Hawke
McKeon &
Sniscak LLP
ATTORNEYS AT LAW

Todd S. Stewart
Office: 717 236-1300 x242
Direct: 717 703-0806
tsstewart@hmslegal.com

100 North Tenth Street, Harrisburg, PA 17101 Phone: 717.236.1300 Fax: 717.236.4841 www.hmslegal.com

June 16, 2015

VIA ELECTRONIC FILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, Filing Room
Harrisburg, PA 17120

RE: Pennsylvania Public Utility Commission v. Columbia Gas of Pennsylvania, Inc., Docket No. R-2015-2469665; **MAIN BRIEF OF THE NATURAL GAS SUPPLIER PARTIES ON REVERSED ISSUES**

Dear Secretary Chiavetta:

Enclosed for electronic filing with the Commission is the Main Brief of The Natural Gas Supplier Parties on Reserved Issues in the above-captioned docket. Copies of the Brief have been served in accordance with the attached Certificate of Service.

Thank you for your attention to this matter. If you have any questions with regard to this filing, please do not hesitate to contact me.

Very truly yours,

Todd S. Stewart
Counsel for Shipley Choice, LLC, Interstate Gas Supply, Inc. and Dominion Retail, Inc. ("NGS Parties")

TSS/jld
Enclosures
cc: Honorable Mark A. Hoyer (via overnight delivery)
Per Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document upon the parties, listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party).

VIA ELECTRONIC & FIRST CLASS MAIL

Scott Granger, Esquire
Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, PO Box 3265
Harrisburg, PA 17105-3265
sgranger@pa.gov

Erin L. Gannon, Esquire
Hobart J. Webster, Esquire
Office of Consumer Advocate
555 Walnut Street
5th Floor Forum Place
Harrisburg, PA 17101-1923
egannon@paoca.org
hwebster@paoca.org

Michael W. Hassell, Esquire
Lindsay A. Berkstresser, Esquire
Post & Schell, P.C.
17 North Second Street, 12th Fl.
Harrisburg, PA 17101
MHassell@PostSchell.com
LBerkstresser@PostSchell.com

Melissa Whitten
La Capra Associates, Inc.
One Washington Mall, 9th Floor
Boston, MA 02108
mwhitten@lacapra.com

John R. Evans
Small Business Advocate
Office of Small Business Advocate
300 North Second Street
Suite 1102
Harrisburg, PA 17101
jorevan@pa.gov

Theodore J. Gallagher, Esquire
Columbia Gas of Pennsylvania, Inc.
121 Champion Way, Suite 100
Canonsburg, PA 15317
tjgallagher@nisource.com

Andrew S. Tubbs, Esquire
NiSource Corporate Services Company
800 N. Third Street, Suite 204
Harrisburg, PA 17102
astubbs@nisource.com

Charis Mincavage, Esquire
Elizabeth P. Trinkle, Esquire
McNees Wallace & Nurick
100 Pine Street
PO Box 1166
Harrisburg, PA 17108
Cmincavage@mwn.com
etrinkle@mwn.com

Todd S. Stewart

DATED: June 16, 2015

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2015-2469665
	:	
Columbia Gas of Pennsylvania, Inc.	:	

MAIN BRIEF OF
THE NATURAL GAS SUPPLIER PARTIES
ON RESERVED ISSUES

Todd Stewart
Attorney I.D. No. 75556
Hawke McKeon & Sniscak LLP
100 North Tenth Street
Harrisburg, PA 17101
Telephone: 717-236-1300
Facsimile: 717-236-4841
tsstewart@hmslegal.com

Counsel for Shipley Choice, LLC, Interstate Gas Supply, Inc. and Dominion Retail, Inc. ("NGS Parties")

DATED: June 16, 2015

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I. INTRODUCTION

In Columbia Gas of Pennsylvania, Inc.'s ("Columbia" or the "Company") 2014 gas reconciliation proceeding pursuant to 66 Pa. C.S. § 1307(f), the Natural Gas Supplier Parties ("NGS Parties") (Interstate Gas Supply, Inc., Shipley Choice, LLC, and Dominion Retail, Inc.), raised the issue of the extreme lack of equity in Columbia's Universal Sharing Mechanism ("USM"). In that proceeding the Commission ordered a study of the USM that was included in Columbia's pre-filing materials. It is because of the results of that study that the NGS Parties again raise the USM issue. The USM is the means by which Columbia returns to customers a portion of the revenue it earns by using interstate transmission and storage capacity assets that are paid for by all customers but which are not needed all of the time ("Capacity Assets"). Columbia returns 75% of this revenue to customers through the USM and retains 25%. NGS Parties' Statement No. 1 ("NGS St. No. 1"), 5:4-17.

There are two mechanisms by which customers' 75% share is returned to them. The first is the Purchased Gas Demand Charge ("PGDC") which is paid by all customers. The PGDC recovers the cost of pipeline and storage capacity that is used to serve customers who purchase gas from Columbia as default service customers (also referred to as Purchased Gas Cost or "PGC" customers) as well as those who purchase gas from Natural Gas Suppliers ("NGS") under Columbia's CHOICE program. CHOICE customers are credited with the cost of some transportation assets that are assigned to their chosen NGS. Instead, the NGSs pay the cost of that capacity directly to the pipeline. It is reasonable to assume that those suppliers will recover the costs of that capacity from their customers. As a practical matter then, all customers pay the same amount for the use of those assets—the same assets that are used to produce the revenue that is distributed through the USM ("USM Revenue"). The PGDC is credited with 40% of the USM revenue. NGS St. 1, 5:12-17.

The other mechanism that is credited with USM Revenue is the Purchased Gas Commodity Charge ("PGCC"). The PGCC recovers the cost of the natural gas that is consumed by default service customers and is paid for only by default service customers. The PGCC receives 60% of the USM revenue. *Id.*

Because the PGDC returns a smaller share (40%) of USM revenue to **all** customers, while the PGCC returns a larger share (60%) only to default service customers, those default service customers receive a credit for USM revenue that is more than 300% larger than CHOICE customers, even though both groups of customers are charged equally for the assets that are used to generate the revenue in the first instance. NGS Exhibit No. 1. It is this unequal and inequitable distribution of USM revenues that is the basis of the NGS Parties dispute. The result is that CHOICE customers subsidize default service in a rather substantial way. Default service rates appear lower than they actually should be based upon market conditions, while CHOICE customers pay more. This impedes CHOICE by making default service rates lower than they otherwise should be, and is, simply put, neither just nor reasonable.

Ironically, it is not the Company that has resisted modifying the sharing mechanism in the manner recommended by the NGS Parties; rather, it is the Office of Consumer Advocate that has resisted ending the obvious subsidy of default service by CHOICE customers, when there is no factual or rational basis for the subsidy. In prior cases the OCA and others have argued that the transactions that generate USM revenue involved a substantial use of gas that had been purchased as part of providing default service. That argument is wrong.

The evidence provided by the Company in this case directly refutes that notion, and makes it clear that each type of transaction that falls under the general umbrella of "off-system sales" is at its very heart, entirely dependent on the transportation and storage capacity assets that are paid for on an equivalent basis by all customers. Columbia Exhibit ("CPA Exh.") No. 16.

Stated differently, but-for Columbia having excess storage and/or pipeline capacity, none of the transaction types would be available to Columbia.

Further, even in the USM transactions that do involve Columbia selling or buying natural gas, it cannot reasonably be said that those transactions should be attributable to the PGCC only. First, it is undisputed that all of the USM transactions described by Columbia involve the use of the Capacity Assets that all customers pay for. CPA Exh. No. 16. Second, the record demonstrates that any entity that holds the rights to the Capacity Assets could engage in the same type of revenue generating activity, regardless of whether that entity purchased gas for retail customers.

In today's liquid commodity market, the scarce resource is the ability to store and move gas; not the gas itself. In short, the evidence makes it clear that the transactions that produce USM Revenue are entirely dependent on the storage and transportation assets that are paid for by all customers, and the revenue should therefore be shared equally by all customers, exclusively through the PGDC.

Returning 100% of the USM revenue to the PGDC is not only the most equitable means to distribute USM revenues; it is also the simplest and least arbitrary. The NGS Parties proposed USM revenue sharing mechanism is the only mechanism proposed in this proceeding (including those proposed by OSBA and I&E) where the overall percentage of USM revenue distributed between PGC and CHOICE customers will not change based on the level of shopping. There is absolutely no reason why a CHOICE customer should get more or less USM revenue, simply because the shopping levels in the Columbia territory increase or decrease over time.

II. LEGAL STANDARD AND BURDEN OF PROOF

A public utility seeking to establish a rate has the burden of proof to establish the justness and reasonableness of each element of its request. This standard is set forth at 66 Pa. C.S. § 315(a), which provides:

> **Reasonableness of rates.** – in any proceeding upon motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceeding upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

66 Pa. C.S. §315(a). The Commonwealth Court of Pennsylvania described a utility's burden of proof in a rate proceeding under 66 Pa. C.S. §315(a) as follows:

> Section 315(a) of the Public Utility Code, 66 Pa. C.S. Section 315(a), places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the public utility. It is well-established that the evidence adduced by a utility to meet this burden must be substantial.

Lower Frederick Twp. Water Co. v. Pennsylvania Pub. Util. Comm'n., 409 A.2d 505, 507 (Pa. Cmwlth. 1980).

In general rate increase proceedings, the burden of proof does not shift to parties challenging a requested rate increase. Rather, the utilities burden of proof to establish the justness and reasonableness of every component of its rate request is an affirmative one, and that burden of proof remains with the public utility throughout the course of the rate proceeding. The Pennsylvania Supreme Court has held:

> [T]he appellants did not have the burden of proving that the planned additions were improper, unnecessary or too costly; on the contrary, that burden is by statute on the utility to demonstrate the reasonable necessity and cost of the installations, and that is the burden which the utility patently failed to carry.

Berner v. Pa. PUC, 382 Pa. 622, 631, 116 A.2d 738, 744 (1955).

However, a public utility does not need to affirmatively defend every claim it has made in its filing, even those which no other party has questioned, in proving that its proposed rates are just and reasonable. The Pennsylvania Commonwealth Court has held:

> While it is axiomatic that a utility has the burden of proving the justness and reasonableness of its proposed rates, it cannot be called upon to account for every action absent prior notice that such action is to be challenged.

Allegheny Center Assocs. v. Pa. PUC, 570 A.2d 149 (Pa. Cmwlth 1989); see also, *Pa. PUC v. Equitable Gas Co.,* 73 Pa. PUC 301, 359-360 (1990).

Additionally, 66 Pa. C.S. § 315(a) does not place the burden of proof on the utility with respect to an issue or adjustment that was not in its general rate case filing but rather raised or sought by another party. In such a situation, the burden of proof must be on a party to a general rate increase case who proposes an adjustment to a rate sought by the utility. *Pa. Pub. Util. Comm'n. v. Columbia Water Company*, Dkt. No R-2008-2045157 (Final Order Entered June 10, 2009).

III. SUMMARY OF THE ARGUMENT

The evidence in this case proves that the Capacity Assets, the costs of which are recovered through the PGDC are <u>the</u> critical asset for each of the five types of transactions Columbia uses to generate USM Revenue, without which USM Revenue would not be possible. The evidence also proves that all customers, CHOICE and default service, pay for the Capacity Assets on an equivalent basis. The evidence also shows that it would be inappropriate to assume that any revenue is generated by assets paid for as part of the PGDC. These facts lead to the inescapable conclusion that the current USM allocation methodology which allocates 60% of the USM revenue to only default service customers and 40% of the

USM revenue to all customers, through the PGDC, is arbitrary, unreasonable, and discriminatory.

The USM is arbitrary because the allocation percentages do not reflect the facts, particularly the fact that the only necessary assets for all of the transactions described by Columbia are the Capacity Assets, not PGC gas. The USM is unreasonable, because the discrepancy in the level of USM Revenue credited, as between default service and CHOICE customers, is so enormous; over 300%. Finally, the USM is discriminatory because it imposes upon CHOICE customers a subsidy to default service customers, to the tune of about $16 per customer, per year. This scheme runs contrary to Section 1304 of the Public Utility Code, 66 Pa. C.S. § 1304, which prohibits the granting of an unreasonable advantage to one class to the disadvantage of another. It also runs counter to Section 2203(4) which requires that Natural Gas Distribution Companies "shall provide distribution service to all retail gas customers . . . on non-discriminatory rates, terms of access and other conditions." 66 Pa. C.S. § 2203(4). Clearly, the current USM fails on both counts and must be modified to be equitable in the only way possible – allocating 100% of USM revenue to the PGDC so there is no disadvantage to any group.

Another area where it appears that an unwarranted subsidy is being required of CHOICE customers, to the benefit of default service customers, is the manner in which NGSs pay for the cost of pipeline capacity used for baseload deliveries to CHOICE customers, but Columbia does not likewise remove the costs of capacity used to serve the daily delivery requirements of Default Service Customers. Rather, those costs are recovered through the PGDC. Without the concomitant charge to the PGCC (and credit to the PGDC) of these baseload capacity costs, CHOICE customers are paying for some portion of the transportation costs of the default service customers, which is an unreasonable and prejudicial subsidy. The

NGS Parties have advocated for a study to determine the extent of the subsidy and to recommend corrective action.

IV. ARGUMENT

A. THE USM SHARING MECHANISM IS BASED ON AN INCORRECT FACTUAL PREMISE, IS ARBITRARY AND MUST BE SUBSTNATIALLY MODIFIED.

1. The Evidence is clear that there is no meaningful distinction between any of the transaction types upon which any difference in USM sharing can be based.

As Mr. White testified, Columbia generates revenues shared under the USM in five types of transactions, all of which require Columbia's retained pipeline and storage assets. NGS St. No. 1, 4-5. While some of the transactions involve the sale of gas to generate revenue, this is not a meaningful distinction for distribution of USM revenues because it has not been shown that the revenue generated is attributable to the sale of the commodity related to retail consumers. NGS St. No. 1, 8.

The five USM transactions include: capacity releases, asset management arrangements ("AMAs"), off-system sales, exchange agreements, and options agreements. CPA Exh. No. 16, 3. As explained below, capacity releases do not involve the sale of gas, and while the other transactions may involve the sale of gas, none of the revenues generated are attributable to the sale of the commodity for default service customers.

a. Capacity Releases

Capacity Release revenues are generated through use of Capacity Assets, as confirmed by Columbia. NGS St. No. 1, 9 (citing CPA Exh. 16, 3). A capacity release is a transaction where Columbia releases pipeline or storage capacity for a period of time to a third party. *Id.* The third party pays for the rights to utilize Columbia's pipeline and storage as part of that transaction. *Id.*

b. AMAs

AMA revenues are generated through use of Capacity Assets and, as confirmed by Columbia, do not involve the sale of natural gas. NGS St. No. 1, 8-9 (citing CPA Exh. No. 16, 3). An AMA is a transaction where Columbia enters into an agreement with a third party who manages the pipeline or storage asset for a set period of time. *Id.* at 8. The asset manager typically pays Columbia for the right to utilize assets and generate revenue from those assets. *Id.* In return the asset manager provides Columbia an option to deliver the maximum daily quantity of gas, as allowed under the contract. *Id.* As Mr. White testified, "[e]ffectively an AMA allows Columbia to use pipeline capacity or storage when Columbia needs it for gas deliveries, but otherwise allows the asset manager to generate revenues from the asset when Columbia is not utilizing the assets to deliver gas." *Id.*

c. Off-System Sales

Off-system sales revenues are generated through use of Capacity Assets, as confirmed by Columbia. NGS St. No. 1, 10 (citing CPA Exh. No. 16, 3). While off-system sales involve wholesale-only gas commodity transactions, the off-system sales revenue is attributable to arbitrage opportunities resulting from Columbia's Capacity Assets. *Id.* An off-system sale is a transaction where Columbia purchases wholesale gas, and then resells that gas to a non-end user, resulting in a wholesale only transaction. *Id.* For example,

> there are times when Columbia has the opportunity to purchase gas at point A on a specific pipeline for a lower price, and use the pipeline to ship the gas to point B on the pipeline where the gas can be resold at a higher price. The price differential between point A and point B is the profit Columbia makes on off-system sales. Columbia is also able to use its storage assets to engage in similar transactions where Columbia can capitalize on the spread between prices differentials during different times of year in order to make a profit.

Id. As this example shows, off-system sales revenue is available because of the arbitrage opportunities created from Columbia retaining its Capacity Assets - opportunities which exist regardless of whether Columbia is purchasing gas for PGC customers. *Id.* Columbia can engage in the same off-system sales regardless of whether the commodity being used is related to a supply obligation for retail customers. *Id.* Off-system sales revenue cannot reasonably be attributed to the PGC. *Id.*

d. Options Agreements

Options transaction revenues are generated through Columbia's sales of the opportunity at a certain market to purchase gas which requires Columbia's Capacity Assets because such option is guaranteed at a certain market area. NGS St. No. 1, 11. The resulting revenue is generated from the buyers' payment to Columbia for the <u>option</u>. *Id.* Columbia is only able to enter options transaction because it retains firm pipeline and storage – Capacity Assets. *Id.* Columbia could not guarantee a third party the ability to receive gas at a certain location without retained firm pipeline capacity nor without retained storage capacity. *Id.*

Revenue from options transaction should not be attributed to the use of PGC gas in the sale of an option purchase gas in storage or an option for the purchase of gas because Columbia can only enter into either of these types of option transactions by retaining Capacity Assets. As Mr. White explained:

> [E]ven options agreements that involve the option to purchase gas should not be attributable to PGC gas. Columbia is only able to offer this option to third parties because Columbia retains firm capacity that guarantees CPA the ability to make gas available in the event the option is called. Thus an option transaction is a wholesale transaction that Columbia is able to enter into because it retains firm capacity. This opportunity to sell an option would exist for any entity that held the Capacity Assets regardless of whether that entity bought gas for retail customers.

Id. Accordingly, options revenue is clearly attributable to Capacity Assets, not the PGC.

e. Exchange Agreements

An exchange transaction occurs when Columbia enters into an agreement with a third party to exchange gas at one market area for gas at another market area. For example, Columbia may own gas at market area A, and a third party owns the same amount of gas in market area B. Under an exchange transaction the third party would pay Columbia a fee to take ownership of gas in market A and CPA would then take ownership in market area B. The Company is able to enter into this transaction because it retains firm pipeline and storage in market area A that allows CPA to ship gas to that area. As Mr. White testified, exchange transactions should not be attributable to the use of PGC gas because PGC gas is not the *sine qua non* of Columbia's ability to enter into an exchange transaction. NGS St. No. 1, 11:1-15. Simply put, an exchange transaction is a wholesale transaction of gas that Columbia is able to enter into because it retains firm capacity. The opportunity to enter into an exchange transaction would exist for any entity that held the Capacity Assets, regardless of whether that entity bought gas for retail customers. Stated differently, the fact that Columbia sells and delivers gas to residential customers is not the basis for the transaction. NGS St. No. 1, 8:1-13:14

As Mr. White points out, any qualified shipper has the opportunity to purchase wholesale gas on the spot market and utilize storage and pipeline assets to engage in off-system sales or otherwise generate revenue with capacity assets. In fact, wholesale players (with no retail obligations) engage in these transactions quite frequently. NGS St. 1-SR, 3:2-19. The driving factor that enables the rights holder to earn off-system sales revenue is the spread value between two points on a pipeline, not whether the rights holder owned gas prior to the off-system sales transaction.

It is obvious that none of these transaction types depends upon the use of PGC gas. Accordingly, there is no basis upon which to conclude that allocating any USM revenue to the

PGCC is reasonable, let alone, 60%. Likewise, it also is obvious that each of these transactions depends entirely upon the use of the Capacity Assets. Similarly, therefore, it is irrational and arbitrary to not allocate all USM revenue to the PGDC. Even ignoring the anti-competitive subsidy that is imposed by the current USM method, the simple facts of how the revenue is generated make clear that the current method is illegal and unwarranted.

2. NGSs cannot utilize the pipeline assets assigned to them for Revenue Generating Activity because NGSs must use those assets to meet baseload delivery requirements.

For all of the transactions classified as capacity release or off-system sales, the basis of transaction is the Capacity Assets, i.e. storage and pipeline capacity, that Columbia holds and that default service and CHOICE customers pay for on the same basis. The Capacity Assets are retained by Columbia in part for meeting customer's demand during periods of above average usage. However, not all of the Capacity Assets are being utilized 365 days a year, like the baseload assets assigned to NGSs. Thus, there are times when Columbia can, and does, utilize the Capacity Assets to engage in transactions that generate revenue. NGSs are unable to engage in these transactions with their baseload capacity because those assets are being utilized for deliveries year round. NGS St. No. 1, 14:8-15:11.

It is also important to consider that NGSs deliver natural gas into the Columbia system every day of the year in 1/365th slices that over the course of the year add up to 100% of the annual usage for each CHOICE customer. *Id.* That gas, particularly in the summer months, is often injected into the storage assets that Columbia retains. When NGSs deliver gas into the system the gas is co-mingled with any gas that may be used to supply PGC customers. *Id.* Thus the gas Columbia uses to make wholesale transactions cannot be said to be solely PGC gas. This is simply one more reason why any attempt to make a distinction between CHOICE gas and PGC gas that Columbia may use to make a wholesale transaction is simply arbitrary. Rather, the driving factor that allows Columbia to enter into wholesale transactions described in the USM Study is the fact that Columbia retains Capacity Assets.

The Public Utility Code prohibits a utility from subjecting any person to an "unreasonable prejudice or disadvantage". 66 Pa. C.S. §1304. The premise of the existing 60/40 split in the USM was that assets attributable to the PGC were the source of most of the USM Revenue and that the Capacity Assets, recovered through the PGDC, were the source of a far smaller percentage of the revenue. In Columbia's previous 1307(f) proceeding, the Commission ordered that this issue be studied to determine the real driver of USM revenues. The evidence adduced in this proceeding makes it clear that this premise, for the existing sharing mechanism, is factually flawed. CPA Exh. No. 16. In truth, all of the transactions have one common necessary element—they depend entirely on the use of the Capacity Assets. The involvement of PGC gas, if present at all, is not the driver of the transactions. What this means is that the only method of allocating USM Revenue that is fair, and in keeping with the facts, is to allocate 100% of the revenue to the PGDC so that all customers share in the revenue equally, since they equally pay for all of the assets that make the transactions possible.

3. The Evidence is indisputable that all customers pay equally for the assets that are used for each type of transaction that generates USM Revenue.

Mr. White's testimony, NGS St. No. 1, 7:16-15:11, and CPA Exh. No. 16 both make clear that all customers, default service and CHOICE, pay an equivalent PGDC rate. Recall that it is the PGDC that recovers the expense associated with the Capacity Assets. OCA witness, Ms. Whitten, testified that because the rate paid for the PGDC for CHOICE customers is different from that of default service customers, the underlying expense is not being recovered from both groups of customers on an equivalent basis. OCA Statement No. 1-R, 7:1-8:4. Ms. Whitten's testimony is incorrect.

It is true that Columbia does credit CHOICE customers for the capacity costs of two interstate pipelines that are assigned to NGSs; but, <u>those costs are paid directly to the pipelines by the NGSs that serve the CHOICE customer</u>. Thus, the cost of the pipeline capacity assigned to NGSs is reflected in the charges paid by the CHOICE customers. The net effect is that all customers pay for the cost of the Pipeline Capacity that Columbia procures equally. Columbia confirms this fact in the USM study submitted in this proceeding as CPA Exh. No. 16.

4. The Alternative USM sharing mechanisms presented by Columbia, the OSBA, and I&E are not reasonable and should not be adopted.

In the USM Study, Columbia presented a potential alternative USM sharing mechanism in which all capacity release revenues could be assigned to the PGDC, and the remaining USM revenue would be shared between the PGCC and PGDC based on the percentage of shopping. CPA Exh. No. 16. It is important to note that Columbia did not endorse this approach, but merely presented it as one potential alternative. Both I&E and OSBA advocated for a variant of the USM sharing mechanism presented by Columbia, in that both proposals would establish a fixed amount that is always assigned to the PGDC, and the remaining amount of the USM revenues are shared between the PGCC and PGDC based on the percentage of shopping. OSBA Statement No. 1, 7:4-9:6, I&E Statement No. 1, 15:1-20:2. These so-called formulaic approaches, while well-intentioned, suffer from two major problems and thus should not be adopted.

First and foremost, neither proposal meaningfully alters the amount of revenue allocated to PGDC, so the inequity of under-allocation of USM revenues to CHOICE customers still remains. For instance, under Mr. Knecht's (OSBA's witness) example set forth in Table IEc-3 at a 30% shopping level (which is close to the shopping levels currently in the Columbia territory) PGC customers would receive a 14.3 cents/DTH credit and CHOICE customers would only receive a 6 cents/DTH. This results in CHOICE customers receiving over 240% higher credit than PGC customers. NGS Parties St. No. 1-R, 5:13-17.

Under the I&E proposal and the proposal set forth in Columbia's study, the revenue allocation to CHOICE customers would be even less. For instance, under the allocation methodology set forth in Columbia's study at 30% shopping PGC customers would receive a 14.7 cent per DTH credit and CHOICE customers would only receive a 5.1 cent per DTH credit which is nearly a 300% higher credit for PGC customers. NGS Parties St. No. 1-R, 4:17-19.

Second, neither proposal actually remedies the problem they are attempting to correct; under both proposals, the level of USM revenue allocation would still vary based on the level of shopping. In fact, under the Company's, I&E's and OSBA's proposals, the revenue allocation methodology would actually have the potential to worsen as shopping decreased. For instance, when there is only 10% shopping in the CPA territory, according to the Company's CHOICE customers would receive only a 3.2 cent per DTH credit, and PGC customers would receive a 12.8 cent credit. This results in PGC customers receiving a 400% higher credit than CHOICE customers. NGS Parties St. No. 1-R, 4:10-19.

The level of shopping has little to do with the disparity caused by the arbitrary USM Revenue allocation, and does not address the source of the problem—that CHOICE customers and default service customers pay the same costs for the same assets that generate USM Revenue, whether there are five hundred CHOICE customers or five hundred thousand.

The formulistic approaches presented by other parties in this proceeding do not materially improve upon the current inequitable USM allocation methodology. The permanent fixed allocation percentage to the PGDC suggested by parties seems to be based upon arbitrary numbers, not selected on any basis of cost causation. Further, while the formulistic methodologies do prevent a scenario where the per DTH credit to PGC customers increases as shopping increases the proposal has the practical outcome of trading one negative component of a proposal for another. Under the formulistic approaches, as shopping declines, the per DTH credit allocates an even higher percentage of USM Revenue to PGC customers on a per DTH basis. NGS Parties St. No. 1-R, 6:14.

In short, these formulaic approaches do not address the cause of the problem and have the potential to further exacerbate the problem over time. They are not "fixes"! The only fix is to adjust the USM so that 100% of the USM Revenue is returned to customers through the PGDC, so shopping levels don't matter, and no self-defeating and complex formula is required.

5. USM Revenue must be shared equally by all customers who pay for the assets that are used to generate the revenue.

It is clear that there is no meaningful way to distinguish the types of transactions that Columbia is able to employ to generate revenues from the Capacity Assets. CPA Exh. No. 16. Recall, however, that under the present USM, of the 75% of revenue that is returned to customers, 60% of that is refunded as a credit to the PGCC, and 40% is refunded as a credit to the PGDC. The PGCC credit is refunded to default service customers only, while the credit for PGDC is refunded to all customers (CHOICE and default service) on a pro-rata basis based on throughput used by the customers; excluding larger customers that do not pay the PGDC. This results in a significant disparity in the way the credit is actually applied that discriminates against CHOICE customers.

Mr. White's testimony provides an illustration of this disparity, by assuming that there would be approximately $10 million of revenues generated from the Capacity Assets during an average year. NGS Exh. No. 1. Mr. White then assumed that Columbia has approximately 415,000 refund eligible customers with 125,000 being CHOICE and the remaining 290,000 being PGC.[1] Finally, he assumes that Columbia retains 25% of the revenues and customers are

[1] These numbers are not precise, because they fluctuate. Mr. White's Testimony clearly identified these as assumptions.

refunded 75% of the revenues. Under his example, which does not differ greatly from reality, the USM would allocate default service and CHOICE customers a vastly different amounts. The calculation would be as follows:

$10,000,000 * 75% = $7,500,000	**Total credit to customers**
$7,500,000 * 60% = $4,500,000	**PGCC credit to Default Service customers only**
$7,500,000 * 40% = $3,000,000	**PGDC credit to all customers**
$4,500,000 / 290,000 = $15.52	**Per customer PGCC credit**
$3,000,000 / 415,000 = $7.23	**Per customer PGDC credit**
PGCC + PGDC = $22.75	**Total Default Service customer credit**
PGDC credit = $7.23	**Total CHOICE customer credit**

Under the above example, default service customers receive approximately $23 credit and CHOICE customers receive a $7 credit, which represents a 315% larger credit for default service customers. This is an unreasonable way of allocating USM costs because it requires that CHOICE customers subsidize default service customers and because both groups of customers pay equally for the assets that produce the revenue. Exhibit NGS-1.

The USM is also flawed because as customers migrate away from default service and onto CHOICE the inequity of the allocation is exacerbated. PGC customers retain 100% of the PGCC credit regardless of the level of migration; therefore, as there are fewer customers to allocate the PGCC credit to, the per PGC customer credit increases. In the above example, if migration to CHOICE were to increase to 250,000 customers, PGC per customer credit would increase to approximately $35 per customer and the CHOICE customer would still receive the $7 per customer credit representing and approximately 500% higher credit for PGC customers. If migration to CHOICE were to increase to 350,000 customers, the allocation would be even more disparate, with approximately $76 going to PGC customers and CHOICE customers still receiving only the $7 credit. Exhibit NGS-1.

As customers migrate to CHOICE, the USM has the effect of subsidizing the PGC price more and more. This serves as an artificial limitation on the amount of customers that would be willing to migrate. Ultimately as shopping increases the credit would get so large that it would not make rational economic sense for customers to leave PGC because the substantial subsidy flowing to the PGC rate.

As discussed above, several parties introduced mechanisms that would adjust the allocation as between the PGDC and PGCC going forward as shopping increases or decreases. Those mechanisms are flawed because the starting point of the present disparate allocation would be retained, and because shopping levels, standing alone, have nothing to do with what assets produce revenue, who pays for those assets and therefore who should receive credit for revenue produced by those assets. While the increasing disparity in credits as shopping increases are a symptom of the current USM, addressing only the symptom will not fix the real problem.

All of these problems led Mr. White to propose that the only long term solution that solves the USM issues that he has identified is to allocate the entire amount of USM Revenue to the PGDC which is shared on a volumetric basis by all customers. This addresses the fact that all customers pay equally for the assets that actually produce the revenue, it eliminates the subsidy currently provided by CHOICE customers to default service customers, and eliminates the need for a complex adjustment mechanism. No other witness has refuted Columbia's Exhibit No. 16, and its conclusion that there is no reasonable means to segregate the types of revenue producing transactions from a PGCC versus a PGDC perspective. This means that the current methodology is clearly broken and discriminatory because it provides a USM credit to default service customers that is three times larger than that provided to CHOICE customers, with no reasonable or other basis for doing so.

Mr. White's recommendation should therefore be adopted going forward.

B. COLUMBIA SHOULD BE REQUIRED TO PERFORM A STUDY TO DETERMINE IF A MORE REFINED CAPACITY RECOVERY MECHANSIM IS WARRANTED.

In Columbia's filing, CPA Exh. No. 16, it states that the total cost of capacity that it retains is split between CHOICE and PGC customers and recovered through the PGDC. Columbia goes on to state, however, that the cost of the capacity assigned to NGSs is deducted from the PGDC costs paid for by CHOICE customers. The reason CHOICE customers do not pay for these costs directly is because when the capacity is assigned to NGSs, NGSs pay for those costs directly to the pipeline company. It also is true that neither CHOICE NGSs, nor their customers have the opportunity to benefit from revenue enhancing transactions based on these assets in a fashion similar to those described above in which Columbia participates, because the assets assigned to CHOICE NGSs are required for baseload delivery 365 days a year. NGS St. No. 1, 13:16-16:2.

It is true, however, that just like CHOICE customers, PGC customers have daily demand which requires that Columbia deliver gas into its system on a year-round basis, solely for PGC customers. The USM study states that the total cost of firm capacity retained by Columbia is recovered through the PGDC. CPA Exh. No. 16. Thus, while CHOICE suppliers pay directly for pipeline costs for the capacity assigned to them, the cost of pipeline capacity Columbia uses to meet PGC year round delivery needs is being recovered through the PGDC which is paid for by both CHOICE and PGC customers.

What this means is that while NGSs are paying the costs of the pipeline assets to make baseload deliveries for CHOICE customers, Columbia does not assign the costs of the slice of assets used solely to make baseload deliveries to default service customers to the PGCC so they are paid for on the same basis as CHOICE customers. NGS. St. No. 1, 15:14-17:17. Rather, it appears that both CHOICE customers and PGC customers are paying the costs for the pipeline assets to make year round deliveries for PGC customers through the PGDC. *Id.* Thus, CHOICE customers are paying for the cost of pipeline assets that are being utilized to serve the PGC year round delivery needs. *Id.* This is an inequitable cost allocation. PGC customers should be paying for the cost of pipeline assets that Columbia utilizes to bring their gas into the system, and CHOICE customers should not be required to contribute to paying those costs.

This is not to suggest that all of the costs of the Capacity Assets be paid for by PGC customers. It is reasonable for CHOICE customers to share in some of the costs of the Capacity Assets. For one, the storage assets Columbia retains should be shared by all customers equally. Storage is used to balance the system and otherwise maintain reliability on colder-than-normal days and thus it is appropriate for CHOICE customers to share in those costs. NGS St. No. 1, 16:21-17:6. Further, the peaking pipeline assets Columbia retains should be paid for by CHOICE and PGC customers equally. *Id.* Peaking pipeline assets are needed to maintain reliability on the system. However, any pipeline assets Columbia is utilizing to make daily deliveries for PGC customers only should be paid for by PGC customers only and should not be recovered through the PGDC.

In order to gather sufficient evidence to determine the scope and scale of this issue, as recommended by Witness White, the Commission should require that Columbia:

> [S]ubmit in its next 1307(F) proceeding an analysis on how the pipeline capacity it retains is being utilized. In the analysis Columbia should be required to calculate A) the portion of the pipeline assets it retains that is being utilized for system peaking needs and B) the portion of the pipeline assets it retains that it utilizes for PGC delivery needs. Once the portion of pipeline assets used to serve only the PGC deliveries is identified, in the next 1307(F) proceeding the Commission should then require that those pipeline costs be allocated to the PGCC.
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> NGS St. No. 1, 17:10-17.

In short, there should no longer be a subsidy in the way the PGDC is calculated or in the way USM revenue is returned to customers. Columbia will likely say that the Company simply recovers the cost of all baseload assets though the PGDC without regard to the type or location of the asset and that it does not make any effort to distinguish and assign which portion of which asset is used to serve a default service or CHOICE customers. To a certain extent, Columbia's explanation is true. But Columbia does extract the costs of two specific assets (baseload pipeline capacity on two interstate pipelines) from the PGDC and charge those directly to the CHOICE suppliers and does not extract the charges for those same assets when used to make baseload deliveries to default service customers and charge them directly to default service customers. So it appears that, at a minimum, CHOICE customers are contributing toward some portion of the costs of those assets that are used to provide year-round baseload delivery to default service customers. The study will show the magnitude of the issue and aid the Commission in deciding whether and what kind of fix is needed.

V. CONCLUSION

It should be obvious that the USM allocation methodology is no longer valid—even if it once was. The facts make it clear that the Capacity Assets are the revenue generators and that the PGC gas, if incorporated at all, is only of ancillary value. There simply is no basis to continue this arbitrary allocation and the evidence also is clear that allocating 100% of the revenue to the PGDC, is the only reasonable and fair way of sharing the revenue. With the facts at hand, which the Commission itself required the Company to provide, no other alternative passes muster. The unwarranted subsidy must end. Likewise, the probable subsidy to the default service customers through the non-allocation of certain capacity costs to default service, as described herein, must also be addressed. The Commission has been clear that customers who choose to shop should not be penalized by additional costs or fees or hidden charges. This is one such charge that must end.

VI. PROPOSED FINDINGS OF FACT

1. In the Commission's final Order in Columbia's 2014 1307(f) proceeding, the Commission directed Columbia to conduct a study to be filed with the pre-filing information for its next 1307(f) case, in 2015, that is intended to address whether the existing methodology for allocating universal sharing mechanism ("USM") proceeds as between the Purchased Gas Distribution Charge and the Purchased Gas Commodity Charge was appropriate. The study was required to address such historical off-system sales, asset management agreements, capacity release and capacity release revenues, and to determine whether the current split of revenues as between the PGDC and PGCC is appropriate. CPA Exh. No. 16, at p. 1.

2. Columbia's current USM methodology has been in place since 2012. The total cost of capacity that Columbia has under contract to provide firm service is split between CHOICE and PGC customers based upon forecasts of annual demand. CPA Exhibit No. 16.

3. Columbia determines the PGDC, based upon the total forecasted firm demand, for both CHOICE and PGC customer, and the PGC is charged to default service customers on a throughput basis. For CHOICE customers, Columbia deducts the costs of capacity on Columbia Transmission and Columbia Gulf from the PGDC that is paid by PGC customers when calculating the PGDC that CHOICE customers pay, because Columbia charges natural gas suppliers serving those customers directly for that capacity. CPA Exh. No. 16.

4. As part of its response to the Commission's Order, Columbia responded to six (6) questions. It stated that storage and transportation assets are equally allocated between CHOICE and PGC customers from a total demand cost perspective. Columbia states that NGSs and PGC customers pay an equivalent load weighted share of total system storage and transportation costs taking into account the NGS assigned capacity and balancing costs. Columbia has not identified any off-system sales arrangements that do not use capacity assets. CPA Exh. No. 16.

5. In Columbia's Asset Management Arrangements ("AMA") as they are structured today, the underlying release of transportation and storage assets are paid for by CHOICE and PGC customers in proportion to their load. NGS St. No.1, 15:4-11.

6. Under Columbia's current released capacity transactions, released transportation and storage assets are paid for by CHOICE and PGC customers in proportion to their load. NGS St. No.1, 15:4-11.

7. Under Columbia's off-system sales transactions, the underlying transportation and/or storage assets are paid for by CHOICE and PGC customers in proportion to their load. (CPA Exh. 16).

8. The vast majority of Columbia's capacity sales options and exchanges use Columbia's capacity, even though some of them may also involve the use of natural gas supply. However, Columbia was not able to identify any transactions which did not use some form of capacity release. Columbia also states that its CHOICE and PGC customers pay equally for the total transportation and storage capacity that is held by Columbia to provide safe and reliable service. NGS St. No. 1, 15-16.

9. Columbia proposed a formula that would include a four (4) year average of revenues derived from capacity release and which would also include an adjustment factor for those percentage of shopping customers noting that in last year's 1307(f) case, the NGS Parties' raised the obvious flaw in the current methodology; as shopping increases, the PGCC's share of USM revenue increases, thus, providing larger and larger credits to non-shopping customers as more customers shop and thus providing greater and greater disincentive to shop. CPA Exh. No. 16, 3-4.

10. As stated by the NGS Parties' witness, Matthew White, Columbia's CHOICE program assigns pipeline assets to natural gas suppliers, such as IGS, based upon the percentage of load that the NGS serves on Columbia's system. The NGS pays for the cost for those assets

directly to the pipeline company. Columbia requires that NGSs deliver baseload supply. That means that every day NGS are required to deliver approximately one 1/365 of each CHOICE customer's annual supply needs. Based upon this baseload delivery requirement, NGSs are only assigned a baseload portion of pipeline capacity and are not assigned any storage assets. NGS St. No. 1, 3:19 – 4:5.

11. Columbia retains pipeline and storage assets that will allow Columbia to serve PGC customers, to balance the system and to otherwise maintain reliability during periods of high-gas usage. The use of these Capacity Assets is not required on a year around basis to maintain reliability, and during periods when those assets are not required for system use, Columbia uses those assets to generate USM Revenue. NGS St. No. 1, 4:8-18.

12. Columbia uses unused/underused Capacity Assets to generate revenue in a variety of ways. However, the five (5) particular ways that Columbia lists in its CPA Exh. No. 16 include: capacity releases, off-system sales, AMAs, exchange arrangements and options agreements. Under the current USM, 75% of USM revenue that is returned to customers and the remaining 25% is retained by the Company. Of the 75% that is provided to customers, 60% is refunded through the PGC, which is paid only by default service customers and 40% is refunded to PGDC, which is paid by all customers. NGS St. No. 1, 5:4-6:17.

13. The current refund structure does not share revenue equally between default service customers, and this disparity is exacerbated because the PGCC only impacts default service customers while the PGDC impacts all customers. Because default service customers receive both credits, and they alone receive the 60% PGDC share, in the aggregate, the default service customers receive a 315% larger credit than CHOICE customers. NGS St. No. 1, 5:4-6:17, NGS Exh. No. 1.

14. As customers migrate away from default service and on to CHOICE, the inequity of the allocation is exacerbated. As shopping increases, the percentage of the credit being

allocated to sales customers increases, thus creating further disincentive for shopping. In the current system, CHOICE customers are subsidizing the non-CHOICE customers in a significant amount. As shopping increases, the subsidy will only increase as well. NGS St. No. 1, 7:10-14.

15. Revenue generated through USM transactions is solely attributable to the use of Capacity Assets, which are paid for equally by all customers. Thus, cost causation principles require that 100% of the credit should be refunded to all customers through the PGDC, which is paid for by all customers equally. NGS St. No.1, 7:16-22.

16. An AMA is an agreement with a third-party asset manager to manage the pipeline or storage asset for a period of time. Typically, the asset manager would pay Columbia for a right to utilize those assets and generate revenue from those assets provided that the asset manager gives Columbia the option to deliver the maximum daily quantity of gas allowable under the capacity contract. Effectively, an AMA allows Columbia to use pipeline capacity or storage when Columbia needs it for gas deliveries, but otherwise allows the asset manager to generate revenues from the asset when Columbia is not using those assets to deliver gas. (NGS Parties' Statement No. 1, 8:10-18).

17. While AMAs rely upon the use of Capacity Assets, AMAs may also involve the sale of natural gas, but are clearly dependent upon the use of Capacity Assets. NGS St. No. 1, 8-9, NGS St. No. 1-R, 4:4-9.

18. A capacity release transaction occurs when Columbia releases pipeline or storage capacity, for a period of time, to a third-party and the third-party pays for the rights to use the storage and/or pipeline capacity as part of transaction. Likewise, capacity release transactions do not relate to the sale involve the purchase of sale of natural gas by Columbia and relate only to the use of Capacity Assets. NGS St. No. 1, 9:6-8

19. An off-system sales transaction is a sale in which an entity, such as Columbia, purchases wholesale gas and then resells the gas to a non-end user customer. Because Columbia

retains the peaking asset, Columbia is able to use those assets to make off-system sales for a profit. In today's liquid natural gas market, the ability to move or store gas is critical and it has become the scarce product. Mr. White states that off-system sales revenues are available because arbitrage opportunities are created due to Columbia retaining Capacity Assets and that these arbitrage opportunities exist regardless of whether Columbia purchases gas for the PGC customers. That is, the holder of Capacity Assets would be able to engage in off-system sales regardless of whether they had any supply obligations to retail customers. Therefore, those off-system sales revenues could not be attributed only to the PGCC. Columbia states that the vast majority of its off-system sales revenue involves transportation storage assets. NGS St. No. 1, 10:9-20.

20. An options transaction occurs when CPA gives a third-party the option to purchase gas or to put gas in the storage in a certain market area and the party pays Columbia for that ability. Columbia is only able enter into these types of transactions because it retains firm pipeline and storage capacity, and would not be able to guarantee the third-party the ability to receive its gas at certain market areas unless it had that capacity and would not be able to allow somebody to put gas in the storage unless Columbia had retained storage capacity. NGS St. No. 1, 11:2-8.

21. An exchange transaction occurs when Columbia enters into an agreement with a third-party to exchange gas at one market area for gas at another market area. Under an exchange transaction, the third-party pays Columbia a fee to take ownership of gas and market area "A" and Columbia would then take ownership of gas and market area "B". Columbia can enter into these transactions on a profitable basis only because it retains pipeline storage in that market area "A" that allows Columbia to purchase and to ship gas into that area. Again, exchanges are made possible only because Columbia has the retaining assets and are not related to the purchase or sale of gas, but would otherwise be used for retail customers. Therefore, the

revenue attributable to these transactions should not solely benefit PGC customers. NGS St. No. 1, 12:1-15.

22. While NGSs are assigned capacity, they do not have the ability to engage in these types of transactions using that capacity, but are required to deliver specific amounts of gas every day and they are only given sufficient capacity to make those deliveries. Thus, if an NGS were to use its assigned capacity for any other transaction, they would have to purchase additional capacity on the Columbia system in order to deliver its assigned gas or be subject to substantial penalties on the system. Furthermore, NGSs' gas is not commingled with gas in storage assets that Columbia retains for PGC customers. Columbia then has access to that gas throughout the year in non-peak periods to make transactions so long as Columbia replaces that gas later on. This gas may allow Columbia to enter into further wholesale transactions, which otherwise will not be able to complete, because it has additional gas supplies for the suppliers. NGS St. No. 1, 14-15:16-2.

23. NGS Parties' witness, White, recommends that Columbia's USM sharing mechanism be modified so that all revenue generated by the Capacity Assets is flowed through to customers through the PGDC which is returned to all customers on a volumetric basis. NGS St. No. 1, 15:5-11.

VII. PROPOSED CONCLUSIONS OF LAW

1. Columbia's current USM is unreasonably discriminatory, in requiring CHOICE customers to subsidize default service customers, and violates both 66 PA. C.S. §§ 1304 and 2203(4).

2. Columbia's current USM is arbitrary and therefore neither just nor reasonable under 66 Pa C.S. § 1301.

3. Columbia's current method of allocating the cost responsibility for baseload capacity assets appears to be unreasonable, 66 Pa. C.S. § 1301, but further study is warranted to determine the extent of any subsidy.

VIII. PROPOSED ORDERING PARAGRAPHS

1. Columbia's current USM is not approved.

2. Columbia shall implement, through a tariff filing, a USM that allocates 100% of all USM revenue to the PGDC.

3. Columbia is ordered to perform a study, to be provided to all parties in the pre-filing information provided with its 2016 1307(f) filing, that explores the extent of the subsidy paid by CHOICE customers to default service customers because of Columbia's direct assignment of the costs of baseload pipeline capacity to CHOICE NGSs, while not providing a similar mechanism to remove the costs of default service baseload capacity from the PGDC.

Respectfully submitted,

Todd Stewart
Attorney I.D. No. 75556
Hawke McKeon & Sniscak LLP
100 North Tenth Street
P.O. Box 1778
Harrisburg, PA 17105-1778
Telephone: 717-236-1300
Facsimile: 717-236-4841
tsstewart@hmslegal.com

Counsel for Shipley Choice, LLC, Interstate Gas Supply, Inc. and Dominion Retail, Inc. ("NGS Parties")

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