



100 Pine Street • PO Box 1166 • Harrisburg, PA 17108-1166
Tel: 717.232.8000 • Fax: 717.237.5300

Teresa K. Schmittberger
Direct Dial: 717.237.5270
Direct Fax: 717.260.1688
tschmittberger@mwn.com

March 12, 2014

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

VIA ELECTRONIC FILING

RE: Joint 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:

Please find enclosed for filing with the Pennsylvania Public Utility Commission ("PUC" or "Commission") the Reply Brief of the Industrial Energy Consumers of Pennsylvania ("IECPA") in the above-referenced proceeding.

As evidenced by the attached Certificate of Service, all parties to the proceeding are being duly served with a copy of this document.

Very truly yours,

McNEES WALLACE & NURICK LLC

By 
Teresa K. Schmittberger

Counsel to the Industrial Energy Consumers of Pennsylvania

TKS/sar
Enclosures

c: Administrative Law Judge Elizabeth H. Barnes (via E-mail and First Class Mail)
Certificate of Service

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CERTIFICATE OF SERVICE

I hereby certify that I am this day serving a true copy of the foregoing document upon the participants listed below in accordance with the requirements of 52 Pa. Code Section 1.54 (relating to service by a participant).

VIA E-MAIL AND FIRST CLASS MAIL

Allison Kaster, Esquire
Pennsylvania Public Utility Commission
Bureau of Investigation and Enforcement
Commonwealth Keystone Building
400 North Street, 2nd Floor West
Harrisburg, PA 17105
akaster@pa.gov

Aron J. Beatty, Esquire
Darryl A. Lawrence, Esquire
Pennsylvania Public Utility Commission
Office of Consumer Advocate
555 Walnut Street
Forum Place, 5th Floor
Harrisburg, PA 17101
abeatty@paoca.org
dlawrence@paoca.org

Elizabeth Rose Triscari, Esquire
Sharon E. Webb, Esquire
Pennsylvania Public Utility Commission
Office of Small Business Advocate
300 North Second Street, Suite 1102
Harrisburg, PA 17101
etriscari@pa.gov
swebb@pa.gov

Theodore J. Gallagher, Esquire
Nisource Corporate Services Company
121 Champion Way, Suite 100
Canonsburg, PA 15317
tjgallagher@nisource.com
Counsel for Columbia Gas of Pennsylvania, Inc.

Mark C. Morrow, Esquire
Melanie J. Elatieh, Esquire
UGI Corporation
460 North Gulph Road
King of Prussia, PA 19406
morrowm@ugicorp.com
elatiehm@ugicorp.com

William H. Roberts, II, Esquire
Peoples Natural Gas Company LLC
375 North Shore Drive, Suite 600
Pittsburgh, PA 15212
william.h.roberts@peoples-gas.com

David P. Zambito, Esquire
Cozen O'Connor
305 North Front Street, Suite 400
Harrisburg, PA 17101
dzambito@cozen.com
Counsel for Peoples Natural Gas Company LLC

Jennifer L. Petrisek, Esquire
Peoples TWP
375 North Shore Drive, Suite 600
Pittsburgh, PA 15212
jennifer.petrisek@peoples-gas.com

Maureen Geary Krowicki, Esquire
National Fuel Gas Distribution Corporation
PO Box 2081
1100 State Street
Erie, PA 16512
krowickim@natfuel.com

Certificate of Service

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Bruce V. Miller, Esquire
Cullen and Dykman LLP
100 Quentin Roosevelt Blvd
Garden City, NY 11530
bmiller@cullenanddykman.com
Counsel for National Fuel Gas Distribution Corporation

Thomas J. Sniscak, Esquire
William E. Lehman, Esquire
Hawke McKeon Sniscak LLP
100 North Tenth Street
P.O. Box 1778
Harrisburg, PA 17105
tjsniscak@hmslegal.com
welehman@hmslegal.com
Counsel for The Pennsylvania State University

Amy Neufeld, Esquire
Exelon Business Services Company
500 North Third Street, Suite 800
Harrisburg, PA 17110
amy.neufeld@exeloncorp.com

Michael S. Swerling, Esquire
Exelon Business Services Company
2301 South Market Street, S23-1
Philadelphia, PA 19101
michael.swerling@exeloncorp.com
Counsel for PECO Energy Company

Charles E. Thomas, Jr., Esquire
Thomas T. Niesen, Esquire
Thomas, Long, Niesen & Kennard
212 Locust Street
P. O. Box 9500
Harrisburg, PA 17108-9500
cthomasjr@thomaslonglaw.com
tniesen@thomaslonglaw.com
Counsel for Equitable Gas Company, LLC

David W. Gray, Esquire
Equitable Gas Company, LLC
225 North Shore Drive
Pittsburgh, PA 15212
dgray@equitablegas.com

Kevin J. Moody, Esquire
Pennsylvania Independent Oil & Gas Association
212 Locust Street, Suite 300
Harrisburg, PA 17101
kevin@pioga.org

Tishekia Williams, Esquire
Duquesne Light Company
411 Seventh Avenue, 16th Floor
Pittsburgh, PA 15219
twilliams@duqlight.com

Benjamin L. Shechtman, Esquire
Stevens & Lee
620 Freedom Business Center, Suite 200
King of Prussia, PA 19406
bls@stevenslee.com
Counsel for Duquesne Light Company

CONSULTANTS

Brian Kalcic, Consultant
Excel Consulting
225 S. Meramec Avenue, Suite 720-T
St. Louis, MO 63105
excel.consulting@sbcglobal.net

Robert D. Knecht
Industrial Economics Incorporated
2067 Massachusetts Avenue
Cambridge, MA 02140
rdk@indecon.com

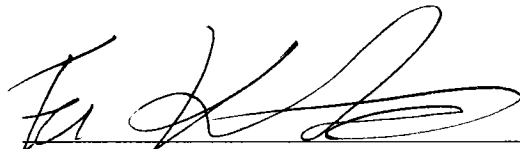
Glenn A. Watkins, Executive/VP Consultant
Technical Associates, Inc.
9030 Stony Point Parkway
Suite 580
Richmond, VA 23235
watkinsg@tai-econ.com

Diane Meyer Burgraff
19 Westwind Drive
Lemoyne, PA 17043
dmburgraff@epix.net

VIA E-MAIL ONLY

Donna M.J. Clark, Esquire
Energy Association of Pennsylvania
800 North Third Street, Suite 205
Harrisburg, PA 17101
dclark@energypa.org
(Courtesy copy; EAP is not a party)

James L. Crist
JLCrist@aol.com



Teresa K. Schmittberger

Counsel to the Industrial Energy Consumers of
Pennsylvania

Dated this 12th day of March, 2014, at Harrisburg, Pennsylvania

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Joint Petition for Generic Investigation	:	
or Rulemaking Regarding "Gas-on-	:	Docket No. P-2011-2277868
Gas" Competition Between	:	
Jurisdictional Natural Gas Distribution	:	
Companies	:	
	:	
	:	
Generic Investigation Regarding Gas-	:	
On-Gas Competition Between	:	Docket No. I-2012-2320323
Jurisdictional Natural Gas Distribution	:	
Companies	:	

**REPLY BRIEF OF THE
INDUSTRIAL ENERGY CONSUMERS OF PENNSYLVANIA**

Charis Mincavage (I.D. No. 82039)
Teresa K. Schmittberger (I.D. No. 311082)
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
Phone: (717) 232-8000
Fax: (717) 237-5300
cmincavage@mwn.com
tschmittberger@mwn.com

Counsel to the Industrial Energy Consumers
of Pennsylvania

Dated: March 12, 2014

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I. INTRODUCTION

A. Procedural History

On December 8, 2011, the Bureau of Investigation and Enforcement ("I&E"), Office of Consumer Advocate ("OCA"), Office of Small Business Advocate ("OSBA"), Peoples TWP LLC ("Peoples TWP"), and Peoples Natural Gas Company LLC ("Peoples") filed with the Pennsylvania Public Utility Commission ("PUC" or "Commission") a Petition requesting that the Commission institute an investigation or rulemaking into gas-on-gas competition. Specifically, each of these parties requested that the Commission evaluate the practice of rate flexing by natural gas distribution companies ("NGDCs") with overlapping service territories. On December 28, 2011, the Industrial Energy Consumers of Pennsylvania ("IECPA") filed an Answer not opposing an investigation or rulemaking regarding gas-on-gas competition, asserting that current public utility law and policy supports the continued use of customer-specific discount rates based on overlapping NGDC service territories.

Approximately seven months later, on July 25, 2012, the Commission issued a Secretarial Letter instituting a generic investigation regarding gas-on-gas competition issues and assigning this matter to the Office of Administrative Law Judge ("OALJ") for disposition and resolution. Administrative Law Judge ("ALJ") Elizabeth H. Barnes held an initial prehearing conference on August 31, 2012, during which she requested that parties submit comments regarding the proposed procedural and substantive scope of the gas-on-gas proceeding. On December 11, 2012, the ALJ issued an Order determining that the investigation should include an analysis of the full impact of flexing distribution rates in order to address whether gas-on-gas competition should be allowed to continue, and if so, whether any modifications to the current practice were necessary.

On January 23, 2014, and February 7, 2014, ALJ Barnes further modified the procedural schedule of the instant proceeding regarding the due dates for Main and Reply Briefs. Pursuant to this modified schedule, IECPA submitted its Main Brief on February 25, 2014. IECPA received Main Briefs from Peoples, OCA, OSBA, I&E (collectively, "State Advocates"), Columbia Gas of Pennsylvania, Inc. ("Columbia"), the Pennsylvania State University ("PSU"), and National Fuel Gas Distribution Corporation ("NFGD"). This Reply Brief will respond to the arguments included in these parties' Main Briefs.¹

II. SUMMARY OF ARGUMENT

The Commission began this investigation without any preconceived notions about whether new circumstances warrant modification of gas-on-gas competition. The July 25, 2012, Secretarial Letter that instituted this investigation explained that the sole reason for this investigation was to address gas-on-gas issues, which arose in multiple base rate cases, in a single proceeding. Beyond providing some background of gas-on-gas competition, and the State Advocates' opposition to it, the Secretarial Letter does not reach any conclusions regarding the current merits of the practice. Based on this language, or lack thereof, it is clear that at the conclusion of this investigation, the Commission is free to continue the practice of gas-on-gas competition as it currently exists (*i.e.*, status quo gas-on-gas competition), or make modifications that are shown to be beneficial as a result of the investigation.

Based on the development of the record in this case, the weight of evidence supports the Commission's approval of continued status quo gas-on-gas competition without modification at the conclusion of this proceeding. Although the State Advocates, with tenuous assistance from

¹ IECPA's Reply Brief will not respond to every argument contained in the parties' Main Briefs but only those issues necessitating additional response. IECPA's decision not to respond to all arguments should not be construed as agreement with the positions of any party on any of the outstanding issues in this proceeding.

Peoples, presented reasons for why gas-on-gas competition should be eliminated or modified, these reasons fail to justify any significant change to a practice that provides benefits to the Western Pennsylvania economy, NGDCs, captive utility customers, and the gas-on-gas customers themselves. Although at times, the State Advocates frame gas-on-gas competition as less than beneficial for residential and smaller commercial customers and uneconomic for NGDCs, the State Advocates are simply unable to support these purportedly "dire" assertions with probative evidence.

Specifically, the State Advocates would have the Commission believe that gas-on-gas rates are improperly derived and unduly discriminatory against customer classes who cannot participate in gas-on-gas competition. The State Advocates fail to acknowledge, however, evidence that smaller customer classes pay rates below their cost of service despite the existence of gas-on-gas competition. In actuality, gas-on-gas rates are just and reasonably derived because an NGDC quantifies the value a gas-on-gas customer presents to its system and then offers the maximum rate to this customer, which will ensure that the NGDC retains the customer on its system. As long as this final gas-on-gas rate (a) covers an NGDC's incremental costs, and (b) exceeds the NGDC's incremental costs to a certain extent so that the gas-on-gas customer is contributing to a portion of the NGDC's fixed costs, then the gas-on-gas customer provides a benefit to the entire NGDC system, including those customer classes who cannot participate in gas-on-gas competition. Section III.A.1., *infra*.

In addition, the State Advocates identify Commission precedent that they claim undermines gas-on-gas competition. To the contrary, all of the cited precedent is limited to unique factual circumstances that have no bearing on whether the practice of gas-on-gas competition as a whole should be preserved in the Commonwealth. Moreover, there is

significant Commission precedent that supports the continuation of status quo gas-on-gas competition. The Commission may first look at its regulations, adopted in the 1980s and further supported upon passage of the Natural Gas Customer Choice and Competition Act ("Competition Act"), which acknowledge and endorse the practice of discounting rates for the purpose of retaining customers on an NGDC's system. These regulations provide for a range of rates that may be offered to large transportation customers beneath an NGDC's maximum rate. The reason identified by the Commission for these flexible rates is a simple one: "it is preferable to keep these customers on the system [of an NGDC], albeit at a lower rate, than to lose all contribution to the company's fixed costs." 17 Pa. B. 548. Here again is an acknowledgement by the Commission that gas-on-gas rates, which cover a customer's incremental costs and a portion of an NGDC's fixed costs, are just and reasonably derived and should be offered to Large C&I customers. Section III.A.2., *infra*.

The State Advocates further allege that discounting rates due to gas-on-gas competition is unreasonable while discounting rates due to a bypass threat, alternative fuel opportunity, or economic development reason is appropriate. Yet, these rates are established in the exact same manner as gas-on-gas rates. Specifically, when faced with a bypass, alternative fuel, or economic development opportunity, an NGDC quantifies the value a customer presents to its system and offers the maximum rate to this customer that will retain the customer on the NGDC's system. Because an NGDC is using the same rate setting methodology for a competing NGDC as it is for "other types of competition," the State Advocates' claims must be discounted. As such, an NGDC should have the right to retain its customers for the benefit of its system based on any competitive threat, including other NGDCs. Section III.A.3., *infra*.

Finally, to justify modification to the status quo, Peoples argues that its merger with Equitable reduces the relevance of gas-on-gas competition because only two NGDCs will continue to offer gas-on-gas rates. Peoples offers no explanation, however, for how the merger removes the benefits provided by gas-on-gas competition to those NGDCs that continue to have overlapping service territories. Accordingly, a reduction in the number of potential gas-on-gas customers should in no way impact the practice of gas-on-gas competition. Section III.A.4., *infra*.

Although IECPA believes status quo gas-on-gas competition is just, reasonable, and offers numerous benefits to all impacted parties, to the extent the Commission is persuaded by the State Advocates' or Peoples' arguments in opposition to gas-on-gas competition, none of the parties to this proceeding provide viable alternatives to the status quo. Peoples' alternative proposal, based on "cost-based rates," is unworkable in practice and would require the expenditure of many more resources to implement. Section III.B.1., *infra*. The State Advocates' transitional periods and plans either lack important due process protections for gas-on-gas customers and NGDCs, or face similar practical challenges to the Peoples' proposal. Section III.B.2., *infra*. As such, no party has presented an alternative method to gas-on-gas competition that would ensure the same benefits to all customer classes that is currently derived from this long-standing methodology. Section III.B.3., *infra*.

As discussed further herein, status quo gas-on-gas competition, based on a historical rate-setting methodology, Commission precedent, and analogy to other discounted rates, which provides numerous benefits to customers and NGDCs, should be approved as just and reasonable.

III. ARGUMENT

A. Contrary to Reasons Presented by State Advocates and Peoples, Gas-on-Gas Competition is Just and Reasonable on Both a Factual and Legal Basis.

1. In Opposite to the State Advocates' Contentions, Gas-on-Gas Competition Is Consistent with Ratemaking Principles And Provides Benefits to All Customer Classes.

The State Advocates' opposition to gas-on-gas competition hinges on gas-on-gas rates qualifying as excessive discounts to Large Commercial and Industrial ("C&I") customers, which would purportedly increase distribution rates for other customer classes. Because this position is unfounded, the State Advocates have no basis for their recommendation to eliminate gas-on-gas competition. As set forth in IECPA's Main Brief, and discussed further herein, contrary to the State Advocates' position, gas-on-gas competition promotes rates that are consistent with ratemaking principles and benefit all customer classes. Accordingly, the crux of the State Advocates' position for eliminating gas-on-gas competition is erroneous.

The State Advocates specifically allege that gas-on-gas competition promotes excessive discounts to Large C&I customers that represent "an uneconomic transfer of wealth from captive ratepayers to a select few customers." OCA M.B., p. 12; *see also* I&E M.B., p. 7; OSBA M.B., p. 7.² Because the State Advocates erroneously believe captive ratepayers in smaller customer classes are paying higher rates to compensate NGDCs for these discounts, the State Advocates maintain that gas-on-gas competition establishes undue discriminatory rates in violation of Section 1304 of the Public Utility Code. 66 Pa. C.S. § 1304; *see also* OCA M.B., pp. 13-14; I&E M.B., p. 7; OSBA M.B., p. 15. Importantly, the State Advocates' assumption that discounts

² Although Peoples also references "discount adjustments" as a reason for modifying gas-on-gas competition, Peoples does not appear to believe that these discounts present the same problems as the State Advocates, instead stating that these discounts merely "create the appearance of a potential windfall for the discount customers at the expense of captive ratepayers." Peoples' M.B., p. 18. Considering Peoples' historic and continued support for gas-on-gas competition, it is unlikely that Peoples believes these discounts are undue discriminatory.

offered to Large C&I customers cause captive ratepayers in smaller customer classes to face unduly discriminatory rates is simply incorrect.

The existence of gas-on-gas discounts in no way causes smaller rate classes to pay excessive and unduly discriminatory rates. The State Advocates ignore evidence that sets forth a foundation for proving that distribution rates for the Large C&I customer class exceed their cost of service, despite the inclusion of Large C&I customers in the class who receive gas-on-gas discounts. IECPA M.B., p. 14. As explained in IECPA's Main Brief, in Peoples' most recent base rate case, the entire Large C&I customer class, including those customers paying discounted rates due to gas-on-gas competition, is currently paying distribution rates that exceed its cost of service while residential and small commercial classes are paying distribution rates below their cost of service.³ *Id.* Because residential and small commercial classes are currently benefiting from below cost of service rates, it is unreasonable for the State Advocates to contend that these classes are subject to unduly discriminatory rates.⁴

Although discounts are offered to Large C&I customers due to gas-on-gas competition, these discounts do not result in rates for captive customers that violate the Public Utility Code. Section 1304 of the Public Utility Code states, in relevant part, that "no public utility shall establish or maintain any unreasonable difference as to rates, either as between localities or as between classes of service." 66 Pa. C.S. § 1304. Gas-on-gas rates would only violate this statute if the State Advocates could show that the differences in rates created by gas-on-gas competition are "unreasonable." As long as the Large C&I customer class, including those customers who pay gas-on-gas rates, is remitting rates above its cost of service, any difference between the rates

³ This recent Peoples base rate case also calls into question I&E's position that tariff rates are necessarily cost-based. I&E M.B., p. 27.

⁴ In actuality, it would be unjust and unreasonable to further reduce the rates of residential and smaller commercial classes below their cost of service.

of the Large C&I customer class and smaller customer classes may hardly be considered "unreasonable."

To that end, price discrimination is considered just and reasonable when there is a legitimate ratemaking principle that justifies the discrimination. IECPA M.B., p. 15; *see also* PSU M.B., p. 6. With respect to gas-on-gas competition, a number of legitimate ratemaking principles, including value of service and proximity to a competitive service alternative, justify its continuation and any price discrimination that it creates.⁵ IECPA M.B., p. 15. When determining a gas-on-gas rate, NGDCs will identify the value a customer contributes to their system and determine the highest rate it may charge the customer without losing the customer to a competitor NGDC. *Id.* at 12-13. Because gas-on-gas competition is based on Large C&I customers' assessed value to the system, any price discrimination that results is just and reasonable. *Id.* at 15-16.

Moreover, despite arguments by the State Advocates to the contrary, smaller customer classes receive a benefit from the continued retention of gas-on-gas customers on their NGDC systems.⁶ In general, if a gas-on-gas customer leaves an NGDC system, the NGDC's overall revenue will decrease more than its costs. *Id.* at 8. As a result, as long as the gas-on-gas customer is paying more than its incremental costs of service, which is the norm, all other customers of the system are better off retaining the customer than losing the customer to a competitor NGDC.⁷ *See id.* at 8-9. For this reason, other NGDC customers are benefited rather than harmed by the presence of gas-on-gas customers.

⁵ The Commission has endorsed value of service as a legitimate ratemaking principle under a number of circumstances, including to justify higher tariff rates for large transportation customers. *See Pa. Pub. Util. Comm'n v. Peoples Natural Gas Co.*, 1992 WL 315144 (Pa.P.U.C. 1992), 9.

⁶ In its Main Brief, Peoples also acknowledges the historical benefits presented by gas-on-gas competition. Peoples M.B., p. 7.

⁷ No party to this proceeding presented evidence that gas-on-gas rates fail to recover incremental costs plus a contribution to fixed costs. As further explained in IECPA's Main Brief, NGDCs do not dispute as part of the

The State Advocates would have the Commission believe that simply because discounts are offered to Large C&I customers, other smaller customers are remitting unduly discriminatory rates. In actuality, smaller customer classes may be paying rates below their cost of service despite the discounts offered to gas-on-gas customers. Moreover, because of the way in which NGDCs establish discounted rates, any price discrimination that occurs as a result of gas-on-gas competition is just, reasonable, and based on legitimate ratemaking principles. Contrary to the position of the State Advocates, all customers benefit from the continuation of gas-on-gas competition. Accordingly, the State Advocates' central position for the elimination of gas-on-gas competition is fundamentally incorrect and must be disregarded.

2. The State Advocates' Reliance on Precedent to Support the Elimination of Gas-on-Gas Competition is Misplaced.

In their Main Briefs, the State Advocates refer to certain references in Commission precedent that they contend support elimination of gas-on-gas competition. Nevertheless, all of these references are limited in scope to the particular facts of their cases. Moreover, other references within this same Commission precedent that support discounted rates undermine the State Advocates' reliance on these cases. In light of other explicit Commission regulations and precedent that endorse discounted rates due to gas-on-gas competition, the State Advocates' reliance on contradictory cases is misplaced.

The State Advocates generally rely on references to the following proceedings: (1) the 2007 Peoples-Equitable Merger proceeding, (2) the 2005 Peoples and Equitable Purchased Gas Cost proceedings, and (3) a 1999 Equitable Certificate of Public Convenience proceeding. I&E M.B., pp. 8, 10-11; *see also* OCA M.B., p. 19. In each case, the Commission agreed that certain

instant investigation that gas-on-gas customers are offered rates that exceed their incremental cost of service and explain instead that gas-on-gas rates should only be offered when they exceed a customer's incremental costs. IECPA M.B., n. 4.

elements of gas-on-gas competition were not beneficial based on particular factual circumstances. For example, in the 2007 Peoples-Equitable Merger proceeding, the Commission agreed that the merger should not be prevented due to the elimination of gas-on-gas competition between Peoples and Equitable. *In re Equitable Resources, Inc.*, 2007 WL 1175710 (Pa.P.U.C. 2007), 35. Similarly, in the 2005 Peoples and Equitable Purchased Gas Cost proceedings, the Commission held that NGDCs should no longer offer discounted retainage rates to attract customers onto their systems. *Pa. Pub. Util. Comm'n v. Equitable Gas Co.*, 2005 WL 6504493 (Pa.P.U.C. 2005), pp. 43-44; *see also Pa. Pub. Util. Comm'n v. Peoples Natural Gas Co.*, 2005 WL 6504491 (Pa.P.U.C. 2005), pp. 33-34. Finally, in the 1999 Equitable Certificate of Public Convenience proceedings, the Commission held that Equitable could not begin furnishing service in areas in which another NGDC was already serving. *In re Equitable Gas Co.*, 1999 WL 33592662 (Pa.P.U.C. 1999). Crucially, at no point in these cases does the Commission hold that NGDCs should stop offering discounted distribution rates due to gas-on-gas competition.

Each of these cases applies to specific facts and reaches conclusions that carry little weight within the instant investigation, which focuses on the statewide practice of gas-on-gas competition. First, the Peoples-Equitable Merger proceeding allowed for the discontinuation of gas-on-gas competition, but only between two NGDCs due to the PUC's perceived benefits of the merger as a whole. Second, the Purchased Gas Cost proceedings only addressed discounted retainage rates, not discounted distribution rates. Third, the Equitable Certificate of Public Convenience proceeding did not address the merits of gas-on-gas competition at all, but instead the economic impacts of overlapping service territories. Because these cases do not reach any conclusions regarding the overall practice of offering discounted distribution rates due to gas-on-gas competition, the foregoing findings are only relevant to their distinguishable factual

circumstances. For this reason, it is inappropriate for the State Advocates to rely on these cases to justify the elimination of status quo gas-on-gas competition.

Moreover, certain language within these same cited cases arguably promotes the continuation of status quo gas-on-gas competition. In the Equitable Purchased Gas Cost proceeding, the Commission explains that while discounted retainage rates are inappropriate, "we believe that there are circumstances in which it may be reasonable to require captive PGC customers to bear the costs of discounted or waived gas delivery related charges incurred to retain throughput." *Pa. Pub. Util. Comm'n v. Equitable Gas Co.*, 2005 WL 6504493 (Pa.P.U.C. 2005), pp. 43-44. The Commission further finds that discounted distribution rates are reasonable and recoverable from captive ratepayers when the utility demonstrates "that the existing customer charges recover, at a minimum, the marginal costs of providing transportation service, so as to ensure a contribution to fixed costs." *Id.*

Discounted distribution rates due to gas-on-gas competition, as currently offered by NGDCs, meet each of these requirements. As discussed in Section III.A.1., *supra*, discounted distribution rates due to gas-on-gas competition are offered when they exceed incremental costs, and thus, contribute to a certain extent of fixed costs. "Moreover, since NGDCs are attempting to maximize revenues from competitive customers, NGDCs, are in the majority of cases, charging rates well above incremental costs...to the benefit of captive customers." Surrebutal Testimony of Diane Meyer Burgraff, IECPA Statement No. 1-SR ("IECPA St. No. 1-SR"), p. 4. Accordingly, the foregoing Commission precedent cited by the State Advocates supports the continuation of discounted distribution rates due to status quo gas-on-gas competition.

In addition, the State Advocates ignore the significant law and precedent that supports the continuation of discounted distribution rates due to gas-on-gas competition. The Commission's

regulations provide for both a "maximum rate" and a "range of rates" that may be offered for transportation service. 52 Pa. Code § 60.2(2)-(3). When adopting these regulations, the Commission further acknowledged the benefits of retaining Large C&I customers on an NGDC's system who can contribute to a portion of an NGDC's fixed costs. 17 Pa. B. 547-48. These regulations were further endorsed upon passage of the Competition Act. *See* IECPA M.B., p. 11; *see also* 66 Pa. C.S. § 2203(14). Since adoption of the Commission's regulations and the Competition Act, the Commission approved many base rate and purchased gas cost proceedings that included the continuation of gas-on-gas competition. IECPA M.B., n. 5. In each of these instances, law and Commission precedent repeatedly acknowledges that the practice of offering discounted distribution rates due to gas-on-gas competition is just and reasonable.

The Commission should not accord any weight to the distinguishable and contradictory precedent offered by the State Advocates, much less interpret the case law as standing for the elimination of gas-on-gas competition. In fact, certain aspects of this Commission precedent, along with significant law (*e.g.*, the Commission's regulations that support discounting rates below tariff levels to allow NGDCs to retain Large C&I load) and precedent (*e.g.*, Commission approval of base rate and purchased gas cost cases including gas-on-gas competition), supports the continuation of status quo gas-on-gas competition. Because significant law and precedent supports gas-on-gas competition, there is no reason to modify this practice.

3. Contrary to the Position of the State Advocates, Discounted Rates Due to Gas-on-Gas Competition Are Analogous to Other Discounted Rates And Must Be Preserved.

The State Advocates maintain that differences between discounted rates due to gas-on-gas competition and discounted rates for other purposes warrant inconsistent treatment by the Commission. Yet, as explained in IECPA's Main Brief, and as discussed more fully herein, discounted rates due to gas-on-gas competition are analogous to all other forms of discounting.

The presence of a competing nearby NGDC warrants discounted rate treatment in the same way proximity to other service alternatives warrants discounted rate treatment. Moreover, it is untrue that gas-on-gas competition leads to inefficiencies and load loss in contrast to other forms of discounting. Because the State Advocates support the continuation of other forms of discounted rates, opposing discounted rates due to gas-on-gas competition is inconsistent and inappropriate.

The State Advocates claim that discounted rates due to gas-on-gas competition are distinguishable from other bases for discounted rates (*e.g.*, bypass, alternative fuel, or economic development) because gas-on-gas competition discounts: (1) are based on proximity to other NGDCs who must serve their customers, (2) cause an inefficient overlap of NGDC facilities, (3) result in loss of NGDC system load and revenues, and (4) do not ensure additional infrastructure investment from customers. OCA M.B., p. 22; *see also* OSBA M.B., p. 13. As explained below, these reasons are either entirely false as applied to gas-on-gas competition or irrelevant as to whether discounted rates due to gas-on-gas competition differ from other forms of discounted rates.

Offering gas-on-gas discounts due to proximity to other NGDC service territories is perfectly acceptable, particularly when considering the analogy to other forms of discounted rates. *Contra* I&E M.B., p. 20; *contra* OSBA M.B., p. 7. Although the State Advocates contend that discounts should not be offered when customers' only options are competing NGDCs, there is no difference between offering a discounted rate due to a competing NGDC and offering a discounted rate due to a competing alternative fuel or bypass threat. *Contra* OCA M.B., p. 22. In testimony, the OCA argued that a discounted rate is appropriate as long as it is no higher than the cost for receiving service by another means. Direct Testimony of Glenn A. Watkins, OCA Statement No. 1 ("OCA St. No. 1"), p. 5. The OCA submits that discounts offered by NGDCs

due to the potential for bypass and alternative fuel are reasonable because it is possible to quantify the cost of the service by another means. *See id.* Yet, NGDCs may just as easily determine what a customer's cost would be for service from another NGDC. IECPA M.B., p. 17. Whether the two service options are NGDCs, rather than one NGDC and a bypass or alternative fuel option, is irrelevant.

In addition, the State Advocates erroneously contend that gas-on-gas discounts lead to an overlap of NGDC facilities in contrast to other forms of discounting. Certainly, discounts offered due to bypass, alternative fuels, or economic development do not lead to an overlap of NGDC facilities. Similarly, discounts offered due to gas-on-gas competition do not lead to an overlap of NGDC facilities. Overlapping NGDC service territories and facilities existed in Western Pennsylvania, in some cases, since before utility regulation began. IECPA St. No. 1, p. 3; *see also* Rebuttal Testimony of Diane Meyer Burgraff, IECPA Statement No. 1R ("IECPA St. No. 1R"), p. 9. Gas-on-gas discounts and the continuation of gas-on-gas competition beyond this investigation will in no way eliminate this overlap.

Moreover, the State Advocates' claim that gas-on-gas discounts lead to loss of NGDC system load and revenues as opposed to other forms of discounts is misleading. In all cases of discounts, an NGDC offers a lower rate to a Large C&I customer in order to retain the customer's load and revenue. IECPA M.B., pp. 16-17. Although in the situation of gas-on-gas competition one NGDC will not benefit from the additional load and revenue of a Large C&I customer, another NGDC is permitted to attract and retain a customer to contribute to its load and revenue. Moreover, the first NGDC is not harmed by gas-on-gas competition, when there are no circumstances, whether or not gas-on-gas competition exists, in which both NGDCs could benefit from the additional load and revenue of the same Large C&I customer. *Contra* OSBA,

pp. 12-13. In this way, contrary to the position of the State Advocates, discounted rates due to gas-on-gas competition are further analogous to other discounted rates, because they present an opportunity for NGDCs to retain load and revenues on their systems.

Finally, the need for a Large C&I customer to invest in new infrastructure to receive a discounted rate for another reason, *i.e.*, bypass or alternative fuel arrangements, is entirely irrelevant as to whether a discounted rate should be offered by an NGDC. As just stated, discounted rates are offered by an NGDC to retain additional load and revenues. These rates are offered first and foremost for the benefit of NGDCs and their customer bases. If the NGDC would not benefit from offering a discounted rate, then the NGDC would not offer the rate. Whether or not the customer would be required to incur additional expenses to pursue another service option should have no impact on the merits of offering a discounted rate.

For all the foregoing reasons, there is no qualitative difference between discounted rates due to gas-on-gas competition and discounted rates for other purposes. The State Advocates fail to provide any legitimate rationale that distinguishes these discounted rates from each other, and in most cases, cite entirely irrelevant reasons to justify differing treatment for gas-on-gas rates. As a result, gas-on-gas discounting should continue just as other discounting should continue for the benefit of all NGDCs and their customers.

4. Peoples Incorrectly Alleges That the Peoples-Equitable Merger Eliminates the Necessity for Gas-on-Gas Competition.

Throughout this proceeding, Peoples has argued that the primary reason for elimination or modification of gas-on-gas competition is the recent merger of Peoples and Equitable, because the merger limits gas-on-gas competition to only two NGDCs. Direct Testimony of Joseph A. Gregorini, Peoples/Peoples TWP Statement No. 1 ("Peoples/Peoples TWP St. No. 1"), p. 13; *see also* Peoples M.B., p. 15. Contrary to Peoples' position, however, after the People-Equitable

merger, gas-on-gas competition continues to impact many customers and a significant volume of load. For this reason, preservation of gas-on-gas competition in its present form to continue the benefits of gas-on-gas competition is essential.

In their Main Briefs, both Peoples and NFGD mistakenly allege that gas-on-gas competition has become less relevant due to the merger of Peoples and Equitable. Peoples M.B., p. 15; NFGD M.B., p. 3. Now that Peoples and Equitable have merged, only Peoples and Columbia continue to compete with each other and offer gas-on-gas discounts. IECPA M.B., p. 19. Peoples' and NFGD's position is inherently flawed, however, simply because gas-on-gas competition continues to exist after the Peoples-Equitable merger. Customers are still receiving gas-on-gas discounts, and NGDCs are still benefiting from the increased load of these customers on their systems. IECPA M.B., p. 19. Similar to rate discounting based on a potential bypass that may be offered to only a few customers located near an interstate pipeline, gas-on-gas discounts should continue to be provided, even if it is to fewer customers, based on these customers' continued existence in overlapping NGDC service territories. Even I&E admits that the merger of Peoples and Equitable would not end gas-on-gas competition in any meaningful way. *See* I&E M.B., p. 24.

Accordingly, the merger of Peoples-Equitable should have no impact on the decision regarding gas-on-gas competition. As stated in IECPA's Main Brief and herein, the benefits of gas-on-gas competition warrant its continuation in its present format. The merger of Peoples and Equitable provides no support for the modification or elimination of gas-on-gas competition.

B. No Party To This Proceeding Offers a Just and Reasonable Solution for Modification or Elimination of Gas-on-Gas Competition.

As stated in Section III.A., *supra*, no party to this proceeding offers any legitimate justification for eliminating status quo gas-on-gas competition. IECPA's Main Brief highlights

the many benefits of gas-on-gas competition, none which have been disproven by other parties. For this reason, this investigation should conclude that status quo gas-on-gas competition must continue.

In addition to arguing for reasons to eliminate gas-on-gas competition, however, parties also suggested specific approaches to modifying or transitioning away from gas-on-gas competition. Assuming *arguendo* that the PUC modifies status quo gas-on-gas competition, the many pitfalls associated with these alternative approaches as opposed to status quo gas-on-gas competition warrant the Commission's rejection of these alternatives. The fact that none of the recommended approaches offer a reasonable and practical alternative to status quo gas-on-gas competition provides additional support that status quo gas-on-gas competition is the most just and reasonable option.

1. Peoples' Proposed Alternative Is Impractical And Unworkable, Particularly When Compared to Status Quo Gas-on-Gas Competition.

In its Main Brief, Peoples outlines an extensive alternative to gas-on-gas competition that would base rates on NGDCs' cost-based rates. Peoples' M.B., pp. 16. Because tariff rates currently do not reflect cost-based rates, Peoples recommends that each NGDC hold a base rate case to determine its true cost-based rates, and competing NGDCs only offer discounts to a competitor's cost-based rates. Peoples' M.B., p. 17. As explained further below, Peoples' recommendations fail to establish a feasible alternative to status quo gas-on-gas competition.

Peoples is proposing to eliminate status quo gas-on-gas competition and instead limit NGDCs to offering "cost-based" rates, which would create the baseline for discounts offered by other NGDCs. *Id.* Despite Peoples' belief to the contrary, determining NGDCs' cost-based rates would be an exercise in futility. IECPA St. No. 1R, p. 26. As IECPA explained in its testimony, "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." *Id.* Although parties may identify their preferred cost of service methodology, agreement upon truly cost-based rates is impossible. *See id.* For this reason, Peoples' proposal to develop cost-based rates and base discounting on these rates is inherently unworkable.

By contrast, gas-on-gas rates are currently derived through standard procedures of NGDCs assessing the value of gas-on-gas customers on their systems. To determine this value, "information is gained through discussions with customers and suppliers, and through the review of competing NGDC's tariff rates." Peoples M.B., p. 11. Because NGDCs have been offering these rates for almost thirty years, NGDCs have standard protocols in place for determining the maximum amount to charge a customer in order to retain the customer on the system while still exceeding incremental costs and representing the NGDC's most competitive rate.⁸ In this way, NGDCs are currently offering just, reasonable, and readily-definable gas-on-gas rates.

Because NGDCs already have a standard and effective methodology for deriving gas-on-gas rates, there is no need to modify this methodology, particularly when the alternative methodology is impossible to determine. Under Peoples' proposed "cost-based" gas-on-gas competition, opposing parties would all suggest opposing cost of service studies, as they do currently in base rate cases, leaving it impossible to determine what a true cost-based rate would be. As a result, because NGDCs are already capable of deriving gas-on-gas rates that benefit their systems and customers bases, the methodology for establishing gas-on-gas rates should remain unchanged.

⁸ Although OSBA identifies a number of theories as to why gas-on-gas competition does not qualify as true competition, OSBA's efforts are irrelevant to whether or not gas-on-gas competition should continue. *See* OSBA M.B., pp. 11-12. Because NGDCs are offering gas-on-gas rates that exceed their incremental costs, and they are maximizing their offers to gas-on-gas customers, gas-on-gas rates are arguably competitive because they are akin to the rates that are offered due to bypass or alternative fuel options. Moreover, gas-on-gas rates derived in the foregoing way benefit NGDC systems and captive customers, and, thus, should continue to be offered.

Peoples' proposal further fails in its recommendation that all NGDCs offering gas-on-gas rates after this investigation must conduct base rate cases to determine their cost-based rates. As explained by the Commission in the July 25, 2012, Secretarial Letter that began this investigation, the purpose of this investigation is to avoid litigation of issues related to gas-on-gas competition in each individual NGDC base rate case. If this investigation concludes that gas-on-gas competition should continue as long as gas-on-gas rates are determined in future base rate cases, this investigation would fail to produce any additional efficiencies within future base rate cases. By contrast, if status quo gas-on-gas competition is maintained, future base rate cases would avoid litigation regarding whether the practice of gas-on-gas competition is just and reasonable. In contrast to Peoples' proposed alternative, retaining status quo gas-on-gas competition would preserve the resources of parties in base rate proceedings by limiting the subject of base rate cases to an evaluation of whether the rates themselves are just and reasonable.

Finally, other parties to this proceeding agree that Peoples' proposal is unworkable for a variety of reasons.⁹ OCA contends that Peoples' proposal could lead to significant loss of load by one of the remaining NGDCs offering competition based on a competitor's cost-based rates.¹⁰ OCA M.B., p. 30. Moreover, I&E believes that it is unnecessary for NGDCs to each hold base rate cases to determine cost-based rates at the conclusion of this investigation. I&E M.B., p. 27. Although IECPA disagrees with the rationales of OCA and I&E, Peoples' proposal is not a workable solution from the perspective of multiple parties to this proceeding. Because other parties also disagree with fundamental aspects of Peoples' modified version of gas-on-gas competition, Peoples' proposal should be rejected.

⁹ Columbia only supports Peoples' proposal if status quo gas-on-gas competition is rejected. Columbia M.B., p. 10.

¹⁰ By contrast, IECPA believes that the elimination of gas-on-gas competition could result in significant load loss for an NGDC that could adversely impact its captive customers. IECPA M.B., pp. 19-20.

As a final matter, Peoples' Main Brief addresses the potential procedural steps that should follow the instant investigation. If this investigation concludes that no change is required to gas-on-gas competition, as IECPA advocates, then the Commission is not required to take any additional procedural steps after the conclusion of this investigation. By contrast, any modification to gas-on-gas competition, including Peoples' proposal, would require an extensive procedural process that could involve the expenditure of significant additional resources by the parties. As a result, from a procedural standpoint, maintaining status quo gas-on-gas competition is significantly preferable to avoid these additional efforts at the conclusion of this investigation.

2. All Transitional Recommendations Offered by the State Advocates Create Multiple Unnecessary Concerns for NGDCs and Current Gas-on-Gas Customers.

In conjunction with their recommendations that gas-on-gas competition should be eliminated, the State Advocates present transitional recommendations as part of their proposed elimination of this practice. As explained below, all of the State Advocates' proposed transitional recommendations either adversely impact Large C&I customers and NGDCs or are logistically unworkable for other reasons.

The State Advocates erroneously submit that gas-on-gas competition should be eliminated at a certain date after varying transitional periods without consideration of current gas-on-gas contracts. OCA M.B., p. 26; I&E M.B., pp. 20; OSBA M.B., p. 18. OCA argues for a three to five year transitional period after this investigation concludes. OCA M.B., p. 26. I&E generally supports a transitional period, but does not recommend a specific length. OSBA identifies a sunset date of December 31, 2016, at which time NGDCs would be prohibited from offering any gas-on-gas discounts. The State Advocates' recommendations are inappropriate, however, because they fail to ensure that all current gas-on-gas contracts have expired by the end of these periods. As explained in IECPA's Main Brief, prohibiting gas-on-gas customers from

receiving the discounts offered under their current contracts with NGDCs is unjust, unreasonable, and may create due process concerns. IECPA M.B., pp. 21-22. At the same time, NGDCs should not be disallowed from collecting the amounts of these discounts from customers after a certain specific date. *Id.* All of the State Advocates' proposed transitional periods are inappropriate because they fail to grandfather current gas-on-gas contracts.

In addition, as part of this transitional period away from gas-on-gas competition, the OCA recommends three potential plans for dividing customers among the previously-competitive NGDCs, all of which are either unreasonable or unworkable. OCA M.B., pp. 27-28. Overlapping NGDC service territories may not be divided into exclusive territories, because NGDC plant overlaps each other, which could lead to significant stranded costs if NGDCs are forced to abandon their plant. IECPA M.B., p. 23. Alternatively, if customers are divided between NGDCs as a result of this investigation, then the Commission would be limiting customers' competitive options. *Id.* Finally, OCA's recommendation that captive and business segments share cost and revenue responsibility is unnecessarily complex and lacks sufficient detail regarding its potential implementation. *Id.* at 24. As a result, the OCA provides no practical recommendations for how NGDCs should divide their customers or service territories upon elimination of gas-on-gas competition.

The State Advocates offer no workable recommendation for a transition away from gas-on-gas competition. Even if all current gas-on-gas contracts are grandfathered, the OCA does not provide a single transition plan that is reasonable or practical for NGDCs or customers. By contrast, the continuation of status quo gas-on-gas competition would not require any transitional period or plan. As a result, from an implementation perspective, retaining gas-on-gas competition in its current form is the best solution.

3. Contrary to the State Advocates' Position, Eliminating Gas-on-Gas Rates Could Create Harmful Economic Consequences for Current Gas-on-Gas Customers.

In their Main Briefs, the State Advocates explain certain factors they argue would limit the economic harm experienced by current gas-on-gas customers upon the elimination of gas-on-gas competition. OCA submits that Large C&I customers are capable of withstanding the economic upheaval associated with a transition away from gas-on-gas rates. OCA M.B., pp. 24-25. I&E submits that there is no evidence Large C&I customers would face economic challenges if gas-on-gas competition is eliminated. I&E M.B., pp. 22-23. The State Advocates err in both respects.

OCA incorrectly claims that Large C&I customers, who are subject to the volatile price of gas in general, are able to withstand an increase in their distribution rates due to the elimination of gas-on-gas customers. OCA M.B., pp. 24-25. Similarly, I&E submits that there is insufficient evidence that Large C&I customers would be subject to economic harm after gas-on-gas rates disappear. I&E M.B., p. 22. Moreover, to the extent Large C&I customers could not withstand the rate increases, I&E alleges that they should pursue economic development rates. *Id.* at 23. Each of these claims are easily rejected below.

The State Advocates' claim that gas-on-gas customers would face limited economic harm from the elimination of gas-on-gas competition is contrary to evidence and common sense. In their Main Briefs, IECPA and PSU each outlined the economic benefits of gas-on-gas competition, as well as the potential adverse consequences of elimination. IECPA M.B., p. 9; PSU M.B., p. 5. Gas-on-gas competition promotes industry and job growth in Western Pennsylvania. IECPA M.B., p. 9. Without gas-on-gas competition, Large C&I customers could face severe budgetary and operating challenges. *Id.* In addition, this economic harm to Large C&I customers is self-evident considering the significant increase in rates that would occur after

almost thirty years of discounting. Therefore, the State Advocates are incorrect to contend that economic harm would not impact current gas-on-gas customers.

Moreover, considering all the reasons that support the continuation of gas-on-gas competition, I&E's suggestion that gas-on-gas rates be replaced by economic development rates, is an unnecessary step where gas-on-gas rates are justifiable in and of themselves. Gas-on-gas rates are sufficiently analogous to economic development rates, as well as other forms of discounted rates, to be preserved by the Commission. Gas-on-gas rates are endorsed under Pennsylvania law, regulations, Commission precedent, and based on legitimate principles of ratemaking. There is no reason to believe gas-on-gas customers are paying unreasonably discounted rates when the Large C&I class as a whole is paying rates above cost of service. Increasing the rates for current gas-on-gas customers would only create further deviations in cost of service to the benefit of smaller rate classes. Rather than subject gas-on-gas customers to unnecessary economic harm via unreasonable and unwarranted rate increases, this investigation should end with an endorsement and continuation of gas-on-gas competition in its current form.

IV. CONCLUSION

The Commission began this investigation to determine whether gas-on-gas competition was a beneficial practice in the Commonwealth. Throughout this investigation, IECPA provided numerous reasons that support the continuation of gas-on-gas competition without modification. In IECPA's opinion, this investigation boils down to the following simple conclusion: Offering discounted rates to Large C&I customers in overlapping NGDC service territories in order to preserve load and revenue on an NGDC's system, as long as the discounted rates exceed customers' incremental costs and contribute to a portion of an NGDC's fixed costs, is just and

reasonable. At the conclusion of this investigation, IECPA urges the Commission to adopt this conclusion in its entirety.

As explained herein, no party to this proceeding presented a legitimate argument in opposition that warrants modifying or eliminating gas-on-gas competition. The State Advocates fail to show that the gas-on-gas discounts violate any ratemaking principles or Commission precedent. Contrary to arbitrary distinctions drawn by the State Advocates, gas-on-gas discounts are analogous to other forms of discounting that the OCA contends should be preserved. Because gas-on-gas competition continues to benefit NGDCs and customers in Pennsylvania, there is no reason to modify or eliminate the practice to the detriment of all customers. Finally, no party provides a reasonable and logistically feasible alternative to gas-on-gas competition, particularly when continuing status quo gas-on-gas competition offers both procedural and substantive benefits. The just and reasonable, as well as the most practical, solution of this investigation is to uphold gas-on-gas competition in its current format.

WHEREFORE, the Industrial Energy Consumer of Pennsylvania respectfully request that the Pennsylvania Public Utility Commission hold as follows:

- (i) Gas-on-gas competition should continue without modification; and
- (ii) As indicated in IECPA's Main Brief, to the extent gas-on-gas competition is modified or eliminated, the transition away from gas-on-gas rates should include the following elements:

- (1) all gas-on-gas contracts should be preserved until their expiration dates,
- (2) all overlapping NGDCs should conduct base rate cases to determine just and reasonable rates for former gas-on-gas customers, and
- (3) a reasonable transition period between the expiration of gas-on-gas rates and tariff rates should be imposed.

Respectfully submitted,

McNEES WALLACE & NURICK LLC

By 

Charis Mincavage (I.D. No. 82039)
Teresa K. Schmittberger (I.D. No. 311082)
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
Phone: (717) 232-8000
Fax: (717) 237-5300
cmincavage@mwn.com
tschmittberger@mwn.com

Counsel to the Industrial Energy Consumers of
Pennsylvania

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