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July 24, 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 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 24th day of July, 2014, at Harrisburg, Pennsylvania

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I. PROCEDURAL HISTORY

This investigation began after 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, *i.e.*, the practice of rate flexing by natural gas distribution companies ("NGDCs") with overlapping service territories. On June 18, 2014, Administrative Law Judge ("ALJ") Elizabeth H. Barnes issued a Recommended Decision ("R.D.") in this investigation recommending, primarily, that the Commission eliminate *status quo* gas-on-gas competition, and secondarily, that the Commission approve an alternative to gas-on-gas competition suggested by Peoples. The Industrial Energy Consumers of Pennsylvania ("IECPA"), Peoples, Pennsylvania State University ("Penn State"), and Columbia Gas of Pennsylvania, Inc. ("Columbia") each filed Exceptions to the ALJ's R.D. IECPA submits these Reply Exceptions to respond to certain positions set forth in other parties' Exceptions.¹

¹ Although IECPA's Reply Exceptions will not respond to every argument contained in the parties' Exceptions, IECPA's decision not to respond to every argument should not be construed as agreement with other parties' arguments. IECPA's position and supporting arguments that *status quo* gas-on-gas competition should remain unmodified at the conclusion of this proceeding have been clearly identified in IECPA's Main Brief, Reply Brief, and Exceptions.

II. EXCEPTIONS

A. Reply Exception No. 1. OSBA errs in recommending that gas-on-gas contracts should be eliminated by December 31, 2016.

While the R.D. inappropriately recommends that gas-on-gas contracts be eliminated by December 31, 2018, the OSBA extrapolates that problem by requesting that the Commission terminate all contracts by December 31, 2016. OSBA Exceptions, p. 5. All of the concerns highlighted in IECPA's Exceptions related to a December 31, 2018, termination date are magnified by an earlier termination date. IECPA Exceptions, p. 16. The Commission should reject any attempt to prematurely terminate gas-on-gas contracts on a uniform end date.

The OSBA offers no reasonable explanation for expediting the proposed gas-on-gas contract expiration date to December 31, 2016. The OSBA's position, that only a small number of contracts would be impacted by this end date, fails to acknowledge that any interruption by the Commission interferes with the private, arms-length contracting of NGDCs and customers in a manner that is arguably illegal. IECPA Exceptions, p. 16; *see also* Peoples Exceptions, p. 8; *see also* Columbia Exceptions, p. 6. Moreover, OSBA's contention that NGDCs and customers should not be rewarded "by entering into longer-term contracts when it became clear that the Commission was revisiting its policy" is entirely inaccurate.² OSBA Exceptions, p. 6. At no point during this investigation has the Commission indicated any desire to eliminate *status quo* gas-on-gas competition. To the contrary, throughout this investigation, IECPA has maintained that this investigation presents an opportunity for the Commission to once again acknowledge

² A gas-on-gas customer and NGDC that entered into a long-term contract (*e.g.*, a seven or ten year contract) before the investigation began in 2012 would have been unaware of the potential impacts of this investigation.

the just and reasonableness of discounted rates due to gas-on-gas competition.³ *See, e.g., Petition for Generic Investigation or Rulemaking Regarding "Gas-On-Gas Competition" Between Jurisdictional Natural Gas Distribution Companies*, Answer, Docket No. P-2011-227786 (Dec. 28, 2011).

In addition, contrary to the OSBA's Exceptions, eliminating gas-on-gas rates at an earlier time will in no way benefit smaller customers. OSBA presents no evidence that smaller customers are paying above their cost of service as a result of gas-on-gas rates. Instead, OSBA makes the mistaken assumption that moving gas-on-gas customers to tariff rates will benefit customers in smaller classes, an assumption that could be undermined once NGDCs file base rate cases post-gas-on-gas competition. *See* OSBA Exceptions, p. 6. The only evidence presented in this investigation regarding cost of service indicates that Large C&I customers pay above their cost of service while smaller customers pay below their cost of service, even with the existence of gas-on-gas discounting. IECPA Exceptions, p. 5. As a result, to the extent gas-on-gas competition is eliminated and NGDCs file base rate cases, under the aforementioned scenario all requested rate increases would be largely assigned to customers in smaller classes. *See id.* at 22. For this reason, the elimination of gas-on-gas competition at an earlier date would likely increase, rather than decrease, rates for customers in smaller classes at an earlier date.

Finally, assuming *status quo* gas-on-gas competition is eliminated by the Commission, a course of action that IECPA would strongly oppose, a two-year period would be a highly insufficient time period to transition from gas-on-gas rates to new rates. *Contra* OSBA

³ The Commission only began this investigation due to the request of I&E, OCA, OSBA, and Peoples, because gas-on-gas competition had not been evaluated in a single Commission proceeding since it was originally adopted in the 1980s. IECPA M.B., p. 11. At no time did the Commission conclude that a problem with gas-on-gas competition required an investigation into the practice.

Exceptions, p. 7. A transition from gas-on-gas rates to new rates would, at a minimum, require (1) the Commission to identify and implement a binding procedure for eliminating gas-on-gas rates, as well as engage in formal rulemaking regarding gas-on-gas competition;⁴ (2) NGDCs to file and parties to litigate base rate cases; and (3) customers in all classes to transition from their current rates to new rates developed in base rate cases in a manner that prevents rate shock.⁵ See IECPA Exceptions, pp. 20-22. As a result, a two-year period would seem entirely inadequate for addressing these transitional requirements.

The OSBA's proposed end date for gas-on-gas contracts of December 31, 2016, should be rejected outright by the Commission. Elimination of these contracts at any uniform date, *e.g.*, December 31, 2016, or December 31, 2018, would create serious due process concerns and inappropriately interfere with customer contracting. In addition, the termination of gas-on-gas contracts at an earlier date would in no way ensure a reduction in rates charged to smaller rate classes, at least for those smaller rate classes that are currently remitting rates below their cost of service. Finally, a two-year period until gas-on-gas contracts would be eliminated provides insufficient time for implementing necessary transitional steps. For the foregoing reasons, the Commission should reject OSBA's proposal that gas-on-gas contracts be eliminated by December 31, 2016.

⁴ A formal rulemaking would likely be mandatory if the Commission adopts any change to *status quo* gas-on-gas competition. See PSU Exceptions, pp. 18-20.

⁵ As discussed further in Section II.B., *infra*, although these steps would be necessary for any transition away from gas-on-gas rates, it is unclear to IECPA that these steps could occur in actuality.

B. Reply Exception No. 2. Peoples errs in recommending that its alternative to gas-on-gas competition, which includes a round of NGDC base rate cases and establishes new rates for gas-on-gas customers, is a reasonable and feasible solution as opposed to *status quo* gas-on-gas competition.

Although *status quo* gas-on-gas competition continues to be a just and reasonable practice that offers many benefits to customers and NGDCs alike, in Exceptions, parties presented their positions regarding alternatives to gas-on-gas competition as a result of the R.D.'s mistaken conclusion that *status quo* gas-on-gas competition be eliminated. Primarily, Peoples supports its proposed alternative to gas-on-gas competition, which Columbia agrees would be preferable to the elimination *status quo* gas-on-gas competition. Peoples Exceptions, p. 3; Columbia Exceptions, p. 8. While IECPA agrees that the elimination of gas-on-gas competition should be avoided at all costs, IECPA disagrees that Peoples' proposal (or a similar proposal) would present a viable alternative to gas-on-gas competition. Because alternative proposals are likely impossible to implement, *status quo* gas-on-gas competition should be maintained by the Commission without modification.

A central component of Peoples' alternative to gas-on-gas competition is the need for a series of NGDC base rate cases for developing cost-based rates, which may be impossible to implement in practice. IECPA's Exceptions, p. 20; *see also* Columbia Exceptions, p. 9. As gas-on-gas rates have been in place for over thirty years, any modification to the methodology for establishing these rates must be carefully designed. The current format of base rate cases does not provide an adequate or feasible methodology. IECPA's Exceptions, p. 20.

First, NGDCs are currently permitted to file for a base rate increase whenever they believe a rate increase is necessary. It is unlikely that the Public Utility Code or the Commission's regulations could allow the Commission to force NGDCs to file base rate cases at the exact same time. *Contra* Columbia Exceptions, p. 9. Because corresponding timing and

coordination of base rate cases among multiple NGDCs is not permitted under current law, Peoples' proposal to require all NGDCs to file base rate cases in the same timeframe after this investigation is not feasible.

Second, gas-on-gas customers have not always chosen to directly participate in previous base rate cases because their rates were established via contract. As a result, NGDC's tariff rates for Large C&I customers currently do not reflect cost of service principles. IECPA Exceptions, p. 20. In order to move Large C&I customers to cost-based rates, particularly when they are already paying above their cost of service, smaller customer classes could face significant rate increases in post-gas-on-gas competition base rate cases. Although the Commission has previously found that large rate increases are unacceptable, the elimination of gas-on-gas competition could put the PUC in a position inconsistent with this precedent in NGDCs' next base rate cases. *See id.* at 21.

Third, the Commission could also be required to contend with gradualism concerns in the NGDCs' next base rate cases. Smaller customers currently paying below their cost of service could be faced with significantly higher rates after a base rate case. Gas-on-gas customers, who, separately from other Large C&I customers, were remitting rates below their cost of service, would also be subject to significant rate increases. If these gas-on-gas customers leave the NGDC's system, then all remaining customers will be subject to increased rates. NGDCs' next base rate cases would likely raise all of these issues, which would place the Commission in the nearly impossible position of determining which customer classes would pay lower rates to avoid rate shock at the expense of other classes. *Id.* at 22. If smaller customers are permitted to remit costs significantly below their cost of service, all Large C&I customers could be subject to exorbitant rates above cost of service, which may contribute to additional customers leaving

NGDCs' systems. *See id.* Base rate cases for determining new rates after gas-on-gas competition would present unprecedented dilemmas for the Commission with respect to its ratemaking principles of cost of service and gradualism.

Fourth, considering the possibility that gas-on-gas customers would begin paying significantly increased rates, NGDCs could face a substantial exodus of Large C&I customers from their systems, which would negatively impact all remaining customers of the NGDCs. PSU Exceptions, p. 13. If subject to unprecedented rate increases, gas-on-gas customers may have no choice but to pursue other options for natural gas service that were previously considered uneconomic. With the elimination of gas-on-gas competition, these customers may pursue bypass or alternative fuel options, because the initial additional costs of these alternatives would be offset by the decreased long-term natural gas rates. *See id.* Meanwhile, NGDCs that rely on current gas-on-gas customers to contribute to their fixed system costs would have no choice but to allocate customers in all rate classes this difference in revenue. *See* IECPA Exceptions, p. 8.

As indicated by the foregoing problems associated with individual NGDC base rate cases, no legitimate avenue appears to exist for establishing new rates for gas-on-gas customers. Base rate cases would face a number of unprecedented issues that could result in serious rate increases and customer exodus. In addition, a separate working group or rulemaking would present feasibility and potential antitrust concerns. IECPA Exceptions, pp. 16-17; Columbia Exceptions, p. 7. Any approach would be challenged by numerous stakeholders as conflicting with principles of cost of service or gradualism, or leading to loss of Large C&I customers as NGDC customers. The likelihood that a just and reasonable procedure would be established is highly improbable. *See* IECPA Exceptions, p. 22.

The solution to the complexities associated with these alternatives is a simple one: allow gas-on-gas competition to continue as it currently exists. The Commission is under absolutely no obligation to modify *status quo* gas-on-gas competition at this time. As discussed by IECPA throughout the proceeding, gas-on-gas competition harms no other customer class, as these classes continue to pay rates below their cost of service. *Id.* at 5. Instead, gas-on-gas competition provides a definitive benefit to NGDCs and customers alike by retaining large customers on NGDC systems to contribute to fixed costs. *Id.* at 8. In addition, after thirty years of discounting, NGDCs have developed a clear methodology for establishing gas-on-gas rates that would not require a controversial Commission rulemaking or a series of simultaneous base rate cases to implement. *Id.* at 19. The Commission's continuation of discounted rates due to gas-on-gas competition would be consistent with historic Commission regulations and policy to promote the greater purpose of preserving load on an NGDC's system for the benefit of all.

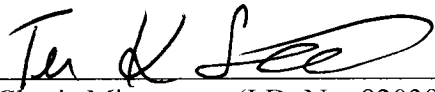
As a result, the continuation of *status quo* gas-on-gas competition is the only just and reasonable outcome for this investigation. No party, including Peoples, has presented an alternative to gas-on-gas competition that could be feasibly adopted or promote the same benefits of gas-on-gas competition. The Commission should take this opportunity to reiterate its support for *status quo* gas-on-gas competition and the importance of such rate discounting in Western Pennsylvania.

III. 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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