economic transfer from captive customers who cannot get such discounts to those customers who can.⁶ If, in fact, the Commission determines that economic development rates in Pennsylvania are required to attract

⁵ IECPA Main Brief at 9.

⁶ OSBA Statement No. 2 at 4. Moreover, the nature of overlapping service territories likely leads to excess spending on duplicative facilities, resulting in a net loss for Pennsylvania ratepayers.

and retain business activity, it should adopt a policy based on economic development, not based on arbitrary geographical considerations. The practice of gas-on-gas discounting does not benefit all ratepayers and should be eliminated.

B. Gas-on-Gas Discounts Violate Public Utility Law and Are Unsupported By Recent Commission Decisions

IECPA argued in its Main Brief that public utility law and regulations support gas-on-gas discounting. Although gas-on-gas discounting has been permitted in Western Pennsylvania for many years, a history of discriminatory policy is no basis for it to continue. In fact, it should be the impetus for change.

As the OSBA explained at p. 16 of its Main Brief, Section 1304 of the Public Utility Code prohibits such discriminatory ratemaking.⁷ As further support, the OCA in its Main Brief cites to the long history of appellate case law on undue price discrimination, while effectively making the argument that gas-on-gas discounts are undue price discrimination.⁸ The Commission has a valid legal basis and perhaps even an obligation to change regulations that currently permit gas-on-gas discounting in violation of the Public Utility Code.

IECPA's argument also ignores the fact that the Commission has already recognized in recent decisions that gas-on-gas discounting is not in the public interest. As I&E and OCA explain in their Main Briefs, there have been multiple Commission decisions that consistently and repeatedly have determined that gas-on-gas competition is harmful and not in the public

⁷ OSBA Main Brief at 16.

⁸ OCA Main Brief at 13-17.

interest.⁹ Specifically, I&E notes that the Commission has stated that it is “wasteful,” “unreasonable,” “wholly uneconomic,” “poor public policy,” and “discriminatory.”¹⁰

IECPA further argues that the Commission has tacitly approved gas-on-gas discounts as a component within settlements in base rate cases. Given the black box nature of settlements, it is disingenuous to suggest that the Commission has somehow approved gas-on-gas “competition” when approving these settlements. Moreover, many settlements of base rates proceedings have flagged the issue of gas-on-gas “competition” and requested that the Commission institute an Investigation such as this one.

C. Gas-on-Gas Discounts Violate Ratemaking Principles

IECPA asserts that gas-on-gas discounts are consistent with ratemaking principles, especially value of service pricing, *i.e.*, what it takes to keep a customer from switching to another NGDC. Although value of service is the criterion generally cited to allow for discounted rates in competitive circumstances, the OSBA has established that gas-on-gas discounting is not competition. Moreover, the reason to discount rates in response to competitive alternatives is to preserve the margin earned from competitive customers for the benefit of all ratepayers. However, in the case of gas-on-gas discounting, the net outcome is not a net benefit to all customers, but is in fact a net cost, when viewed from a Commonwealth-wide perspective. Additionally, IECPA’s value-of-service argument relies upon circular reasoning. Of course the rate charged to a gas-on-gas discount customer is based on value of service considerations, because the Commission has permitted these considerations to exist. However, the whole point of this Investigation is to determine whether that type of value of service pricing should be

⁹ I&E Main Brief at 9-14, OCA Main Brief at 18-20.

¹⁰ I&E Main Brief at 12.

continued and, if so, in what form. The simple fact that gas-on-gas discounting exists is not a valid argument that the status quo should continue.

With respect to the polestar of ratemaking, cost of service, IECPA argues that gas-on-gas discounting does not “offend” this principle, nor the rule against undue price discrimination. In support of this argument, IECPA uses the example of Peoples most recent base rates proceeding where gas-on-gas discounts were allowed, but residential and small commercial rate classes paid rates below their cost of service. First, it is not clear if this example is true for PTWP, Columbia, or Equitable, about which IECPA offers no evidence. More importantly, even if residential and small commercial rates are set below cost of service, it would necessarily mean that industrial customers with gas-on-gas discounts are being subsidized by industrial customers that do not qualify for a gas-on-gas discount. The cost of the discounted rates must fall on someone, and it is clear that the NGDCs are not providing the subsidy. Unlike IECPA, who does not seem concerned about industrial customers who are not favorably located, the OSBA opposes requiring one set of industrial customers to subsidize another set of industrial customers for no valid economic or policy reason. Moreover, the OSBA is skeptical that IECPA will advocate in the future that all subsidies for gas-on-gas customers must be recovered solely from other industrial customers.

D. Gas-on-Gas Discounts Are Fundamentally Distinguishable From Other Flex Rate Offerings That Address Real Competitive Threats

IECPA argues that gas-on-gas discounts are no different than the flex rates offered in response to the threat of Competitive Options and since the statutory advocates endorse those instances of flex rates, gas-on-gas discounts should also continue.¹¹ However, gas-on-gas

¹¹ IECPA Main Brief at 16.

discounts are fundamentally distinguishable from other flex rate offerings. The OCA in its Main Brief gives a thorough explanation of the multiple fundamental distinctions between gas-on-gas discounts and rate discounts that address Competitive Options.¹² The OSBA will not repeat the OCA's credible argument here.

Unlike gas-on-gas discounting, flexing rates for customers with Competitive Options can create a net benefit for ratepayers and thus there is an economic justification for this type of price discrimination. Competitive Options, as defined above, equate to real competitive threats that could induce a customer to choose not to be served by any Pennsylvania NGDC, unlike gas-on-gas discounts which are offered only to prevent a customer from switching to another Pennsylvania NGDC. Whereas flexing rates for customers with Competitive Options is economically justified and therefore is not undue price discrimination, gas-on-gas discounting is undue price discrimination because it does not provide a benefit to the overall Pennsylvania NGDC customer base.

E. Gas-on-Gas Discounting is a Discriminatory Policy that Warrants Elimination Regardless of Any Change in Circumstances in Western Pennsylvania

IECPA appears to argue that the consolidation of the gas distribution industry in Western Pennsylvania does not present a change of circumstances that warrants any change to the policies with respect to gas-on-gas discounting. Even if this argument were assumed to be true, such consolidation is irrelevant to this Investigation because a change in circumstances is not required to modify discriminatory policies. If existing gas-on-gas discounting policies remain unchanged, captive ratepayers will continue to subsidize flex rate contracts with customers in the overlapping service territories of Columbia and the Peoples affiliates.

¹² OCA Main Brief at 22-24

F. IECPA's Recommendations For Transition To Tariff Rates Should Be Rejected

IECPA argues that prior to being transitioned to tariff rates, NGDCs that previously provided gas-on-gas discounted rates should be required to conduct base rates cases to determine just and reasonable rates for previous gas-on-gas discount customers. Gas-on-gas customers would continue to receive discounted rates until after the NGDC base rates proceedings. This recommendation should be rejected. NGDC base rate proceedings are unnecessary before transitioning gas-on-gas rate customers to tariff rates because current tariff rates have already been deemed to be just and reasonable by the Commission. If tariff rates are just and reasonable for regular customers, they are just and reasonable for gas-on-gas customers. Moreover, Peoples/PTWP has agreed to a five-year stayout as part of its merger with Equitable. Waiting for all competing NGDCs to have a base rates case would cause an unreasonable and unnecessary delay in alleviating the burden on captive ratepayers who would continue to be forced to subsidize gas-on-gas discounts.

IECPA also recommends a long transition period from discounted rates to tariff rates to allow gas-on-gas customers the opportunity to prepare for higher rates. Any transition period beyond the expiration of current discount agreements is also unnecessary. Gas-on-gas discount customers could only reasonably expect to receive discounts through the end of their existing contracts. There is no reason for a gradual transition upon expiration of discount agreements.

G. If the Commission Rejects the OSBA's Argument to End Gas-on-Gas Discounting, the Proposal of Peoples/PTWP is Reasonable Provided That All "Potential Acceptable Options" Described in Appendix B of Peoples/PTWP's Main Brief Are Adopted

If the Commission disagrees with the OSBA that gas-on-gas discounting should be eliminated by phasing it out over a reasonable period of time and determines that gas-on-gas

discounting should continue in a modified way, the OSBA believes that the proposal presented by Peoples/PTWP is a reasonable compromise, provided that all of the “Potential Acceptable Options” described in Appendix B of Peoples/PTWP’s Main Brief are adopted. By precluding NGDCs from discounting below the full tariff rate of the alternative NGDC, the Peoples/PTWP proposal essentially ensures that rates will be consistent with at least one NGDC’s costs, and the net Commonwealth-wide subsidy provided by captive customers is essentially eliminated. While the Peoples/PTWP approach will not encourage NGDCs to be efficient, it will at least eliminate the worst of the rate discrimination and cross-subsidies in the existing rate régime. The OSBA also recognizes that due process may require additional steps in this proceeding, such as, a tentative order or other comment process.

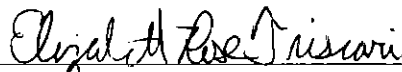
IV. CONCLUSION

For the reasons set forth in its Main Brief and those presented herein, the OSBA respectfully requests that the ALJ and the Commission:

- (1) Prohibit NGDCs from entering into new agreements or renewing existing agreements that offer a below regular tariff rate to obtain or retain a customer that has the option of taking service from another NGDC, but does not have real competitive supply options such as interstate pipeline bypass, alternative fuel capability, or local gas supply; and
- (2) Permit NGDCs to recover the revenue shortfall in base rates proceedings of existing discount agreements, but only through such agreements’ current expiration date or December 31, 2016, whichever is earlier; or

(3) Alternatively, if the Commission determines that gas-on-gas discounting should continue in a modified way, adopt the Proposal presented by Peoples/PTWP including all of the "Potential Acceptable Options" described in Appendix B of Peoples/PTWP's Main Brief.

Respectfully submitted,



Elizabeth Rose Triscari
Assistant Small Business Advocate
Attorney ID No. 306921

For:

John R. Evans
Small Business Advocate

Office of Small Business Advocate
300 North Second Street, Suite 1102
Harrisburg, PA 17101

Dated: March 12, 2014