

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF CONSUMER ADVOCATE

555 Walnut Street, 5th Floor, Forum Place
Harrisburg, Pennsylvania 17101-1923
(717) 783-5048
800-684-6560

FAX (717) 783-7152
consumer@paoca.org

July 24, 2014

Rosemary Chiavetta, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
Harrisburg, PA 17120

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

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

Dear Secretary Chiavetta:

Enclosed please find the Office of Consumer Advocate's Reply Exceptions in the above-referenced proceeding.

Copies have been served as indicated on the enclosed Certificate of Service.

Sincerely,

A handwritten signature in black ink, appearing to read "Darryl A. Lawrence".

Darryl A. Lawrence
Assistant Consumer Advocate
PA Attorney I.D. # 93682

Enclosures

cc: Hon. Elizabeth H. Barnes, ALJ
Certificate of Service

*159861

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Petition for Generic Investigation or	:	
Rulemaking Regarding "Gas-On-Gas"	:	
Competition Between Jurisdictional Natural	:	P-2011-2277868
Gas Distribution Companies	:	
	:	
	:	
Generic Investigation Regarding Gas-On-Gas	:	
Competition Between Jurisdictional Natural	:	I-2012-2320323
Gas Distribution Companies	:	

REPLY EXCEPTIONS OF THE
OFFICE OF CONSUMER ADVOCATE

Darryl Lawrence
PA Attorney I.D. # 93682
E-mail: DLawrence@paoca.org
Assistant Consumer Advocate

Counsel for:
Tanya J. McCloskey
Acting Consumer Advocate

Office of Consumer Advocate
555 Walnut Street 5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152

DATED: July 24, 2014

TABLE OF CONTENTS

I. INTRODUCTION.....	1
II. REPLY EXCEPTIONS.....	2
OCA Reply to IECPA Exception No. 1 and PSU Exception No. 3: The ALJ Was Correct In Finding That Gas-on-Gas Rate Discounting is Discriminatory And Not In Accord With The Public Utility Code. (IECPA Exceptions at 4-11; PSU Exceptions at 9-11; R.D. at 30, 38; OCA M.B. at 12-25; OCA R.B. at 6-9).....	2
OCA Reply to IECPA Exception No. 1, PSU Exception No. 3, and Peoples Exceptions B and C: The ALJ Was Correct In Finding That Gas-on-Gas Rate Discounting Provides No Benefit To Captive Ratepayers (IECPA Exceptions at 4-11; PSU Exceptions at 9-11; Peoples Exceptions at 6-7; R.D. at 23-30; OCA M.B. at 12-25; OCA R.B. at 2-6).....	5
OCA Reply to IECPA Exception No. 2: The ALJ Was Correct In Finding That Gas-on-Gas Rate Discounting Is Not The Same As Other Forms Of Rate Discounting (IECPA Exceptions at 12-15; R.D. at 27-29; OCA M.B. at 22-24; OCA R.B. at 13-16).....	9
OCA Reply to PSU Exception No. 4: The ALJ Was Correct In Finding That Gas-on-Gas Rate Discounting Should End Within A Reasonable Period Of Time And That There Is No Need For All NGDCs To Move All Customers To “True Cost Of Service” Prior To This Occurring. (PSU Exceptions at 16-18; R.D. at 30-31; OCA M.B. at 26-31; OCA R.B. at 17-18)	11
OCA Reply to IECPA Exception No. 3; PSU Exception No. 1; Columbia Exception No. 1; and Peoples Exception D: The ALJ Was Correct In Finding That Gas-on-Gas Rate Discounting Should End Within A Reasonable Period Of Time. (IECPA Exceptions at 15-17; PSU Exceptions at 4-7; Columbia Exceptions at 5-7; and Peoples Exceptions at 8-9; R.D. at 30-33; OCA M.B. at 26-31; OCA R.B. at 17-18)	13
OCA Reply to IECPA Exception No. 3; PSU Exception No. 5; Columbia Exception No. 2; and Peoples Exception A: ALJ Barnes Did Not Solely Recommend A Division Of Service Territories As The Only Possible Avenue To Bring A Complete End To Gas-On-Gas Discounting, As Some Of The Parties Exceptions Imply. (IECPA Exceptions at 16-17; PSU Exceptions at 18; Columbia Exceptions at 7-8; and Peoples Exceptions at 4-6; R.D. at 37; OCA M.B. at 26-31; OCA R.B. at 17-20).....	15
OCA Reply to IECPA Exception No. 3; Columbia Exception No. 2; Peoples Exception E; and OSBA Exception No. 2: The ALJ Was Correct In Recommending A Working Group Or Collaborative Process To Implement The Commission’s Final Determination In This Matter. (IECPA Exceptions at 17; Columbia Exceptions at 7-8; Peoples Exceptions at 10; and OSBA Exceptions at 8; R.D. at 31, 37; OCA M.B. at 26-31; OCA R.B. at 20).....	18

III. CONCLUSION20

TABLE OF CITATIONS

Cases

Accord Bell Telephone Co. of Pa. v. Pa. PUC, 5 A.2d 410 (Pa. Super. Ct. 1939)3

Allegheny Ludlum Corp. v. Pa. PUC, 612 A.2d 604 (Pa. Commw. Ct. 1992).....3

Alpha Portland Cement Co. v. Public Service Comm’n, 84 Pa. Super. 225 (1925)3

Bldg. Owners & Managers Ass’n v. Pa. PUC, 470 A.2d 1092 (Pa. Commw. Ct. 1984).....3

City of Phila. v. Pa. PUC, 63 A.2d 391 (Pa. Super. Ct. 1949)3

Hatfield Twp. Mun. Auth. v. Pa. PUC, 853 A.2d 1 (Pa. Commw. Ct. 2004)3

Lloyd v. Pa. PUC, 904 A.2d 1010 (Pa. Commw Ct. 2006).....3

Lukens Steel Co., Div. of Lukens, Inc. v. PA PUC, 499 A.2d 1134, at 1137 16

Mfrs. Ass’n of Erie v. Pa. PUC, 407 A.2d 114 (Pa. Commw. Ct. 1979)3

Mill v. Commonwealth, 447 A.2d 1100 (Pa. Commw. Ct. 1982).....3

Peoples Natural Gas Co. v. PA PUC, 554 A.2d 585, at 592 (Pa. Comm. Ct. 1989)..... 16

Peoples Natural Gas Co. v. Pa. PUC, 409 A.2d 446 (Pa. Commw. Ct. 1979).....3

Phila. Elec. Co. v. Pa. PUC, 470 A.2d 654, 657 (Pa. Commw. Ct. 1984)3, 5

Phila. Suburban Water Co. v. Pa. PUC, 808 A.2d 1044 (Pa. Commw. Ct. 2002)3

Riverton Consol. Water Co. v. Pa. PUC, 140 A.2d 114 (Pa. Super. Ct. 1957).....3

U.S. Steel Corp. v. Pa. PUC, 390 A.2d 865 (Pa. Commw. Ct. 1977)3

Statutes & Regulations

66 Pa. C.S. § 13042

66 Pa.C.S.A. § 1103(a)..... 16

I. INTRODUCTION

On June 24, 2014, the Office of Administrative Law Judge issued the Recommended Decision (R.D.) of Administrative Law Judge Elizabeth H. Barnes (ALJ Barnes) in this matter. ALJ Barnes made a primary recommendation that the Commission end gas-on-gas rate discounting completely by December 31, 2018. R.D. at 36-37. ALJ Barnes made an alternative recommendation that should the Commission not adopt her primary recommendation, the Commission should adopt Peoples Compromise Proposal (Peoples Proposal). R.D. at 36-37. In either case, ALJ Barnes recommended that the Commission establish either a working group or a collaborative to assist in carrying out the Commission's final determination as to practical and procedural matters. R.D. at 36-37. The OCA submits that ALJ Barnes' primary recommendation in this matter is well reasoned, consistent with the law and sound public policy, and should be upheld.

On July 14, 2014, Exceptions were filed by the Industrial Energy Consumers of Pennsylvania (IECPA), the Pennsylvania State University (PSU), Columbia Gas of Pennsylvania, Inc. (Columbia), Peoples Natural Gas Company LLC, including its Equitable Division and Peoples TWP LLC (Peoples), and the Office of Small Business Advocate (OSBA). The OCA files these Reply Exceptions to address the various Exceptions of the other parties as they relate to ALJ Barnes' conclusion and primary recommendation that gas-on-gas rate discounting be ended.

At the outset, the OCA notes that a consistent theme found in many of the Exceptions is that ending gas-on-gas rate discounting is simply too arduous a task for the Commission to accomplish. The OCA disagrees. The OCA submits that the record evidence in this matter provides several reasonable options for ending this discriminatory practice that are well within

the Commission's purview and capabilities.

In these Reply Exceptions, the OCA will summarize its arguments in support of ending gas-on-gas rate discounting in response to the Exceptions of the other parties. A full discussion is presented in the OCA's Briefs.

II. REPLY EXCEPTIONS

OCA Reply to IECPA Exception No. 1 and PSU Exception No. 3: The ALJ Was Correct In Finding That Gas-on-Gas Rate Discounting is Discriminatory And Not In Accord With The Public Utility Code. (IECPA Exceptions at 4-11; PSU Exceptions at 9-11; R.D. at 30, 38; OCA M.B. at 12-25; OCA R.B. at 6-9).

In its Exceptions, IECPA argues that the current practice of gas-on-gas rate discounting is consistent with the Public Utility Code, and, specifically, is not discriminatory. IECPA Exc. at 4. Similarly, PSU defends the current practice and argues that it is not discriminatory. PSU Exc. at 9-11.¹ In the R.D., ALJ Barnes specifically held that:

I find the evidence in the current Investigation supports a finding that gas-on-gas rate discounting appears to be discriminatorily beneficial to a select group of large industrial customers fortunate enough to be located in an overlapping service territory and is financially burdensome to other captive customers.

R.D. at 30.

As discussed in detail in the OCA's Main Brief, gas-on-gas rate discounting is not in accord with the Public Utility Code, Pennsylvania appellate court decisions, Commission precedent or sound public policy. See OCA M.B. at 7-25. The Public Utility Code prohibits unreasonable discrimination in rates. 66 Pa. C.S. § 1304. Pursuant to Section 1304 of the Public Utility Code:

¹ IECPA Exception No. 1 and PSU Exception No. 3 both go on to include the policy argument that all customers benefit from gas-on-gas rate discounting. As these assertions are not directly relevant to the initial legal inquiry as to whether the current practice of gas-on-gas rate discounting is unduly discriminatory under the Public Utility Code, the OCA will address these policy arguments in the following section.

No public utility shall, as to rates, make or grant any unreasonable preference or advantage to any person, corporation, or municipal corporation, or subject any person, corporation, or municipal corporation to any unreasonable prejudice or disadvantage. No public utility shall establish or maintain any unreasonable difference as to rates, either as between localities or as between classes of service.

Id. Although not all differences in rates are discriminatory and therefore unlawful, *unreasonable* differences are prohibited. Id. As explained by the Commonwealth Court of Pennsylvania:

Before a rate can be declared unduly preferential and therefore unlawful, it is essential that there be not only an advantage to one, but a resulting injury to another. Such an injury may arise from collection from one more than a reasonable rate to him in order to make up for inadequate rates charged to another, or because of a lower rate to one of two patrons who are competitors in business. There must be an advantage to one at the expense of the other.

Phila. Elec. Co. v. Pa. PUC, 470 A.2d 654, 657 (Pa. Commw. Ct. 1984), (citing Alpha Portland Cement Co. v. Public Service Comm'n, 84 Pa. Super. 225 (1925)).²

The unreasonable discrimination that results from gas-on-gas rate discounting is both interclass and intra-class. As for the interclass discrimination, it is undisputed that certain (but not all) industrial and commercial customers that benefit from gas-on-gas discounting receive an advantage – a natural gas distribution rate below that of the full tariff rate. OCA St. 1 at 3. And while the Commonwealth Court of Pennsylvania has stated that a mere difference in rates between classes does not rise to the level of undue price discrimination, see, e.g., Alpha Portland

² Vernon Twp. v. Pub. Serv. Comm'n, 75 Pa. Super. 54 (1920) (holding that furnishing free gas was unduly discriminatory because “[i]f any service is rendered by the utility free or at a reduced price, it necessarily must be paid for by someone, and the burden of its cost is imposed upon other shoulders”); Alpha Portland Cement Co. v. Pub. Serv. Comm'n, 84 Pa. Super. 255 (1925) (recognizing that different rates can be charged for different services provided to different classes). Accord Bell Telephone Co. of Pa. v. Pa. PUC, 5 A.2d 410 (Pa. Super. Ct. 1939); City of Phila. v. Pa. PUC, 63 A.2d 391 (Pa. Super. Ct. 1949); Riverton Consol. Water Co. v. Pa. PUC, 140 A.2d 114 (Pa. Super. Ct. 1957); U.S. Steel Corp. v. Pa. PUC, 390 A.2d 865 (Pa. Commw. Ct. 1977); Mfrs. Ass’n of Erie v. Pa. PUC, 407 A.2d 114 (Pa. Commw. Ct. 1979); Peoples Natural Gas Co. v. Pa. PUC, 409 A.2d 446 (Pa. Commw. Ct. 1979); Mill v. Commonwealth, 447 A.2d 1100 (Pa. Commw. Ct. 1982); Phila. Elec. Co. v. Pa. PUC, 470 A.2d 654 (Pa. Commw. Ct. 1984); Bldg. Owners & Managers Ass’n v. Pa. PUC, 470 A.2d 1092 (Pa. Commw. Ct. 1984); Allegheny Ludlum Corp. v. Pa. PUC, 612 A.2d 604 (Pa. Commw. Ct. 1992); Phila. Suburban Water Co. v. Pa. PUC, 808 A.2d 1044 (Pa. Commw. Ct. 2002); Hatfield Twp. Mun. Auth. v. Pa. PUC, 853 A.2d 1 (Pa. Commw. Ct. 2004); Lloyd v. Pa. PUC, 904 A.2d 1010 (Pa. Commw. Ct. 2006).

Cement Co. v. Pub. Serv. Comm'n, 84 Pa. Super. 255, 271 (1925), the practice of gas-on-gas discounting is more than a mere, reasonable difference in rates.³

As OCA Witness Watkins discussed in his testimony, captive ratepayers – those customers without a NGDC option – subsidize the discounted rates so as to allow the NGDCs to collect their full revenue requirement. OCA St. 1 at 10, 14. Thus, the discounted rates cause added expense to captive ratepayers that those customers would not pay in the absence of gas-on-gas discounts. More plainly, the captive ratepayers suffer an injury.

The evidentiary record in this matter is clear – certain customers are able to extract discounts on monopoly distribution service from the NGDCs based solely on their geographic location. These discounts, totaling into the tens of millions of dollars, are then collected from all other customers who have no opportunity whatsoever to likewise negotiate for discounted rates. These facts highlight the unreasonable nature of this practice as it currently exists.

Moreover, ALJ Barnes recognized that unreasonable discrimination in rates exists not just between classes of customers, but also within the same class. As the R.D. provides:

I believe the primary concern of the Commission should be to end the subsidization of revenue lost by the captive customers in these NGDCs' territories. This should happen within a reasonable time frame, but no later than December 31, 2018. Understandably, gas-on-gas competition has been ongoing for thirty years; however, it appears to be inherently unfair to require residential and business captive customers to subsidize the price of natural gas for some large businesses. *It is not unforeseeable that some of these captive customers may be small businesses giving subsidies to their business competitors merely because the competitor is located in a more favorable location.* This is a discriminatory practice which should end.

R.D. at 37 (emphasis added).

OCA Witness Watkins provided the following example to illustrate this intra-class price discrimination, as recognized in the R.D.:

³ See e.g., OCA St. 1 Highly Confidential, Schedule GAW-2.

Consider two commercial laundry/uniform service providers in the greater Pittsburgh area. These laundry/uniform service providers use a significant amount of natural gas which reflects a substantial portion of their operating costs and compete neck and neck with each other. However, one of these customers is able to enjoy lower natural gas rates simply because it happens to be located on a street in Pittsburgh that has mains owned by two different NGDCs. The other laundry/uniform service provider is captive to one NGDC and pays significantly higher rates for natural gas delivery service than his competitor across town. All else constant, the second laundry/uniform service provider is clearly injured in that it is unable to effectively compete with the other supplier without reducing its profits below those of the competitor with gas-on-gas discounted rates.

OCA St. 1 at 17.

It is not only the case that non-discounted commercial customers are at a disadvantage as to competitors that do receive a gas-on-gas discount, but the non-discounted commercial customers subsidize the discount, just as the residential customers do. There is not just a competitive disadvantage for non-discounted commercial customers; the non-discounted commercial customers are paying for their competitors' economic advantage. This situation is exactly the type of "advantage to one and resulting injury to another" that the Commonwealth Court of Pennsylvania has identified as prohibited undue price discrimination. See Phila. Elec. Co., 470 A.2d at 657 (stating that "injury may arise from collection from one more than a reasonable rate to him in order to make up for inadequate rates charged to another, or because of a lower rate to one of two patrons who are competitors in business").

The ALJ was correct in finding that gas-on-gas rate discounting is a discriminatory practice. As such, IECPA's and PSU's Exceptions in this area should be denied.

OCA Reply to IECPA Exception No. 1, PSU Exception No. 3, and Peoples Exceptions B and C: The ALJ Was Correct In Finding That Gas-on-Gas Rate Discounting Provides No Benefit To Captive Ratepayers (IECPA Exceptions at 4-11; PSU Exceptions at 9-11; Peoples Exceptions at 6-7; R.D. at 23-30; OCA M.B. at 12-25; OCA R.B. at 2-6).

Peoples argues that gas-on-gas rate discounting is beneficial to captive ratepayers. Peoples alleges that if NGDCs could not offer discounts to keep "flex" customers on their

system, those customers could leave and the remaining customers would have to make up for the resultant revenue deficiencies. Peoples Exc. at 7. In addition, Peoples suggests that the continuation of gas-on-gas rate discounting incentivizes NGDCs to provide better service, lower gas costs and more customer friendly tariffs. Peoples Exc. at 6. In its Exceptions, IECPA argues that gas-on-gas rate discounting benefits all customers because larger customers are kept on the system and contribute to the NGDC's fixed costs. IECPA Exc. at 7-12. PSU's Exceptions on this issue mirror those of IECPA. PSU Exc. at 11-13. IECPA also argues that Commission regulations, precedent and current public utility law all support the continuation of gas-on-gas rate discounting in its current form. IECPA Exc. at 9-12.

Peoples' first argument in defense of the current practice appears to overlook the fact that gas-on-gas rate discounting is not only used as a shield, a mechanism to keep larger customers on a particular NGDC's system, but also as a sword. As OSBA witness Robert Knecht testified:

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

OSBA St. 1 at 3-4. As such, the potential harms of ending gas-on-gas discounting that Peoples warns of are already actually occurring through the continuation of this practice. Bringing a complete end to the practice in a reasoned and thoughtful manner is a certain way to avoid these harms.

As to Peoples second argument about non-rate benefits, such benefits, as the OCA understands Peoples position, would only accrue to those customers who actually have a choice of NGDCs. Captive customers, those who pay the fare for these "competitive" activities, are already provided the assurance that NGDCs will strive for better customer service, customer

friendly tariffs and low gas costs through the operation of statutes and regulations. The OCA submits that there are no benefits or gains to be had for captive customers by continuing gas-on-gas discounting.

As for IECPA's and PSU's "all customers benefit" arguments, ALJ Barnes performed a searching inquiry of Commission regulations and precedent and found no such evidence of benefits to captive customers. In fact, the ALJ's review of the evidence as set out in the R.D. provides that gas-on-gas discounting harms captive customers, is poor public policy and finds no support in either the Commission's regulations or recent precedent. The record evidence supports the conclusions of all three of the Statutory Advocates' (I&E, OSBA and OCA) witnesses as to lack of benefits for captive customers, in relevant part as follows.

I&E witness Mr. Cline testified in relevant part that:

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

I&E St. 1 at 7.

OSBA witness Mr. Knecht testified as follows:

Customers who are not afforded discriminatory below-tariff rates are, in total, detrimentally impacted by this policy in two ways. First, the duplicative construction of gas mains that allows customers to be served by multiple NGDCs is economically inefficient, and the excess costs related to this inefficient investment are borne by ratepayers. Second, absent gas-on-gas price discrimination, regular tariff rate revenues from gas-on-gas customers would be higher than they are now, offsetting the revenue requirement for other customers.

OSBA St. 3 at 2.

OCA witness Mr. Watkins testified as follows:

These gas-on-gas discounted rate customers must receive their natural gas distribution service from one of the regulated NGDCs in Pennsylvania.

Therefore, if for instance, Equitable were to argue that its captive customers are better off with some revenue contribution from Customer A than if that customer's business is lost to People's, and People's argues that its captive customers are better off with revenue contributions from Customer B than if that customer's business is lost to Equitable, it becomes a circular, nonsensical argument. Under current practices, the only thing that is achieved is that Customers A and B are able to enjoy subsidized rates at the expense of Equitable's and People's collective captive ratepayers.

OCA St. 1 at 16.

As set out in the R.D., neither the Commission's regulations nor its recent precedent provide support for gas-on-gas discounting, in relevant part as follows:

- In Equitable and Peoples 2005 PGC proceedings the Commission specifically held that it was not appropriate to shift costs to captive customers when such costs were created by the practice of gas-on-gas discounting. R.D. at 24-25.
- In those same 2005 PGC Orders, the Commission specifically held that such gas-on gas discounts could not be recovered from captive ratepayers. R.D. at 25.
- In the 2007 Equitable/Peoples merger case, the Commission specifically found and held that gas-on-gas discounting is "poor public policy", "wholly uneconomic" and "a dead weight loss". R.D. at 26-27.
- Gas-on gas rate discounting is inconsistent with the intent and plain language of the Commission's regulations at 52 Pa.Code Section 60.3. R.D. at 27.
- The Commission has specifically held that utilities must exercise caution when deviating from their tariffed rates, especially when the costs of such deviation are to be passed on to customers of a different class than the beneficiaries of such "flexed" rates. R.D. at 29-30.

ALJ Barnes concluded that:

I agree with Dr. Hieronymus that gas-on-gas rate discounting creates winners and losers, enables large amounts of load to switch back and forth between NGDCs at the end of each "discount" contract period, creates no new revenues, but rather creates additional expense.

R.D. at 28.

The substantial evidence of record in this matter is clear that captive ratepayers are harmed by the practice of gas-on-gas rate discounting. The OCA submits that the Commission should end this discriminatory and harmful practice.

OCA Reply to IECPA Exception No. 2: The ALJ Was Correct In Finding That Gas-on-Gas Rate Discounting Is Not The Same As Other Forms Of Rate Discounting (IECPA Exceptions at 12-15; R.D. at 27-29; OCA M.B. at 22-24; OCA R.B. at 13-16).

IECPA argues that gas-on-gas discounting is no different from discounts given for bypass capability, dual fuel use or for economic development purposes. As the argument goes, a customer who leaves the NGDC's distribution system for any reason creates the same effects and leaves behind the same stranded costs. Accordingly, gas-on-gas discounting should be endorsed in order to prevent this situation from occurring. IECPA Exc. at 12-15.

The OCA submits that pipeline bypass, dual fuel and economic development discounting practices reflect legitimate business practices, result in reasonable price discrimination and are in the public interest. The OCA does not advocate for any change of the status quo with regard to these legitimate discount practices as part of the final resolution of this matter. In his Direct Testimony, OCA witness Watkins explained why bypass, dual fuel and economic development discounting practices reflect legitimate business practices and distinguished gas-on-gas discounts, stating:

There is a fundamental principle of regulatory economics that no price (rate) should be higher than a customer's "stand-alone" cost; i.e., the cost of providing a regulated product or service by another means. With respect to the potential for interstate transmission pipeline by-pass, as well as the substitutability of natural gas with alternative fuels, these are definite examples of customer-based "stand-alone" costs. This pricing below a customer's stand-alone cost is in stark contrast to gas-on-gas rate discounting in which traditional distribution service is required but discounted to meet a lower price of another similar NGDC. That is, under gas-on-gas rate discounting, each customer still requires a traditional natural gas distribution supplier. Hence, gas-on-gas discounted rates do not reflect the NGDC's cost to serve, nor do they reflect the maximum threshold of a customer's stand-alone cost.

With respect to economic development/sustainability rates, economics may take a back seat to other public policy considerations such as the creation or preservation of jobs, the overall economic multiplier effect of a particular large natural gas user on a locality or the Commonwealth as a whole, impacts on state and local tax revenues, etc.

OCA St. 1 at 5.

As Mr. Watkins testified, so called “flex” customers still require the use of a NGDC’s distribution system. This situation is structurally different from other forms of rate discounting where the customer can effectively leave the entire natural gas distribution system, of any NGDC. In the R.D., ALJ Barnes accurately recognized this important distinction by stating:

Customers with dual fuel capability have the option to leave the natural gas distribution system entirely by utilizing whatever alternative source of fuel their particular infrastructure supports, such as fuel oil, propane or diesel. Conversely, gas-on-gas customers must use the natural gas distribution system to take service from an NGDC.

R.D. at 27-28.

Gas-on-gas discounting is also dissimilar to these other forms of rate discounting in that the former perpetuates the continuation of inefficient and costly duplicate distribution infrastructure. As OCA witness Watkins testified:

It is well known that distribution utilities are considered natural monopolies and it has been the long-standing belief and practice of regulators that duplicative utility distribution facilities are not in the public interest such that regulation of monopoly providers will serve as a surrogate for effective competition and are deemed the most efficient utilization of society’s resources. As such, the additional costs posed by duplicative facilities are considered a societal cost, or negative benefit.

OCA St. 1 at 16-17. OSBA witness Knecht also testified that:

Gas-on-gas price discrimination is fundamentally different from the other forms of rate discounting cited by Ms. Burgraff because (a) the practice results in inefficient duplication of facilities, and (b) it does not preserve load that would otherwise be lost to Pennsylvania NGDCs. The fundamental difference between gas-on-gas discounting and other discounting is that the other discounting

techniques will retain margin revenues that would otherwise be lost to Pennsylvania customers, whereas gas-on-gas discounting reduces Pennsylvania NGDC margin revenues.

OSBA St. 3 at 7.

In sum, gas-on-gas rate discounting is not the same as negotiated rates for pipeline bypass capability, alternative fuels, and economic development because: (1) “gas-on-gas discounted customers must obtain their natural gas distribution service from a NGDC while those with bypass or alternative fuel capabilities do not;” (2) gas-on-gas “results in inefficient duplication of facilities and does not preserve load that would otherwise be lost to Pennsylvania NGDCs”; (3) other discounting techniques will retain margin revenues that would otherwise be lost to Pennsylvania customers, whereas gas-on-gas discounting reduces Pennsylvania NGDC margin revenues; and (4) customers that negotiate reduced rates because of pipeline bypass or alternative fuels have made or would need to make the investment in additional infrastructure.

OCA St. 1-S at 2; OSBA St. 3 at 7.

In the R.D., ALJ Barnes concludes that the continuation of gas-on-gas rate discounting is “not in the public interest” and that:

Flex rates for dual fuel, bypass or economic development purposes can be used to further important public policy goals and the continuance of these practices is in the public interest. Gas-on-gas rate discounting, however, appears to be discriminatory and unfair to rate classes.

R.D. at 29. The OCA submits that the ALJ’s decision on this issue is based on a substantial record of evidence, is correct, and should be upheld. Accordingly, IECPA’s Exception on this issue should be denied.

OCA Reply to PSU Exception No. 4: The ALJ Was Correct In Finding That Gas-on-Gas Rate Discounting Should End Within A Reasonable Period Of Time And That There Is No Need For All NGDCs To Move All Customers To “True Cost Of Service” Prior To This Occurring. (PSU Exceptions at 16-18; R.D. at 30-31; OCA M.B. at 26-31; OCA R.B. at 17-18).

In its Exceptions, PSU argues that should the Commission decide to end gas-on-gas rate discounting it should order all involved NGDCs to first file base rate cases so that all customers can be moved to “true cost of service.” The main thrust of PSU’s argument is that current tariff rates were created as a result of black box settlements in the NGDCs’ recent base rate cases, and it is unknown whether such rates actually reflect true cost of service for flex customers. PSU Exc. at 16-18. In her R.D., ALJ Barnes recommended that gas-on-gas rate discounting end within a reasonable period of time in accord with a phase-out plan and did not include a recommendation that all involved NGDCs should complete base rate cases prior to this occurring. R.D. at 30-31.

The OCA submits that it is not necessary, reasonable or appropriate to require base rate proceedings prior to the complete end of gas-on-gas discounting. All involved NGDCs have approved tariffed rates that are currently being charged to all customer classes, including large C&I customers. As gas-on-gas discounting ends through a reasonable phase-out period, the former flex customers will simply be migrated to the existing tariff rates for their respective customer classes. These are the same tariff rates currently being paid by all other large C&I customers who do not have the good fortune to be located in an area where they can extract rate discounts from NGDCs due to the existence of duplicative/overlapping infrastructure.

Further, the Commission should reject PSU’s invitation to further complicate the resolution of this matter by entering the morass of “cost of service.” A similar idea was put forth by Peoples’ witness Mr. Gregorini during this proceeding, and was soundly rejected by numerous parties, including PSU.⁴ Mr. Watkins testified as to the inherent difficulties of including class cost of service matters in this Investigation, as follows:

⁴ See PSU St. 1 at 11; OCA St. 1-R at 8; OSBA St. 2 at 9; I&E St. 1R at 10; Columbia St. 1R at 8; NFGD St. 1 at 6; and IECPA St. 1R at 25.

Mr. Gregorini recommends that if gas-on-gas rate discounting is discontinued or abolished in Pennsylvania, that a generic investigation be initiated to evaluate cost allocation methods and to establish a state-wide cost allocation methodology. With respect to this recommendation, and with all due respect to Mr. Gregorini, this generic investigation is about gas-on-gas rate discounting and should not be sidetracked with other issues, namely, the never ending and controversial topic of class cost allocations. In this regard, Peoples is free to request a generic investigation if they so desire. However, this case is complicated enough with the issues at hand and no further discussion of class cost allocation methods should be devoted to this topic. I will make one observation regarding Mr. Gregorini's opinion and that is, any assertion that a state-wide cost allocation methodology (whether appropriate or not) would result in nothing more than the tail wagging the dog. That is, while the allocation of an NGDC's total cost of service may vary across the various NGDC's in Western Pennsylvania, the reality is, each NGDC has a much different total cost structure. In other words, due to the very nature in which we establish rates in Pennsylvania, we consider an NGDC's total cost of service. These total Company revenue requirements vary greatly across NGDCs. Therefore, cost allocations play only a partial role in developing a particular distribution rate and will vary across NGDCs simply because the total costs vary across NGDCs.

OCA St. 1-R at 8-9 (emphasis in original). As Mr. Watkins testified, class cost of service issues are one of the most controversial and subjective issues that come before the Commission. To engage in base rate proceedings to arrive at "true cost of service", as PSU suggests, would certainly accomplish nothing more than to substantially complicate the matter at hand and significantly delay the resolution of this matter. The OCA submits that ALJ Barnes was correct to not include such a recommendation as part of a reasonable phase-out plan. Accordingly, PSU's Exception in this area should be denied.

OCA Reply to IECPA Exception No. 3; PSU Exception No. 1; Columbia Exception No. 1; and Peoples Exception D: The ALJ Was Correct In Finding That Gas-on-Gas Rate Discounting Should End Within A Reasonable Period Of Time. (IECPA Exceptions at 15-17; PSU Exceptions at 4-7; Columbia Exceptions at 5-7; and Peoples Exceptions at 8-9; R.D. at 30-33; OCA M.B. at 26-31; OCA R.B. at 17-18).

Numerous parties argue that ending gas-on-gas discounting by a time certain could invite contentious litigation and could be in violation of constitutional safeguards. The main thrust of these arguments is that existing flex contracts may need to be modified or abrogated in whole by

the Commission in order to effectuate such a hard stop.⁵ In her R.D., ALJ Barnes provided the following as to a definitive end date for gas-on-gas discounting activities:

I recommend the Commission take action to end the current practice of gas-on-gas discounting through a reasonable phase-out plan, the length of which may be determined by the Commission. At a minimum, I recommend the Commission direct that ratepayer funded gas-on-gas rate discounts be abolished no later than December 31, 2018. I recommend the Commission issue this directive by the end of 2014.

R.D. at 30.

The OCA took no firm position in this proceeding as to a definitive end date for all gas-on-gas discounting activities. Rather, the OCA recommended a transition period and suggested that a period of 3-5 years could be reasonable. As OCA witness Watkins explained:

First and foremost, it is recognized that the mandated abandonment of the current practices will certainly create significant challenges for the Commission and all stakeholders. The practices and unfairness associated with ratepayer funded gas-on-gas rate discounting have existed for decades, and in my opinion, cannot be fairly resolved overnight. Regardless of the ultimate approach or mechanism utilized to abolish ratepayer funded gas-on-gas rate discounts, I recommend that there be a definite and reasonable transition period so that all stakeholders can plan for, and accommodate, these required changes. The time period should be long enough to facilitate the orderly transition of this change in regulatory practice, but not so long as to unreasonably delay the correction of the current unjustness to captive ratepayers. In this regard, a time period of three to five years after the issuance of a Commission Order in this case should provide ample time for a fair and orderly transition.

Second, the issues surrounding the ultimate approach and mechanism to abolish ratepayer funded gas-on-gas rate discounts are clearly complex. There are no obvious or clear-cut approaches that are simple, and at the same time, fair to all stakeholders. Indeed, due to the labyrinth of multi-utility owned natural gas distribution mains in Western Pennsylvania, as well as the locations and unique characteristics of many commercial/industrial customers currently receiving gas-on-gas distribution rate discounts, inputs and expertise from these customers, the NGDC's, statutory parties, and potentially other stakeholders are required to formulate fair and effective procedures to abandon the current unjust practice of ratepayer funded gas-on-gas rate discounting. As such, the initial decision in this case should be a directive that ratepayer funded gas-on-gas rate discounts will be abolished within a definite and predefined period of time and that a task force

⁵ IECPA Exc. at 15-17; PSU Exc. at 4-7; Columbia Exc. at 5-7; and Peoples Exc. at 8-9.

comprised of all stakeholders will be formed to make recommendations, or at least provide alternative solutions, to accomplish this directive. The task force should report their findings and recommendations to the Commission within one to two years from the time of an initial decision in this case.

OCA St. 1 at 20-21. The OCA submits that ALJ Barnes' recommendation is consistent with the format laid out by Mr. Watkins; is reasonable, provides a sufficiently long transitional period and should be considered by the Commission as it reaches its final determinations in this matter.

As discussed, the OCA took no firm position as to the establishment of a hard stop in this matter. The OCA submits, however, that the ALJ's December 31, 2018 end date finds support in the evidentiary record through OSBA testimony. As the OSBA discussed, the vast majority of flex contracts reviewed as part of this matter have end dates prior to OSBA's proposed December 31, 2016 end date. In addition, OSBA contends that parties entering into these flex rate contracts should have reasonable protections built into such agreements that protect the parties from an unexpected change in regulatory law or policy. Further, all stakeholders have been on notice for many years that flex rates have been routinely opposed by many parties in rate cases, and as such, continuation of such contracts without necessary protections would indicate that the parties involved assumed the risk of proceeding in such a manner.⁶

OCA Reply to IECPA Exception No. 3; PSU Exception No. 5; Columbia Exception No. 2; and Peoples Exception A: ALJ Barnes Did Not Solely Recommend A Division Of Service Territories As The Only Possible Avenue To Bring A Complete End To Gas-On-Gas Discounting, As Some Of The Parties Exceptions Imply. (IECPA Exceptions at 16-17; PSU Exceptions at 18; Columbia Exceptions at 7-8; and Peoples Exceptions at 4-6; R.D. at 37; OCA M.B. at 26-31; OCA R.B. at 17-20).

ALJ Barnes provided a clear primary recommendation that the Commission should end all gas-on-gas rate discounting practices. R.D. at 30, 36-37. Through their Exceptions, some of the Parties appear to place undue significance on the ALJ's discussion of potentially dividing service territories as one possible means to end gas-on-gas discounting. Specifically, the Parties'

⁶ See OSBA M.B. at 18-20.

Exceptions on this issue are styled in such a manner that a division of service territories is the *only* potential solution recommended by ALJ Barnes.⁷ The OCA, however, does not read the R.D. in such a limited fashion as to the potential solutions that ALJ Barnes actually recommended.

The R.D. provided that:

If the Commission decides to end gas-on-gas competition altogether in these overlapping service territories, a division of territory may be warranted and explored further.

R.D. at 36. This sentence appears to be the focal point of many of the Parties' Exceptions as to the issue of dividing service territories. By and large, the Parties' Exceptions raise constitutional concerns, stranded cost issues and even question the Commission's authority to re-draw the boundaries of the involved NGDCs' service territories.⁸

Initially, the OCA submits that the Commission's authority to assign or amend service territories is not as limited as some Parties suggest.⁹ That said, however, the OCA appreciates that some potential avenues for completely ending gas-on-gas discounting may be more challenging than others. With respect to specific approaches, OCA witness Watkins's first recommendation was to "(1) create specific and exclusive service areas in Western Pennsylvania for each NGDC". OCA St. 1 at 21. As Mr. Watkins explained, establishing specific and exclusive service areas is likely the most effective method, as it would eliminate the continuation of duplicative facilities. OCA St. 1 at 21. This option, however, is likely the most complex and

⁷ IECPA Exc. at 16-17; PSU Exc. at 18; Columbia Exc. at 2; and Peoples Exc. at 4-6.

⁸ See e.g., PSU Exc. at 18.

⁹ See 66 Pa.C.S.A. § 1103(a); Lukens Steel Co., Div. of Lukens, Inc. v. PA PUC, 499 A.2d 1134, at 1137 (Pa. Comm. Ct. 1985) (The power of the PUC to grant certificates of public convenience and to establish territories in which a public utility may serve is exclusive). See also Peoples Natural Gas Co. v. PA PUC, 554 A.2d 585, at 592 (Pa. Comm. Ct. 1989) (the extent to which competition may be allowed between utilities is a matter within the exclusive discretion of the Commission).

challenging from both a legal and technical perspective because it would require the transfer of assets between NGDCs and/or abandonment of facilities. OCA St. 1 at 21.

As Mr. Watkins discussed, there are pros and cons to a division of service territories as a resolution of this matter, but the OCA submits that the ALJ's recommendation for the Commission to *consider* this course of action is reasonable.

The R.D. also goes on to list several other potential resolutions as to how the Commission could bring about a complete end to gas-on-gas discounting. As the R.D. next provides:

The Commission might consider assigning the 74 current GOGC customers to specific NGDCs.

R.D. at 37. As the ALJ recommended, this process of treating all flex customers as a group is additionally a viable option for the Commission to consider.

Further, the R.D. provided that:

In the alternative, the Commission could allow all NGDCs to keep their current customers. Then, the NGDCs involved in this could choose service areas that are in the conflicted regions. From this point onward, any new customer in any conflicted area could first be offered to the NGDC who was given this service area (primary NGDC). Only if a primary NGDC declines, should a different NGDC be allowed to offer a large-load customer service. Some arrangement similar to this could help separate the NGDCs over time, as arguably, a primary NGDC would likely expand anywhere there is not a captive customer of another NGDC's service territory. The other NGDC would then focus its efforts in other areas.

R.D. at 37.

The R.D. includes several alternative recommendations as to how the Commission could bring a complete end to gas-on-gas discounting.¹⁰ The OCA submits that some of the Exceptors'

¹⁰ The record evidence in this matter also includes several reasonable options for ending gas-on-gas discounting. See e.g., OCA St. 1 at 20-21.

focus on the division of service territories should not limit the Commission from exploring the full quantum of potential resolutions as contained in the R.D. and the record of this matter.

OCA Reply to IECPA Exception No. 3; Columbia Exception No. 2; Peoples Exception E; and OSBA Exception No. 2: The ALJ Was Correct In Recommending A Working Group Or Collaborative Process To Implement The Commission's Final Determination In This Matter. (IECPA Exceptions at 17; Columbia Exceptions at 7-8; Peoples Exceptions at 10; and OSBA Exceptions at 8; R.D. at 31, 37; OCA M.B. at 26-31; OCA R.B. at 20).

In their Exceptions, many of the Parties question the usefulness or efficiency of creating a working group or collaborative process in order to implement the Commission's final decision in this matter.¹¹ The R.D. provided that should the Commission order a complete end to gas-on-gas rate discounting, a working group or collaborative should be established to effectuate this outcome. R.D. at 31, 37. The OCA agrees with ALJ Barnes that a working group or collaborative process may be necessary in order to work out procedural details for the complete end of gas-on-gas discounting activities. The OCA understands and appreciates the views of some of the Parties on this issue, as this matter has been long, and, at times, relatively contentious; however, a well-rounded group of stakeholders may well be necessary in order to provide a reasonable and workable path forward. In the OCA's view, however, the initial requirement is for the Commission to issue a clear directive that all gas-on-gas rate discounting activities will cease, at some specific future period of time.

OCA witness Glenn Watkins testified as to the need for a group of stakeholders in order to create some reasoned path forward in the aftermath of gas-on-gas discounting, as follows:

Indeed, due to the labyrinth of multi-utility owned natural gas distribution mains in Western Pennsylvania, as well as the locations and unique characteristics of many commercial/industrial customers currently receiving gas-on-gas distribution rate discounts, inputs and expertise from these customers, the NGDC's, statutory parties, and potentially other stakeholders are required to formulate fair and effective procedures to abandon the current unjust practice of ratepayer funded gas-on-gas rate discounting. As such, the initial decision in this case should be a

¹¹ See IECPA Exc. at 17; Columbia Exc. at 7-8; Peoples Exc. at 10; and OSBA Exc. at 8.

directive that ratepayer funded gas-on-gas rate discounts will be abolished within a definite and predefined period of time and that a task force comprised of all stakeholders will be formed to make recommendations, or at least provide alternative solutions, to accomplish this directive. The task force should report their findings and recommendations to the Commission within one to two years from the time of an initial decision in this case.

OCA St. 1 at 20-21. As Mr. Watkins explained, a multi-disciplinary group of stakeholders will likely be needed in order to analyze, discuss and ultimately work out some of the procedural and practical challenges presented by the Commission's final action in this matter. The OCA submits, however, that keeping the ultimate directive clear and pointed, will significantly enhance the ability of any such group to collectively overcome any procedural challenges.

Alternatively, the OCA is not discounting the possibility that the Commission could craft a final order in this matter that would need little, if any further collaboration or input from the Parties. Although, the OCA recognizes that the ultimate resolution of this matter may well require further deliberation and study. To this end, the OCA agrees with ALJ Barnes' recommendation to assemble a working group with the end goal of implementing the Commission's final order in this matter.

III. CONCLUSION

For the reasons set forth above, and for the reasons set forth in the OCA's Briefs, the OCA submits that the ALJ's primary recommendation, that gas-on-gas rate discounting should be ended within a reasonable timeframe, should be adopted.

Respectfully Submitted,



Darryl A. Lawrence
PA Attorney I.D. #93682
Assistant Consumer Advocate
E-Mail: DLawrence@paoca.org

Counsel for:
Tanya J. McCloskey
Acting Consumer Advocate

Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Telephone: (717) 783-5048
Facsimile: (717) 783-7152
Dated: July 24, 2014

187237

CERTIFICATE OF SERVICE

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

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

I hereby certify that I have this day served a true copy of the foregoing document,
the Office of Consumer Advocate's Reply Exceptions, upon parties of record in this proceeding
in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant),
in the manner and upon the persons listed below:

Dated this 24th day of July 2014.

SERVICE BY E-MAIL & INTER-OFFICE MAIL

Allison C. Kaster, Esq.*
Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Bldg.
P.O. Box 3265
Harrisburg, PA 17120

SERVICE BY E-MAIL & FIRST CLASS MAIL, POSTAGE PREPAID

Elizabeth Rose Triscari, Esq.*
Office of Small Business Advocate
Suite 1102, Commerce Bldg.
300 North Second Street
Harrisburg, PA 17101

Maureen Geary Krowicki, Esq.
National Fuel Gas Distribution Corp.
P.O. Box 2081
1100 State Street
Erie, PA 16512

Mark C. Morrow, Esq.
UGI Corp.
460 North Gulph Road
King of Prussia, PA 19406

Theodore J. Gallagher, Esq.
NiSource Corporate Services Co.
121 Champion Way - #100
Canonsburg, PA 15317

William H. Roberts, Esq.
Jennifer L. Petrisek, Esq.
Peoples Natural Gas Co., LLC
375 North Shore Drive - #600
Pittsburgh, PA 15212

Benjamin L. Shechtman, Esq.
Stevens & Lee
620 Freedom Business Center
Suite 200
King of Prussia, PA 19406

Charis Mincavage, Esq.
Teresa K. Schmittberger, Esq.
McNees Wallace & Nurick LLC
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108

William E. Lehman, Esq.
Thomas J. Sniscak, Esq.
Hawke McKeon & Sniscak LLP
100 North Tenth Street
P.O. Box 1778
Harrisburg, PA 17105
jlcris@aol.com **(E-Mail only)**

Dawn Lindner
Peoples TWP, LLC
205 N. Main Street
Butler, PA 16001

Charles E. Thomas, Jr., Esq.
Thomas T. Niesen, Esq.
Thomas, Long, Niesen & Kennard
212 Locust Street
P.O. Box 9500
Harrisburg, PA 17108-9500

David W. Gray, Esq.
General Counsel
Equitable Gas Company, LLC
225 North Shore Drive
Pittsburgh, PA 15212-5861

Michael S. Swerling, Esq.
Exelon Business Services Co.
2301 Market Street, S23-1
Philadelphia, PA 19101-8699

Donna M.J. Clark, Esq. **(E-Mail Only)**
Energy Assoc. of Pennsylvania
800 North Third Street, Suite 205
Harrisburg, PA 17101

Amy Neufeld, Esq.
500 North Third Street
Suite 800
Harrisburg, PA 17110

Kevin J. Moody, Esq.
Pennsylvania Independent Oil &
Gas Association
212 Locust St., Suite 300
Harrisburg, PA 17101-1510

Tishekia Williams, Esq.
Duquesne Light Company
411 Seventh Avenue
Pittsburgh, PA 15219

David P. Zambito, Esq.
Cozen O'Conner
305 North Front Street, Suite 400
Harrisburg, PA 17101-1236

Bruce V. Miller, Esq.
Cullen & Dykman LLP
100 Quentin Roosevelt Blvd.
Garden City, NY 11530



Darryl A. Lawrence
PA Attorney I.D. # 93682
Email: DLawrence@paoca.org

Aron J. Beatty
PA Attorney I.D. # 86625
Email: ABeatty@paoca.org

Counsel for
Office of Consumer Advocate
555 Walnut Street 5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152
159862

*Receiving Highly Confidential Information
Where Applicable