BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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| Application of UGI Penn Natural Gas, Inc. for Approval of the Transfer by Sale of 9.0 Mile Natural Gas Pipeline Appurtenant Facilities and Right of Way, Located in Mehoopany, PA | : | Docket No. A-2010-2213893 |
| Affiliated Interest Filing of UGI Penn Natural Gas, Inc. | : | Docket No. G-2010-2213894 |

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**PREPARED REBUTTAL TESTIMONY OF**
**ROBERT F. BEARD, JR. P.E.**
**UGI PENN NATURAL GAS, INC.**

DATE SERVED: March 2, 2011
DATE ADMITTED: ____________

PNG Statement No. 1-R
3-16-2011
Harrisburg, PA
Docket Nos.
A-2010-2213893
G-2010-2213894

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**PREPARED REBUTTAL TESTIMONY OF**
**ROBERT F. BEARD, JR. P.E.**

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

**A.** My name is Robert F. Beard, Jr. My business address is 2525 N. 12th Street, Suite 360 Reading, Pennsylvania 19612.

**Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

**A.** I am employed by UGI Utilities, Inc. ("UGI"). I am Vice President of Marketing, Rates and Gas Supply.

**Q. HAVE YOU PREVIOUSLY SERVED DIRECT TESTIMONY IN THIS PROCEEDING?**

**A.** Yes, my testimony was presented in support of the application of UGI Penn Natural Gas, Inc. ("PNG").

**Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

**A** My testimony responds to the direct testimony presented by the Office of Trial Staff ("OTS") witness Michael Gruber, the Office of Consume Advocate ("OCA") witness Jerome Mierzwa, and the Office of Small Business Advocate ("OSBA") witness Robert Knecht.

**Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY?**

A. As explained in my direct testimony, PNG's proposal to transfer the 9.0 mile Auburn Line to UGI Energy Services, Inc. ("UGIES"), who will invest the considerable capital required to prepare it for use as a gathering line while PNG maintains distribution service to PNG customers, is a unique opportunity that will provide important benefits to PNG customers. First, in PNG's next base rate case, PNG customers will receive a credit to base rates of $154,000, reflecting the revenue requirement associated with the depreciated original cost of the Auburn Line and associated operating expenses. Second, for a fee of $60,000 per year (for a net rate reduction of $94,000) PNG's customers currently served from the Auburn Line will continue to receive distribution service from the line, and PNG will be able to provide service to any new customers along the Auburn Line. Third, and of particular importance, in anticipation of this transaction, Procter & Gamble Paper Products Company ("P&G"), PNG's largest customer, has entered into a 20-year agreement to continue to take distribution service from PNG. This will assure continued annual revenue to PNG, which is very substantially above the cost of serving P&G and which will contribute to PNG's recovery of fixed cost of service from all customers and avoid or defer the need for, and the amount of, future base rate increases. Fourth, completion of this transaction will resolve the very real threat that Citrus and its working interest partners will seek alternative means to transport Marcellus Shale gas to market and bypass PNG altogether. Fifth, even if the gathering venture for UGIES does not succeed, or if UGIES defaults on the agreement, PNG will have the ability to reacquire those portions of the Auburn Line required to continue providing distribution service at the then depreciated original cost, PNG customers will see no disruption in service, and PNG customers will not pay for any of the substantial capital investment which is to be made for pipeline upgrades and compression facilities needed to convert the line to gathering operations. Finally, the proposed transaction will help facilitate the development of the Marcellus Shale gas market in the area and produce many related benefits to the local economy, and will otherwise help constrain the wholesale market price for gas to the ultimate benefit of consumers. Despite these benefits, the parties raise several concerns and conclude this transfer should not be approved as presented. I will address each of those concerns in detail below to show they are without merit and that this transfer should be approved.

**Q. OSBA WITNESS KNECHT (PAGE 3) INITIALLY ASSERTS THAT HE IS ADVISED BY COUNSEL THAT SINCE THE COST OF THE AUBURN LINE HAS BEEN REFLECTED IN RATES PAID BY PNG CUSTOMERS THEY ARE ENTITLED TO A REASONABLE SHARE OF THE ECONOMIC VALUE OF THESE ASSETS. DO YOU AGREE?**

**A.** I am not a lawyer and will not attempt to present legal conclusions in my testimony. The Company will address these legal issues in its briefs to the ALJ and Commission. However, as a preliminary matter and as Mr. Knecht recognizes, it is important to note that the Auburn Line is essentially a dedicated line, *i.e.*, it was designed and installed to serve a single customer, P&G. As a result, virtually all of the costs of the Auburn Line and its operating costs have been assigned to and included in the rates paid by P&G. Therefore, if any gain in excess of depreciated original cost were to be realized upon the sale of the Auburn Line, and if any such gain were to be shared with customers, it should be assigned to P&G, and not to core market customers. This transaction, taken as a whole, has many benefits for P&G, including a 20-year agreement with PNG to receive distribution service and a means to transport the Marcellus Shale gas located on its property to market. P&G has expressed its full support for this transaction through a letter previously filed with the Commission.

Moreover, the issue of the treatment of gain on the sale of a utility asset is not properly at issue in this proceeding. The proposed sales price is equal to the depreciated original cost and, therefore, there is no "gain" to share with or allocate to customers. Any effort to attribute some hypothetical gain to the transaction would fundamentally alter the economics of the transaction, not just to PNG and UGIES, but also to Citrus Energy Corporation ("Citrus") and potentially, ultimately P&G. It is not possible to change one term of the transaction without recasting the entire transaction. There is no assurance that a new modified transaction would be agreed to by the parties, that the many benefits to customers from this transaction could be retained, or that Citrus would not simply abandon this transaction and begin the construction of bypass facilities to avoid further delay.

In addition, even if some hypothetical additional value were attributed to the line, customers should not share in that value because that value is clearly associated with operating the Line as a <u>gathering</u> line. Importantly, the use of the Auburn Line as a <u>distribution</u> line is not being transferred to UGIES. It is being retained by PNG and its customers through the Interconnection, Operating and Emergency Service Agreement.

Since there is no functional transfer of the distribution service provided by the line, there is no basis for sharing any hypothetical gain with customers. Indeed, PNG and its customers are specifically retaining the value of the line as a distribution line as evidenced by the continued provision of distribution service to P&G and the farm tap customers and the associated revenue from this service. Similarly, the cost of the Auburn Line that has been reflected in PNG's rates relates solely to the use of the Auburn Line as a distribution line. Customers are not being asked to pay, and will not pay, the very substantial investment necessary to convert the Auburn Line into a gathering line, and they are assuming no risk if the project fails or is not profitable. Furthermore, any hypothetical value to be shared with customers would have to be divided between the gain associated with depreciable and non-depreciable property. I am advised by counsel that any gain on non-depreciable property, such as land, is not to be shared with customers. The existing distribution pipe itself cannot be used to provide gathering services without the associated transferred land interest.

Finally, and as noted above, the issue of sharing of value is largely moot. As explained above, virtually the entire cost of the Auburn Line has been assigned to and paid by one customer – P&G. It is, in essence, a dedicated line serving a single customer. If there were any value to be provided to customers, it should be allocated to P&G, which would reduce its distribution rates but not the rates of core market customers. But, at the same time, a higher price paid for the line by UGIES would increase the transportation charge for use of the line as a gathering line and would reduce the amount of money that producers and landowners would receive for the gas produced. Producers would receive lower "net-back" pricing, and landowners, such as P&G, would receive lower royalty payments. P&G may receive a distribution rate credit if someone were inclined to pay a higher price for the line than net book value, but could suffer reduced royalty or working interest revenue (as will any affected landowner) as a result of increased transport fees to use the line and resulting lower "net-back" price received by the producer. In any event, P&G has made its desires known. P&G fully supports the transaction and Commission approval of it, as evidenced by its letter previously filed with the Commission and attached as Exhibit RFB-3 to my rebuttal testimony. On this basis, I conclude that the issue of treatment of any gain on the sale of the asset has been essentially settled since the only customer even arguably entitled to any material share of the gain has already agreed to PNG's proposal.

**Q. AT PAGES 4-5 OF HIS TESTIMONY, MR. KNECHT PROVIDES A DESCRIPTION AS TO HOW THE VALUE OF THE AUBURN LINE AS A GATHERING LINE SHOULD BE DETERMINED. DO YOU AGREE WITH THIS CHARACTERIZATION?**

**A.** Mr. Knecht's theoretical discussion of value is irrelevant and incomplete. First, his discussion ignores the fact the Auburn Line as it currently exists cannot provide gathering service and can only do so with very substantial capital investment, the costs of which are not included in the rates paid by customers. He also essentially ignores the fact that the distribution service function of the Auburn Line and the right to use its capacity to continue offering distribution service is being retained by PNG. Second, his entire discussion of value assumes that this value is a given and does not consider or address the risk that the investment will fail or be less profitable than anticipated. This is a fundamental flaw in Mr. Knecht's testimony as well as that of OTS witness Gruber. They focus on the hypothetical value of a possible transaction but do not consider the investment that must be made to complete the transaction and the risk that it will not succeed. The reality is that the Auburn Line in its current configuration is not capable of providing gathering service to producers, and that the distribution function and access to the capacity of the Line is not being transferred. Moreover, there is significant risk that producers would prefer to build an alternative line capable of moving larger volumes and would essentially forego use of the Auburn Line if the transport charges did not provide a compelling reason to use it. UGIES' ability to provide an attractive transportation rate is, in substantial part, a function of the price they will pay for the asset. This risk is further amplified by the obligations imposed on UGIES in the Interconnection, Operating and Emergency Service Agreement. It is unreasonable in my opinion to conclude that distribution customers should share in the possible future value of this transaction when they are not being asked to pay for the incremental investment needed to provide gathering services, are assuming no risk if the venture should fail, and are retaining the value of the line as a distribution line.

**Q. MR. BEARD, CAN YOU ELABORATE ON THE RISKS ASSOCIATED WITH A PROJECT OF THIS TYPE?**

**A.** The exploration and production business is ripe with risk at various points along the production line. Any midstream or gathering business tied directly to or largely reliant on a particular producer or acreage position realizes many of these risks, as well. Risks on the producers range from inability to find marketable quantities of gas, inability to find downstream markets willing to purchase production, inability to realize prices that enable a reasonable return on investment, changes in regulatory requirements, changes in permitting and environmental requirements, discovery of other more economic producing basins, liquidity, etc. These risks ultimately pass through to anyone providing infrastructure that serves a producer. There are additional risks for this project related to gas quality control, compression, operation and maintenance, etc.

This filing is the result of a multi-party arrangement between PNG, Citrus, and UGIES. It is a competitive arrangement in that Citrus has other gathering options in the area to move gas supplies get to Tennessee Gas Pipeline ("Tennessee") and/or Transcontinental Gas Pipeline ("Transco"). Although Citrus has completed only 3 or 4 wells to meet the needs of P&G, there is still substantial risk associated with further drilling in that Citrus may not find marketable quantities of gas or that gas prices will be too low to sustain a drilling program.

Gathering has the same risk profile as producing since it is entirely dependent upon the drilling of wells. Natural gas production of any sort, including Marcellus Shale production is risky. Gathering facilities generally have a much shorter life than utility assets. Production is unpredictable. For example, on November 17, 2010, Encana Oil & Gas (USA) Inc. announced that after two years of collecting mineral rights for thousands of acres and drilling two exploratory wells, it plans to stop work and leave Pennsylvania.[1] Dr. Terry Engelder, a geosciences professor at Penn State University and Marcellus Shale expert, said during an interview published in The Citizens' Voice on February 19, 2011, that high temperatures which formed the anthracite might have "cooked" the natural gas out of the shale.[2]

Other risks attendant to production and gathering are clearly illustrated by the following news stories:

> "Citing environmental concerns involving Pennsylvania's fledgling natural gas play, New York Governor David Paterson issued an executive order prohibiting high-volume hydraulic fracturing of horizontally drilled wells to July 1. That's the technology being used to extensively in Pennsylvania to tap highly productive gas in the deep Marcellus shale formation." American Agriculturalist, December 15, 2010.

> "With hydrofracking, a well can produce over a million gallons of wastewater that is often laced with highly corrosive salts, carcinogens like benzene and radioactive elements like radium, all of which can occur naturally thousands of feet underground. Other carcinogenic materials can be added to the wastewater by the chemicals used in the hydrofracking itself.... The risks are particularly severe in Pennsylvania, which has seen a sharp increase in drilling, with roughly 71,000 active gas wells, up from about 36,000 in 2000.... Recently, Pennsylvania has tried to increase its oversight, doubling the number of regulators, improving well-design requirements and sharply decreasing how much drilling waste many treatment plants can accept or release." *Regulation Lax as Gas Wells' Tainted Water Hits Rivers*, New York Times, p. A1, February 27, 2011.

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[1] *See* Encana Letter to Lessor, dated November 17, 2010, *available at* http://www.wbcitizensvoice.com/pdfs/encanalttr.pdf (Last visited February 23, 2011).

[2] *See* New production data shows shale's promise and growth, *available at* http://citizensvoice.com/news/new-production-data-shows-shale-s-promise-and-growth-1.1107228#axzz1EoZsHYGR (Last visited February 23, 2011).

I am not an environmental expert and am not testifying as to the accuracy of the above-referenced statements However, there is clearly significant opposition to Marcellus Shale drilling in Pennsylvania and the future of drilling, while promising now, is clouded by the potential for negative political and regulatory action.

**Q. MR. KNECHT, AT PAGE 4 OF HIS TESTIMONY AND MR. GRUBER, AT PAGE 10 OF HIS TESTIMONY, ASSERT THAT THE COMPANY HAS PROVIDED LITTLE INFORMATION AS TO THE VALUE OF THE AUBURN LINE AS A GATHERING LINE. CAN YOU RESPOND?**

**A** First, PNG has provided some information as to the replacement value of the Auburn Line. As I stated in my direct testimony, our estimate of the current cost of building such a line is considerably less than the present value to customers of retaining the right to serve Procter & Gamble and other customers on the Line.

Second, the replacement cost sets the obvious upper limit that someone might pay for the line. Replacement cost is not necessarily the price a buyer would pay if they are seeking to provide gathering service for anticipated Marcellus Shale wells. In that case, the buyer, as UGIES presumably has done, would weigh several items including the risk that production will not occur as expected (*see* Encana, above), competitive projects, the economics of building a larger line capable of carrying a higher volume, operating at higher pressures than the Auburn Line is capable of in order to avoid compression costs, whether there are better options than Tennessee as an interstate pipeline to access, and whether an alternate route would access other producing areas and attract a larger volume. For example, producers may obtain higher prices for gas delivered into Transco than into Tennessee because Tennessee is saturated with Marcellus Shale gas. Further, Tennessee has a limited capacity in this region. As a result, many producers who are able to access either pipeline would opt to deliver into Transco as a higher value point of delivery with greater capacity. The P&G plant and surrounding producing acreage is located less than 20 miles from Transco, well within a reasonable construction distance.

Third, the parties disregard that the transaction is subject to additional obligations and conditions required under the Pipeline Interconnection, Operating and Emergency Service Agreement between PNG and UGIES, including: The obligation to connect and service new customers; sell, exchange, or transport natural gas for PNG in the event of an emergency; and PNG's option to re-acquire portions of the Line at net book value should the Agreement be terminated. These additional obligations further reduce the value of the Auburn Line to a third party.

Finally, I do not believe additional information regarding the value of the Line is relevant to this proceeding. As explained above, the value of the Line as a distribution line is being retained by PNG. And, unless customers are going to make the investment and bear the risk of loss and the risk of operating the Line as a gathering line, they are not entitled to share in any ultimate economic value.

**Q. MR. KNECHT (PAGE 5) AND MR. GRUBER (PAGE 14) ASSERT THAT UGI PNG SHOULD CONSIDER SELLING THE LINE TO A THIRD PARTY. IS THIS A REASONABLE APPROACH IN YOUR VIEW?**

**A.** No, it is not. As I explained in my direct testimony, the proposal before the Commission is more than just a straight asset sale because it allows PNG to keep the economic value of the line as a distribution line. It also is a transaction not just involving PNG and UGIES, but also P&G and Citrus. There are various aspects of the transaction that would not likely be attractive to an independent, unregulated producer or midstream operator including: the limited capacity of the line; the larger amount of investment necessary for compression due to the operating pressure limitations of the pipeline; and additional obligations required under the Pipeline Interconnection, Operating and Emergency Service Agreement between PNG and UGIES. The Pipeline Interconnection, Operating and Emergency Service Agreement between PNG and UGIES imposes significant conditions and obligations, including: The obligation to connect and service new customers; sell, exchange, or transport natural gas for PNG in the event of an emergency; and PNG's option to re-acquire portions of the line at net book value should the Agreement be terminated. It is not clear to me why a third-party would want to agree to these additional conditions where other options are available. These obligations and conditions would obviously affect the price that would be paid by a third party.

PNG wishes to maintain natural gas transportation and sales service to P&G and other existing customers. The proposed transaction is the best way to do this, and I do not believe that this result could be achieved through a sale to an independent third party.

There presently is an overall transaction that is acceptable to PNG, UGIES, P&G, and Citrus and beneficial to PNG's customers. There is no assurance that a similarly acceptable agreement could be achieved through a sale to an independent producer or midstream operator, that the many benefits to customers from this transaction would be retained, or that Citrus would not begin the construction of bypass facilities to avoid further delay. Moreover, a transaction with an affiliate provides certain additional benefits to customers, the Commission, and the parties. For example, the Commission's jurisdiction over utility contracts with affiliates would not exist if the asset were sold to an independent third party.

**Q. MR. KNECHT (PAGES 9-10) ARGUES THAT PNG HAS IMPROPERLY INCLUDED CONTINUED REVENUES FROM P&G IN ITS ANALYSIS BECAUSE THERE IS NO LONG-TERM ASSURANCE THAT P&G WILL REMAIN A PNG CUSTOMER. IS THIS ACCURATE?**

**A.** No, it is not. As part of this overall transaction, P&G and PNG have entered into a 20-year agreement under which P&G agrees to take and PNG agrees to provide distribution service to P&G's Mehoopany facility. Therefore, continued P&G distribution revenues are appropriately considered as a benefit to this transaction. This also refutes Mr. Knecht's argument that this transaction and project may increase the risk of a P&G bypass. The bypass risk is currently mitigated under the assumption that this transaction, and the many benefits associated with it, is approved. In addition, it is important to point out that the revenues to be received from P&G under this agreement substantially exceed the cost of providing distribution service to P&G.

**Q. COULD THIS AGREEMENT WITH P&G BE PART OF A SALE TO AN INDEPENDENT THIRD PARTY?**

A. I do not think this is a realistic assumption. Gathering lines are currently largely unregulated. As explained in the Pipeline Interconnection, Operating and Emergency Service Agreement attached as Exhibit E to the Application, UGIES is agreeing to many substantial conditions regarding continued operation of the Auburn Line in a way that permits P&G and other customers to continue to receive distribution service from the line. In my opinion, an independent third party would have little interest in agreeing to accept these conditions and constraints when other options are available without these conditions and constraints. Moreover, it is highly unlikely that P&G would support a transaction where they are no longer afforded the benefit of regulated utility service.

**Q. MR. KNECHT (PAGE 7) ACKNOWLEDGES THAT VIRTUALLY THE ENTIRE COST OF THIS LINE HAS BEEN ALLOCATED TO P&G IN PRIOR PNG BASE RATE PROCEEDINGS, BUT CONTENDS THAT OTHER CUSTOMERS STILL SHOULD SHARE IN ANY GAIN FROM THE TRANSACTION. DO YOU AGREE?**

A. No, I do not. Mr. Knecht starts his testimony with proposition that ratepayers should share in the gain from the sale of the Auburn Line because the cost of the line has been reflected in rates paid by customers. Yet, later in his testimony he agrees that virtually the entire cost of the line has been assigned to and paid for almost exclusively by P&G. This is an inherently inconsistent position. The cost of the line has been reflected in rates paid by P&G, and P&G is receiving benefits from the overall transaction which are acceptable to it and allow it share in the value of the project. Any further credit to other customers would be inappropriate under the standard specified by Mr. Knecht himself.

**Q. MR. KNECHT (PAGE 7), MR. GRUBER (PAGES 9-10), AND MR. MIERZWA (PAGE 6) ASSERT THAT CUSTOMERS MAY BE AT RISK OF PAYING FOR THE LINE (AND ANY IMPROVEMENTS) IN THE FUTURE IF THE PROPERTY IS RETURNED TO PNG. DO YOU AGREE?**

A. No. Mr. Knecht, Mr. Gruber, and Mr. Mierzwa have misread the agreement. As provided in the Pipeline Interconnection, Operating and Emergency Service Agreement attached as Exhibit E to the Application, in the event that this Agreement is terminated for any reason PNG shall have the option to re-acquire such portions of the Auburn Line as PNG may require to assure the continuity of its retail distribution service. PNG would pay the net book value for only those portions of the Auburn Line necessary to provide retail delivery service. Thus, if the line is returned to PNG, PNG ratepayers will not be asked to pay for the cost of the compression facilities or any other facilities which are not required to assure the continuity of its retail distribution service. To the extent that improvements are made which enhance delivery service, the costs of such improvements would be appropriately included in the rates paid by customers. However, as noted above, virtually all of these costs would be assigned to P&G and not to customers in general.

**Q. MR. KNECHT (PAGE 11) QUESTIONS YOUR ASSERTION THAT THIS PROJECT WILL ENHANCE SYSTEM RELIABILITY BECAUSE THE LINE DOES NOT HAVE ANY EXISTING PROBLEMS. WHAT WAS THE BASIS FOR YOUR STATEMENT?**

A. My point was that after this project, P&G and other customers connected to the line will have at least two delivery points for supply and potentially additional supply receipt points instead of the one historical single delivery point of Tennessee. This obviously improves the reliability of service to customers served by the Auburn Line, which is especially critical to P&G.

**Q. MR. GRUBER (PAGES 5, 8) OPPOSES THE TRANSFER OF THE AUBURN LINE, IN PART, BECAUSE THERE IS NO IMMEDIATE BENEFIT TO CUSTOMERS AND BECAUSE IN THE SHORT RUN CUSTOMERS WILL PAY MORE THAN THEY CURRENTLY DO FOR SERVICE. IS THIS ACCURATE?**

A. In terms of PNG rates, Mr. Gruber is technically correct, since under the Company's proposal, base rates would not be reduced until PNG's next base rate case. Mr. Mierzwa makes the same point and proposes that rates be reduced immediately upon closing of the transaction or that the reduction be deferred and credited in the next rate case. PNG does not support these proposals, as they would be impermissible single-issue ratemaking. Many things change between rates cases. Given the relatively small amount at issue, this item does not rise to the level of an extraordinary, non-recurring event which would justify an exception to this general rule. In addition, I would like to reiterate that there are immediate benefits to customers who may have a working or royalty interest in the gas produced into Auburn, as well as, all other gas customers from the positive benefits of additional supplies reaching the marketplace.

**Q. MR. GRUBER (PAGE 6) ASSERTS THAT THE COMPANY HAS PROVIDED LITTLE DETAIL AS TO WHY PNG SHOULD NOT UNDERTAKE THIS PROJECT ON ITS OWN. CAN YOU PROVIDE ADDITIONAL DETAIL ON THIS POINT?**

**A.** Yes, due to the risks identified earlier in my testimony, PNG does not believe that this type of project is appropriate for a natural gas distribution company.

**Q. MR. GRUBER (PAGE 9) EXPRESSES THE ADDITIONAL CONCERN THAT CUSTOMERS SERVED FROM THE AUBURN LINE WILL ONLY BE ABLE TO RECEIVE GAS (UNDER NORMAL OPERATING CONDITIONS) FROM MARCELLUS PRODUCERS, THEREBY LIMITING THEIR ACCESS TO DIVERSITY OF SUPPLY AND AFFECTING THEIR ABILITY TO SHOP FOR GAS SERVICE. IS THIS CORRECT?**

**A.** No, as explained in response to OSBA Interrogatory Set I-10, while farm tap customers on the Auburn Line will be physically served by local production except under emergency conditions, they will be free to shop for an alternative supplier if they so desire. Such arrangements will be handled by displacement of supply. As to P&G, it has entered into a voluntary arrangement to purchase gas from Citrus and to be served by PNG through its connection with Tennessee pipeline during emergency conditions.

**Q. MR. GRUBER (PAGE 12) IS ALSO CONCERNED THAT THERE MAY BE A LOSS OF COMMMISSION SAFETY JURISDICTION OVER THE AUBURN LINE IN THIS TRANSACTION IS APPROVED. IS THIS CORRECT?**

A. The agreement by and between PNG and UGIES provides that UGIES will own and operate the Auburn Line, including all future expansions thereof, as a Type A regulated onshore gathering pipeline operating in a Class 2 location subject to the safety regulations and requirements established by the Pipeline and Hazardous Materials Safety Administration ("PHMSA") of the United States Department of Transportation. PHMSA has promulgated minimum safety standards for the design, installation, inspection, emergency plans and procedures, testing, construction, extension, operation, replacement, and maintenance of pipeline facilities. 49 C.F.R. Parts 190-99 govern Type A gathering lines, transmission lines, and distribution lines operating in a Class 2 location. The fact that the Auburn Line would be regulated by federal law rather than state law is not a reasonable basis to deny the proposed application. Further, I note that in January 2011, State Senator Lisa Baker and State Representative Matthew E. Baker reintroduced legislation (Senate Bill 325 and House Bill 344) that would transfer inspection authority for intrastate gathering pipelines in Pennsylvania from the PHMSA to the Commission. Senate Bill 325 was reported out of committee on February 28, 2011, and the House Bill 344 was reported and tabled on March 1, 2011. These bills, if passed, permit the Commission to regulate gas pipelines without having to declare them a public utility line. These bills would have the Commission use the same safety and operational standards as outlined in PHMSA regulations.

**Q. MR. GRUBER (PAGE 11), IN DISCUSSING THE POTENTIAL VALUE OF THE AUBURN LINE AS A GATHERING LINE, PROVIDES A HYPOTHETICAL CALCULATION WHICH ASSUMES A CHARGE BY THE LINE OWNER OF $.88/MCF AND AN ESTIMATED VALUE OF $38 MILLION. DOES THIS HYPOTHETICAL HAVE ANY APPLICATION TO THE AUBURN LINE?**

A. Mr. Gruber provides no information about the nature, size, location, or services to be provided from this unnamed line. There is absolutely no basis to determine whether it bears any relationship to the Auburn Line transaction. Further, the rate cited by Mr. Gruber appears to be a maximum rate. There is no evidence as to what rate may actually be charged, whether any customers have signed up for the service and at what rate, or whether the project will even be built at all. Therefore, it is inappropriate for Mr. Gruber to rely on this unnamed line for guidance on the potential value of the Auburn Line. I note that PNG served discovery on OTS regarding this issues and, as of the service date of this rebuttal testimony, PNG has received no response from OTS. I reserve the right to supplement my rebuttal testimony based on these responses.

**Q. OCA WITNESS MIERZWA (PAGE 5) CONTENDS THAT THE COMMISSION SHOULD NOT APPROVE THIS TRANSACTION UNTIL PNG HAS COMPLETED A GAS PURCHASE AGREEMENT WITH CITRUS AND THE COMMISSION HAS FOUND THIS AGREEMENT TO BE REASONABLE. DO YOU AGREE?**

A. There is no reason to wait for the final negotiation of a gas price with Citrus in order for the commission to approve this transaction. The price paid will be subject to review in future PNG PGC proceedings and can be disallowed if determined to be imprudent or unreasonable. Moreover, the farm tap customers will not pay the rate negotiated with Citrus. They will pay the overall PNG PGC rate. To put this issue in context, the total annual sales for the 12 months ended September 30, 2010 for PNG customers other than P&G served from the Auburn Line were 3310 Mcf as compared to total PNG PGC sales for the same period of 20,980,000 Mcf (20.98 Bcf), or 0.016%. On this basis, a $.10/Mcf increase in the price paid for gas by Auburn Line customers (other than P&G) would increase PNG's overall PGC rate by $0.00002/Mcf (two thousandths of a cent per Mcf), or approximately $0.0017 annually (less than two tenths of a cent per year) for a typical residential heating customer (108 Mcf/year).

**Q. MR. MIERZWA (PAGES 5-6) ALSO CONTENDS THAT RATEPAYERS SHOULD RECEIVE A CREDIT TO BASE RATE IMMEDIATELY OR THAT THE CREDIT SHOULD BE ACCUMULATED AND DEFERRED FOR PNG'S NEXT RATE CASE. IS THIS REASONABLE?**

**A.** I do not believe it is. As explained above, such a result would be impermissible single-issue ratemaking. Many things change between rate cases. It would not be appropriate to change base rates in between rate cases for this item, particularly considering the relatively small amount of money involved.

**Q. MR. MIERZWA (PAGE 6) ALSO PROPOSES THAT COMMISSION APPROVAL OF THE TRANSACTION BE CONDITIONED ON A PROVISION THAT RATEPAYERS WILL NOT PAY ANY ADDITIONAL COSTS. IS THIS ACCEPTABLE?**

**A.** No. I believe as explained above that this is already covered by the agreement between PNG and UGIES. Even if the gathering venture for UGIES does not succeed, or if UGIES defaults on the agreement, PNG will have the ability to reacquire those portions of the Auburn Line required to continue providing distribution service at UGIES' then undepreciated book value, PNG customers will see no disruption in service, and PNG customers will not pay for any of the substantial capital investment which is to be made for compression facilities needed to convert the line to gathering operations.

**Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

**A.** Yes. I reserve the right to supplement my testimony as additional issues arise during the course of this proceeding.

Exhibit RFB-3

**Exhibit RFB-3**

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January 3, 2011

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*Via Regular U.S. Mail & Hand Delivered*

Ms. Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
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Harrisburg, PA 17105-3265

Re: **Application of UGI Penn Natural Gas, Inc. for Expedited Review and Approval of the Transfer By Sale of a 9.0 Mile Natural Gas Pipeline, Appurtenant Facilities and Right of Way located in Mehoopany, Pennsylvania, and a Related Affiliated Interest Agreement, Docket No. A-2010-2213893 and G-2010-2213894**

**The Procter & Gamble Paper Products Company – Letter of Support**

Dear Secretary Chiavetta:

Enclosed please find a Letter of Support, filed on behalf of The Procter & Gamble Paper Products Company, in reference to the above-noted matter.

All participants have been served copies, as evidenced by the attached Certificate of Service.

Please contact the undersigned should you have any questions.

Very truly yours,

Paul L. Zeigler

PLZ/em
Enclosure
cc: All parties per Certificate of Service
Alex P. Fried, Public Relations, Health, Safety, Environmental and Energy Affairs Manager, The Procter & Gamble Paper Products Company

**Exhibit RFB-3**

**CERTIFICATE OF SERVICE**

The undersigned certifies that he served a copy of the foregoing document upon the following participants this 3rd day of January, 2011 via first-class mail, and/or hand delivery:

Kent D. Murphy, Esquire
UGI Penn Natural Gas, Inc.
460 North Gulph Road
King of Prussia, PA 19406-2807

Irwin A. Popowsky, Esquire
Office of Consumer Advocate
555 Walnut Street - 5th Floor
Harrisburg, PA 17101-1923

Johnnie E. Simms, Esquire
Office of Trial Staff
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
P.O. Box 3265
Harrisburg, PA 17015-3265

William R. Lloyd, Jr., Esquire
Office of Small Business Advocate
300 North Second Street, Suite 1102
Harrisburg, PA 17101

DATE: January 3, 2011

**Law Office of**
**PAUL L. ZEIGLER, P.C.**

By: ______________________
Paul L. Zeigler, Esquire
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P&G

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PA PUC
SECRETARY'S BUREAU

December 31, 2010

VIA REGULAR U.S. MAIL AND HAND DELIVERY

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

**Re: Application of UGI Penn Natural Gas, Inc. for Expedited Review and Approval of the Transfer By Sale of a 9.0 Mile Natural Gas Pipeline, Appurtenant Facilities and Right of Way located in Mehoopany, Pennsylvania, and a Related Affiliated Interest Agreement, Docket No. A-2010-2213893 and G-2010-2213894**

Dear Secretary Chiavetta:

My name is Alex P. Fried and I am the Mehoopany Public Relations, Health, Safety, Environmental and Energy Affairs Manager for The Procter & Gamble Paper Products Company. I am in receipt of the above application of UGI Penn Natural Gas, Inc. ("PNG") for approval to transfer the 9.0 mile natural gas pipeline known as the Auburn Line to UGI Energy Services, Inc. For the following reasons, Procter & Gamble fully supports this application.

As a matter of background, Procter & Gamble owns and operates a paper products plant that has been located in Mehoopany since 1966 and currently employs 2,300 local residents in the plant's management and operations. Since 1966, the plant in Mehoopany has been served annually with large volumes of natural gas transported from the Tennessee Gas Pipeline Company through the Auburn Line by PNG and PNG's predecessor companies, PG Energy and Pennsylvania Gas and Water. Over time, our relationship to the local gas company has evolved as the natural gas industry has evolved, with the plant being served retail gas originally to recently where the plant uses the Auburn Line simply to transport nearly 100 percent of gas requirements that we purchase from third party suppliers using Tennessee capacity held by us or held by our suppliers.

Now, with the advent of Marcellus Shale exploration nearby to the Mehoopany plant, our relationship to PNG and the Auburn Line continues to evolve. Gas exploration on Procter & Gamble's

P&G

property has provided Procter & Gamble with a new source of competitively priced natural gas that currently supplies a significant portion of our needs. This was made possible with PNG's cooperation through a recently installed interconnection with PVR Marcellus Gas Gathering and Citrus Energy.

Ideally, Procter & Gamble will fully replace its gas supply with competitively priced and reliable locally produced natural gas. To enable the producer (Citrus Energy) to commit to producing sufficient volumes to supply Procter & Gamble and to market additional volumes of production, access to additional markets through the most cost efficient means is necessary. Additional markets can be accessed most efficiently and quickly through the use of the existing Auburn Line to gather Citrus' production for delivery to our plant and into Tennessee.

By accessing this larger market, a larger continuous stream of gas can be transported and allow the producer to improve the economics for its well production. The greater the continuous amount of production, the better economics for both the supplier and the market it serves, including Procter & Gamble and the markets served from Tennessee, including additional PNG retail markets. Improved economics of gas production allows for better pricing of that gas, for the benefit of the producer and the downstream Pennsylvania markets. PNG's recent reduction in its purchased gas cost can be linked to the effective development of Marcellus Shale, such as that taking place around our plant. While PNG's purchased gas cost has no direct impact on Procter & Gamble, it certainly impacts our customers, employees and business partners.

Procter & Gamble believes that the Auburn Line is the best option for this venture. For one, the line exists and therefore the environmental impact of building a new line that serves this purpose is avoided. Also avoided would be substantial costs that would require producers to tie into another gathering system.

Accordingly, PNG's proposal in this matter provides PNG, local producers and Procter & Gamble enhanced access to competitively priced, locally produced natural gas. The enhanced access benefits the Mehoopany plant by making the plant more competitive and sustainable, as plant prosperity benefits

**Exhibit RFB-3**

its employees, the employees' families, the local economy, PNG's customers and the Pennsylvania economy as a whole.

For these reasons, Procter & Gamble submits that PNG's application in this matter should be granted by the Commission.

Very truly yours,

Alex P. Fried
Mehoopany Public Relations, HSE & Energy Affairs Manager
The Procter & Gamble Paper Products Company

cc: W. Lloyd, Office of Small Business Advocate
I. Popowsky, Office of Consumer Advocate
J. Simms, Director, Office of Trial Staff
K. Murphy, UGI Corporation
Paul L Zeigler

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

| | | |
|---|---|---|
| Application of UGI Penn Natural Gas, Inc. for Approval of the Transfer by Sale of 9.0 Mile Natural Gas Pipeline Appurtenant Facilities and Right of Way, Located in Mehoopany, PA | : | Docket No. A-2010-2213893 |
| Affiliated Interest Filing of UGI Penn Natural Gas, Inc. | : | Docket No. G-2010-2213894 |

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**PREPARED REJOINDER TESTIMONY OF**
**ROBERT F. BEARD, JR. P.E.**
**UGI PENN NATURAL GAS, INC.**

DATE SERVED: March 15, 2011
DATE ADMITTED: ____________

PNG Statement No. 1-RJ
3-16-2011
Harrisburg, PA
Docket Nos.
A-2010-2213893
G-2010-2213894

**PREPARED REJOINDER TESTIMONY OF**
**ROBERT F. BEARD, JR. P.E.**

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A. My name is Robert F. Beard, Jr. My business address is 2525 N. 12th Street, Suite 360 Reading, Pennsylvania 19612.

**Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

A. I am employed by UGI Utilities, Inc. ("UGI"). I am Vice President of Marketing, Rates and Gas Supply.

**Q. HAVE YOU PREVIOUSLY SERVED TESTIMONY IN THIS PROCEEDING?**

A. Yes. I previously presented direct and rebuttal testimony in support of the application of UGI Penn Natural Gas, Inc. ("PNG").

**Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

A My testimony responds to the surrebuttal testimony presented by the Office of Trial Staff ("OTS") witness Michael Gruber, the Office of Consumer Advocate ("OCA") witness Jerome Mierzwa, and the Office of Small Business Advocate ("OSBA") witness Robert Knecht.

**Q. MR. KNECHT (PAGE 2) AGREES THAT THE P&G RATE XD AGREEMENT IS IMPORTANT TO ANALYZING THIS APPLICATION AND MAY PRESENT A BENEFIT, BUT ASSERTS THAT IT IS ONLY RELEVANT IF IT IS**

**CONTINGENT UPON THE CONVERSION OF THE AUBURN LINE TO A GATHERING LINE. DO YOU AGREE?**

A. I do not. While the P&G Rate XD agreement is not expressly contingent upon the conversion of the Auburn Line to a gathering line, I can assure the Commission that the two agreements are inextricably interrelated. Simply put, under normal circumstances the purchaser of a pipeline acquires both title to the physical asset and the associated economic value of serving customers from that line. In this proposed transaction, however, PNG has retained the market value of the Auburn Line as an input to its distribution service by retaining the right to receive gas from the line and by continuing to serve its retail customers. In contrast, the typical transaction reflects the transfer by sale of the facility as well as the right to serve the customers. By retaining the right to serve the customers as well as to receive gas from the line through the Interconnection Agreement with UGIES, PNG has retained the economic value of the line, the ability to provide distribution service to P&G. The long-term Rate XD agreement with P&G is an essential part of the value retained by PNG under the Interconnection Agreement and therefore highly relevant to evaluating this transaction. The fact that PNG will retain the current market value of the line obviously restricts the marketability of the Auburn Line to other potential purchasers. Mr. Knecht's analysis fails to appreciate the importance of this restriction and its benefits to customers.

Q. **MR. KNECHT (PAGES 5-6) APPEARS TO AGREE THAT THE COST OF THE AUBURN LINE HAS BEEN REFLECTED IN RATES PAID BY P&G BUT ASSERTS (PAGES 3-4) THAT OTHER CUSTOMERS SHOULD SHARE IN ANY**

**GAIN UPON SALE OF THE LINE BECAUSE UNDER SOME HYPOTHETICAL SCENARIO THE COST OF THE LINE MIGHT BE INCLUDED IN THEIR RATES AT SOME UNSPECIFIED FUTURE DATE. DO YOU AGREE?**

**A.** I do not. First, as I explained in my rebuttal testimony, and as Mr. Knecht appears to agree, PNG proposes to transfer the line at depreciated original cost so there is no "gain" to share under the transaction as proposed by the Company. Second, I am advised by counsel that the premise for any sharing of gain with customers is that customers' rates reflected the cost (through depreciation expense) of the property at issue. It would be unreasonable, in my opinion, for customers to share in the gain on the sale of property that was never reflected in their rates simply because it might possibly be reflected in future rates. Third, Mr. Knecht's concern is at best premature and need not be addressed in this proceeding. If, in the future, PNG were to seek to include the cost of the Auburn Line in rates and some portion of the cost is allocated to customers other than P&G, then the issue presented by Mr. Knecht might be relevant, but, in my view, it has no significance at this time.

**Q. MR. KNECHT (PAGES 5-6) ALSO QUARRELS WITH YOUR TESTIMONY THAT P&G HAS PAID THE "ENTIRE COST" OF THE LINE. IS THIS A RELEVANT COMMENT?**

**A.** It is not. My testimony, read as a whole, clearly says that the cost of the Auburn Line has been included solely and entirely in rates paid by P&G, *i.e.*, the entire cost of the line has been assigned or allocated to P&G. Obviously, the line is not fully depreciated and indeed, the proposed transfer price is the current depreciated original cost. Mr. Knecht's assertion that the line is not fully depreciated is correct, but has no relevance to the issues presented in this case.

**Q. MR. KNECHT (PAGES 3-4) ASSERTS THAT THE COMPANY HAS NOT ADEQUATELY CONSIDERED CERTAIN HYPOTHETICAL ALTERNATIVE TRANSACTIONS. DO YOU AGREE?**

**A.** I do not. The Company has presented a proposed transaction to the Commission which provides many benefits to customers. The Company has fully supported this transaction, has explained why it did not pursue other possible transactions, and has explained that the outer limits to the market value would be the replacement cost of the line less the value associated with PNG's retained right to serve its distribution markets from the line. It is not the obligation of the Company to address other hypothetical and speculative possible alternative transactions in order gain approval of the transaction presented. The Commission, in my opinion, should review the transaction as presented and approve it because of the substantial benefits associated with it. The Commission should not reject this project, as proposed by Mr. Knecht, because the Company has not supported other hypothetical projects that are not presented for review.

**Q. MR. GRUBER (PAGE 2) STATES THAT HE DOES "NOT OBJECT TO THE BASIC IDEA BEHIND THE PROPOSAL MADE BY THE COMPANY," BUT BELIEVES THAT THE TRANSACTION SHOULD BE STRUCTURED TO BENEFIT CUSTOMERS. DO YOU AGREE?**

A. I emphatically agree, and this is precisely what PNG has done at every step of this transaction. Under the transaction as proposed, customers are assured of continued safe and reliable distribution service from the Auburn Line at reduced distribution rates. Moreover, through the P&G XD Rate Agreement, PNG has retained the value of distribution service from this facility. At the same time, customers are insulated from the very significant investment risk of converting the line to gathering service. Moreover, this project will provide broader long-term benefits to PNG customers and the Commonwealth through the development of Marcellus Shale gas resources. In addition, if the Auburn Line project does not proceed or subsequently is abandoned, PNG has the right to reacquire the assets (and only those assets) needed to provide safe and reliable service at the then depreciated original cost of those assets, thereby further assuring reliable service to customers. This entire project has been developed around the legitimate interests of PNG customers. I simply do not understand Mr. Gruber's concerns in this regard.

**Q. MR. GRUBER (PAGE 7) ALSO ASSERTS THAT THE PROJECT HAS BEEN STRUCTURED SO THAT PNG CUSTOMERS ARE PROVIDING A SAFETY NET TO UGIES AND PNG. DO YOU AGREE?**

A. I do not. Indeed, exactly the opposite is true. This transaction in fact is structured so that customers are provided a safety net which assures continued safe and reliable service at lower rates, while avoiding the risk associated with investing in converting the line to gathering service.

**Q. MR. GRUBER (PAGE 2) ASSERTS THAT PNG HAS PROVIDED NO ANALYSIS AS TO THE IMPACT OF THIS PROJECT ON THE 14 FARM TAP CUSTOMERS. IS THIS TRUE?**

**A.** It is not. My direct and rebuttal testimonies describe in great detail the impact on customers other than P&G, including the 14 farm tap customers. Mr. Gruber seems to misunderstand how rates are set by the Commission. The rates paid by the 14 farm tap customers are not based on the local costs incurred to provide service. PNG's rates, and effectively all utilities' rates to the best of my knowledge, are based on class ratemaking not individual customer ratemaking. The rates paid by the 14 farm tap customers are the generally applicable system wide average residential and small commercial rates. The distribution rates of the 14 farm tap customers are not based on the local cost of the Auburn Line; they are based on the average cost of service for their respective rate classes. Similarly, the 14 farm tap customers do not and will not pay gas cost rates based on the cost of local supply. While these customers will be physically supplied by local gas under normal conditions, these customers will continue to pay the same average PGC rate paid by all are market sales customers. For example, Mr. Gruber provides the following hypothetical example on page 3 of his surrebuttal testimony which assumes that the farm tap customers may shop for supply because they can buy gas from the market at a rate less then the local Marcellus Shale rate:

> As I understand this part of the deal, if a customer finds a cheaper supplier than the Company's proposed Marcellus shale gas, then this supply will be handled by a displacement of supply with the new cheaper supply being delivered to the Company somewhere else and the Company supplying Marcellus Shale gas to the customer. If this is true then presumably the supply being bought by one of these customers costs less than the Marcellus shale gas being purchased to supply the customer.

This is an incorrect analysis because these customers do not pay the local gas rate; they pay the average PGC rate. Also, Mr. Gruber's statement doesn't recognize the reality that customers may shop for other reasons, such as guaranteed price stability. By providing information on the impact of this transaction on PNG customer rates, PNG also has fully described the impact on the 14 farm tap customers. There is no further impact to describe.

**Q. MR. GRUBER (PAGES 4-5) AND MR. MIERZWA (PAGES 1-2) ARE CONCERNED THAT IF PNG REACQUIRES THE AUBURN LINE IN THE FUTURE IT (AND ULTIMATELY CUSTOMERS) MAY INCUR HIGHER COSTS. IS THIS A VALID CONCERN?**

**A.** It is not, in my view. First, as I explained in my rebuttal testimony, PNG has the right to reacquire only those assets needed to provide distribution service. PNG and its customers will not bear any costs associated with conversion of the Auburn Line to gathering service. To the extent improvements have been made that enhance distribution service, PNG would pay those costs, but they could not be reflected in rates until the Commission determined that these additional costs were prudent and used and useful in providing distribution service.

**Q. MR. GRUBER (PAGES 5-6) ALSO IS CONCERNED THAT THERE IS NO IMMEDIATE RATE REDUCTION BENEFIT TO CUSTOMERS BECAUSE IT IS NOT KNOWN WHEN PNG WILL FILE FOR ANOTHER BASE RATE INCREASE. MR. MIERZWA (PAGE 2) ALSO ADDRESSES THIS ISSUE AND**

**PROPOSES AN IMMEDIATE RATE REDUCTION OR DEFERRAL UNTIL NEXT RATE CASE. ARE THESE VALID CONCERNS?**

**A.** I do not think so. PNG has relatively flat sales growth and has increasing operating expenses and must invest in new facilities to continue to provide safe and reliable service to customers. As a result, it is very likely that PNG will seek further base rate relief in the near future. However, to allay this concern, PNG is willing to revise its application to provide that it will not seek to recover the $60,000 per year interconnection fee through its purchased gas cost rates at least until the effective date of rates generated from the base rate case immediately following the transfer of the Auburn Line.

**Q. MR. MIERZWA ALSO STATES THAT HE BELIEVES THAT THE TRANSFER QUALIFIES AS AN EXTRAORDINARY AND NONRECURRING EVENT THAT JUSTIFIES AN EXCEPTION TO THE PROHIBITON AGINST SINGLE ISSUE RATEMAKING. DO YOU AGREE?**

**A.** No, I do not. There is noting extraordinary about this transaction. While the transfer may be somewhat unusual, the amount of the rate impact is hardly extraordinary. The net reduction of the transaction on the Company's revenue requirement is only about $94,000. PNG's overall operating revenues in fiscal year 2010 were approximately $344 million.

**Q. DOES THIS CONCLUDE YOUR REJOINDER TESTIMONY?**

**A.** Yes. I reserve the right to supplement my testimony as additional issues arise during the course of this proceeding.