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July 14, 2014

Rosemary Chiavetta, Secretary
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400 North Street, 2nd Floor
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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 Exceptions 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)
Office of Special Assistants (via E-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).

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Dated this 14th day of July, 2014, at Harrisburg, Pennsylvania

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I. 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 Natural Gas Company, and Peoples TWP LLC (jointly, "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, but rather, asserting that current public utility law and policy supports the continued use of customer-specific discounted 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 *status quo* practice were necessary.

After a fully litigated proceeding,¹ on February 25, 2014, and March 12, 2014, parties to this investigation submitted their Main and Reply Briefs. IECPA and Penn State University ("PSU") each set forth positions that supported no change from current procedures for gas-on-gas competition (*i.e.*, *status quo* gas-on-gas competition). Similarly, Columbia Gas of Pennsylvania, Inc., ("Columbia") endorsed *status quo* gas-on-gas competition rather than seeking its elimination by the Commission.² The State Advocates (*i.e.*, OCA, OSBA, and I&E) recommended that the Commission wholly eliminate gas-on-gas competition. Finally, Peoples proposed an alternative process to replace *status quo* gas-on-gas competition.³

On June 18, 2014, ALJ Barnes issued a Recommended Decision ("R.D.") in this investigation. In the R.D., ALJ Barnes recommends that the Commission eliminate *status quo* gas-on-gas competition. In its place, ALJ Barnes suggests certain transitional proposals for moving current gas-on-gas customers to tariff rates. In the alternative, ALJ Barnes states that, if the Commission disagrees with her conclusion that gas-on-gas competition should be eliminated, then Peoples' proposal, or a similar process to Peoples' proposal, should be adopted in lieu of *status quo* gas-on-gas competition. IECPA submits the following Exceptions to this R.D.

II. SUMMARY OF ARGUMENT

¹ A more comprehensive summary of the procedural steps of this investigation is included in IECPA's Main Brief ("M.B."). IECPA M.B., pp. 1-3.

² Although Columbia explicitly states that it is not recommending a change from *status quo* gas-on-gas competition, Columbia expresses support for Peoples' proposal as an alternative if the Commission seeks to modify the practice. Columbia M.B., p. 9.

³ Equitable Gas Company ("Equitable") was also a party for a significant duration of this investigation. After its merger with Peoples in December 2013, however, only Peoples submitted briefs. Equitable originally supported the continuation of *status quo* gas-on-gas competition in testimony. Direct Testimony of Carol A. Scanlon, Equitable St. No. 1, p. 6.

The purpose of this investigation is to provide the Commission with an opportunity to evaluate the current practice of gas-on-gas competition as it exists throughout the Western portion of the Commonwealth. Importantly, this investigation was not initiated due to any perceived problems regarding the practice. 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 in a single proceeding, as compared to the PUC's previous consideration in NGDCs' individual base rate cases. In fact, this investigation was originally requested, not by the Commission, but by Peoples and the State Advocates. As a result, the Commission is under no obligation to modify *status quo* gas-on-gas competition at the conclusion of this proceeding.

As further explained herein, contrary to the conclusions of the R.D., gas-on-gas competition should not be altered by the Commission, as it presents numerous benefits to customers, natural gas distribution companies ("NGDCs"), and the Western Pennsylvania economy. This practice is consistent with public utility law and ratemaking principles and does not result in harm or discrimination to customers in smaller classes. *See* Section III.A., *infra*. Gas-on-gas competition is akin to other forms of rate flexing, all of which are endorsed in the R.D. *See* Section III.B., *infra*. Moreover, no transitional proposal advanced in the R.D. is feasible, and all are inferior to continuing *status quo* gas-on-gas competition. *See* Section III.C., *infra*. Similarly, Peoples' proposal is an inappropriate and unsatisfactory alternative to *status quo* gas-on-gas competition. *See* Section III.D., *infra*. In opposition to the R.D., the Commission should ultimately conclude that the merits of gas-on-gas competition warrant its continuation in present form.

III. EXCEPTIONS

A. Exception No. 1. The Recommended Decision erred in concluding that gas-on-gas competition offends public utility law and precedent when, in actuality, gas-on-gas competition is consistent with this authority and presents numerous benefits to customers and NGDCs.

The R.D. incorrectly finds that gas-on-gas competition is inconsistent with public utility law and precedent. *See* R.D., p. 27. In reaching this finding, the R.D. cites certain statutes, regulations, and precedent as purported justification for the elimination of gas-on-gas competition. *Id.* at 23-27. Unfortunately, the R.D. fails to recognize IECPA's repeated showing that *status quo* gas-on-gas competition is consistent with current public utility law and ratemaking principles, and in no way causes harm or discrimination to customers in smaller classes. Moreover, gas-on-gas competition provides numerous benefits to ratepayers and NGDCs, which have been acknowledged and endorsed within public utility law and precedent. Due to these benefits and this consistency with relevant law, *status quo* gas-on-gas competition should be continued without modification by the Commission.

The R.D. states that gas-on-gas competition should be eliminated because: (1) public utilities may not offer rates that "grant any unreasonable preference or advantage to any person;" and (2) natural gas transportation service must both minimize cost shifting to retail customers, and "be provided without discrimination as to type and location of customer." *Id.*; 66 Pa. C.S. §§1301, 1304; 52 Pa. Code §§ 60.1, 60.3. Nevertheless, *status quo* gas-on-competition offends neither of these important legal principles.

Although gas-on-gas competition provides certain Large C&I customers with discounted rates due to gas-on-gas competition, these rates are entirely consistent with the Public Utility Code and the Commission's regulations. IECPA R.B., p. 7. The Public Utility Code states, in relevant part, that no public utility shall offer rates that "grant an unreasonable preference or

advantage to any person" or "maintain any unreasonable difference as to rates, either as between localities or as between classes of service." 66 Pa. C.S. §§1301, 1304. The Commission's regulations explain further that rate differences may be unreasonable when significant cost shifting or discrimination occurs among classes. 52 Pa. Code §§ 60.1, 60.3. Crucially, gas-on-gas rates would only conflict with these provisions if they are determined to "grant an unreasonable preference" or "maintain any unreasonable difference" for Large C&I customers who receive gas-on-gas rates such that other customer classes experience significant cost shifting or discrimination.⁴ For a number of reasons, discounted rates due to gas-on-gas competition do not qualify as unreasonable in either respect.

Chiefly, the existence of discounted gas-on-gas rates does not require customers in smaller classes to pay above their cost of service; as a result, the difference in rates offered by gas-on-gas competition or the purported preference to Large C&I customers simply cannot qualify as unreasonable. Examination of rates from Peoples' most recent base rate case indicates that smaller customers are remitting costs below their cost of service even while gas-on-gas customers in the Large C&I class are remitting costs below their maximum tariff rate. IECPA M.B., p. 14. Peoples' blended Cost of Service Study ("COSS") reflects residential and small commercial customers paying rate of return percentages of 5.25% and 5.10%, respectively, as compared to an overall system rate of return of 6.07%. *Id.* By contrast, medium and Large C&I customers were paying rate of return percentages of 8.68% and 9.93%, despite the inclusion of customers within these classes who receive rate discounts due to gas-on-gas competition. *Id.* As indicated by this COSS, Large C&I customers are arguably paying above their cost of service

⁴ The existence of discounted rates offered for other purposes, such as bypass, alternative fuel, and economic development rates, clearly indicates that mere differences with respect to rates between customer classes do not violate the Public Utility Code.

while residential and small commercial classes are paying below their cost of service despite taking into account discounted gas-on-gas rates provided to Large C&I customers.⁵ As long as smaller customers are remitting rates below their cost of service, gas-on-gas rates for Large C&I customers may not constitute unreasonable rates.

In fact, differences in rates, such as those provided for gas-on-gas competition, are perfectly legitimate under public utility law and the Commission's regulations. The polestar criterion by which the Commission uses for determining when rate differences and preferences are reasonable (as opposed to unreasonable) is cost of service. *Id.* at 14-15. Where customers are paying rates below their cost of service, they cannot be experiencing unreasonable rates.⁶ *See id.* Because small commercial and residential customers appear to remit costs below their cost of service despite the existence of gas-on-gas rates for Large C&I customers, these smaller classes are experiencing reasonable, rather than unreasonable, rates consistent with the Public Utility Code and regulations.

In addition, other legitimate ratemaking principles, in particular, value of service, justify rate discounting provided as a result of gas-on-gas competition and prevent any unreasonable discrimination or subsidization impacting other classes. Other than cost of service, rates may be established based on a number of principles, including value of service, gradualism, ability to pay, etc. IECPA M.B., p. 12. When establishing rates based on value of service principles, an

⁵ Although Peoples proposed to decrease rates for Large C&I customers in Peoples' base rate proceeding to reduce this customer class rate of return percentage, the final settlement of the proceeding resulted in no change to the revenues remitted by Large C&I customers, indicating that Large C&I customers continue to pay rates above their cost of service. IECPA MB., n. 7.

⁶ Simply because there is a difference between the revenue received by an NGDC at discounted rates, as compared to the revenue that could be received by an NGDC at the maximum tariff rate, does not necessarily mean that any other customer classes are suffering harm or are burdened with any costs above that class' cost of service. *See* Surrebuttal Testimony of Diane Meyer Burgraff, IECPA St. No. 1-S, p. 13.

NGDC identifies the value a customer contributes to its system and determines the highest rate that may be charged to that customer without losing the customer. *Id.* at 15-16. Value of service principles legitimize gas-on-gas rates, which are developed by NGDCs as the highest rate they can charge gas-on-gas customers without losing them, to reduce the fixed costs of the systems spread among all customer classes.⁷ *Id.* Therefore, contrary to the R.D.'s conclusion that smaller customer classes are harmed or discriminated against due to gas-on-gas rates, these customers are actually being charged rates that are justified pursuant to public utility law and ratemaking principles.

In addition to its consistency with relevant law and ratemaking principles, gas-on-gas competition provides a number of benefits to all customers and NGDCs. Smaller customers and NGDCs receive a tangible benefit and value by retaining Large C&I customers rather than allowing those customers to switch to a competitor. *Id.*; *see also* Direct Testimony of Carol A. Scanlon, Equitable St. No. 1, p. 6.⁸ Specifically, customers in smaller classes benefit by retaining large customers on their NGDC's system to contribute to incremental costs:

In general, the incremental cost incurred by an NGDC to serve a particular customer is typically less than the fully allocated cost to serve that customer, as measured by the COSS [Cost of Service Study]. If the customer leaves the system, the NGDC's overall revenue will decline by more than its costs. This shortfall would need to be made up by remaining customers. Thus, as long as that

⁷ All NGDCs maximize the revenues received from gas-on-gas customers. IECPA St. No. 1S, Ex. DMB-1S.

⁸ Two of the three NGDCs, Equitable and Columbia, who participated in the instant proceeding support the continuation of gas-on-gas competition in their testimony. Equitable St. No. 1, p. 5 ("In Equitable's view, competition between natural gas distribution companies with overlapping service territories should continue with ratemaking impact addressed in each NGDC's base rate proceeding as has been done in the past."); *see also* Surrebuttal Testimony of Nancy J. D. Krajovic, Columbia Statement No. 1-SR, p. 5 ("In the meantime, IECPA's advocacy for the status quo would appear to be a reasonable suggestion."). In addition, Peoples acknowledges its long-standing support for gas-on-gas competition, a position that Peoples only slightly modified in the instant investigation. *See* Rebuttal Testimony of Joseph A. Gregorini, Peoples/Peoples TWP Statement No. 1-R, pp. 13-14 ("[I]f my recommendation that gas-on-gas competition at full margin rates is not accepted, then continuation of gas-on-gas competition in its present form is preferable to the alternatives of having to establish non-overlapping service territories and addressing the issues that flow from that process.").

customer is paying rates that exceed the NGDC's incremental cost of providing service, the rest of the customers are better off retaining the customer, even if it means discounting rates below regular tariff rates. Thus it is not uncommon to see regulators allowing "flex" rates or "load retention" or "economic development" rates in order to keep customers from leaving the system.

IECPA M.B., p. 8. For this reason, smaller customer classes are benefitting from larger customers' continued contribution to the fixed costs (*i.e.*, the system costs that exceed a customer's incremental costs) of their NGDC's system. Moreover, because NGDCs maximize revenues from gas-on-gas customers, they are generally charging gas-on-gas rates that are well above gas-on-gas customers' incremental costs.⁹ *Id.* at 8-9. If NGDCs were to lose these customers to competitor NGDCs, then smaller customers would be harmed by the loss of these large customers who can no longer remit a portion of NGDCs' fixed costs. *Id.* at 9. As a result, customers in smaller classes receive a clear benefit from their NGDC offering discounted rates due to gas-on-gas competition.

Therefore, contrary to the R.D.'s conclusion that gas-on-gas competition is "financial burdensome to other captive customers," smaller captive customers receive significant benefit from the presence of gas-on-gas customers on their system. *Contra* R.D., p. 30. Not only are these smaller customers currently remitting rates below their cost of service while Large C&I customers pay rates above their cost of service, but these smaller customers receive a benefit from the contribution to fixed costs provided by gas-on-gas customers. Accordingly, in contrast to the R.D., captive customers are better off while *status quo* gas-on-gas competition continues.

⁹ No NGDC in this investigation denies that gas-on-gas rates exceed customers' incremental costs. IECPA M.B., n. 4.

Along these same lines, NGDCs benefit from gas-on-gas competition, because it presents an opportunity for NGDCs to attract additional load to contribute to their incremental costs. If gas-on-gas competition is eliminated, one NGDC may benefit from additional load at the expense of the other NGDC, which will, in turn, be required to increase costs to its remaining customer base. *Id.* at 8. Accordingly, continued gas-on-gas competition will ensure that gas-on-gas customers remain on the NGDC system where they present the greatest benefit.

These tangible benefits of gas-on-gas competition have existed since gas-on-gas competition in Western Pennsylvania was first introduced as a solution for the economic woes of customers and NGDCs in the 1980s. Unlike utilities in other parts of the Commonwealth, NGDCs in Western Pennsylvania offer service to the same customers because their systems are built in close proximity to, and in some cases, overlap each other, such that customers may be located in more than one NGDC service territory. *Id.* at 6. Since the 1980s, after the fall of the basic iron and steel industry in Western Pennsylvania, NGDCs and customers alike have been pursuing every cost saving opportunity due to the closure of a number of major steel plants and the pressure of high inflation. *Id.* at 7. Gas-on-gas competition presents an opportunity for Large C&I customers to lower their natural gas rates while contributing to the overall operational costs of NGDCs for the benefit of NGDCs and their other captive customers.¹⁰ *Id.*

The Commission acknowledged these benefits of gas-on-gas competition in the 1980s by formally adopting regulations that allow for discounting natural gas rates and promote gas-on-gas competition. In particular, the regulations state that an NGDC's tariff must include "a range

¹⁰ While gas-on-gas competition exists, industry and job growth continues for these Large C&I customers. IECPA M.B., p. 9. By contrast, if gas-on-gas competition is eliminated, Large C&I customers could face severe budgetary and operating challenges, the first of which being the significant increase in rates that would occur after almost thirty years of discounting. *See id.*

of rates for transportation service," but also establish a "maximum rate allowed for transportation service." 52 Pa. Code § 60.2(2)-(3). The PUC's recognition of a "maximum rate" is an acknowledgement that rates may be offered below this rate. In addition, the PUC's regulations require NGDCs to "maximize system throughput," which mandates that NGDCs pursue every opportunity to increase system load. *Id.* § 60.2(7). As a result of this regulatory language, where their service territories overlap, NGDCs have an obligation to offer a competitive rate to Large C&I customers to retain their contribution to system costs.

The regulatory history associated with these regulations further legitimizes discounting rates due to gas-on-gas competition. When referring to discounted natural gas rates in general, the Commission explains that "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. Therefore, NGDCs should offer a "range of rates" to large customers, to give NGDCs more flexibility to respond to particular situations. *Id.* at 547. Crucially, these regulations and their history do not limit the application of discounted rates to only certain large transportation customers or circumstances of discounting. IECPA M.B., p. 10. In fact, because these regulations were adopted as gas-on-gas competition was spreading in Western Pennsylvania, the Commission was arguably directly addressing circumstances of gas-on-gas competition. As a result, the Commission has approved the overall practice of discounting rates due to gas-on-gas competition as beneficial to NGDCs and their customers, which is reflected within the Commission's regulations.

The merits of the overall practice of gas-on-gas competition have not been considered by the Commission since the passage of these regulations. The R.D.'s citation to potentially conflicting Commission precedent is actually not applicable, as no such precedent addresses the

practice of gas-on-gas competition as a whole. R.D., pp. 25-26. The R.D. relies on the 2005 Peoples and Equitable Purchased Gas Cost proceedings; however, these proceedings were limited to whether NGDCs should offer discounted retainage rates to attract customers onto their systems, rather than discounted distribution or transportation rates. *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. The R.D. also refers to the 2007 Peoples-Equitable Merger proceeding, which allowed for the discontinuation of gas-on-gas competition, but only between two NGDCs due to the PUC's perceived overall benefits of the merger. *In re Equitable Resources, Inc.*, 2007 WL 1175710 (Pa.P.U.C. 2007), 35. Because neither of these cases considers the benefits of the overall practice of gas-on-gas competition as applied throughout Western Pennsylvania, the Commission's findings are only relevant to the distinguishable factual circumstances of those cases.

In fact, since gas-on-gas competition began, the Commission has provided glimpses of continued support for the overall practice of gas-on-gas competition. In the Equitable Purchased Gas Cost proceeding cited in the R.D., 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. In addition, the Commission notes 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.* In addition,

over the last two decades, the Commission has approved innumerable base rate and purchased gas cost settlements that allowed for the continuation of discounted distribution rates due to gas-on-gas competition. IECPA M.B., p. 11. Each of these indicators within Commission precedent provides insight into the continued reasonableness and benefits of gas-on-gas competition.

The R.D. errs in its finding that gas-on-gas competition conflicts with current public utility law and precedent. In actuality, the Public Utility Code, associated regulations, and a significant amount of Commission precedent support the overall practice of discounting rates due to gas-on-gas competition. This practice is both promoted under current law, as well as justified by legitimate ratemaking principles. Moreover, discounting rates due to gas-on-gas competition provides benefits to customers and NGDCs alike and offers an important solution to the presence of overlapping service territories and economic concerns in Western Pennsylvania. For these reasons, the Commission should continue *status quo* gas-on-gas competition.

B. Exception No. 2. The Recommended Decision erred in differentiating gas-on-gas competition from other forms of rate discounting.

The R.D. inappropriately distinguishes between discounted rates due to gas-on-gas competition, which purportedly should be eliminated, and discounted rates offered for other purposes, which should continue to be offered. R.D., pp. 26, 29. By contrast, discounted rates due to gas-on-gas competition are analogous to other forms of discounted rates in practically all respects. Because rate discounting for other purposes is accepted and even championed within the R.D., as well as by the Commission and other stakeholders,¹¹ discounted rates due to gas-on-gas competition should likewise be endorsed.

¹¹ "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." R.D., p. 29.

Although the R.D. generally posits that rate discounting based on competition with an unregulated entity is distinguishable from rate discounting due to gas-on-gas competition, the reasoning within the R.D. fails to support this difference. R.D., p. 26. Specifically, the R.D. states that while customers receiving discounted rates in other scenarios threaten to stop contributing to an NGDCs' fixed costs altogether, gas-on-gas customers will continue to contribute to an NGDC's fixed costs, but at a reduced rate. *Id.* Here, the R.D. fails to recognize that an identical situation would occur with respect to both discounted rates due to competition with an unregulated entity, such as a bypass option, and competition with another NGDC. *See* IECPA R.B., p. 14. In both situations, the customer with the competitive option will approach its NGDC to receive a discounted rate due to the presence of the competitive option. If the customer believes the discounted rate is insufficient, the customer will leave the NGDC's system and no longer contribute to the fixed costs of the system. The amount the customer would contribute to the fixed costs of the system would not be smaller as a result of gas-on-gas competition as opposed to competition with an unregulated entity. Instead, this amount would solely be based on the price of the competitive option. *See id.* For example, if the customer is located close to an interstate pipeline, the costs for bypass service could be incredibly low, which would require an NGDC to offer a significantly discounted rate in order to retain the customer on its system. The R.D. provides no support for the contention that discounted rates due to gas-on-gas competition offer lower contributions to NGDCs' fixed costs as opposed to other discounted rates. As a result, the R.D.'s distinction between rate discounting based on competition with another NGDC versus rate discounting based on competition with an unregulated entity is a distinction without a difference.

The R.D. further errs in finding that rate discounting due to gas-on-gas competition differs from other forms of rate discounting because gas-on-gas competition: (1) discriminates against other rate classes; (2) results in an inefficient duplication of NGDC facilities; and (3) does not preserve load that would otherwise be lost to Pennsylvania NGDCs. R.D., p. 29. First, as discussed in III.A., *supra*, gas-on-gas competition does not result in unduly discriminatory rates for smaller customer classes, but instead is justified under both cost of service and value of service ratemaking principles. Moreover, discounting due to gas-on-gas competition, as well as other purposes for discounting, such as bypass, alternative fuel, or economic development, all result in discounted rates to Large C&I customers such that they contribute smaller amounts to NGDCs' fixed costs than if they were charged NGDCs' tariff rates. If this lesser contribution to fixed costs does not qualify as discriminatory with respect to other forms of discounting, then it likewise should not with respect to gas-on-gas competition.

Second, discounting due to gas-on-gas competition in no way perpetuates an inefficient duplication of NGDC facilities. Admittedly, other forms of discounts, *i.e.*, bypass, alternative fuel, and economic development, do not result in any duplication of NGDC facilities. IECPA R.B., p. 14. Neither, however, does discounting due to gas-on-gas competition. The close proximity and overlap of NGDC facilities is based on the original construction of the NGDC systems, which occurred long before rate discounting for gas-on-gas competition was even envisioned. *See* R.D., p. 2; *see also* IECPA R.B., p. 14. Continuation of gas-on-gas competition would in no way impact this already-existing overlap of NGDC facilities in Western Pennsylvania.

Third, the R.D. incorrectly asserts that discounted rates due to gas-on-gas competition fail to preserve NGDC load in the same manner as discounted rates for other purposes.

Preliminarily, all discounted rates, including gas-on-gas, bypass, alternative fuel, and economic development, are offered by NGDCs for the purpose of preserving load on their systems. IECPA R.B., p. 14. Although gas-on-gas competition is the only form of discounting that results in one NGDC losing load to another NGDC, the cause for rate discounting is no different than in other circumstances. The Large C&I customer will either choose service from one NGDC or the other, just as, in the case of a bypass alternative, the Large C&I customer will be choosing between an NGDC or a bypass. In other words, because discounted rates due to gas-on-gas competition are offered by NGDCs to retain customers' load on their systems due to a competitive threat, these discounted rates are no different from other forms of discounted rates.

In light of the foregoing, discounted rates due to gas-on-gas competition are overwhelmingly similar to discounted rates offered as a result of bypass, alternative fuel, and economic development options. These discounted rates are offered to retain load and revenue on NGDC systems due to the presence of a competitive alternative. None of these discounted rates lead to discriminatory rates for other classes or an inefficient duplication of NGDC facilities. In light of the R.D.'s explicit support for other forms of rate discounting, the R.D. errs in rejecting the continuation of discounted rates due to gas-on-gas competition.

C. Exception No. 3. The Recommended Decision erred in recommending a transition away from gas-on-gas competition that is unjust, unreasonable, and unworkable.

Because the R.D. recommends the elimination of gas-on-gas competition, the R.D. sets forth certain proposals for how such an elimination should take place. Nevertheless, these proposals contain a number of irredeemable deficiencies that do not provide a reasonable, or even feasible alternative, to *status quo* gas-on-gas competition. Considering the benefits provided by gas-on-gas competition, as well as the many deficiencies of the transitional proposals, *status quo* gas-on-gas competition should be continued.

The R.D. recommends that the Commission should eliminate gas-on-gas competition "within a reasonable timeframe, but no later than December 31, 2018." R.D., p. 37. As identified by a number of parties throughout the investigation, a proposal to establish a uniform end date for all gas-on-gas contracts is unreasonable because it would interrupt current customer contracts that were negotiated in good faith and at arms length. IECPA M.B., pp. 21-22. Due to the existence of these contracts, customers have relied on their gas-on-gas rates in projecting energy costs over the duration of their contracts. *Id.* As a result, eliminating gas-on-gas rates, which equate to their contract rates, would create serious due process concerns, as well as potential circumstances of an unlawful taking from these customers. *Id.*

The R.D. further inappropriately recommends that the Commission divide service territories among NGDCs as part of the process for eliminating gas-on-gas competition, or assign gas-on-gas customers to particular NGDCs. R.D., p. 37. This first recommendation is unworkable due to NGDCs' long-term investment of millions of dollars into their overlapping facilities. IECPA M.B., p. 23. Forcing these NGDCs to abandon portions of their facilities would arguably lead to significant stranded costs that would be recoverable from customers. *Id.* Moreover, coordination of NGDCs to determine how they will divide their service territories also gives rise to potential antitrust concerns. *Id.* In addition, a proposal for assigning customers to NGDCs is unreasonable, because it limits customers' ability to choose their natural gas service provider. *Id.* If a customer is assigned to an NGDC from which the customer believes it is not receiving adequate service, this assignment choice may be considered unduly discriminatory. *Id.* For these reasons, neither dividing NGDC service territories nor assigning customers would result in a just and reasonable outcome for gas-on-gas customers.

Finally, the R.D. endorses the establishment of a working group to determine how customers and service territories should be divided upon gas-on-gas competition elimination. R.D., p. 37. Any benefits of a working group would be undermined, however, due to the inherent unfeasibility of dividing up customers and/or service territories. In addition, the format of a working group for addressing these issues is unclear. The purpose of the instant investigation was to evaluate the merits of gas-on-gas competition, consider evidence, and render a decision regarding the practice. Initiating a working group to further address these gas-on-gas issues could be an unnecessary expenditure by stakeholders, who have already invested time and resources in this investigation. If the results of the working group were binding on NGDCs and customers, then this investigation would be rendered unnecessary. Because a working group would create both feasibility and practicality concerns, this proposal is an inappropriate step subsequent to the investigation.

The transition plans recommended by the R.D. are unreasonable and unworkable proposals for replacing *status quo* gas-on-gas competition. A uniform end date for gas-on-gas contracts is unjust and unreasonable for requiring the interruption of gas-on-gas contracts that have been negotiated and relied upon by parties. Neither the assignment of customers to NGDCs nor the division of NGDC service territories is feasible, and both options would create potentially significant legal concerns. Finally, a working group would likely be unproductive, and possibly waste the resources of stakeholders who have already invested significantly in this investigation to evaluate the merits of gas-on-gas competition. Because all of the transitional proposals are either unjust, unreasonable, or unworkable, *status quo* gas-on-gas competition, which offers a number of advantages to customers and NGDCs and presents none of these transitional challenges, should be continued by the Commission.

D. Exception No. 4. The Recommended Decision erred in recommending Peoples' proposal as an alternative to *status quo* gas-on-gas competition when no change to *status quo* gas-on-gas competition is warranted.

If the R.D.'s recommendation that *status quo* gas-on-gas competition be eliminated is rejected by the Commission, the R.D. alternatively recommends that the Commission consider a separate proposal presented by Peoples. R.D., p. 31. For the reasons highlighted herein, Peoples' proposed alternative to gas-on-gas competition is significantly inferior to *status quo* gas-on-gas competition and should be rejected by the Commission. Assuming *arguendo*, however, that the Commission seeks to modify *status quo* gas-on-gas competition, the Commission must address certain complex transitional issues discussed below.

Peoples' proposal is significantly less preferable to *status quo* gas-on-gas competition. As indicated within the foregoing Exceptions, *status quo* gas-on-gas competition is just and reasonable under current public utility law, analogous to other legitimate forms of discounting, and beneficial to customers and NGDCs alike. In fact, none of the parties have provided any justification that has not been thoroughly rebutted during the course of this proceeding for the elimination or modification of gas-on-gas competition at this time. As a result, Peoples' proposal is an unnecessary and inferior option to gas-on-gas competition as it is currently offered.

Specifically, Peoples' proposal contains a number of substandard components as compared to *status quo* gas-on-gas competition.¹² Primarily, Peoples proposes that all gas-on-gas NGDCs conduct base rate cases to develop cost-based tariff rates, which would become the new gas-on-gas discounting floor. *Id.* The main concern related to this proposal is the potential ineffectiveness of individual NGDC base rate cases to derive reasonable cost-based rates. *See*

¹² IECPA would note, however, that Peoples' proposal correctly acknowledges that any modification to gas-on-gas competition may not interrupt current gas-on-gas contracts. R.D., p. 31.

IECPA R.B., p. 17. As indicated by Peoples' most recent base rate case, Large C&I customers continue to pay rates above their cost of service despite the inclusion of gas-on-gas customers. As a result, development of cost-based rates in future base rate cases appears highly unlikely without specific changes to the usual base rate case dynamic, particularly when stakeholders disagree on the definition of cost-based rates. *Id.* at 17-18.

By contrast, under *status quo* gas-on-gas competition, NGDCs already have a clear methodology in place for deriving discounted rates that has been utilized for over 30 years. *Id.* at 18. *Status quo* gas-on-gas competition offers a significantly more straightforward process for determining appropriate transportation rates, *i.e.*, NGDCs assess the value the gas-on-gas customer offers to the system, as well as attempt to maximize revenue from the customer. *See id.* at 18. Specifically, this rate is determined from information that "is gained through discussions with customers and suppliers, and through the review of competing NGDCs' tariff rates." Peoples M.B., p. 11. Modifying the process for determining discounted rates is inappropriate and unnecessary when there is no current problem with gas-on-gas rate-setting.

Additionally, Peoples' proposal could lead to significant load loss by one of the remaining NGDCs that would be avoided if *status quo* gas-on-gas competition is maintained. *See* OCA M.B, p. 30. After NGDCs' base rate cases occur, gas-on-gas customers may flock to the NGDC providing the lowest "cost-based" rates despite their prior discounting agreement with another NGDC. Such a massive shift in load would not occur if *status quo* gas-on-gas competition continues because customer contracts expire at different intervals and both the NGDC and customer would have the ability to evaluate the importance of continued service with a specific NGDC. Therefore, to avoid the potential for significant load loss, the Commission should simply maintain gas-on-gas competition as it currently exists.

Although *status quo* gas-on-gas competition offers multiple advantages to Peoples' proposal, and is without question preferable to elimination of the practice altogether, IECPA will prudently address the possibility that the Commission could consider modifying this practice at the conclusion of this investigation. Specifically, to the extent the Commission pursues modification of the current practice, there are a few crucial elements that the Commission must address to promote a just and reasonable solution for current gas-on-gas customers, which Peoples' proposal fails to address.

Specifically, although Peoples correctly proposes that a base rate case and the development of cost-based rates is necessary, Peoples fails to address the significant logistical and transitional issues associated with base rate cases for NGDCs that have offered discounted rates for over 30 years. Because the evidence presented raises significant concerns that tariff rates for Large C&I customers are not cost-based, if gas-on-gas competition is modified or eliminated, NGDCs and the Commission would face the daunting task of transitioning gas-on-gas customers away from their negotiated rates to new, undefined rates. *See* IECPA M.B., pp. 22, 26.

While IECPA agrees that base rate cases would be the only way to manage this transition, simply holding base rate cases in their current format would fail to address the complexities of this new ratemaking process where maximum transportation rates have been set for decades without active analysis and input from the majority of larger customers due to the existence of Commission-endorsed gas-on-gas negotiation. Quite simply, the gaps between the existing tariff rates and cost-based transportation rates may be so large that it is politically unpalatable to implement the necessary changes to properly protect larger customers. In addition, the

incremental revenue received by the NGDC between the expiration of contracts and the rate case may delay the NGDC's need for rate relief.

The following hypothetical provides important insight into challenges that would be faced by the Commission if *status quo* gas-on-gas competition is modified or eliminated. Under the current environment of gas-on-gas competition, assume that an NGDC is receiving \$150 million annually from the Large C&I class, (*i.e.*, both its Large C&I customers at tariff rates and gas-on-gas rates). If gas-on-gas rates are eliminated before a rate case is filed, assume that the NGDC would receive \$200 million from Large C&I customers if all were served at tariff rates. *See id.* at 14. In other words, the mere elimination of gas-on-gas negotiation produces an incremental profit to the NGDC of \$50 million annually. Despite this incremental revenue, the NGDC could determine that it requires rate relief of \$100 million due to increased overall expenses to provide utility service, which would have been an increase of \$150 million if the negotiated contracts were not eliminated. In the first base rate case following the elimination of the gas-on-gas negotiated rates, to ensure consistency with cost causation principles, the NGDC would be required to recommend a rate decrease to the Large C&I class of at least \$50 million, while assigning a corresponding rate increase of at least \$150 million to the residential and small commercial classes for a net increase of \$100 million. Based on recent precedent, the Commission has rejected proposals to assign more than the total rate increase to certain customer classes to implement rate decreases for other customers even when those rate decreases were consistent with the adopted COSS. *See Pa. Pub. Util. Comm'n v. PPL Electric Utilities Corporation*, Opinion and Order, R-2012-2290597 (Dec. 5, 2012). Nevertheless, if *status quo* gas-on-gas competition is eliminated, the Commission would face this unprecedented scenario to ensure that distribution rates remain consistent with cost causation principles.

In addition to facing unprecedented base rate proposals, the Commission would need to consider the impact of gradualism on the rates of all customers in these base rate cases. If the Commission chooses the above approach of allowing significant decreases to Large C&I rates and increases to residential and small commercial rates, the Commission would need to address gradualism concerns regarding smaller customers' rates. *See id.* at 25. If, to avoid these concerns, the Commission allows all Large C&I customers to begin paying rates close to current tariff rates, the Commission would be faced with gradualism concerns related to Large C&I rates, which are suddenly exorbitantly beyond customers' cost of service. *See id.* As a result, the Commission, as well as NGDCs, would be subject to the significant challenge of deciding whether to set aside the core ratemaking principle of gradualism or cost causation when determining these new rates.¹³ In making either choice, the Commission would inevitably significantly harm one or more customer class.

For these reasons, while IECPA agrees that holding base rate cases would be the only means for determining new rates for previous gas-on-gas customers, IECPA is highly skeptical of the effectiveness of these base rate cases without harming certain customers. As part of this proceeding, there is insufficient evidence that certain customer classes would not be treated unjustly and unreasonably if *status quo* gas-on-gas competition is eliminated. Maintaining *status quo* gas-on-gas competition would avoid these difficult scenarios for NGDCs and the Commission.

¹³ If the Commission determines that rates will dramatically increase for one or more customer classes, IECPA would further recommend that a transition period be adopted between the imposition of these new rates and current tariff rates for the impacted customers. IECPA M.B., p. 26.

In sum, no credible arguments have been presented that support the elimination or modification of gas-on-gas competition. In comparison to Peoples' proposal, *status quo* gas-on-gas competition has already been deemed consistent with public utility law and ratemaking principles, and is further justified by its many benefits to customers and NGDCs, as well as by analogy to other discounted rates. In addition, Peoples' proposal is associated with a number of feasibility concerns that are not present with *status quo* gas-on-gas competition. For this reason, the Commission should find *status quo* gas-on-gas competition just and reasonable, and hold that this practice continue indefinitely without modification.

IV. CONCLUSION

WHEREFORE, the Industrial Energy Consumer of Pennsylvania respectfully request that the Pennsylvania Public Utility Commission reject the R.D. and hold that gas-on-gas competition continue without modification.

Respectfully submitted,

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Dated: July 14, 2014