

COMMONWEALTH OF PENNSYLVANIA



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March 12, 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 Reply 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	:	

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REPLY BRIEF OF THE  
OFFICE OF CONSUMER ADVOCATE

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## **I. INTRODUCTION**

On February 25, 2014, the Industrial Energy Consumers of Pennsylvania (IECPA), the Pennsylvania State University (Penn State), Columbia Gas of Pennsylvania, Inc. (Columbia), National Fuel Gas Distribution Corporation (NFGD), Peoples Natural Gas Company LLC, including its newly-acquired Equitable Division and Peoples TWP LLC (Peoples), the Office of Small Business Advocate (OSBA), the Bureau of Investigation and Enforcement (I&E) and the Office of Consumer Advocate (OCA) submitted Main Briefs in this matter. In accord with the procedural schedule adopted in this matter and the subsequent Scheduling Order entered by Administrative Law Judge Elizabeth Barnes (Judge Barnes), the OCA now submits this Reply Brief.

The OCA's Main Brief contained a comprehensive discussion of the evidence and its position on all issues as to this matter. Accordingly, the OCA will not repeat those arguments in this Reply Brief. Rather, the OCA will respond to those matters raised by other parties not previously addressed or which require additional clarification.

## **II. REPLY ARGUMENT**

### **A. Introduction.**

As set out in their respective Main Briefs, OSBA, I&E, Peoples and OCA agree that the current form and practice of gas-on-gas rate discounting should be ended. Columbia takes no position as to whether the status quo should be maintained or whether gas-on-gas rate discounting should be ended or modified. Similar to Columbia, NFGD takes no position as to whether the current form and practice of gas-on-gas rate discounting should be allowed to continue. Conversely, IECPA and Penn State argue that the current practice of gas-on-gas rate discounting should be allowed to continue in its present form with no modification.

In this Reply Brief, the OCA will first address the arguments advanced by IECPA in support of maintaining the status quo. Next, the OCA will respond to arguments presented by Penn State as to the unabated continuation of gas-on-gas rate discounting. Finally, the OCA will discuss and respond to some of the positions taken in Peoples' Main Brief. As discussed above, Peoples agrees that the current form and practice of gas-on-gas rate discounting should end. Peoples, however, has forwarded a compromise position whereby gas-on-gas discounting would continue but with certain modifications and restrictions that do not currently exist. It is this compromise position taken by Peoples that the OCA will discuss and provide responses to.

The OCA notes that nothing in the Main Briefs of the other parties has caused the OCA to reconsider its position in this matter, as the OCA discussed in its Main Brief. The OCA submits that the Commission should reach a decision in this matter that ends the current form and practice of gas-on-gas rate discounting.

B. OCA Responses to IECPA.

1. The Current Form and Practice of Gas-on-Gas Rate Discounting is Harmful to Captive Ratepayers.

In its Main Brief, IECPA argues that gas-on-gas rate discounting should continue in its present form as it is a beneficial practice for all ratepayers. IECPA M.B. at 6; see also Penn State M.B. at 6-9.<sup>1</sup> IECPA's assertions are without merit. Gas-on-gas rate discounting is only a benefit to a select few large commercial and industrial (C&I) customers who happen to be located in the right spot. To all other ratepayers, including all the other large C&I customers who are not so fortuitously located, gas-on-gas discounting is harmful and creates unnecessary

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<sup>1</sup> In the main, Penn State's argument for maintaining the current form and practice of gas-on-gas rate discounting because all customers benefit from the current practice is substantially similar to those of IECPA. Accordingly, separate responses directed solely to Penn State on this issue would be duplicative and unnecessary.

added expenses for monopoly service due to the discounts extracted by this select few customers. This practice is not “competition”, nor does it serve any reasonable public policy goals.

IECPA’s chief argument as to the merits of gas-on-gas rate discounting is that so long as a discount customer is contributing any amount at all to the NGDC’s fixed costs, all captive customers are better off. IECPA M.B. at 8; Penn State M.B. at 8-9. IECPA ignores the fundamental fact that this is a monopoly service supported by all ratepayers. OCA witness Watkins testified as to whether captive ratepayers are better off under the current form of gas-on-gas discounting, by stating that:

Absolutely not. These gas-on-gas discounted rate customers must receive their natural gas distribution service from one of the regulated NGDCs in Pennsylvania. Therefore, if for instance, Equitable were to argue that its captive customers are better off with some revenue contribution from Customer A than if that customer’s business is lost to People’s, and People’s argues that its captive customers are better off with revenue contributions from Customer B than if that customer’s business is lost to Equitable, it becomes a circular, nonsensical argument. Under current practices, the only thing that is achieved is that Customers A and B are able to enjoy subsidized rates at the expense of Equitable’s and People’s collective captive ratepayers.

OCA St. 1 at 16. As Mr. Watkins testified, under current gas-on-gas rate discounting practices, the only beneficiaries are those select few C&I customers receiving the discounts. All other customers are harmed by this practice as they must pay the price for this practice.

As to whether all other customers are better off under the current form of gas-on-gas rate discounting, OSBA witness Knecht testified as follows:

No. Customers who are not afforded discriminatory below-tariff rates are, in total, detrimentally impacted by this policy in two ways. First, the duplicative construction of gas mains that allows customers to be served by multiple NGDCs is economically inefficient, and the excess costs related to this inefficient investment are borne by ratepayers. Second, absent gas-on-gas price discrimination, regular tariff rate revenues from gas-on-gas customers would be higher than they are now, offsetting the revenue requirement for other customers.

OSBA St. 3 at 2. In response to the same question, I&E witness Mr. Cline testified in relevant part that:

allowing an NGDC to grant a discount *to obtain or keep* a customer from switching to another NGDC and recover the revenue shortfall from tariff customers should not be permitted to continue because it is not in the public interest, results in a lower overall contribution to fixed costs and is unfair to the other NGDCs and its customers.

I&E St. 1 at 7 (emphasis added). As Mr. Cline testified, the current form and practice of gas-on-gas discounting is not in the public interest, and it is simply unfair to all other customers who must pay for these discounts. Further, it is important to recognize, as Mr. Cline testified, NGDCs do not merely use gas-on-gas discounting as a shield – a practice employed only to retain customers – but also as a sword because this practice is used to obtain customers from neighboring NGDCs. As OSBA witness Robert Knecht testified:

In reality, the only real incentive created by "gas-on-gas competition" is for NGDCs to poach one another's customers in between base rates cases. A successful poacher can earn itself additional revenues until the next base rates case, and pass on any revenue shortfall related to these discounts to other less fortunately situated ratepayers in its next base rates proceeding.

OSBA St. 1 at 3-4. The OCA submits that continuing the current form and practice of gas-on-gas rate discounting, which creates incentives for NGDCs to "poach" each other's C&I customers is not in the public interest due to the creation of winners and losers as a result of this uneconomic contest.

In its Main Brief, IECPA recognizes that this contest between NGDCs for C&I customers is harmful to other ratepayers. IECPA's Main Brief provides, in relevant part:

By contrast if gas-on-gas competition is eliminated and customers must choose between NGDCs, then one NGDC may benefit from additional load at the expense of another NGDC. Specifically, the "loser" NGDC could lose a sizeable amount of large volume load, causing the rates for remaining customers of the "loser" NGDC to increase. As a result, allowing NGDCs to continue providing

competitive rates to gas-on-gas customers will ensure that NGDCs have a means for retaining customers to contribute to the costs of their system when necessary.

IECPA M.B. at 8 (internal citations omitted). IECPA styles its argument as the pitfalls that could occur if gas-on-gas discounting is eliminated, but fails to acknowledge that the harms it warns of are occurring right now and are due to the current practice of gas-on-gas discounting. See also IECPA M.B. at 19-20. This is a fatal flaw that is prevalent throughout IECPA's Main Brief, as only the idea of "retaining" customers is discussed without acknowledging that it is only from the existence of gas-on-gas rate discounting that such retention efforts are necessary.

Finally, as to the question of whether all customers are better off due to gas-on-gas rate discounting as it is currently being practiced, the Commission has previously spoken directly to this issue. In the attempted acquisition of Peoples by Equitable in 2007, the Commission reviewed all arguments for and against the continuation of gas-on-gas rate discounting. See, In re Equitable Resources, Inc., 2007 PA PUC LEXIS 32 (Apr. 13, 2007) (Equitable 2007). In Equitable 2007, the Commission's Final Order provided:

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. 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. Furthermore, Dr. Hieronymus concluded that maintenance of gas-on-gas distribution competition is poor public policy.

Equitable 2007 at \*102 (internal citations omitted).

As the Commission confirmed, Dr. Hieronymus was correct in 2007 – gas-on-gas rate discounting as practiced then and now is "poor public policy", "wholly uneconomic" and "a dead weight loss". All of the evidence in the current Investigation leads to the same conclusions.

Gas-on-gas rate discounting is harmful to customers, and accordingly, the OCA submits that the current practice and form of gas-on-gas discounting should be ended.

2. The Current Form and Practice of Gas-on-Gas Rate Discounting finds no Support in the Regulations or the Statute cited by IECPA.

IECPA argues in its Main Brief that the Commission's Regulations, the regulatory history enacting such Regulations and the Natural Gas Choice and Competition Act (Gas Competition Act) all provide support for the current form and practice of gas-on-gas rate discounting. IECPA M.B. at 10-12.<sup>2</sup> IECPA's arguments in this regard are meritless and should be disregarded. A review of the materials cited by IECPA in support of its position clearly shows that reliance on these materials is misplaced.

First, the Pennsylvania Code is cited for the proposition that a "presumption" exists within the regulations that gas-on-gas discounting is appropriate. IECPA M.B. at 10. IECPA argues that the Regulations at 52 Pa. Code, Chapter 60, Natural Gas Transportation Service provide in part that NGDCs must establish a "range of rates" for transportation service, must also establish a "maximum rate" and that NGDCs should seek to "maximize system throughput". Id.<sup>3</sup> From these carefully selected snippets of the Regulation, IECPA concludes that gas-on-gas discounting is presumptively supported by the Regulation. Id.

The OCA submits that a review of the Regulation at issue here weighs against the current practice of gas-on-gas rate discounting. First, the Regulation provides in relevant part:

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<sup>2</sup> It is worth noting that despite IECPA's assertions that gas-on-gas rate discounting is supported by the laws of Pennsylvania and the Commission, IECPA has not cited to a Commission decision or Pennsylvania appellate court case that supports this argument.

<sup>3</sup> Gas-on-gas rate discounting deals with flex rates for monopoly distribution service, not transportation service. Customers receiving gas-on-gas discounts do not necessarily have to also be transport customers. As such, the OCA questions the relevance of regulations for transportation service as to the matter at hand.

### **§ 60.1. General.**

The transportation of natural gas by jurisdictional gas utilities is in the public interest. Transportation service should be provided under terms, conditions and rates which *minimize the shifting of costs to retail customers* and provide the natural gas utility with an *opportunity to recover the fixed costs incurred to serve the transportation service customers*. The development of Pennsylvania natural gas should be promoted, because it will achieve benefits that accrue to gas utilities and their customers.

52 Pa. Code § 60.1 (emphasis added).<sup>4</sup> The Regulation provides that cost shifting to retail (captive) customers should be minimized, as NGDCs should seek to recover their fixed costs from transportation customers. The current practice of gas-on-gas discounting where millions of dollars of costs are shifted to captive customers annually, and “discount” customers pay only a minimal contribution to fixed costs is inconsistent with the plain language and certainly the spirit of the Regulation. The Regulation further provides that:

### **§ 60.3. Eligibility for natural gas transportation service.**

(a) Transportation service shall be provided without discrimination as to type and location of customer. A natural gas utility shall state in its tariff the minimum volume of transported natural gas that entitles a customer to transportation service. These volumes shall be set at a level which maximizes the number of customers that can receive transportation service while permitting the natural gas utility to effectively and efficiently manage its natural gas distribution system. The minimum volume of transported natural gas that entitles a customer to transportation service may not be greater than 5,000 Mcf (thousand cubic feet) per customer or buyer group per year.

52 Pa. Code § 60.3. Here the Regulation provides for open access, non-discriminatory treatment and a goal of maximizing the number of customers who can participate. Conversely, the current practice of gas-on-gas rate discounting is discriminatory and limited in participation to a select

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<sup>4</sup> The complete text of Chapter 60 is available at:  
<http://www.pacode.com/secure/data/052/chapter60/chap60toc.html>

few C&I customers who happen to be located in just the right spot. Contrary to IECPA's assertions, Chapter 60 provides no support for the current practice of gas-on-gas discounting.

IECPA also cites the regulatory history that accompanied the implementation of Chapter 60 as further support for gas-on-gas discounting. IECPA M.B. at 10. Specifically, IECPA cites a statement by the Commission as published in the Pennsylvania Bulletin, to the effect that keeping customers on the NGDC's system at a lower rate is preferable to losing the customer altogether. Id. A review of the cited text, however, reveals that the portion of the statement quoted by IECPA was taken out of context. The full statement provides that:

Assuming that many of these customers are able to burn another type of fuel, it is preferable to keep these customers on the system, albeit at a lower rate, than to lose all contribution to the company's fixed costs.

17 Pa.B. 548 (January 31, 1987).<sup>5</sup> It is clear from the quoted language that the Commission was referring to customers with dual fuel capabilities, and not making any generalized statement in support of gas-on-gas discounting. Customers with dual fuel capability have the option to leave the natural gas distribution system entirely by utilizing whatever alternative source of fuel their particular infrastructure supports, such as fuel oil, propane or diesel. Conversely, gas-on-gas customers must use the natural gas distribution system to take service from an NGDC. Similar to the language of the Regulation itself, the discussion and commentary that accompanied the implementation of Chapter 60 lends no support to the current practice of gas-on-gas rate discounting.<sup>6</sup>

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<sup>5</sup> The OCA was unable to locate any online source for the Pennsylvania Bulletin in 1987. Accordingly, a complete copy of this source is attached to this Reply Brief as Appendix A.

<sup>6</sup> IECPA also argues that adoption of the Gas Competition Act after the Chapter 60 Regulations were implemented tends to "legitimize" discounting practices such as gas-on-gas discounting. IECPA M.B. at 11. As the OCA discussed above, the Regulations at Chapter 60 provide no support for gas-on-gas discounting. Further, the Gas Competition Act was created to enable retail choice for natural gas commodity supply. As such, the Gas Competition Act, notwithstanding its potential benefits to consumers, is irrelevant as to the present inquiry relating to gas-on-gas rate discounting for monopoly distribution service.

Lastly, IECPA opines that since passage of the Gas Competition Act, neither the Legislature nor the Commission has “seen a need to review gas-on-gas competition with respect to multiple NGDCs.” IECPA M.B. 11. The obvious conclusion that IECPA wishes to be drawn from this statement is that no review is needed. Equally as obvious, however, is the fact that the Commission has indeed opened a generic investigation into all aspects of gas-on-gas rate discounting in this very docket. The Commission has, apparently, seen a need to review the current practice of gas-on-gas discounting as to multiple NGDCs.

As the OCA discussed throughout its Main Brief, the current practice of gas-on-gas rate discounting is not in accord with Commission precedent or the case law of the appellate courts of Pennsylvania. As discussed herein, IECPA’s arguments that Commission Regulations or the Competition Act somehow provides support for the practice are unconvincing. The current practice of gas-on-gas rate discounting does nothing to further important public policy goals, is wholly uneconomic, and is unfair and discriminatory to captive ratepayers who must foot the bill for the millions of dollars of discounts provided to a select few C&I customers.

3. The Current Form and Practice of Gas-on-Gas Rate Discounting is not in Accord with Public Utility Ratemaking Principles.

IECPA argues in its Main Brief that gas-on-gas discounting is consistent with accepted ratemaking principles and should continue in its current form. IECPA M.B. at 12. IECPA posits that gas-on-gas discounting is justified on a “value of service” basis, and is consistent with “cost of service” principles. Id. Further, IECPA alleges that gas-on-gas discounting represents perfectly acceptable price discrimination “among customer classes”. Id. at 15.

The OCA submits that IECPA is incorrect on all points. The current form and practice of gas-on-gas rate discounting cannot be justified based on accepted ratemaking principles in Pennsylvania. Further, the level of “discounts” that a few C&I customers are able to extract

from neighboring NGDCs raises serious questions as to undue discrimination between various customer classes, and between customers in the *same* class.<sup>7</sup>

IECPA's "value of service" argument is a slight variation on its argument that gas-on-gas discounting benefits all customers. See IECPA M.B. at 12-13. The OCA addressed that argument in Section B. 1. above. As to setting rates using the concept of "value of service", OCA witness Watkins testified that:

value of service should be evaluated on a case-by-case basis that considers circumstances such as threats of by-pass and the costs of natural gas end-users constructing their own "stand-alone" facilities as well as the cost of alternative fuels *vis a vis* the cost of natural gas. However, the implication of Ms. Burgraff's "value of service" pricing discussion on page 11 of her direct testimony implies that such "value of service" must be below full cost of service; i.e., lower than full tariff rates. Ms. Burgraff fails to mention that value of service pricing works both ways. In other words, if, and when, value of service pricing is considered, those customers may actually pay more than full embedded costs of providing service. Indeed, this is the practice in Kentucky in which a customer with alternative energy sources (other than natural gas) elects to move to a Commission approved "flex rate schedule" that is based on value of service pricing, that customer must remain on this rate schedule for the duration of their contract with the local NGDC. In situations in which the price of alternative fuel sources is greater than natural gas, these flex customers must be prepared to pay a distribution rate higher than the traditional tariff rate due to the customer's election to participate in "value of service" pricing.

OCA St. 1-R at 5. As Mr. Watkins explained, IECPA's value of service pricing arguments are incomplete and fail to take into account the actual case-by-case examination that should be conducted under such a rate setting mechanism. As such, the OCA submits that the current form and practice of gas-on-gas discounting cannot be justified based on value of service principles.

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<sup>7</sup> In its Main Brief, the OCA provided a number of Commission Decisions and Pennsylvania Appellate Court cases that discussed and illustrated the concept of "undue price discrimination" and how the current form and practice of gas-on-gas rate discounting is consistent with this level of discrimination. See OCA M.B. at 7-25. The OCA will not repeat those arguments here. The OCA would note, however, that a review of the NGDCs Commission-approved distribution rates for C&I customers against OCA St. 1, Highly Confidential Version, Schedule GAW-2 is illustrative as to the level of "discounts" at issue here.

OSBA witness Robert Knecht testified that the current form and practice of gas-on-gas rate discounting violates numerous ratemaking principles. OSBA St. 2 at 7-8. Specifically, Mr. Knecht testified that:

- The rate stability criterion is violated, because rates to any particular customer are subject to the pricing whims of NGDCs (who can just pass costs on to other ratepayers).
- Gas-on-gas flex rates do not reflect value of service, because customers who value the service equally may face very different rates, since the gas-on-gas rates are differentiated based on location and not value of service.
- The revenue stability criterion is violated, because customers can switch back and forth among NGDCs, causing revenue requirements of individual NGDCs to fluctuate.
- Gas-on-gas flex rates are dynamically inefficient, because they encourage duplication of gas distribution facilities in overlapping service territories.
- Gas-on-gas flex rates are inequitable, in that comparable customers are not treated comparably.
- Gas-on-gas flex rates are not simple, understandable, or free from controversy as to interpretation.

Id. In short, gas-on-gas flex rates fail on both cost and non-cost rate design criteria. As Mr. Knecht testified, gas-on gas discounting under current practices does not comport with non-cost design criteria, and also is inconsistent with traditional cost of service ratemaking principles.

IECPA argues, however, that gas-on-gas discounting is supported by traditional cost of service principles by pointing to a cost of service study (COSS) submitted in a recent Peoples base rate proceeding.<sup>8</sup> IECPA M.B. at 14-15. IECPA reasons that since this one COSS, submitted by Peoples, showed that C&I customers were paying more than the system average rate of return, and the C&I class included C&I customers currently receiving gas-on-gas

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<sup>8</sup> See In re Peoples Natural Gas Company, LLC, Docket No. R-2012-2285985, Recommended Decision at 33-34 (Entered Aug. 29, 2012) (Peoples R.D.).

discounts, then it follows that gas-on-gas discounting is consistent with cost of service principles.

Id. The OCA submits that IECPA's reliance on this one COSS is misplaced.

It is a well-accepted fact that COSSs do not represent a pure mathematical exercise, but are rather as much art as science. The COSS in a base rate case, and the use thereof to assign class cost responsibility is one of the most subjective and contentious issues in such matters. As to Peoples most recent base rate case, a COSS was also submitted in that proceeding by OCA witness Jerome D. Mierzwa.<sup>9</sup> Mr. Mierzwa's COSS, using the peak and average methodology approved by the Commission in many prior NGDC base rate cases, found that Large General Service customers were providing a rate of return of 5.86%, less than the system average rate of return of 6.07%.<sup>10</sup> Accordingly, Mr. Mierzwa's COSS could be viewed as evidence that C&I customers receiving discounts due to gas-on-gas discounting practices are contributing to sub-par returns for the C&I class as a whole, and thus, gas-on-gas discounting is inconsistent with cost of service principles. The point being, IECPA's reliance on the mathematical precision of one party's COSS submitted in the context of a litigated proceeding in order to prove the reasonableness of current gas-on-gas discounting practices is questionable. IECPA's own witness agrees with this lack of precision.

In response to Peoples witness Gregorini's suggestion that a uniform, state-wide cost allocation method be established (Peoples St. 1 at 18-19), IECPA witness Burgraff responded in her Rebuttal Testimony, as follows:

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<sup>9</sup> See Peoples R.D. at 34.

<sup>10</sup> See Peoples R.D. at 34, Table 4S. Ultimately, the Peoples case was resolved by Settlement. As such, none of the competing COSSs that were submitted in that proceeding were actually used to assign costs to the various customer classes. Judge Mary D. Long recommended approval of the Settlement. See Peoples R.D. The Commission affirmed the R.D. in all respects and approved the Settlement. In re Peoples Natural Gas Company, LLC, Docket No. R-2012-2285985, Order (entered Sept. 27, 2012).

My problem, therefore, with Witness Gregorini's recommendation is that it is unrealistic. There is no one true cost-of-service even though every party to a rate case believes there is. Every cost allocation witness has his or her preferred method. An investigation into cost-of-service to set rates for competing utilities will not bring everyone onto the same page either. Witnesses for the small volume customers favor a study that shifts costs to larger customers, and larger customers favor studies that move costs to smaller customers.

IECPA St. No. 1R at 26. As discussed, IECPA's argument that one COSS proves that current gas-on-gas discounting practices comport with cost of service ratemaking principles is without merit and should be rejected.

IECPA goes on to argue that “[p]rice discrimination among customer classes is perfectly acceptable when there is a legitimate ratemaking principle that justifies the discrimination.” IECPA M.B. at 15. As discussed above, however, no legitimate ratemaking principle supports the current form and practice of gas-on-gas rate discounting. Further, as discussed in OCA's Main Brief at pages 15-16, current gas-on-gas discounting practices create discrimination between classes and within the same class of customers – C&I customers who do not receive discounted rates. IECPA fails to address why this intra-class discrimination is in accord with accepted ratemaking principles. Accordingly, the current form and practice of gas-on-gas discounting is inconsistent with traditional ratemaking principles and must be ended.

4. Gas-on-Gas Rate Discounting is Different in Character than other Forms of Flex Rates.

IECPA argues that gas-on-gas discounting is similar to other NGDC practices where flex rates are offered to customers, such as for bypass capabilities, dual fuel capabilities or economic development initiatives. IECPA concludes that, as such, gas-on-gas discounting should continue in its current form. IECPA M.B. at 16-18.

IECPA's initial premise here is incorrect – gas-on-gas discounting is unlike other flex rate practices – and, its conclusion therefore is without merit. The differences between these

practices are the potential outcomes. Unlike gas-on-gas discount customers who switch from one NGDC's to another NGDC's distribution system, other flex rate customers have the ability to leave the *entire* natural gas distribution system. Customers with dual fuel capability can effectively leave the natural gas distribution system entirely by switching to an alternative fuel, based on capital investments that customer has already made in such facilities. Customers with pipeline bypass capability can effectively leave the natural gas distribution system entirely by making the necessary investment in facilities to take service directly from the pipeline. Customers seeking economic development rates can effectively leave the natural gas distribution system entirely by moving to another state, closing its facilities or shifting production elsewhere. Providing gas-on-gas discounts does not prevent a customer from leaving the distribution system, it only keeps the customer on the current NGDC's distribution system or it entices the customer to jump to the neighboring NGDC's distribution system.

Unlike other legitimate forms of flex rates, gas-on-gas discounting is contrary to the public interest. As explained by Dr. Hieronymus in his Rebuttal Testimony in Equitable 2007:

Because gas-on-gas distribution competition is, in the vernacular of economists, a "negative sum game." This means that participants, in this case all customers collectively, are harmed even though some customers benefit. Discounts given to favorably situated customers are not absorbed by the shareholders of the distribution utilities. Rather, via ratemaking processes (base rate cases and, for retainage discounts, purchased gas adjustment clause cases) such discounts are paid by other, less favored customers. If 20 percent of customers pay only half of their properly allocated costs of service, the remaining 80 percent necessarily make up the difference.

The division of the revenue requirement pie is a "zero sum game"- what one customer wins via discounts, others lose via higher tariff rates. What makes this a negative sum game is that the costs incurred to enable the competition that creates the need to grant discounts are themselves a dead weight loss and wholly uneconomic.

...

In fact, the substitution of one distributor for the other creates no new revenues. Indeed, what is lost by Equitable if Peoples gains a customer is almost assuredly more than Peoples gained (otherwise, the customer would not switch.). Once the effects of the transaction are flowed through revenue requirements, Equitable's remaining customers will lose the revenues previously garnered from the customer while Peoples customers will benefit from a smaller increment of revenues and bear the dead-weight loss of the incremental costs incurred to gain the customer. For customers other than the customer who benefits, the loss will be equal to the cost of accessing the customer plus the additional discount that the customer was able to bargain for.

I&E Exh. No. 1 at 14, 16.

As explained by Dr. Hieronymus, gas-on-gas rate discounting creates winners and losers, enables large amounts of load to switch back and forth between NGDCs at the end of each “discount” contract period, creates no new revenues, but rather creates additional expense in order to carry on this wholly uneconomic practice. OSBA witness Robert Knecht also testified as to further differences between these flex rate practices, as follows:

Gas-on-gas price discrimination is fundamentally different from the other forms of rate discounting cited by Ms. Burgraff because (a) the practice results in inefficient duplication of facilities, and (b) it does not preserve load that would otherwise be lost to Pennsylvania NGDCs. The fundamental difference between gas-on-gas discounting and other discounting is that the 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. As Mr. Knecht additionally points out, gas-on-gas rate discounting works to perpetuate the existence of inefficient, duplicative distribution facilities. Such a practice is not in the public interest, as explained by OCA witness Watkins:

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 16-17.

Flex rates for dual fuel, bypass or economic development purposes can be used to further important public policy goals and the continuance of these practices is in the public interest. Gas-on-gas rate discounting, however, is discriminatory, unfair, serves to further no public policy goals, is uneconomic and its current practice should be ended.

5. IECPA's Argument is Internally Inconsistent.

IECPA makes one final point as to why gas-on-gas discounting should continue in its present form. IECPA argues that if the current practice of gas-on-gas discounting is ended, customers could be harmed. As the argument goes, large C&I customers could switch NGDCs and leave customers of the losing NGDC with higher rates in order to make up for the loss. IECPA M.B. at 19-20.

The current form and practice of gas-on-gas rate discounting creates the exact scenario that IECPA now warns against. NGDCs actively compete to *take* each other's customers. As the OCA explained in Section B. 1. of this Reply Brief, NGDCs do not use gas-on-gas discounting to only retain customers, but also to "poach" customers from neighboring NGDCs, as OSBA witness Knecht described the practice. See OSBA St. 1 at 3-4. IECPA argues that gas-on-gas rate discounting should continue exactly as it is currently being practiced,<sup>11</sup> and yet, IECPA obviously agrees that the "current practice" of large C&I customers switching back and forth between NGDCs is harmful to customers.

6. Conclusion.

IECPA's arguments for maintaining the current practice of gas-on-gas discounting are largely off base and unconvincing. The current practice rewards a few large C&I customers at

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<sup>11</sup> See, e.g., "IECPA is strongly in favor of continuing gas-on-gas competition in its current format." IECPA M.B. at 20.

the expense of all other customers of the natural gas distribution system in Western Pennsylvania. As explained herein, all distribution customers of every NGDC that engages in gas-on-gas rate discounting suffers, save for the select few “discount” customers, due to this wholly uneconomic practice that results in a negative sum game.

C. OCA Response To IECPA And Penn State.

IECPA argues in the alternative that should the Commission decide to end gas-on-gas discounting, a reasonable transition period should be established before C&I customers would start to be charged the Commission-approved tariff rates for their particular class. IECPA M.B. at 26-28. Penn State argues against any change to the current status quo, or “unintended adverse economic consequences” may occur. Penn State M.B. at 5. The OCA agrees that a reasonable transition period should be implemented. The record in this matter indicates that no Party to this proceeding is advocating for sudden or immediate changes.

OCA witness Watkins provided a format for how the Commission could implement a phase out of gas-on-gas rate discounting. Mr. Watkins recognized the inherent challenges in this process, as he testified in relevant part:

First and foremost, it is recognized that the mandated abandonment of the current practices will certainly create significant challenges for the Commission and all stakeholders. The practices and unfairness associated with ratepayer funded gas-on-gas rate discounting have existed for decades, and in my opinion, cannot be fairly resolved overnight. Regardless of the ultimate approach or mechanism utilized to abolish ratepayer funded gas-on-gas rate discounts, I recommend that there be a definite and reasonable transition period so that all stakeholders can plan for, and accommodate, these required changes. 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.

Second, the issues surrounding the ultimate approach and mechanism to abolish ratepayer funded gas-on-gas rate discounts are clearly complex. There are

no obvious or clear-cut approaches that are simple, and at the same time, fair to all stakeholders. Indeed, due to the labyrinth of multi-utility owned natural gas distribution mains in Western Pennsylvania, as well as the locations and unique characteristics of many commercial/industrial customers currently receiving gas-on-gas distribution rate discounts, inputs and expertise from these customers, the NGDC's, statutory parties, and potentially other stakeholders are required to formulate fair and effective procedures to abandon the current unjust practice of ratepayer funded gas-on-gas rate discounting. As such, the initial decision in this case should be a directive that ratepayer funded gas-on-gas rate discounts will be abolished within a definite and predefined period of time and that a task force comprised of all stakeholders will be formed to make recommendations, or at least provide alternative solutions, to accomplish this directive. The task force should report their findings and recommendations to the Commission within one to two years from the time of an initial decision in this case.

OCA St. 1 at 20-21. The OCA submits that the format laid out by Mr. Watkins is reasonable, and provides a sufficiently long transitional period. As to the need for a transitional period, the OCA agrees with IECPA.

As to Penn State's concerns over economic consequences, a reasonable transition period should serve to address concerns over any possible economic disruptions. As IECPA explained, sufficient advance notice will enable businesses to prepare for the coming changes through budgeting and operational forecasting and decision making. See IECPA M.B. at 27. In the OCA's view, a reasonable transition period will enable businesses to adjust to the changing regulatory climate.

D. Response To Peoples.

Peoples agrees with the Statutory Advocates that the current practice of gas-on-gas rate discounting should be ended. Peoples M.B. at 17-21. Peoples argues, however, that gas-on-gas discounting should not be completely ended, but, rather substantially modified. Peoples sets out the basic framework of its Proposal, as follows:

Peoples and Peoples TWP are, in essence, proposing the creation of a reasonable floor on gas-on-gas discounting for all new and renewal gas-on-gas discount agreements. That floor would be the lowest non-discounted tariffed distribution

rates of any of the NGDCs competing for the customer's load. All existing gas-on-gas discount agreements would be permitted to run their terms. The NGDCs would be allowed rate recovery for Discount Adjustments for existing agreements as well [as] new/renewal agreements; provided that the NGDC can demonstrate that the discounts were prudently awarded and are reasonable.

Peoples M.B. at 18. Peoples included a draft of certain provisions for this limited continuation of gas-on-gas rate discounting, as testified to by Peoples witness Mr. Gregorini in his Surrebuttal Testimony. See Peoples Exh. JAG-2; Peoples M.B. at Appendix A. As further explained in its Main Brief, Peoples acknowledges that the provisions included at Appendix A may not address some of the concerns and comments of the other Parties expressed throughout this proceeding, most notably those of OSBA, I&E and the OCA. To address these concerns, Peoples added Appendix B which contains a list of potential compromise positions that, taken together with the provisions at Appendix A, would create a comprehensive proposal (Proposal) that Peoples could agree to.

In response, the OCA appreciates that Peoples has recognized the inherent problems and basic inequities created by the current practice of gas-on-gas discounting and has attempted to provide a solution through its Proposal. The OCA submits, however, that the preferred outcome here remains that the Commission issue an Order ending the current practice of gas-on-gas discounting, consistent with the discussion contained in the OCA's Main Brief. See OCA M.B. at 26-31.

Alternatively, should the Commission wish to further consider Peoples Proposal, the OCA submits that the Commission should enter an Order ending the current form and practice of gas-on-gas rate discounting, and further directing all Parties to engage in a collaborative process using Peoples Appendices A and B as a platform to create one document that would capture all of the necessary provisions and guidelines to be implemented for a modified form of gas-on-gas

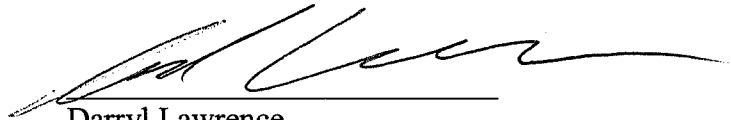
rate discounting. As Mr. Watkins recommended in his Direct Testimony, it may be necessary to create a collaborative or working group to ensure that all issues have been addressed after the Commission issues its Order to end the current practice of gas-on-gas rate discounting.

To be clear on this point, should the Commission decide that gas-on-gas rate discounting should continue, consistent with the framework put forth by Peoples, the provisions contained in Appendix B will need to be included in any final document in order to ensure a fair and reasonable outcome for all parties. As to the current matter and the decisions to come, the OCA recognizes that additional processes and procedures may be necessary in order to reach a final resolution on these complex issues.

### III. 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 in the OCA’s Main Brief and in this Reply Brief. Alternatively, should the Commission determine that such gas-on-gas rate discounting should continue, the Commission should direct the Parties to engage in a collaborative to consider Peoples Proposal as presented in Appendices A and B of its Main Brief.

Respectfully Submitted,



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Dated: March 12, 2014

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# APPENDIX A

The State Board of Podiatry, acting under the authorizing statute, orders:

(A) That the regulations of the State Board of Podiatry, 49 Pa. Code Chapter 29, are amended by amending § 29.15 to read as set forth at 16 Pa.B. 4323 (November 1, 1986).

(B) That the State Board of Podiatry shall submit this order and 16 Pa.B. 4323 to the Office of Attorney General and the Office of General Counsel for approval as to legality as required by law.

(C) That the State Board of Podiatry shall certify this order and 16 Pa.B. 4323 and deposit them with the Legislative Reference Bureau as required by law.

(D) That this order shall take effect upon publication in the *Pennsylvania Bulletin* and shall apply retroactively to December 31, 1986.

By the State Board of Podiatry

MICHAEL R. MARINO, D.P.M.,  
Chairman

**Fiscal Note:** Fiscal Note 16A-152 remains valid for the final adoption the subject regulation.

**(Editor's Note:** For the text of the order of the Independent Regulatory Review Commission relating to this document, see 16 Pa.B. 4828 (December 13, 1986).)

[Pa.B. Doc. No. 87-192. Filed January 30, 1987, 9:00 a.m.]

## Title 52—PUBLIC UTILITIES

### PENNSYLVANIA PUBLIC UTILITY COMMISSION

[L-860018]

#### [52 PA. CODE CH. 60]

#### Natural Gas Transportation Service

At its public meeting held October 16, 1986, the Pennsylvania Public Utility Commission issued an order finally adopting regulations governing intrastate natural gas transportation rates and services of Pennsylvania natural gas utilities. Notice of proposed rulemaking was published at 16 Pa.B. 2142 (June 14, 1986). The proposal was approved by the Senate Committee on Consumer Protection and Professional Licensure on June 10, 1986, the House Committee on Consumer Affairs on June 17, 1986 and the Independent Regulatory Review Commission on August 4, 1986.

Certain definitional and substantive amendments have been made to the proposal to provide for clearer understanding of the requirements being imposed upon affected utilities. A notable amendment is the advancement of the date of filing tariffs with the Commission reflecting the rates, terms and conditions of transportation services under § 60.9 from 90 days to 30 days of the effective date of the regulations. Another notable amendment is the expansion of the range of rates under § 60.2 to provide the local distributor companies flexibility in providing services.

The regulations will implement the terms and objectives for the provision of intrastate natural gas service with the intent to reduce costs paid by retail customers. The regulations also establish eligibility requirements, various rates to be charged for each element of service, natural gas storage service, reporting requirements and will permit end users to obtain their own supplies of

natural gas. The regulations will become effective upon publication in the *Pennsylvania Bulletin*.

Public Meeting held  
October 16, 1986

Commissioners present: Linda C. Taliaferro, Chairman, dissenting; Frank Fischl; and Bill Shane.

#### Order

On September 26, 1985, the Commission adopted an order in response to the petition of the Pennsylvania Natural Gas Associates for an expedited rulemaking regarding gas transportation by natural gas utilities. This order directed the staff to draft proposed regulations. On February 13, 1986, the Commission adopted an order (Chairman Taliaferro dissenting) which proposed new regulations governing intrastate natural gas transportation rates and service. These proposed regulations were published for comment at 16 Pa.B. 2142 (June 14, 1986).

Comments to the proposed rules have been filed by a variety of parties including local distribution companies, natural gas producers, industrial users of natural gas and other interested groups.<sup>1</sup>

The proposed rulemaking was approved by the Senate Consumer Protection and Professional Licensure Committee on June 10, 1986, and by the House Consumer Affairs Committee on June 17, 1986. By letter dated July 28, 1986, the Commission agreed to modify the proposed regulations in accordance with an order issued by the Independent Regulatory Review Commission (IRRC).

First, we have clarified the definitions of the maximum rate (§ 60.2(3)) and the minimum rate (§ 60.2(4)). Second, we have defined the term "natural gas shortage" (§ 60.2(14)). Third, we have withdrawn the requirement that only customers who can burn more than one type of fuel are eligible for interruptible transportation service (§ 60.3(c)). Fourth, we have added the word "weighted" before "average cost of gas" in § 60.2(14). Fifth, we agreed to amend § 60.7(a) so that it was consistent with § 60.2(14); however, this amendment has become moot since we have decided to delete the language in § 60.7(a). Finally, we agreed to advance the effective date by requiring utilities to file tariffs within 30 days of the effective date of these regulations, instead of the 90 days stated in our proposal (§ 60.9). As a result of our substantial concurrence with IRRC's order, IRRC approved the proposed regulations on August 4, 1986.

The following is a section by section summary of the comments and the Commission's response to those comments.

**(Editor's Note:** The Pennsylvania Public Utility Commission published notice of proposed rulemaking at 16 Pa.B. 2142 (June 14, 1986). The text discussed in the order reflects a version which was presented to the members of the Commission following publication of the notice of proposed rulemaking, receipt of comments by the Commission staff and discussion with the Independent Regulatory Review Commission.)

<sup>1</sup> Commentators include Apollo Natural Gas and Carnegie Natural Gas Co. (joint comments), Columbia Gas of Pennsylvania, Equitable Gas Co., National Fuel Gas Distribution Co., Peoples Natural Gas Co., the Pennsylvania Gas Association, Pennsylvania and Southern Gas Co., Penn Fuel Gas, Inc., North Penn Gas Co., UGI Corporation, Pennsylvania Gas and Water Co., Philadelphia Electric Co.—Gas Division, Sun Exploration and Production Co., Pennsylvania Natural Gas Assoc. and Pennsylvania Oil and Gas Assoc. (joint comments), Keystone Carbon Company, Industrial Energy Consumers of Pennsylvania, Pennsylvania Industrial Gas Consumers, Babcock and Wilcox, the law firm of Shearer, Mette and Woodside, the Office of Consumer Advocate, the Commission's Bureau of Rates, the Commission's Bureau of Conservation, Economics and Energy Planning, and Gerald L. Bowman, P.E.

§ 60.1. General.

The transportation of natural gas by jurisdictional gas utilities is in the public interest. Transportation service shall be provided under terms, conditions and rates which minimize the shifting of costs to retail customers and provide the natural gas utility with an opportunity to recover the fixed costs incurred to serve the transportation customers. The development of Pennsylvania Natural Gas should be promoted because it will achieve benefits that accrue to gas utilities and their customers.

Comments:

National Fuel Gas Distribution Company (NFG) and Columbia Gas of Pennsylvania (Columbia) support this section. The Peoples Natural Gas Company (Peoples) suggests that Pennsylvania transportation policy should be neutral and not promote one source of supply over another.

The Philadelphia Electric Company—Gas Division (PECO) asserts that the language declaring transportation of natural gas to be in the public interest is too broad and should be qualified. PECO believes that in some cases the transportation of natural gas by a local distribution company (LDC) for a customer will result in the shifting of costs to remaining customers. PECO believes that this shifting of costs is not in the public interest and that transportation service is primarily beneficial to large end-users in periods of excess deliverability.

Commission's Response:

As explained in the narrative under § 60.2(6), we are retaining the preference for Pennsylvania natural gas in these regulations. With regard to PECO's comments, we have crafted our policy to minimize concerns over cost shifting, but this concern must be weighted against the expected benefits of our policy. With increased gas transportation, LDCs will have an added incentive to increase the efficiency of their gas purchasing practices, providing benefits to all classes of customers.

§ 60.2. Natural gas transportation service and objectives.

A natural gas utility shall maintain a gas transportation program that adheres to the following terms and objectives when providing natural gas transportation service:

(1) The tariff shall separately state and price the components of transportation service to afford customers flexibility in choosing the degree of supply risk they are willing to assume.

(2) The tariff shall indicate a range of rates for transportation service.

(3) The maximum rate allowed for transportation service shall be the weighted average retail rate for that type of retail service less all costs relating to natural gas supply including natural gas demand, commodity, and storage costs.

(4) The minimum rate allowed for firm and interruptible transportation service shall be based upon a current cost of service study. Only those costs identifiable as related to transportation service shall be allocated to transportation customers.

Comments:

There is no clear consensus among the comments of the LDCs on the provisions regarding transportation

rates. PECO suggests that a range of rates is inappropriate as it will force all rates to the minimum level. Instead, PECO would make the minimum rate available only to certain classes of customers. NFG does not support a range of rates; it agrees with a simple margin rate as long as it is supplemented by a separate standby charge. According to NFG, this would cause the nongas portions of the sales and transportation rates to be equivalent, and the customer's choice of transportation or retail service would hinge on its ability to acquire a cheaper source of gas.

Columbia, Peoples and the Pennsylvania Gas Association (PGA) support the range of rates concept; however, they argue that a minimum rate should not be established in the regulations. In their view, this will enhance the ability of LDCs to respond to competition. A minimum rate is not needed because LDCs already have an incentive to recover the highest possible amount for transportation service. Furthermore, Peoples argues that the publishing of a minimum rate will lead to undercutting by other LDCs in situations where the customer can be served by more than one LDC.

The Pennsylvania and Southern Gas Company (Pennsylvania and Southern) states that the maximum rate should be set at the gross margin unless the LDC is able to realign its demand costs with its pipeline suppliers. Pennsylvania and Southern supports a minimum transportation rate based upon cost of service, but suggests that this will shift costs to remaining retail customers. T.W. Phillips Gas and Oil Co. (Phillips) also supports the minimum transportation rate. Apollo Gas Company (Apollo) and Carnegie Natural Gas Company (Carnegie) assert that the minimum rate should be based upon the average variable cost of providing the service.

Industrial customers of LDCs advocate basing transportation rates upon costs. The law firm of Shearer, Mette and Woodside, representing commercial and industrial customers, argues that transportation rates should be based only upon the cost of providing the service. The Industrial Energy Consumers of Pennsylvania (IECPA) and the Pennsylvania Industrial Gas Consumers (PIGC) support establishing a range of rates; however, they disagree with the specific range set out in the proposed regulations. In the view of these groups, the maximum rate should recover the costs of providing transportation service (this was the minimum rate in the proposed regulations). The minimum rate should be based only upon the short-run variable cost of providing transportation service.<sup>2</sup>

Commission's Response:

At the outset we note that we are amending this provision so that the regulations apply only to Class A and Class B gas utilities. This modification maintains the applicability of the regulations to the vast majority of potential transportation customers and limits the administrative burden to complete review of initial tariffs.

The LDCs seek to eliminate the minimum rate to give them more flexibility to respond in particular situations. We agree with this recommendation. It appears that a minimum rate is unnecessary because LDCs have a financial incentive to maximize the contribution from transportation rates. As PGA points out in its comments (page C-2), LDCs will not be able to obtain retroactive recovery from other customers of revenue

<sup>2</sup> This is the minimum rate set by the Federal Energy Regulatory Commission in Order No. 436, 50 Fed. Reg. 42, 408 (October 18, 1985).

shortfalls resulting from discounted transportation rates; moreover, the volumes and revenues attributable to transportation service will be reviewed prospectively during general rate case proceedings. Finally, the publication of a minimum transportation rate might have the undesirable side effect of hampering the LDC's ability to compete with alternative providers of energy services.

The industrial customers seek to establish cost of service as a ceiling on transportation rates. While this position has some merit, we decline to accept it. The transition from traditional public utility regulation to a more competitive natural gas industry must be made gradually. With these regulations, we are making it possible for many gas customers in the Commonwealth to take advantage of the competitive market for natural gas, thereby reducing their energy bills. We are concerned that establishing cost of service as a ceiling on transportation rates could lead to a precipitous decline in revenue from transportation service, thereby damaging the financial health of the LDC and raising the threat that costs will be shifted to sales customers.

With regard to PECO's argument that competition will force it to offer the minimum rate to all customers, we cannot halt all the forces of competition, we can only give PECO the tools to respond to that competition. Assuming that many of these customers are able to burn another type of fuel, it is preferable to keep these customers on the system, albeit at a lower rate, than to lose all contribution to the company's fixed costs. With regard to NFG's argument, we will address standby charges in our discussion under § 60.5.

#### § 60.2(6)

*The minimum rate shall be made available if the gas to be transported is produced from wells located within this Commonwealth.*

#### *Comments:*

Among the LDCs, only T.W. Phillips supports a mandatory cost of service rate for gas produced in Pennsylvania. Phillips supports this provision if it is amended so that the rate is available to LDCs which secure 50% of their system supply from Pennsylvania sources.

The mandatory cost of service rate for Pennsylvania gas was opposed by PGA, Apollo, Carnegie, NFG, Columbia, Equitable Gas Co. (Equitable), Pennsylvania Gas and Water Co. (PG&W) and the Peoples Natural Gas Co. (Peoples). The objections of the LDCs are best stated in the comments of PGA. PGA criticized the requirement that gas produced in Pennsylvania must be transported at the minimum rate. First, PGA asserts that this provision is an unwise policy which will subsidize Pennsylvania gas producers at the expense of the small customers of LDCs. The increased throughput which may result from charging this rate will not suffice to allow margins to be maintained; moreover, every mcf of Pennsylvania gas moved under the minimum rate represents a foregone opportunity to move interstate gas at a higher rate. On the other hand, PGA argues that the provision may be ineffective in stimulating Pennsylvania production, because out-of-State producers may lower their price to offset the difference in the transportation rates.

Finally, PGA argues that this provision constitutes an undue burden on interstate commerce in violation of Article I, Section 8 of the United States Constitution.

According to PGA, this provision constitutes exactly the type of economic protectionism which the commerce clause was designed to prevent.

The Commission's Bureau of Rates and the Office of Consumer Advocate (OCA) also oppose mandatory cost-based rates for Pennsylvania gas. The Bureau of Rates opines that this rate will benefit the producers at the expense of ratepayers. OCA states that the provision contradicts the Commission's overall purpose because it is discriminatory and it prevents the LDC from maximizing the contribution to fixed costs.

The Pennsylvania Natural Gas Associates (PNGA) and the Pennsylvania Oil and Gas Association (POGAM) support the cost of service rate for transportation of Pennsylvania gas. According to these parties, this rate will spur the exploration and development of Pennsylvania gas. Because it is close to markets in the State, gas produced in Pennsylvania will be cheaper to deliver and will be more reliable in the event of a gas shortage. Also, the cost of service rate will help prevent industries from switching to alternate fuels, from bypassing the LDC or from moving to other states. PNGA and POGAM also argue that the provision would not unduly burden interstate commerce. They argue that the requirement that the rate for transporting gas produced in Pennsylvania be set at the utility's cost of service is constitutional because it is supported by legitimate State objectives which outweigh the minimal burden on interstate commerce.

The Commission's Bureau of Conservation, Economics and Energy Planning (CEEP) also supports this provision. CEEP points out that the Commonwealth will lose tax revenue as customers switch from sales to transportation, because transportation service is not subject to the gross receipts tax. By stimulating gas exploration, drilling and production in Pennsylvania, this provision will help offset some of this tax loss. Sun Exploration and Production Company, an out-of-State producer, urges the Commission to extend the mandatory cost of service rate to gas which does not originate in Pennsylvania.

#### *Commission's Response:*

This issue is one of the more difficult to resolve in the instant rulemaking. We indicated in our order issuing these regulations for comment that Pennsylvania natural gas has a unique value. That value lies in the proximity of the gas to market areas and the fact that LDCs, which we regulate under the Public Utility Code, may in many instances constitute the only carrier necessary to bring this commodity to end users. This is a very important consideration given that the Natural Gas Policy Act and the Natural Gas Act are strong influences upon the quantity and price of natural gas reaching Pennsylvania from out of State. Our experience with gas cost recovery proceedings in the early 1980's tells us that these Acts of Congress can work together to bring Pennsylvania consumers the combination of natural gas at very high prices and, at the same time, excessive supplies of gas. This was not the intention of Congress when the NGPA was passed. That intention was largely aligned with the needs of the nation to have sufficient quantities of gas available at market prices.

Market forces and the implementation of additional provisions of the NGPA have mitigated the high pipeline prices paid by Pennsylvania LDCs. We have not yet seen, however, whether the NGPA will work to provide sufficient supplies of gas as excess deliverability declines

on pipeline systems. Supplies are currently adequate, we expect and hope that they will continue to be adequate. Nevertheless, it is our obligation to consider and implement policy that gives some consideration to Pennsylvania's ability to cope with a natural gas shortage.

PNGA and POGAM have provided disturbing information regarding the health of the natural gas production industry in Pennsylvania. We learn that "... during the period of June 1986 only 168 well drilling permit applications were received by the Department of Environmental Resources... compared with approximately 418 permits *actually issued* for the same period in 1985". These producer organizations also advise us that "planned drilling activity is down in Pennsylvania" and that "[f]ailure to finalize Section 60.2(6) as proposed, could lead to a significant reduction in the number of new gas wells being drilled and, perhaps more important, lead to a dismantling of Pennsylvania's natural gas exploration and development industry". These comments concern us in relation to Pennsylvania's ability to weather any pendulum swings of natural gas supply and demand that may develop.

We agree with PNGA and POGAM that "[t]he Commonwealth has a vital interest in conserving and developing its own energy reserves so that, in a time of shortage, emergency, or peak usage, the health, welfare and safety of its residents (sic) will be protected". The ability of Pennsylvania gas to reach market in a timely fashion in period of increasing demand and in the wake of a dismantling of the natural gas production industry, is a definite source of concern for us.

At the same time we note these concerns about the future availability of Pennsylvania gas, we must also note that we will not aid Pennsylvania's gas consuming residents by resolving these concerns through an illegal action. PGA and several LDCs have cautioned us that explicit discrimination in favor of Pennsylvania natural gas supplies is of doubtful constitutionality. These commentators have suggested that § 60.2(6) would constitute an impermissible interference with interstate commerce. The LDCs have argued that the regulation is the very type of state action struck down by the United States Supreme Court in such cases as *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 104 S. Ct. 3049 (1984) or *Baldwin v. G.A.F. Sielig, Inc.*, 294 U.S. 511, 55 S. Ct. 497 (1935). It is argued that a rule of per se invalidity should apply in the case of Section 60.2(6). *New England Power Company v. New Hampshire*, 455 U.S. 331 102 S. Ct. 1096 (1982).

PNGA and POGAM have contended that the more liberal test of *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 90 S. Ct. 844 (1976) should be applied to the regulation. This test, applied in *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 103 S. Ct. 1905 (1983), is more liberal because it evaluates the legitimacy of the local interest of the state and balances it against the degree of interference with interstate commerce.

We do not wish to enact barriers to interstate commerce through our regulations. Moreover, our effort to spur the transportation of natural gas in Pennsylvania will not be aided by a cloud of illegality over this rulemaking.

Interestingly PGA advises us that our regulation has a disadvantage beyond illegality—it won't work. This commentator states that "... the interstate gas suppliers have lower wellhead prices and transportation rates

applicable to those supplies can be bid down to a point where interstate gas *will get the sale and* the distribution utility will still enjoy a higher transportation rate". PGA also suggests that "[t]he true economic effect of the special rate will be to favor *interstate* production and actually injure Pennsylvania gas producers". We also recall at this time the view expressed by PECO regarding the likely outcome of a range of rates approach to transportation service:

PECO believes that a "range of rates" for transportation services is inappropriate for an LDC. The comments of the PGA are correct in their description of how this proposal will cause all rates to be forced to the minimum level.

PECO informed us that we had proposed a "flexible rate" which is "predestined to be implemented at its minimum level".\* This is a very relevant observation given our preference for elimination of the floor rate in the proposed range of rates.

If PGA and the LDCs are correct, our designation of a cost of service rate for Pennsylvania gas combined with eliminating the floor rate provides Pennsylvania producers with a very minor advantage over out-of-State gas; it may in fact provide no advantage whatsoever. We will therefore determine that Pennsylvania gas should be transported by LDCs at a rate no higher than a cost of service rate.\*\* The transportation rate for Pennsylvania gas can be lower than cost of service and the rate associated with interstate gas may also be lower than a cost of service rate. The cost of service rate would be a fixed point in the new expanded range of rates. If the commentators are correct that rates will move toward the minimum charge, transporters of Pennsylvania gas may gain no advantage and many of the transactions originating out of State may occur at or below the cost of service rate.

Thus the overall effect of this regulation, as modified, may be to infringe in no way on the amount of interstate gas that would otherwise be transported by Pennsylvania LDCs if § 60.2(6) did not exist. In PGAs view, limiting the transportation rate for Pennsylvania gas may actually increase the appeal of interstate gas.

The overall impact of the regulation is crucial. In the view of the U. S. Supreme Court:

We have also recognized that there is no clear line regarding the category of state regulation that is virtually *per se* invalid under the Commerce Clause, and the category subject to the *Pike v. Bruce Church* balancing approach. In either situation the critical consideration is the *overall effect* of the statute on both local and interstate activity. (Emphasis supplied).

*Brown-Forman Distillers v. N.Y. State Liquor Authority*, \_\_\_ U.S. \_\_\_, 106 S. Ct. 2080, 2084 (1986).

The advantage provided to Pennsylvania producers through the regulation, as modified, is a mere potentiality. In the view of PGA, it provides no actual advantage to Pennsylvania producers because of the ability of interstate gas to compete. We hope that Pennsylvania production remains available as a resource to Pennsylvania consumers of natural gas. We also recognize the protectionist action is not in the interest of Pennsylvania ratepayers or anyone interested in the implementation of

\*Columbia of Pennsylvania concurs in this position by stating "[i]f the Commission's final transportation rule requires a minimum or floor transportation rate for Pennsylvania produced gas, it is likely that most transportation arrangements, including gas from interstate sources, will move toward the minimum charge".

\*\*The cost of service rate should be specified in each tariff.

an effective transportation program in the Commonwealth. We hope our action today strikes the correct balance between Pennsylvania interests and the interests of the nation.

§ 60.2(7)

*Transportation service shall be provided under a contract between the jurisdictional natural gas utility and the customer. The contract terms shall be consistent with rates and rules found in the natural gas utility's tariff. Contracts shall be effective for no less than a 12 month period. The rates set shall recover, to the maximum extent possible, the fixed costs associated with the service.*

*Comments:*

Apollo, Carnegie and NFG all argue that the 12-month minimum term should be eliminated. Apollo and Carnegie use the example of an asphalt plant requiring seasonal service and ask whether a contract with a term of 12 months which provides service for 3 months qualifies under the regulations. Finally, Apollo and Carnegie suggest that the term "customers" be broadly defined to permit a LDC to be considered a customer of another LDC for transportation purposes.

IECPA and PIGC state that the minimum contract term should be shortened from 1 year to 1 month. If the minimum term is longer than 1 month, IECPA advocates allowing the customer to switch sellers under the contract. IECPA further comments that the language stating that rates should recover fixed costs to the extent possible is preferable to the language establishing the maximum rate in § 60.2(3).

Shearer, Mette and Woodside states that this subsection should be amended to allow for monthly transportation amounts or levels. This amendment is necessary to make transportation service viable for customers whose seasonal usage fluctuates.

*Commission's Response:*

With regard to the 12-month minimum contract period, it is necessary to balance the benefits of giving LDCs stability in regard to the amount of transportation service provided with the benefits that accrue to customers from short term transactions. The ground rules should be clear to LDCs and customers. We believe the best resolution of this controversy is to amend this provision to state that contracts may be effective for less than 12 months where both the LDC and the customer agree to a shorter term. If the customer desires a 12-month contract, the utility shall agree to this.

We agree with Apollo and Carnegie that the term "customer" should be broadly defined. We believe a restrictive interpretation of our regulations at this point in the evolving revolution wrought by FERC Order 436 ill serves the public interest. We stress that this Commonwealth's intrastate transportation programs are intended to compliment FERC Order 436 transportation programs. We anticipate a truly sophisticated natural gas intrastate transportation network will result from this broad interpretation and this sophistication can only result in increased movement of both out-of-State and Pennsylvania-produced gas. Consequently we will grant the request of Apollo and Carnegie that an LDC could be a transportation customer.

We see no need, however, to specifically define the term "customer". Our discussion should be sufficient

evidence of our intent to apply a broad interpretation to this term. We believe any further action by this Commission may negate the innovative spirit of these regulations. Finally, we believe that any concerns associated with a broad application of this term can be resolved in applicable future proceedings.

§ 60.2(8).

*A natural gas utility shall provide transportation service in a manner and according to terms which maximize system throughput.*

*Comments:*

Several LDCs (Apollo, Carnegie, NFG and PECO) object to this provision because, in their view, it conflicts with another goal of the regulations—to maximize the contribution provided by transportation rates to the LDCs' fixed costs. NFG states that transportation terms and rates should be designed to meet competition, though this might constitute discrimination in violation of § 60.3(a). PECO states that this provision should be deleted or clarified. The main goal, according to PECO, should be to maximize cost recovery.

*Commission's Response:*

We do not believe that maximizing system throughput is necessarily in conflict with the goal of maximizing contribution to fixed costs. The main goal is to maximize cost recovery, but this cannot be achieved unless the LDC transports a substantial quantity of gas. In response to NFG's comments, we indicate that an LDC may base its rate to a given customer upon competitive considerations, as long as the rate falls within the range set out in § 60.2(3) and (4). Therefore, we will retain this provision.

§ 60.2(9)

*The tariff may not unreasonably restrict Pennsylvania natural gas producer access to gas utility facilities.*

*Comments:*

This provision is supported by Apollo, Carnegie and NFG. Apollo and Carnegie believe that some LDCs have been able to hinder the transportation of natural gas by transporting only retail sales gas released by an affiliate of the LDC. They request that the final regulation clearly prohibit the granting of any affiliate preference in access to a LDC's system.

PNGA and POGAM support this provision, stating that it will give Pennsylvania producers access to LDCs through gathering, distribution or transmission facilities, and that this will allow the producers to take advantage of their close proximity to utility markets. IECPA also supports this provision but they would expand it to include out-of-State producers as well.

*Commission's Response:*

The concern of Apollo and Carnegie is alleviated by the requirement in § 60.3(a) that transportation service be provided without discrimination as to type or location of customer. We decline to extend this provision to out-of-State producers, as suggested by IECPA, only because they will not normally be attempting to gain direct access to the LDC's facilities. However, if the situation were to arise, we would not permit an LDC to unreasonably restrict an out-of-State producer's access to the LDC's facilities.

§ 60.2(10)

*The tariff shall offer firm transportation service as well as service that is subject to distributor interruption.*

*Comments:*

NFG, Columbia, Peoples and Penn Fuel Gas Co. (Penn Fuel) disagree with the requirement that LDCs must offer both firm and interruptible transportation service. They argue that the LDC should have the choice of offering interruptible service based upon the capacity of its system. For example, Penn Fuel, Columbia and Peoples argue that they have sufficient capacity to offer firm transportation service to all customers. Columbia points out, however, that capacity may be a problem for transporting gas through interstate pipeline; therefore, the LDC's tariff should provide for passing along to the end user the reservation fee which the LDC pays an interstate pipeline. IECPA supports the requirement that LDCs offer both firm and interruptible service.

*Commission's Response:*

We agree with the LDCs that the regulations should not require every LDC to file interruptible transportation rates. The rationale for an interruptible transportation rate is that there may be times when the LDC's facilities will be filled to their capacity, requiring interruption of the service of the interruptible transportation service customer. In recognition of this possibility, interruptible transportation rates traditionally recover only the variable costs of providing the service; they do not recover any of the LDC's fixed costs. However, where an LDC's system rarely, if ever, runs at full capacity, then there is no practical difference between interruptible and firm service. Requiring an LDC to offer interruptible service in this latter situation would, without economic justification, absolve the customer of its responsibility for any of the LDC's fixed costs. Of course, LDCs which do have capacity constraints remain free to file interruptible transportation rates.

With respect to Columbia's comment, nothing in these regulations prohibits an LDC from filing a tariff which provides for recovery of a reservation fee which the LDC pays to an interstate pipeline. Such a filing however does raise the issues of whether such capacity should be utilized to acquire lower cost supplies for retail customers or whether the capacity is unnecessary.

§ 60.2(11)

*The transportation service tariff shall specify that the distribution utility makes no guarantee against, and assumes no liability for, interruption caused by third parties.*

*Comments:*

Columbia believes this condition may be unnecessary if a reservation charge is paid to the interstate pipeline for capacity on that system. NFG agrees with the rule to the extent that under § 60.5 a customer need not select standby service, however, NFG does not believe that standby service should be optional.

*Commission's Response:*

Neither of these comments calls for deleting or amending this provision; therefore, we will adopt it as proposed.

§ 60.2(12)

*The location of entry points necessary for the introduction of customer owned gas into the natural gas utility's facilities shall be determined by each natural gas utility.*

*Construction necessary to accomplish each natural gas connection will be conducted by the natural gas utility or under its supervision at the customer's expense. The natural gas utility shall own and maintain each natural gas connection.*

*Comments:*

NFG, Peoples and Columbia all support this provision. Apollo and Carnegie ask the Commission to add language stating that all LDC interconnections are available for transportation unless the LDC shows compelling reasons to the contrary.

*Commission's Response:*

We do not necessarily disagree with the comments of Apollo and Carnegie that LDC interconnections should normally be available for transportation. However, since we did not seek comments on this specific issue, we do not know what arguments could be raised against it. Therefore, we will not add the requested language.

§ 60.2(13)

*Natural gas owned by the transportation service customer shall be considered the last gas through the meter when delivered to the customer's premises.*

*Comments:*

The LDCs are split on the issue of priority of gas through the meter. PG&W agrees with this provision. NFG agrees that transported gas should be considered last through the meter, but only for billing purposes, not for the purposes of determining whether customer-owned gas injected into the LDC's system has been received by the customer.

Peoples disagrees with this provision, arguing that transportation gas should be considered the first gas through the meter. In Peoples' view, the customer prefers to take the cheaper source of gas first. Moreover, to bill for retail services first, a customer would be required to nominate maximum daily and monthly retail volumes.

PECO and Columbia disagree with the provision, arguing that the Commission should not mandate any particular sequence of gas through the meter because of differences in various LDC sales services which are available. PECO explains that it is only appropriate to consider transportation gas last through the meter when the customer's rate schedule provides for a fixed maximum daily quantity (MDQ), such as PECO's firm rate L. However, where the customer's load is served under an open-ended rate schedule, such as PECO's Interruptible Rate IS, it is simpler to treat transportation gas as first through the meter.

Apollo and Carnegie disagree that transportation gas should always be considered last through the meter. They suggest that firm sales gas should be first, firm transportation gas should be second and interruptible transportation and general service or interruptible sales gas should be last.

The industrial customers (IECPA, PIGC and Shearer, Mette and Woodside), oppose this provision, arguing that customer-owned gas should be considered first through the meter. IECPA argues, alternatively, that the shortfall in the customer's purchases should be apportioned pro rata to both services. IECPA also states that when a customer chooses to meet its full requirements by transportation, the transported gas should be considered first through the meter—whether the customer has elected standby service or not.

PIGC states that this provision would encourage customers to meet all of their requirements through transportation because this is the only way they can be sure of getting the benefits of their own lower priced gas. Furthermore, the provision undercuts the standby service concept, because the utility and the customers can agree upon different levels of standby service.

*Commission's Response:*

As we expected, the question of priority of gas through the meter has proven to be a controversial issue. As we stated in our proposed rulemaking, our reason for providing that transported gas would be last through the meter was to compensate the LDC when it is placed in the involuntary role of retailer, 16 Pa.B. 2144. Thus, the rule was designed to protect the LDCs. The LDCs, however, do not all agree that they need this protection in every case.

The issue of priority of gas through the meter only arises when a customer has elected a mix of both transportation and retail service to meet its normal requirements. After reviewing carefully the comments of Peoples, PECO and Columbia, it now appears to us that the resolution of this question probably should turn on the type of rate under which the customer is taking its retail service. Thus, under a rate which provides for a fixed maximum daily quantity, transported gas should be considered last through the meter. This will help to avoid situations where the customer pays for gas from the LDC which the customer did not actually consume.<sup>3</sup> However, where the customer's sales service is under an open-ended rate schedule, transported gas may be considered first through the meter. This helps to relieve LDCs of the burden of balancing customer owned supplies which remain in the LDC's system.

Rather than attempting to craft a rule to govern all cases, we believe it is most expedient to delete the provision from the regulations and to address the question when reviewing the tariff filing of each LDC.

§ 60.2(14)

*The transportation service customer shall agree to sell its natural gas supply to the natural gas distribution utility at the higher of the natural gas utility's average cost of gas or the customer's own cost in the event of a distributor natural gas supply shortage. A natural gas shortage exists when the supply of gas is insufficient to meet the requirements of priority 1 customers as specified in § 69.21 (relating to priority of service) on a continuing basis or when continued delivery of gas to customers would prevent the injection of gas into underground storage pools for the protection of winter supply, such that service to priority 1 customers is threatened. The customer shall demonstrate its cost of natural gas by making a copy of the contract with the natural gas supplier available to the gas utility upon request.*

*Comments:*

The LDCs (Apollo, Carnegie, NFG, Peoples, Columbia, PECO) generally agree with this provision. Apollo and Carnegie suggest that invoices can be used to demonstrate the customer's cost of gas, and that the customer's cost should be deemed to include transportation and shrinkage charges paid by the customer to a transporter other than the LDC. They also suggest that an LDC should have the option of returning a like amount of gas

<sup>3</sup> It is our understanding that the customer pays for a certain amount of gas, whether he takes it or not, under a rate schedule containing a fixed maximum daily quantity.

to the customer within 6 months rather than purchasing the gas. Peoples recommends that the price to be paid for the gas use should be either the average cost of gas (as determined by the LDC's section 1307(f) rate) or the customer's own total delivered cost to the LDC's system.

PECO recommends allowing the LDC to appropriate the customer's gas only if alternative sources of supply have been exhausted and curtailment of all noncritical load has been accomplished. PECO believes that appropriation must be restricted to these extreme situations or transportation customers will have an incentive to bypass the LDC.

IECPA states that the price which the utility pays the transportation customer for this gas should be based upon the cost of the customer's alternative fuel in order to compensate the customer. At least, according to IECPA, the price should be the higher of the customer's cost or the utility's weighted average cost.

*Commission's Response:*

The second sentence of this paragraph which defines when a natural gas shortage exists, was added under the order issued by IRRIC. A further clarification is the inclusion of the word "weighted" in the first sentence.

This provision requires the LDC to pay the higher of the customer's cost or the LDC's own weighted average cost when it appropriates the transportation customer's gas due to a supply shortage. This subsection was inconsistent with § 60.7(a), which had provided that the LDC should pay the lesser of these two amounts in this situation. IRRIC had reconciled these conflicting provisions by directing that we change "less" to "higher" in § 60.7(a). However, we now believe it would be better to simply delete § 60.7(a).<sup>4</sup>

Most of the LDC's comments address questions which do not call for changes in this regulation. If the LDC is content to examine an invoice instead of a copy of the transportation customer's contract, this is a matter for the LDC and the customer to decide. We do not necessarily disagree that the customer's cost should be deemed to include transportation and shrinkage charges paid by the customer to a transporter other than the LDC; however, we do not think it is advisable to include this in the rule and completely foreclose the issue. Utilities should specify, in their tariff rules, conditions or circumstances under which the cost of gas should not include shrinkage or transportation charges. Hopefully, the appropriation of gas will rarely, if ever, occur. With regard to PECO's comment, nothing in this rule prevents PECO from searching for alternatives before it appropriates the transportation customer's gas due to a shortage.

§ 60.2(15)

*The natural gas utility may retain a reasonable allowance of customer owned natural gas for gas which is lost or unaccounted for in its operations.*

*Comments:*

NFG and Columbia agree with this provision. Apollo and Carnegie would add the phrase "compressor fuel" to the end of this paragraph. Peoples would change this provision to read "gas which is used in company operations or unaccounted for gas."

<sup>4</sup> § 60.7(b) is also being deleted because it is not necessary to specify the interruptible transportation customers may be interrupted due to a capacity shortage; this is the essential nature of interruptible transportation service. (See the narrative under § 60.2(10)). The new § 60.7 will now address balancing.

*Commission's Response:*

We will adopt this subsection as proposed because the commentators have not fully explained this importance or necessity of their proposed revisions.

§ 60.2(16)

*Representative levels of transportation service shall be set for each jurisdictional natural gas utility in every proceeding under 66 Pa.C.S. § 1308 (relating to voluntary changes in rates).*

*Comments:*

Apollo and Carnegie believe the term "proceeding" should be preceded by the phrase "general rate" because there are many tariff changes made under section 1308 which are unrelated to overall revenue or sales levels. NFG believes parties to a base rate proceeding should be able to advance any approach to the treatment of transportation revenues that they deem appropriate. NFG feels the above provision is too restrictive. Peoples accepts this provision as long as revenues are not calculated upon the maximum transportation rate.

*Commission's Response:*

We accept the suggestion of Apollo and Carnegie to clarify that this provision applies to general rate proceedings, as provided in 66 Pa.C.S. § 1308(d). This change is consistent with our intention in adopting the proposed regulation. With respect to NFG's comment, we believe that examining levels of transportation in rate cases is the preferred approach; unusual circumstances can be handled through petitions to waive the regulation. With respect to Peoples' comment, revenues will only be calculated upon the maximum rate if it appears, based upon the record, that the utility was able to market its transportation service at the maximum rate.

§ 60.3. *Eligibility for natural gas transportation service.*

*(a) Transportation service shall be provided without discrimination as to type and location of customers. A natural gas utility shall state in its tariff the minimum volume of transported gas that entitles a customer to transportation service. These volumes shall be set at a level which maximize the number of customers that can receive transportation service while permitting the natural gas utility to effectively and efficiently manage its natural gas distribution system.*

*Comments:*

NFG believes this provision prohibits an LDC from establishing an rate design to retain load. NFG submits that an LDC should be permitted to reduce margin on both retail sales and transportation services if it would allow for retention of customers. In addition, NFG agrees that minimum volumes should be set to ease administrative problems. Peoples would add the phrase "as long as capacity exists" to the first sentence to reflect the finite nature of capacity.

IECPA and Shearer, Mette and Woodside support the requirement that LDCs provide transportation service without discrimination as to the type or location of customer. PIGC argues that the regulations should state that LDCs may not refuse to transport gas on the grounds that it displaces their sales. PIGC further argues that whenever an LDC refuses to transport gas for reasons other than capacity limitation, the LDC should bear the burden of proving an absence of

discrimination. PIGC also stated that minimum volumes should be established generically in the regulations rather than being established in each LDC's tariff.

*Commission's Response:*

With respect to NFG's comments, the prohibition against discrimination would not prevent an LDC from reducing its margin to the minimum rate where necessary to retain the customer. This type of rate discounting is legitimate under these regulations. With respect to Peoples' suggestion, we decline to accept the proposed language because the issue of capacity constraints can be addressed if it ever arises by reference to general principles of utility law. There is no reason to specifically qualify the right to transportation service.

We decline PIGC's suggestion to amend the regulation to allocate the burden of proof on the discrimination question because we cannot foresee every factual situation in which discrimination will become an issue. We continue to hesitate to set a minimum volumetric amount due to the possibility that a utility in the Commonwealth could accommodate a transportation customer at a lower volume.

*(b) The tariff shall permit individual customers or groups containing no more than three customers to be eligible for transportation service.*

*Comments:*

NFG believes the provision is appropriate. PG&W, Apollo and Carnegie believe that permitting buyer's groups will create inefficiency and will make transportation programs more difficult to administer. Columbia submits that none of the individuals in a customer group should be permitted to request transportation below a certain minimum level.

IECPA opposes limiting buyer's groups to no more than three customers, because allowing larger groups would spread the benefits of transportation service among a wider group of customers. If the LDC claims that there are extra administrative costs associated with transportation for small users, the LDC can impose a flat customer charge provided it documents the additional costs. The three customer limitation was also opposed by OCA and by Gerald L. Bowman, a consulting engineer, because it prevents small users from forming coalitions to purchase and transport gas.

*Commission's Response:*

Most of the LDCs view buyers' groups with disfavor, while customers argue that the three customer cap should be lifted. Resolution of this question requires us to balance potential benefits to customers against the administrative costs to the LDC. We believe the best resolution of this issue is to retain the present language, but to provide that larger customer groups will be permitted where the LDC and the customers agree.

*(c) Gas injected into the natural gas utility's system shall be of a quality and pressure that is acceptable to the utility.*

*Comments:*

Columbia agrees with this provision. IECPA recommends revising the provision to provide that "the gas shall be of a quality and pressure which is reasonably acceptable to the utility." Insertion of the word "reasonably" would prevent utilities from discouraging transportation service under the guise of quality and pressure standards.

*Commission's Response:*

We agree with IECPA's reasoning and will insert the word "reasonably" in this subsection.

*§ 60.4. Rebuttable presumptions.*

(a) *There shall be a rebuttable presumption in the rate proceeding of a natural gas utility governed by 66 Pa.C.S. § 1308 (relating to voluntary changes in rates) that additional fixed costs may not be recovered from remaining retail customers due to retail customers' use of transportation service.*

*Comments:*

PGA opposes this rebuttable presumption. According to PGA, the use of legal presumptions is inappropriate because the presumptions are not based upon a sound public policy or the probability of a particular fact. In a nutshell, PGA argues that the increased revenue from an LDC's transportation service probably will not offset the losses to its sales service, and that this revenue loss must be recovered from the remaining sales customers because the LDC was not culpable.

Many of the LDCs echo the fears of PGA. Specifically, Peoples believes the presumptions should be eliminated and adopts as its rationale that of the PGA. Similarly, NFG contends this presumption should be eliminated and argues that fixed costs should be allocated to sales and transportation services on an equal basis. Equitable, likewise, maintains that an LDC's rate design should assign cost responsibility based upon the level of service provided to a customer. According to Equitable, customers who more fully utilize a service should pay for that level of service.

Columbia contends the presumption is unwarranted and counterproductive. It foresees the shifting of fixed costs unless substantial new transportation markets develop. Columbia considers this development highly unlikely to occur.

IECPA and PIGC are concerned that the presumptions will prevent implementation of cost-based transportation rates. In lieu of this presumption, IECPA suggests a presumption that the costs related to any LDC service should not be recovered from customers receiving other LDC services.

PNGA and POGAM state that the rebuttable presumptions neither add to nor detract from the utility's burden of proof when it seeks a rate change. Moreover, they state that utility sales have been declining and that further declines will not be attributable solely to the adoption of market-oriented transportation rates.

OCA supports the presumptions but cautions that the effectiveness of the presumptions cannot be gauged until the regulations are implemented.

*Commission's Response:*

Many commentators misperceive our intended use of this presumption and mistakenly believe the presumption is irrebuttable. It is our intent that the rebuttable presumption is just that: an LDC is never precluded from adducing evidence effectively rebutting the policy that cost shifting should not occur as a result of the rendition of transportation service. We do not intend this language to require a specific conclusion in every section 1308 base rate proceeding. This presumption merely recognizes that a LDC has a heavy burden of

proving that costs<sup>8</sup> must be shifted to retail customers as a result of a LDC's offering of transportation services. Evidence sufficient to rebut the presumption may be produced and reflected in a properly developed record. This presumption is only a further articulation of the Public Utility Code standard that rates be just and reasonable.

We also disagree with those commentators who suggest that this rebuttable presumption is not founded on a proper policy standard. It is our policy, correct from public interest and economic standpoints, that the rendering of transportation service should not harm remaining retail sales customers. These customers, who we believe will be predominantly residential and small commercial customers, will not possess the ability to independently access other natural gas markets other than through their LDC supplier. Consequently they should not be further penalized by the additional detriment of unjustified cost shifting by their LDC.

Another valid basis for this rebuttable presumption is the fact that while these regulations establish a general policy of encouraging gas transportation, the ultimate effect of the regulations upon an LDC is largely within the control of that LDC. For example, the LDC has some flexibility in choosing which rate—within a permissible range—will be offered to a particular end user. Since the effectiveness of the gas transportation program is largely within the LDC's control, it is appropriate to require the LDC to demonstrate that cost shifting is necessary and appropriate.

We will adopt as our final rule this rebuttable presumption. We caution LDCs that we will not countenance unjustified cost shifting and we will examine with a discerning eye any foregone opportunities under FERC Orders 436 and 436-A.

(b) *There shall be a rebuttable presumption in a proceeding governed by 66 Pa.C.S. § 1307 (relating to sliding scale of rates; adjustments) that natural gas supply fixed costs relating to transportation customers should not be recovered from sales customers.*

*Comments:*

PGA, NFG and Penn Fuel state the FERC Order 436 contract reduction right underlying this presumption is not a valid basis for the presumption. This is so because the LDC's reduction right with its interstate pipeline suppliers is not likely to coincide (both in time and magnitude) with the reduction of its retail sales as customers switch from sales service to transportation service. Furthermore PGA argues that because of uncertainty regarding the future availability and cost of gas, reduction of the LDC's contract demand rights can only be exercised with an abundance of caution. Large reductions in an LDC's contract demand rights would be contrary to the LDC's public service obligation.

Columbia contends that it retains the public utility obligation to serve even those transportation customers who do not elect standby service. Consequently it may be unable to reduce contract demand because it must maintain adequate supplies and thus must be permitted to collect this cost from either the transportation customers or the remaining sales customers.

Apollo and Carnegie maintain that as a general proposition, there are no natural gas supplier fixed costs

<sup>8</sup> By additional fixed costs we mean those costs presently incurred by the LDC to serve transportation customers as retail customers. It may be proposed that these "sales" costs be shifted to customers who do not elect transportation service. It is these costs that should not be shifted to remaining retail sales customers as costs in addition to those already allocated to them for retail sales service.

associated with transportation service. They contend the only exception are fixed costs associated with standby sales service.

*Commission's Response:*

We disagree with those parties who argue that our awareness of FERC Orders 436 and 436-A reduction/conversion rights as a basis for the presumption is misplaced. Through this rulemaking we intend to open new natural gas markets to industry and LDCs in this Commonwealth. Our intent is supported and complemented by FERC Orders 436 and 436-A. For us to ignore the new regulatory environment created by these orders would amount to a dereliction of our duty to assure that public utilities operate in the public interest. We desire to send a clear and strong signal to LDCs that we intend for them to be active and full players in this new arena as a continuing extension of the Legislature's mandate that they operate under a least cost fuel procurement policy. Our LDCs are on notice that we intend to closely scrutinize their use of cost saving opportunities under Orders 436 and 436-A. We are not confiscating utility property by the use of this presumption. There are many ways a LDC may reduce its costs and these orders are just one method. We are merely stating the LDCs bear the economic risk of their activities under this new regime.

*(c) In determining the natural gas utility's ability to serve a firm transportation customer, there is a rebuttable presumption that sufficient capacity in the utility system exists.*

*Comments:*

NFG was the only LDC submitting specific comments on this aspect of the regulations and it concurs in the appropriateness of this provision. PGA comments that this presumption should apply only with respect to a request for transportation service by existing firm sales customers while IECPA and PIGC support this presumption; IECPA would expand it to include interruptible service.

*Commission's Response:*

Again, we reiterate that this provision is not a conclusion but rather a presumption that can be rebutted by sufficient convincing contradictory evidence. We see no need to limit its application to only existing firm sales customers and believe such an approach will not achieve our goal of maximizing throughput. We believe IECPA's comments are resolved by the mandatory nondiscriminatory nature of transportation service.

We will, however, modify the proposed regulation to meet changes completed in other portions of these regulations; specifically § 60.2(4) and (10). Therefore we will delete the word "firm" so as to reflect our belief that there may not be a need to distinguish between the quality of transportation service; we will allow LDCs to address the level of services in individual tariffs.

§ 60.5. Standby sales service.

*Standby retail service shall entitle a transportation service customer to purchase natural gas at tariffed retail rates and shall be made available to transportation service customers subject to the following conditions:*

*(1) The transportation customer and the natural gas utility shall agree upon the maximum sales volumes that will be provided upon the request of the customer. Volumes taken in excess of this amount will require the payment of a penalty.*

*Comments:*

IECPA, PG&W, PECO, Penn Fuel and Columbia support the provision that transportation customers should be permitted to contract for a specified amount of standby sales service. Penn Fuel and Columbia, however, would limit this service to only dual fuel customers; both believe it would be inappropriate to permit nondual fuel customers to elect standby service. In addition Penn Fuel believes the so-called gas bubble will dissipate in a few years leaving a tight natural gas market in its wake. Customers who did not elect standby service will have caused the LDC to forfeit long term supplies either by contract reductions or by nonrenewal of long term contracts.

Penn Fuel goes on to state that industrial customers will be required to request Commission assistance to acquire necessary gas supplies. Meanwhile PG&W contends that it cannot provide standby service to interruptible transportation customers because it makes provision in its gas supply to provide service to interruptible customers on an as-available basis. PECO requests the Commission to disavow a standby sales service concept which is used by a transportation customer as a peaking service.

In contrast Equitable contends that LDCs should not be required to provide standby sales service; Equitable believes the supply of such service should be rendered on a voluntary basis. On the other hand NFG submits that standby sales service should be mandatory for all transportation customers until the LDC can avoid those costs by contract reductions with its suppliers.

NFG also requests that the Commission consider the ramifications of allowing customers to elect standby sales service. Specifically NFG believes the Commission should study the increased take-or-pay charges that may be incurred as a result of migration to transportation service and whether transportation customers not electing standby service should pay for those costs. NFG maintains that the Commission should examine the need for a reentry fee for transportation customers who do not elect standby service and desire retail sales service at a future date. NFG proposes a fee to recover any incremental cost of gas supply required to serve the customer as opposed to allowing the customer to enjoy the benefits of the LDC's rolled in pricing formula. NFG concedes the calculation of this fee may be difficult to accomplish because of the complexity of identifying incremental gas supply costs.

PIGC urges the Commission to clarify that a customer may select a mix of transportation and sales service without incurrance of a standby charge. However, where a customer selects such a mix of service, the customer should have the option of selecting a level of standby service to back up its transportation service.

IECPA believes the penalty for purchases above this level should only apply in peak periods and should be no larger than the penalty charged to a sales customer which exceeds its maximum contract quantities. Columbia also agrees that a penalty should be imposed for excess takes and contends it should reflect a careful determination by the customer. Apollo and Carnegie support the penalty provision if gas is unavailable for sale to the transportation customer. If gas is available, the penalty for excess takes should not be applied as it does not attempt to maximize throughput.

*Commission's Response:*

We reject contentions that standby service should be mandatory for all transportation customers or that it be

optional on the part of an LDC. We do not believe that either argument is consistent with our concept of the unbundling of the various services provided by a LDC. As we have already stated, several methods exist for the reduction of gas costs and we intend our LDCs to forcefully and actively explore those opportunities. We believe that the offering of a menu of services is appropriate in the new regulatory era created by FERC and is consistent with the requirement that LDCs operate under a least cost fuel procurement policy. The offering of unbundled services promotes competition and allows for the shedding of unnecessary costs by both the transportation customer and LDC. We emphasize again our intent to verify that LDCs effectively manage their fuel procurement programs. We are not persuaded that the continuation of a bundled service is in the public interest.

We also disagree with PIGC's argument that no charge should be collected for standby service. An unbundling of LDC services requires that the services be separately charged. A transportation customer who requests standby service should pay the costs necessary for the rendering of that service.

We will not take a position on the specific volumetric level necessary for the incurrence of a penalty. We believe such levels are best established by each LDC in recognition of the specific circumstances of each LDC's operating system.

*(2) The rate charged for standby service shall recover natural gas supply fixed costs incurred to maintain natural gas supply for the transportation customer. Revenues for standby service shall be credited against natural gas costs in a proceeding under 66 Pa.C.S. § 1307 (relating to sliding scale of rates; adjustments).*

*Comments:*

PGA does not object to the concept of standby service as long as the rate recovers gas supply demand charges, other interstate pipeline billings appropriate for the transportation end user, plus other costs based on the volume reserved. Likewise Apollo, Carnegie and T. W. Phillips believe the standby sales service rate should provide recovery of pipeline demand charges (Apollo and Carnegie refer to this as natural gas supply fixed costs). In addition T. W. Phillips, Equitable and Penn Fuel would add minimum commodity bills to the components of the standby sales service rate. Equitable, Apollo and Carnegie would also consider the standby sales service rate as a means of recovering fixed costs associated with facilities to provide standby sales service. Equitable also maintains that the standby charge should include fixed costs associated with maintaining entitlements to provide standby service.

In a similar vein T. W. Phillips suggests that it may be difficult to determine fixed costs incurred to maintain gas supply from Pennsylvania producers. T. W. Phillips asserts that a traditional standby charge will not assure the availability of sufficient production to meet a substantial standby obligation. T. W. Phillips seems to imply that local producers will not commit large reserves of natural gas unless there is some assurance of an adequate demand for that gas. As a solution, T. W. Phillips suggests that end-users be required to purchase 30% of their total gas requirements from an LDC with transportation gas comprising the remainder of its requirements, and that the standby sales service rate be designed to recover incentive payments to local producers who are shut in as a standby reserve.

PGA also urges that the Commission provide for the end user to pay a reservation fee to the LDC which would compensate the LDC for the reservation fee it pays to an interstate pipeline to reserve firm transportation capacity. For some customers, reservation of this pipeline capacity would be an alternative to standby sales service.

In regard to the crediting provision Apollo and Carnegie also maintain that system administrative and general costs, and system fixed costs collected in a standby service rate should not be credited against gas costs in a § 1307(f) proceeding. They also contend that LDC should be permitted to propose alternate accounting methods to reflect any distortion caused by the use of a standby service. Peoples believes that only costs related to gas supply should be credited under 66 Pa.C.S. § 1307(f).

Several commentators have raised certain policy considerations. For instance, NFG proposes that purchased gas demand costs be recovered from customers in proportion to their peak demands rather than as a rolled-in average amount per Mcf. NFG considers these to be the gas costs incurred to maintain gas supply. NFG believes the key to this provision will be a proper rate design and a proper cost allocation reflecting the various levels of utilization of the LDC's system.

PECO believes it will be easier to calculate a standby charge for a customer who requests the option to return to retail sales service upon expiration of a transportation contract. PECO contends, however, that calculation of a standby service as a peaking service for a transportation customer will be impossible to establish. Finally, PIGC urges that generic guidelines should be set for a standby sales service rate to assure that, when combined with the transportation rate, it does not equal a rate set under the discredited gross margin approach.

*Commission's Response:*

We do not believe it necessary at this time for this Commission to pass judgment upon the various elements to be included in a standby sales service rate. We only offer this directive: standby sales service rates must be cost based and reflect the actual cost of providing that service. LDCs are free to suggest what they consider are justifiable standby sales service costs.

As transportation tariffs are filed by LDCs, appropriate administrative procedures will exist for their scrutiny and challenge. Furthermore, because standby sales service rates are closely related to gas costs, an annual reexamination of the rate should occur in connection with § 1307(f) proceedings. The standby sales service rate will then be subject to examination by this Commission and other interested parties.

*(3) A natural gas utility maintains no duty to provide retail service to a transportation customer who declines to elect standby retail service.*

*Comments:*

IECPA argues that LDCs retain a duty to provide retail sales service to customers electing transportation services. Apollo, Carnegie, NFG, Peoples and Columbia fear they still retain the public utility obligation to serve those transportation customers who do not elect standby sales service (Apollo and Carnegie would consider this interruptible service).

Finally, PIGC comments that transportation customers not electing standby sales service should still be able

to purchase gas from an LDC without incurring a penalty if the LDC has gas available for delivery.

*Commission's Response:*

Many of the commentators have misperceived the thrust of this provision. This regulation is merely designed to reflect the fact that a LDC does not possess the duty to provide standby sales service to a nonelecting transportation customer. Any other interpretation is inconsistent with our notion of unbundling the services provided by LDCs. We believe, however, that some parity between the opportunities of retail and transportation customers to access firm supplies should be specified.

A transportation customer who does not choose standby service and suffers unanticipated interruption must incur the economic consequences of that decision. This is a business decision of the transportation customer and not the responsibility of the utility. We do intend, however, to hold LDCs responsible for supplying the service to those transportation customers who elect this option. On the other hand if gas is available for sale to a nonelecting transportation customer, then LDCs shall sell that supply to a transportation customer who requires that gas. The rate applied, however, might be higher than a conventional retail rate based on average gas costs. We do not intend, however, for LDCs to develop supply plans based on the assumption that they must serve customers who do not elect standby service.

We will add clarifying language to this regulation. After the phrase "natural gas supply fixed costs" we add the additional phrase "and any other costs (including storage service costs)" to reflect our change to the provisions of § 60.6(a).

§ 60.6. *Natural gas storage service.*

(a) *A tariff rate for optional natural gas storage service shall be available for use when the transportation customer fails to take delivery of the entire net volume of natural gas delivered to the distribution utility for the customer's account. The tariff rate for optional storage service shall reflect any contribution toward the utility storage costs made by the customer as part of the customer's transportation rate.*

*Comments:*

Certain commentators suggest that this language should be construed as meaning that storage service must be provided to transportation customers only if the LDC possesses storage capability. For example, PGA states that some LDCs may not have storage capability and urges that the regulation not be applied to such LDCs. Also included in this group are Apollo, Carnegie, T. W. Phillips, PECO, NFG and Columbia. The Commission's Bureau of Rates recommends the insertion of clarifying language to verbalize this effect.

Penn Fuel is unclear as to the Commission's interpretation of this provision and believes it may be construed to mean that:

(1) Penn Fuel may be required to sell FERC regulated storage service, which it believes will create legal problems, or

(2) Penn Fuel may be required to exchange gas over time as a means of providing storage service.

Several commentators have advanced positions on the design of storage service rates. Apollo and Carnegie suggest there should be a specific rate for each component of storage service. Along with PECO, they also

argue that the storage service rate should be fully allocated. On the other hand, Peoples maintains storage service is an integral part of a transportation system, and should be included in a transportation rate, not separately charged. Finally, NFG contends, storage service should be contracted for in advance and be paid regardless of whether it is actually utilized.

North Perin and PG&W urge that limitations as to volumes stored and the period of storage should be placed upon rendition of storage service.

*Commission's Response:*

Many commentators also misconstrue the intent of this regulation. We do not intend for this provision to require LDCs to create storage service capability that they do not presently possess. This regulation applies only to those LDCs who possess storage capability. We assume that once LDCs begin to reduce or convert contract demand with their various interstate suppliers, excess storage capacity should be available for use by transportation customers. We will not, however, venture a concrete regulation on the amount of capacity available for utilization by transportation customers. LDCs possess the ability to quantify this amount based upon their separate operating characteristics.

We also believe it is inappropriate at this time to specifically design storage service rates or to advance limitations as to its rendition. We will allow LDCs to propose such rates and limitations in their tariffs. Appropriate administrative procedures are available to anyone contesting storage services rates or the manner in which such service is provided.

We will modify the language of our regulation, however, to reflect our belief that the services and rates should be unbundled. Consequently, the term "transportation" shall be changed to the phrase "standby sales service." Before a rate is designed to recover the costs of storage service, the utility should recognize as a credit to those costs, any contribution to storage costs made by customers that elect and pay for standby sales service.

(b) *The customer's failure to elect the storage service option will entitle the natural gas utility to buy unused natural gas from the customer at a price equal to the utility's lowest cost gas or at the customer's cost, whichever is less. The customer shall demonstrate its cost of natural gas by making a copy of the contract with the supplier available to the natural gas utility.*

*Comments:*

Most commentators suggest that a balancing provision is necessary to supplement the rules on storage service. They suggest various time periods to allow for adjustment of transportation and/or storage volumes. Specifically the Commission's Bureau of CEEP, Columbia, PECO, T. W. Phillips and IECPA suggest that balancing occur on a monthly basis. Columbia also suggests that balancing may take place on a seasonal basis. PIGC suggests that balancing take place within a 2-month period while PGA argues for a 3-month balancing period. T. W. Phillip also adds that an LDC should be permitted to terminate a transportation contract if the customer fails to consume all transportation volumes for two consecutive months.

IECPA also advocates creating a balancing margin. The LDC's right to purchase the customer's gas or charge a storage fee would arise only if the customer overdelivered gas by an amount greater than the margin

and failed to remedy the imbalance within the following month. Although not related to storage costs, the balancing swing margin would also apply to situations where the customer withdrew more gas than it delivered into the utility's system.

Under IECPA's proposal, if the customer delivers more than 110% of its takes, and fails to remedy this imbalance by the following month, the LDC could either charge a storage fee or purchase the gas. If the customer delivers more than 130% of its take, and fails to remedy this in the following month, the LDC could either charge a storage fee, purchase the gas or interrupt deliveries into its system. If, on the other hand, the customer takes out of the LDC's system more than 110% of the amount it delivers into the system, and fails to remedy the imbalance in the following month, the customer would be required to purchase its takes in excess of the 110% at the LDC's sales rate. If the customer takes out more than 130% of the amount it delivers into the LDC's system, the LDC could charge the sales rate for the excess or it could interrupt the customer's takes until the account is balanced.

Several commentators also advocate policy considerations regarding a balancing mechanism. PECO suggests the preferable option, in lieu of storage, is for the transportation customer to negotiate delivery flexibility in a contract with a supplier. IECPA argues that where a customer has delivered too much gas into the LDC's system the customer should be given the opportunity to find another purchaser of the gas.

On another policy note, Equitable suggests that transportation customers causing supply imbalances with a LDC's supplier should be responsible for any costs associated with the incurrence of that imbalance. Further, Equitable submits that an over-supplied imbalance should be viewed as a storage service. Finally, Equitable suggests costs associated with an imbalanced-caused disruption that disables the least cost purchasing policy of an LDC should be borne by the culpable customer. Equitable believes the culpable customer should remit the difference between the cost paid to the supplier as a result of the disruption and the cost that would have been paid without the disruption.

Several commentators address the demonstration of the cost of a customer's natural gas supply. Both IECPA and Babcock and Wilcox recommend that proof of the transportation customer's cost of gas need not be demonstrated by submission of the entire sales contract. Rather, they believe that a sworn affidavit would serve the same purpose. Babcock and Wilcox goes on to suggest that the LDC should be required to retain an accurate record concerning the volumes of natural gas stored on behalf of a transportation customer.

#### *Commission's Response:*

Because of various concerns of the commentators that the Commission should consider adding a balancing provision, we shall add such language in a new § 60.7. We agree that equity requires that a LDC should be permitted to operate its system within reasonable bounds without any jeopardy to heat sensitive customers caused by the actions of transportation customers.

Our regulation, however, will not be fact specific or designed to apply to the multitude of various operational constraints of individual LDCs. The final regulation will be designed to reflect a skeletal approach with the LDCs permitted to flesh out various provisions to reflect operational considerations. We assume, therefore, that

some LDCs may be able to establish a higher margin of error for transportation customers who misjudge their needs or deliveries of transportation gas because of operational considerations.

On the other hand we recognize some LDCs may not be able to establish a similar margin of error because of operational constraints. We intend the balancing provision in an LDC's tariff to reasonably reflect a mechanism which adequately recognizes the operational capabilities of that LDC's system. Therefore, our regulation will only establish a minimum time period in which to permit the balancing of deliveries into and withdrawals from an LDC's system. We will permit LDCs to suggest the various margins of error they will permit and reasonable actions, if any, necessary to enforce the balancing mechanism.

We will modify the language of this regulation, however, to reflect the concerns of those parties who do not desire the submission of an entire gas supply contract as proof of a transportation customer's cost of gas. We will amend the language to permit the submission of a sworn affidavit as proof of the cost of gas. Thus new language, "... sworn affidavit of the cost of gas" will be added to the subsection. The option of the utility to purchase gas that is not balanced remains available as specified in § 60.6(b).

#### *§ 60.7. Priority status of transportation service.*

*(a) Service of transportation customers may not be interrupted unless a natural gas supply shortage for priority one customers is threatened. In the event of a natural gas supply shortage, the utility may purchase the natural gas of a transportation customer at a price equal to the utility's weighted average cost of gas or at the customer's costs, whichever is less.*

#### *Comments:*

NFG agrees with the language of this provision while PECO believes this provision should specifically refer to transportation customers. On the other hand Columbia prefers the priority language and discussion in the Commission's order proposing these regulations. That language stated that in a capacity shortage firm retail customers had top priority, followed by interruptible retail customers and firm transportation customers. Interruptible transportation customers had the lowest priority. IECPA comments, however, that firm transportation customers should have parity with interruptible retail customers. Apollo and Carnegie argue that transportation and retail gas customers should be treated equally.

In regard to the payment for seizure of gas, PNGA, POGAM and the Commission's Bureau of Rates contend the LDC should pay the customers' cost of the natural gas.

#### *Commission's Response:*

We shall delete this section because of the modifications made in § 60.2(14).

*(b) The gas utility may interrupt service to interruptible transportation service customers due to a capacity shortage.*

#### *Comments:*

NFG agrees with this provision while PECO states it does not interrupt service due to capacity shortage because it has not constructed its system to serve

interruptible and transportation customers. Therefore, PECO only provides interruptible service when underutilization of its system occurs.

*Commission's Response:*

We shall delete this section to reflect our change in § 60.2(10).

§ 60.8. Reporting requirements.

A natural gas utility, shall submit to the Commission an annual report due at the same time as Form 1 as specified in § 59.61(a)(1) relating to periodic reporting requirements for major gas utilities—regarding transportation service that includes the following information:

- (1) The volumes transported for each customer.
- (2) The rate charged each customer for transportation service.
- (3) A description of the Federal authorization under which the gas is carried to the facilities of the natural gas utility.

*Comments:*

NFG agrees with this provision while the Commission's Bureau of CEEP urges that a copy of each transportation contract also be submitted with this information.

PGA, Equitable and Peoples take various positions on releasing this information. All submit that releasing the information may result in the leaking of competitive information. Peoples contends this information should not be transferred to the Commission. Equitable hesitates in releasing the information as it believes the current aggregate information submitted to the Commission complies with the intent of these reporting requirements. If the Commission persists in requiring the disclosure of this information, Equitable maintains it should be submitted under appropriate confidentiality procedures. Likewise, PGA recommends as alternatives to the reporting requirements that LDCs be permitted to file aggregate data or that a coding system be developed. Finally, Peoples contends the Commission has no need to receive the paragraph (3) information.

*Commission's Response:*

We decline to accept the proposals advocated by the parties. Submission of this data is the only way the Commission can determine whether the transportation regulations are being implemented properly and whether LDCs are discriminating in violation of these regulations. Any concerns of competitive information leaking to other parties must fall before our need to assure the protection of the public interest.

We shall clarify the language concerning the description of the Federal authorization under which gas is transported. By the new language we intend to determine the FERC rates and service by which gas is moved to this Commonwealth. Submission of this data will assist the Commission in implementing these regulations as we are made aware of programs available to LDCs, and will assist the Commission in formulating proposals to encourage LDCs to achieve maximum benefit from various transportation programs. In all other respects we adopt the language as proposed.

§ 60.9. Effective date.

A natural gas utility shall file a tariff offering gas transportation services consistent with §§ 60.1—60.7 by (Editor's Note: The blank refers to a date 90 days after the effective date of adoption of this proposed

rulemaking), effective (Editor's Note: The blank refers to a date 150 days after the effective date of adoption of this proposed rulemaking).

*Comments:*

Apollo, Carnegie, PNGA and POGAM state that the effective date should be accelerated. PNGA and POGA believe the Commission should order LDCs to file their tariffs shortly after entry of the Final Order; these tariffs should become effective upon final publication of the regulations in the *Pennsylvania Bulletin*.

Apollo and Carnegie contend the tariffs should become effective immediately, subject to investigation. IECPA comments that tariffs should become effective no later than 120 days after final regulations are adopted.

On the other hand NFG proposes that all changes be reflected in the LDC's next base rate proceeding because the proposals in a transportation tariff may necessitate changes in a sales tariff. NFG does not believe the changes in the sales tariff could be reflected in the transportation tariff filing.

Finally, PG&W argues that any cost of service study it may use to justify transportation rates is now obsolete. PG&W proposes it be allowed to set a minimum rate to be justified in a later section 1307(f) proceeding. PG&W desires it be permitted to recoup lost revenue from other classes of customers subject to the above justification.

*Commission's Response:*

We believe the expedited timetable indicated by the Commission to IRRC adequately addresses the concerns of those LDCs desiring expeditious approval of final transportation regulations. We do not believe that proposals to delay implementation of transportation tariffs will serve the public interest. The public interest will be best served by the expeditious offering of natural gas transportation in this Commonwealth under these regulations. We expect LDCs to submit transportation tariffs which comply with our final regulations and thus displace any existing inconsistent provisions in their current tariffs.

Accordingly, we hereby amend 52 Pa. Code by adding Chapter 60, §§ 60.1—60.9, to read as set forth in Annex A; Therefore,

It is Ordered:

1. That the regulations set forth at Annex A are hereby adopted and made final.
2. That the Secretary shall submit this order and Annex A to the Office of Attorney General for approval as to legality.
3. That the Secretary shall deposit the original certified order and Annex A with the Legislative Reference Bureau for publication in the *Pennsylvania Bulletin*.
4. That the regulations set forth at Annex A shall take effect upon publication in the *Pennsylvania Bulletin* and as provided in § 60.9.
5. That a copy of this order and Annex A shall be served upon all jurisdictional gas utilities.

By the Commission

JERRY RICH,  
Secretary

Fiscal Note: Fiscal Note 57-56 remains valid for the final adoption of the subject regulations.

(Editor's Note: See 16 Pa.B. 3165 (August 23, 1986) for the Independent Regulatory Review Commission order relating to this document.)

Annex A

TITLE 52. PUBLIC UTILITIES

PART I. PUBLIC UTILITY COMMISSION

Subpart C. FIXED SERVICE UTILITIES

CHAPTER 60. NATURAL GAS TRANSPORTATION SERVICE

§ 60.1. General.

The transportation of natural gas by jurisdictional gas utilities is in the public interest. Transportation service should be provided under terms, conditions and rates which minimize the shifting of costs to retail customers and provide the natural gas utility with an opportunity to recover the fixed costs incurred to serve the transportation service customers. The development of Pennsylvania natural gas should be promoted, because it will achieve benefits that accrue to gas utilities and their customers.

§ 60.2. Natural gas transportation service terms and objectives.

A Class A and B natural gas utility shall maintain a gas transportation program that adheres to the following terms and promotes the following objectives when providing natural gas transportation service:

(1) The tariff shall separately state and price the components of transportation service to afford customers flexibility in choosing the degree of supply risk they are willing to assume.

(2) The tariff shall indicate a range of rates for transportation service.

(3) The maximum rate allowed for transportation service shall be the weighted average retail rate for the otherwise applicable retail service less costs relating to natural gas supply, including natural gas demand, commodity and storage costs.

(4) The maximum rate for transporting gas which is produced in this Commonwealth shall be based upon a cost of service study. Only costs identifiable as related to transportation service shall be recovered through this rate.

(5) The rates described in paragraphs (3) and (4) shall be maintained as tariffed rates on file with the Commission.

(6) Transportation service shall be provided under a contract between the jurisdictional natural gas utility and the customer. The contract terms shall be consistent with rates and rules found in the natural gas utility's tariff. A contract shall be effective for no less than a 12-month period, except that a contract for a shorter period is permitted if the utility and the customer agree. The rates set shall recover, to the maximum extent possible, the fixed costs associated with the service.

(7) A natural gas utility shall provide transportation service in a manner and according to terms which maximize system throughput.

(8) The tariff may not unreasonably restrict Commonwealth natural gas producer access to gas utility facilities.

(9) The transportation service tariff shall specify that the distribution utility makes no guarantee against, and assumes no liability for, interruption caused by third parties.

(10) The location of entry points necessary for the introduction of customer owned gas into the natural gas utility's facilities shall be determined by a natural gas utility. Construction necessary to accomplish a natural gas connection will be conducted by the natural gas utility or under its supervision at the customer's expense. The natural gas utility shall own and maintain a natural gas connection.

(11) The transportation service customer shall agree to sell its natural gas supply to the natural gas distribution utility at the higher of the natural gas utility's weighted average cost of gas or the customer's own cost in the event of a distributor natural gas supply shortage. A natural gas shortage exists when the supply of gas is insufficient to meet the requirements of Priority 1 customers as specified in § 69.21 (relating to priority of service) on a continuing basis or when continued delivery of gas to customers would prevent the injection of gas into underground storage pools for the protection of winter supply, so that service to Priority 1 customers is threatened. The customer shall demonstrate its cost of natural gas by making a copy of the contract with the natural gas supplier available to the gas utility upon request.

(12) The natural gas utility may retain a reasonable allowance of customer-owned natural gas for gas which is lost or unaccounted for in its operations.

(13) Representative levels of transportation service shall be set for each jurisdictional natural gas utility in every general rate proceeding under 66 Pa.C.S. § 1308 (relating to voluntary changes in rates).

§ 60.3. Eligibility for natural gas transportation service.

(a) Transportation service shall be provided without discrimination as to type and location of customer. A natural gas utility shall state in its tariff the minimum volume of transported natural gas that entitles a customer to transportation service. These volumes shall be set at a level which maximizes the number of customers that can receive transportation service while permitting the natural gas utility to effectively and efficiently manage its natural gas distribution system.

(b) The tariff shall permit individual customers or groups containing no more than three customers to be eligible for transportation service. Larger groups shall be permitted if the utility and the customers agree.

(c) Gas injected into the natural gas utility's system shall be of a quality and pressure that is reasonably acceptable to the utility.

§ 60.4. Rebuttable presumptions.

(a) There shall be a rebuttable presumption in the rate proceeding of a natural gas utility governed by 66 Pa.C.S. § 1308 (relating to voluntary changes in rates) that additional fixed costs may not be recovered from remaining retail customers due to retail customers' use of transportation service.

(b) There shall be a rebuttable presumption in a proceeding governed by 66 Pa.C.S. § 1307 (relating to sliding scale of rates; adjustments) that natural gas supply fixed costs relating to transportation customers may not be recovered from sales customers.

(c) In determining the natural gas utility's ability to serve a transportation customer, there is a rebuttable presumption that sufficient capacity in the utility system exists.

§ 60.5. Standby sales service.

Standby retail service shall entitle a transportation service customer to purchase natural gas at tariffed retail rates and shall be made available to a transportation service customer subject to the following conditions:

(1) The transportation customer and the natural gas utility shall agree upon the maximum sales volumes that will be provided upon the request of the customer. Volumes taken in excess of this amount will require the payment of a penalty.

(2) The rate charged for standby service shall recover natural gas supply fixed costs and any other costs, such as storage service costs where applicable, incurred to maintain natural gas supply for the transportation customer. Revenues for standby service shall be credited against natural gas costs in a proceeding under 66 Pa.C.S. § 1307 (relating to sliding scale of rates; adjustments).

(3) A natural gas utility maintains no duty to provide retail service to a transportation customer who declines to elect standby retail service.

§ 60.6. Natural gas storage service.

(a) A tariff rate for optional natural gas storage service shall be available for use when the transportation customer fails to take delivery of the entire net volume of natural gas delivered to the distribution utility for the customer's account. The tariff rate for optional storage service shall reflect any contribution toward the utility's storage costs made by the customer as part of the customer's standby sales service rate.

(b) The customer's failure to elect the storage service option will entitle the natural gas utility to buy unused natural gas from the customer at a price equal to the utility's lowest cost gas or at the customer's costs, whichever is less. The customer shall demonstrate its cost of natural gas by supplying a sworn affidavit of the cost of gas to the natural gas utility.

§ 60.7. Balancing of deliveries and withdrawals.

(a) A natural gas utility providing transportation service shall reflect in its tariff a 3-month time period, as a minimum, within which the transportation customer shall balance deliveries into and withdrawals from the natural gas utility's system. The time period shall commence upon initial delivery of natural gas into the natural gas utility's system. Deliveries and withdrawals may be considered as balanced if they fall within a range specified in a natural gas utility's tariff.

(b) The tariff of a natural gas utility shall specify the action that may be taken by the utility if deliveries and withdrawals are not balanced.

§ 60.8. Reporting requirements.

A natural gas utility shall submit to the Commission an annual report due at the same time as Form 1 as specified by § 59.61(a)(1) (relating to periodic reporting requirements for major gas utilities) regarding transportation service that includes the following information:

(1) The volumes transported for each customer.

(2) The rate charged each customer for transportation service.

(3) A description of the rate and service, approved by the Federal Energy Regulatory Commission, under which the gas is carried to the facilities of the natural gas utility.

§ 60.9. Effective date.

A natural gas utility shall file a tariff offering gas transportation services consistent with §§ 60.1--60.7 by March 2, 1987, effective May 1, 1987.

[Pa.B. Doc. No. 87-205. Filed January 30, 1987, 9:00 a.m.]

## Title 64—SECURITIES

### PART I. SECURITIES COMMISSION

#### [64 PA. CODE CH. 203]

#### Cooperative Business Associations Exemption

The Securities Commission, under section 203(r) of the Pennsylvania Securities Act of 1972 (70 P. S. § 1-101 *et seq.*), hereby adopts amendments to 64 Pa. Code Chapter 203, relating to cooperative business associations exemption. Notice of proposed rulemaking was published at 16 Pa.B. 3848 (October 11, 1986).

#### Comments

No comments were received by the Commission on this regulation.

This regulation is being promulgated under the Commission's discretionary authority in section 203(r) of the Pennsylvania Securities Act of 1972 to exempt classes of securities transactions which the Commission finds that registration is not necessary or appropriate for the protection of the investors. In the regulation, the Commission has found that offers and sales of securities of retail or wholesale cooperative business associations to their members or to persons who, upon purchase of the securities, will become members, is a class of securities transactions for which regulation is not necessary or appropriate for the protection of investors. The investor under the regulation would be a member who is engaged, in whole or in part, in the same trade as the cooperative business association which is offering and selling the securities. Being in the same business, the investor would be intimately familiar with the business risks pertinent to the cooperative business association whose securities he is purchasing.

#### Fiscal Impact

Minor revenue loss would occur, in that transactions which would not be exempt under this regulation would have previously filed under section 205 and paid a \$500 fee, section 203(i) and paid a \$100 fee or section 203(d) and paid a \$25 fee. Best agency estimates as to revenue loss would be \$1,000 per fiscal year.

#### Paperwork

No additional paperwork will be required by this regulation.

#### Contact Person

The contact person for an explanation of the regulation is G. Philip Rutledge, Director, Division of Corporation Finance, Securities Commission, 333 Market Street, 14th floor, Harrisburg, Pa. 17101, (717) 787-5401.

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 Reply 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:

Dated this 12th day of March 2014.

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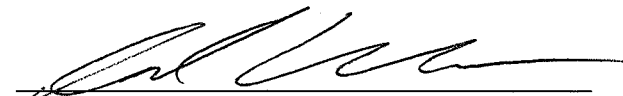
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